

FEDERAL HOME LOAN BANK OF CINCINNATI

2006 ANNUAL REPORT

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For Management's Discussion and Analysis of Financial Condition and Results of Operations as well as other information and exhibits, please reference the FHLBank's Form 10-K report filed with the SEC. The Form 10-K can be found either on the FHLBank's Web site, [www.fhlbcin.com](http://www.fhlbcin.com), Investor Relations button, or directly at [www.sec.gov](http://www.sec.gov).



March 15, 2007

The Audit Committee of the Board of Directors of the Federal Home Loan Bank of Cincinnati (FHLBank) for 2006 was composed of five Directors, one who represents the public sector and four who represent industry members. The members of the Audit Committee at year-end 2006 were James R. Powell, Chair; Richard C. Baylor; Michael R. Melvin; R. Stan Puckett; and Stephen B. Smith.

The 2007 Audit Committee is comprised of five Directors, one who represents the public sector and four who represent industry members. Both the 2006 and 2007 Audit Committee members are independent, as defined by the Federal Housing Finance Board.

The Audit Committee oversees the FHLBank's financial reporting process; reviews compliance with laws, regulations, policies and procedures; and evaluates the adequacy of administrative, operating, and internal accounting controls. The Audit Committee has adopted and is governed by a written charter as posted on the FHLBank's Web site at [www.fhlbcin.com](http://www.fhlbcin.com). The Audit Committee met on 11 occasions to satisfy its responsibilities during 2006 in compliance with the charter. In fulfilling its responsibilities under its charter, the Audit Committee has reviewed and discussed the audited financial statements with management and the Independent Registered Public Accounting Firm. The Audit Committee also discussed with the Independent Registered Public Accounting Firm the matters required to be discussed by Statement on Auditing Standards (SAS) No. 61 and SAS No. 90, Audit Committee Communications. The Committee also received the written disclosures and the letter from the Independent Registered Public Accounting Firm required by Independence Standard Board Statement No. 1, and discussed with the auditors the Firm's independence.

Based on the review and discussions referred to above, the 2007 Audit Committee recommended to the Board of Directors that the FHLBank's audited financial statements for the fiscal year ended December 31, 2006, be included in the Annual Report and in the FHLBank's annual report on Form 10-K filed with the Securities and Exchange Commission.

James R. Powell, *Chair*  
Richard C. Baylor  
R. Stan Puckett  
Stephen B. Smith  
Billie W. Wade

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

In our opinion, the accompanying statements of condition and the related statements of income, capital and of cash flows present fairly, in all material respects, the financial position of the Federal Home Loan Bank of Cincinnati (the "FHLBank") at December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the FHLBank's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



February 26, 2007

## STATEMENTS OF CONDITION

(in thousands, except par value)

	December 31,	
	2006	2005
<b>ASSETS</b>		
Cash and due from banks (Note 3)	\$ 4,022	\$ 4,948
Interest-bearing deposits	6,535,562	6,284,166
Securities purchased under agreements to resell (Note 4)	1,150,000	1,000,000
Federal funds sold	9,641,700	7,487,900
Trading securities (Note 5)	4,602	6,187
Available-for-sale securities (a) (Note 6)	1,188,450	1,151,271
Held-to-maturity securities includes \$0 and \$0 pledged as collateral in 2006 and 2005 that may be repledged (b) (Note 7)	12,099,348	12,290,770
Advances (Note 8)	41,956,538	40,261,623
Mortgage loans held for portfolio, net (Note 11)	8,460,716	8,418,139
Accrued interest receivable	300,555	238,625
Premises, software, and equipment	8,412	7,999
Derivative assets (Note 17)	12,555	65
Other assets	24,210	28,157
<b>TOTAL ASSETS</b>	<b>\$ 81,386,670</b>	<b>\$ 77,179,850</b>
<b>LIABILITIES AND CAPITAL</b>		
Deposits (Note 12):		
Interest bearing	\$ 926,874	\$ 910,453
Non-interest bearing	360	264
Total deposits	927,234	910,717
Consolidated Obligations, net (Note 13):		
Discount Notes	21,946,379	17,577,416
Bonds	53,239,244	53,520,279
Total Consolidated Obligations, net	75,185,623	71,097,695
Mandatorily redeemable capital stock (Note 14)	137,109	418,381
Accrued interest payable	559,358	436,981
Affordable Housing Program (Note 9)	96,240	91,035
Payable to REFCORP (Note 10)	17,205	15,773
Derivative liabilities (Note 17)	107,559	427,727
Other liabilities	449,493	72,479
Total liabilities	77,479,821	73,470,788
Commitments and contingencies (Note 19)		
<b>CAPITAL (Note 14)</b>		
Capital stock Class B putable (\$100 par value) issued and outstanding shares: 36,576 and 35,035 shares in 2006 and 2005	3,657,645	3,503,481
Retained earnings	255,529	207,785
Accumulated other comprehensive income:		
Net unrealized (loss) gain on available-for-sale securities (Note 6)	(531)	1,882
Other (Note 15)	(5,794)	(4,086)
Total capital	3,906,849	3,709,062
<b>TOTAL LIABILITIES AND CAPITAL</b>	<b>\$ 81,386,670</b>	<b>\$ 77,179,850</b>

(a) Amortized cost: \$1,188,981 and \$1,149,389 at December 31, 2006 and 2005.

(b) Fair values: \$11,822,438 and \$12,036,737 at December 31, 2006 and 2005.

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

## STATEMENTS OF INCOME

(in thousands)

	For the Years Ended December 31,		
	2006	2005	2004
<b>INTEREST INCOME:</b>			
Advances	\$ 2,290,444	\$ 1,526,609	\$ 770,420
Prepayment fees on Advances, net	5,841	337	69,244
Interest-bearing deposits	233,671	152,416	90,825
Securities purchased under agreements to resell	54,332	22,369	750
Federal funds sold	309,483	224,615	104,565
Trading securities	262	289	406
Available-for-sale securities	59,619	45,622	15,153
Held-to-maturity securities	548,569	536,644	496,076
Mortgage loans held for portfolio	430,416	428,033	405,326
Loans to other FHLBanks	465	433	769
Total interest income	<u>3,933,102</u>	<u>2,937,367</u>	<u>1,953,534</u>
<b>INTEREST EXPENSE:</b>			
Consolidated Obligations – Discount Notes	924,690	676,545	371,855
Consolidated Obligations – Bonds	2,566,112	1,878,316	1,265,418
Deposits	42,562	29,177	12,819
Borrowings from other FHLBanks	20	–	19
Mandatorily redeemable capital stock	13,162	13,335	1,350
Other borrowings	120	6	108
Total interest expense	<u>3,546,666</u>	<u>2,597,379</u>	<u>1,651,569</u>
<b>NET INTEREST INCOME</b>	<u>386,436</u>	<u>339,988</u>	<u>301,965</u>
<b>OTHER INCOME:</b>			
Service fees	1,268	1,533	1,651
Net gain (loss) on trading securities	17	(35)	(33)
Net realized loss from sale of available-for-sale securities	–	–	(3)
Net gain (loss) on derivatives and hedging activities	1,929	(648)	39,555
Other, net	2,467	2,260	2,499
Total other income	<u>5,681</u>	<u>3,110</u>	<u>43,669</u>
<b>OTHER EXPENSE:</b>			
Compensation and benefits	24,783	21,700	18,131
Other operating	11,655	11,959	10,413
Finance Board	2,920	2,890	2,468
Office of Finance	2,115	2,222	2,226
Other	4,690	3,846	3,210
Total other expense	<u>46,163</u>	<u>42,617</u>	<u>36,448</u>
<b>INCOME BEFORE ASSESSMENTS</b>	<u>345,954</u>	<u>300,481</u>	<u>309,186</u>
Affordable Housing Program	29,584	25,890	25,377
REFCORP	63,274	54,918	56,762
Total assessments	<u>92,858</u>	<u>80,808</u>	<u>82,139</u>
<b>NET INCOME</b>	<u>\$ 253,096</u>	<u>\$ 219,673</u>	<u>\$ 227,047</u>

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

## STATEMENTS OF CAPITAL

(in thousands)

	Capital Stock Class B*		Retained Earnings	Accumulated Other Comprehensive Income	Total Capital
	Shares	Par Value			
<b>BALANCE, DECEMBER 31, 2003</b>	36,453	\$ 3,645,253	\$ 92,150	\$ (3,730)	\$ 3,733,673
Proceeds from sale of capital stock	902	90,193			90,193
Net reclassified to mandatorily redeemable capital stock	(871)	(87,074)			(87,074)
Comprehensive income:					
Net income			227,047		227,047
Other comprehensive income:					
Net unrealized loss on available-for-sale securities				(82)	(82)
Other (Note 15)				(417)	(417)
Total other comprehensive income				(499)	(499)
Total comprehensive income					226,548
Dividends on capital stock:					
Cash			(242)		(242)
Stock	1,515	151,480	(151,415)		65
<b>BALANCE, DECEMBER 31, 2004</b>	37,999	3,799,852	167,540	(4,229)	3,963,163
Proceeds from sale of capital stock	246	24,569			24,569
Net reclassified to mandatorily redeemable capital stock	(4,973)	(497,254)			(497,254)
Comprehensive income:					
Net income			219,673		219,673
Other comprehensive income:					
Net unrealized loss on available-for-sale securities				1,972	1,972
Other (Note 15)				53	53
Total other comprehensive income				2,025	2,025
Total comprehensive income					221,698
Dividends on capital stock:					
Cash			(149)		(149)
Stock	1,763	176,314	(179,279)		(2,965)
<b>BALANCE, DECEMBER 31, 2005</b>	35,035	3,503,481	207,785	(2,204)	3,709,062
Proceeds from sale of capital stock	382	38,258			38,258
Net reclassified to mandatorily redeemable capital stock	(928)	(92,764)			(92,764)
Comprehensive income:					
Net income			253,096		253,096
Other comprehensive income:					
Net unrealized loss on available-for-sale securities				(2,413)	(2,413)
Other (Note 15)				44	44
Total other comprehensive income				(2,369)	(2,369)
Total comprehensive income					250,727
Adjustment to initially apply SFAS 158 (Note 15)				(1,752)	(1,752)
Dividends on capital stock:					
Cash			(167)		(167)
Stock	2,087	208,670	(205,185)		3,485
<b>BALANCE, DECEMBER 31, 2006</b>	36,576	\$ 3,657,645	\$ 255,529	\$ (6,325)	\$ 3,906,849

\*Putable (Note 14)

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

## STATEMENTS OF CASH FLOWS

(in thousands)

	For the Years Ended December 31,		
	2006	2005	2004
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 253,096	\$ 219,673	\$ 227,047
Adjustments to reconcile net income			
to net cash provided by operating activities:			
Depreciation and amortization	(36,058)	(16,393)	81,768
Change in net fair value adjustment on derivative and hedging activities	(75,630)	517	(88,383)
Other adjustments	13,130	13,325	1,242
Net change in:			
Trading securities	1,585	2,276	3,456
Accrued interest receivable	(61,930)	(52,797)	15,200
Other assets	(1,936)	1,599	(735)
Accrued interest payable	122,377	47,523	39,823
Other liabilities	18,726	18,099	20,610
Total adjustments	(19,736)	14,149	72,981
Net cash provided by operating activities	233,360	233,822	300,028
<b>INVESTING ACTIVITIES:</b>			
Net change in:			
Interest-bearing deposits	(251,396)	(502,900)	504,072
Securities purchased under agreements to resell	(150,000)	(300,000)	(700,000)
Federal funds sold	(2,153,800)	54,900	(292,300)
Premises, software and equipment	(2,369)	(3,209)	(2,846)
Available-for-sale securities:			
Proceeds	108,395,000	96,735,645	72,037,510
Purchases	(108,374,973)	(96,928,730)	(72,110,521)
Held-to-maturity securities:			
Net decrease in short-term	(5,521)	(3,384)	(1,955)
Proceeds from long-term	2,142,008	2,757,179	2,989,295
Purchases of long-term	(1,575,562)	(3,319,993)	(3,841,780)

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

**STATEMENTS OF CASH FLOWS** (continued from previous page)

(in thousands)

	For the Years Ended December 31,		
	2006	2005	2004
Advances:			
Proceeds	\$ 1,974,813,063	\$ 2,261,563,078	\$ 2,325,820,033
Made	(1,976,598,421)	(2,260,800,609)	(2,324,944,227)
Mortgage loans held for portfolio:			
Proceeds	1,105,720	1,694,935	2,004,810
Purchases	(1,164,375)	(1,760,102)	(2,307,281)
Net cash used in investing activities	<u>(3,820,626)</u>	<u>(813,190)</u>	<u>(845,190)</u>
<b>FINANCING ACTIVITIES:</b>			
Net increase (decrease) in deposits and pass-through reserves	16,517	(130,463)	(377,253)
Net proceeds from issuance of Consolidated Obligations:			
Discount notes	821,869,538	951,365,321	826,021,476
Bonds (including \$0, \$85,734 and \$349,542 transferred from other FHLBanks)	20,410,899	16,698,550	33,206,055
Payments for maturing and retiring Consolidated Obligations:			
Discount notes	(817,494,689)	(952,423,677)	(836,841,046)
Bonds	(20,870,337)	(14,831,592)	(21,495,520)
Proceeds from issuance of capital stock	38,258	24,569	90,193
Payments for redemption of mandatorily redeemable capital stock	(383,679)	(129,505)	(53,907)
Cash dividends paid	(167)	(149)	(242)
Net cash provided by financing activities	<u>3,586,340</u>	<u>573,054</u>	<u>549,756</u>
Net (decrease) increase in cash and cash equivalents	(926)	(6,314)	4,594
Cash and cash equivalents at beginning of the year	<u>4,948</u>	<u>11,262</u>	<u>6,668</u>
Cash and cash equivalents at end of the year	<u>\$ 4,022</u>	<u>\$ 4,948</u>	<u>\$ 11,262</u>
<b>Supplemental Disclosures:</b>			
Interest paid	<u>\$ 3,466,937</u>	<u>\$ 2,501,909</u>	<u>\$ 1,582,784</u>
AHP payments, net	<u>\$ 24,379</u>	<u>\$ 23,774</u>	<u>\$ 22,090</u>
REFCORP assessments paid	<u>\$ 61,842</u>	<u>\$ 54,255</u>	<u>\$ 53,422</u>

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



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## NOTES TO FINANCIAL STATEMENTS

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### Background Information

The Federal Home Loan Bank of Cincinnati (the FHLBank), a federally chartered corporation, 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. The FHLBank provides a readily available, low-cost source of funds to its member institutions. The FHLBank is a cooperative, which means that current members own nearly all of the outstanding capital stock of the FHLBank and may receive dividends on their investment. Regulated financial depositories and insurance companies engaged in residential housing finance may apply for membership. State and local housing authorities that meet certain statutory criteria may also borrow from the FHLBank; while eligible to borrow, housing authorities are not members of the FHLBank and, as such, are not required to hold capital stock.

All members must purchase stock in the FHLBank. Members must own capital stock in the FHLBank based on the amount of their total assets. Each member may be required to purchase activity-based capital stock as it engages in certain business activities with the FHLBank. Former members own the remaining capital stock to support business transactions still carried on the FHLBank's Statements of Condition. As a result of these requirements, the FHLBank conducts business with stockholders in the normal course of business. For financial statement purposes, the FHLBank defines related parties as those members with more than 10 percent of the voting interests of the FHLBank capital stock outstanding. See Note 21 for more information relating to transactions with stockholders.

The Federal Housing Finance Board (Finance Board), an independent agency in the executive branch of the U.S. government, supervises and regulates the FHLBanks and the Office of Finance. The Office of Finance is a joint office of the FHLBanks established by the Finance Board to facilitate the issuance and servicing of the Consolidated Obligations of the FHLBanks and to prepare a combined financial report of all 12 FHLBanks. The Finance Board's principal purpose is to ensure that the FHLBanks operate in a safe and sound manner. In addition, the Finance Board ensures that the FHLBanks carry out their housing finance mission, remain adequately capitalized, and can raise funds in the capital markets. Also, the Finance Board establishes policies and regulations covering the operations of the FHLBanks. Each FHLBank operates as a separate entity with its own management, employees, and board of directors. The FHLBank does not have any special purpose entities or any other type of off-balance sheet conduits.

As provided by the Federal Home Loan Bank Act of 1932, as amended (the Act), or Finance Board Regulation, the FHLBanks' debt instruments (Consolidated Obligations) are backed only by the financial resources of the FHLBanks and are the primary source of funds for the FHLBanks. Deposits, other borrowings, and capital stock issued to members provide other funds. The FHLBank primarily uses these funds to provide Advances to members and to purchase loans from members through its Mortgage Purchase Program. Some FHLBanks also provide member institutions with correspondent services, such as wire transfer, security safekeeping, and settlement.

### Note 1—Summary of Significant Accounting Policies

*Use of Estimates.* The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP) requires management to make assumptions and estimates. These assumptions and estimates affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expenses. Actual results could differ from these estimates.

*Interest Bearing Deposits in Banks, Securities Purchased Under Agreements to Resell (Resale Agreements), and Federal Funds Sold.* These investments provide short-term liquidity and are carried at cost. The FHLBank treats securities purchased under agreements to resell as collateralized financings.

*Investment Securities.* The FHLBank classifies certain investments acquired for purposes of liquidity and asset/liability management as trading and carries them at fair value. The FHLBank records changes in the fair value of these investments through other income. However, the FHLBank does not participate in speculative trading practices and holds these investments indefinitely as management periodically evaluates its liquidity needs.

The FHLBank classifies certain investments that it may sell before maturity as available-for-sale and carries them at fair value. The change in fair value of the available-for-sale securities is recorded in other comprehensive income as a net unrealized gain or loss on available-for-sale securities.

The FHLBank carries, at cost, investments that it has both the ability and intent to hold to maturity (classified as held-to-maturity on the Statements of Condition), adjusted for the amortization of premiums and accretion of discounts using the level-yield method.

Under Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115), changes in circumstances may cause the FHLBank to change its intent to hold a security to maturity without calling into question its intent to hold other debt securities to maturity in the future. Thus, the sale or transfer of a held-to-maturity security due to certain changes in circumstances, such as evidence of significant deterioration in the issuer's creditworthiness or changes in regulatory requirements, is not considered to be inconsistent with its original classification. Other events that are isolated, nonrecurring, and unusual for the FHLBank that could not have been reasonably anticipated may cause the FHLBank to sell or transfer a held-to-maturity security without necessarily calling into question its intent to hold other debt securities to maturity.

In addition, in accordance with SFAS 115, sales of debt securities that meet either of the following two conditions may be considered as maturities for purposes of the classification of securities: (1) the sale occurs near enough to its maturity date (or call date if exercise of the call is probable) that interest rate risk is substantially eliminated as a pricing factor and the changes in market interest rates would not have a significant effect on the security's fair value, or (2) the sale of the security occurs after the FHLBank has already collected a substantial portion (at least 85 percent) of the principal outstanding at acquisition due either to prepayments on the security or to scheduled payments on the security payable in equal installments (both principal and interest) over its term. The FHLBank has not sold any securities out of its held-to-maturity portfolio during 2006, 2005 or 2004.

The FHLBank computes the amortization and accretion of premiums and discounts on mortgage-backed securities and other investments with a term of greater than one year using the level-yield method over the estimated cash flows of the securities. This method requires a retrospective adjustment of the level yield each time the FHLBank changes the estimated cash flows as if the new estimate had been known since the original acquisition date of the securities. The FHLBank uses nationally recognized, market-tested third party prepayment models to project estimated cash flows. The FHLBank computes the amortization and accretion of premiums and discounts on other investments with a term of one year or less using the straight-line method to the contractual maturity of the securities due to their short term nature. Analyses of the straight-line compared to the level-yield method have been performed by the FHLBank and the FHLBank has determined that the impact to the financial statements for each period reported, taken individually and as a whole, is not material.

The FHLBank computes gains and losses on sales of investment securities using the specific identification method and includes these gains and losses in other income.

The FHLBank regularly evaluates outstanding investments for changes in fair value and records impairment when a decline in fair value is deemed to be other than temporary. An investment is deemed impaired if the fair value of the investment is less than its amortized cost. After the investment is determined to be impaired, the FHLBank evaluates whether this decline in value is other than temporary. When evaluating whether the impairment is other than temporary, the FHLBank takes into consideration factors that include, but are not limited to, the creditworthiness of the issuer and the underlying collateral; the length of time and extent that fair value has been less than amortized cost; and the FHLBank's intent and ability to hold the investment for a sufficient amount of time to recover the unrealized losses. If there is an other-than-temporary impairment in value of an investment, the decline in value is recognized as a loss and presented in the Statements of Income as other income. The FHLBank did not experience any other-than-temporary impairment in value of investments during 2006, 2005, or 2004.

*Advances.* The FHLBank presents Advances (loans to members) net of unearned commitment fees and discounts on Advances for the Affordable Housing Program (AHP), as discussed below. The FHLBank amortizes the premiums and discounts on Advances to interest income using the level-yield method. The FHLBank credits interest on Advances to income as earned. Following the requirements of the Act, the FHLBank obtains sufficient collateral on Advances to protect it from losses. The Act limits eligible collateral to certain investment securities, residential mortgage loans, cash or deposits with the FHLBank, and other eligible real estate-related assets. As Note 8 more fully describes, community financial institutions (FDIC-insured institutions with average assets over the preceding three-year period of \$587

million or less during 2006) are eligible to utilize expanded statutory collateral rules that include secured small business and agricultural loans and securities representing a whole interest in such secured loans. The FHLBank has not incurred any credit losses on Advances since its inception. Based upon the collateral held as security for the Advances and the repayment history of the FHLBank's Advances, management believes that an allowance for credit losses on Advances is unnecessary.

*Mortgage Loans Held for Portfolio.* The FHLBank has a Mortgage Purchase Program under which it invests in government (FHA-insured) and conventional residential mortgage loans purchased directly from participating members. The FHLBank manages the liquidity and interest rate risk of the loans, while the members either retain or release the servicing activities. If participating in the servicing-released program, a member concurrently sells the servicing of the mortgage loans to an unrelated designated mortgage service provider. The FHLBank and the member share in the credit risk on conventional loans, with the member assuming a first loss obligation equivalent to the greater of expected losses or the required deductible for the supplemental mortgage insurance policy and with the FHLBank assuming credit losses in excess of mortgage insurance coverage, supplemental mortgage insurance coverage, and the member's obligation.

To ensure the retention of credit risk on conventional loans originated or acquired by a member, a Lender Risk Account (LRA) is funded by the FHLBank as a portion of the purchase proceeds of the loans to cover, at a minimum, the expected losses. This account is established to conform to Finance Board Regulations for all conventional Mortgage Purchase Programs that stipulate the member is responsible for all expected losses on the mortgages being sold to the FHLBank. In order to comply with this Regulation, the FHLBank evaluates, through use of a Nationally Recognized Statistical Rating Organization (NRSRO) model, the proposed conventional mortgages to be sold (either the specific portfolio or a representative sample) to determine the amount of expected losses that will occur. The expected losses represent the amount to be deposited into the LRA and these funds are used to offset any losses that may occur. After five years, excess funds over required balances are distributed to the member in accordance with a step-down schedule that is established at the time of a Master Commitment Contract. No LRA balance is required after eleven years. The LRA is recorded in other liabilities and totaled \$45,961,000 and \$42,472,000 at December 31, 2006 and 2005.

In addition to the expected losses covered by the LRA, the member selling conventional loans is required to purchase Supplemental Mortgage Insurance (SMI) and to designate the FHLBank as the beneficiary as an enhancement to cover losses over and above losses covered by the LRA. The LRA and SMI are calculated to provide, at a minimum, the equivalent to an investment grade rating (e.g., AA credit rating) for the loans purchased. In the event the LRA and the standard SMI policy do not provide sufficient loss protection to support the equivalent investment grade rating, additional mortgage insurance coverage called SMI Plus also must be purchased by the member. This policy covers the expected losses to achieve an investment grade rating equivalent to AA over and above the LRA and SMI.

The FHLBank classifies mortgage loans as held for investment and, accordingly, reports them at their principal amount outstanding net of unamortized premiums and discounts and unrealized gains and losses from loans initially classified as mortgage loan commitments.

The FHLBank defers and amortizes mortgage premiums and discounts paid to and received by the FHLBank's participating members as interest income using the level-yield method over the estimated cash flows of the related mortgage loans. Actual prepayment experience and estimates of future principal prepayments are used in calculating the estimated cash flows of the mortgage loans. The FHLBank aggregates the mortgage loans by similar characteristics (type, maturity, note rate and acquisition date) in determining prepayment estimates. The estimated cash flow method requires a retrospective adjustment each time the FHLBank changes the estimated amounts as if the new estimate had been known since the original acquisition date of the assets. The FHLBank uses nationally recognized, market-tested third party prepayment models to project estimated lives.

The FHLBank may receive non-origination fees, called pair-off fees. Pair-off fees represent a make-whole provision and are assessed when a member fails to deliver the quantity of loans committed to in the Mandatory Delivery Contracts. The FHLBank includes the pair-off fees in determining the periodic mark to market adjustment of the Mandatory Delivery Contracts, which is recorded in "Net gain (loss) on derivatives and hedging activities."

The FHLBank places certain conventional mortgage loans on nonaccrual status when the collection of the contractual principal or interest is 90 days or more past due, unless the loan is well secured and in the process of collection. When a conventional mortgage loan is placed on nonaccrual status, accrued but uncollected interest is charged against interest income. The FHLBank generally records cash payments received on nonaccrual loans first as interest income

and then as a reduction of principal as specified in the contractual agreement, unless the collection of the remaining principal amount due is considered doubtful. Government-insured loans are not placed on nonaccrual status when the collection of the contractual principal or interest is 90 days or more past due because of the (1) U.S. government guarantee of the loans and (2) contractual obligation of the loan servicer. Also, conventional loans that are settled monthly on a schedule/scheduled basis are not placed on nonaccrual status. Monthly settlement on a schedule/scheduled basis means that the Participating Financial Institution (PFI) is obligated to remit the contractual mortgage payments on mortgage loans sold to the FHLBank, regardless of whether or not the PFI received payment from the mortgagor.

The FHLBank bases the allowance for credit losses on management's estimate of credit losses inherent in the FHLBank's mortgage loan portfolio as of the Statement of Condition date. The FHLBank performs periodic reviews of its portfolio to identify the losses inherent within 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 data observations such as past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, and prevailing economic conditions. As a result of this analysis, the FHLBank has determined that each member's obligation for losses and the mortgage insurance coverage exceeds the inherent loss in the portfolio. Accordingly, no allowance for loan losses is considered necessary.

*Premises, Software and Equipment.* The FHLBank records premises, software and equipment at cost less accumulated depreciation and amortization. The FHLBank's accumulated depreciation and amortization related to these items was \$9,760,000 and \$8,317,000 at December 31, 2006 and 2005. The FHLBank computes depreciation on the straight-line method over the estimated useful lives of relevant assets ranging from three to ten years. Leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term are amortized over the shorter of the useful life of the asset or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. The FHLBank capitalizes improvements and major renewals but expenses ordinary maintenance and repairs when incurred. Depreciation and amortization expense for premises, software and equipment was \$1,954,000, \$1,693,000, and \$1,345,000 for the years ended December 31, 2006, 2005, and 2004. The FHLBank includes gains and losses on disposal of premises, software and equipment in other income. The net realized gain (loss) on disposal of premises, software and equipment was \$(2,000), \$(1,000), and \$4,000 in 2006, 2005, and 2004.

Cost of computer software developed or obtained for internal use is accounted for in accordance with Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). SOP 98-1 requires the cost of purchased software and certain costs incurred in developing computer software for internal use to be capitalized and amortized over future periods. As of December 31, 2006 and 2005, the FHLBank had \$4,367,000 and \$3,910,000 in unamortized computer software costs included in FHLBank premises, software and equipment. Amortization of computer software costs charged to expense was \$964,000, \$777,000, and \$585,000 for the years ended December 31, 2006, 2005, and 2004.

*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*, 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* (SFAS 133). All derivatives are recognized on the Statements of Condition at their fair values. The FHLBank has two primary objectives when using derivatives:

1. hedging market risk exposure; and
2. providing intermediation between the preferences of the capital markets for the kinds of debt securities in which they want to invest and the preferences of member institutions for the kinds of Advances they want to hold and the kinds of mortgage loans they want to sell.

Each derivative is designated as one of the following:

1. a hedge of the fair value of a recognized asset or liability (a "fair value" hedge); or
2. a non-qualifying hedge of an asset or liability ("economic hedge") for asset/liability management purposes.

Changes in the fair value of a derivative that 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, are recorded in other income as “Net gain (loss) on derivatives and hedging activities.”

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) on fair value hedges is reflected in other income as “Net gain (loss) on derivatives and hedging activities.”

Changes in the fair value of a derivative not qualifying as a hedge are recorded in current period earnings with no fair value adjustment to an asset or liability.

The differentials between accruals of interest receivables and payables on derivatives that are designated and qualify as fair value hedges are recognized as adjustments to the income or expense of the designated underlying investment securities, Advances, Consolidated Obligations or other financial instruments. The differentials between accruals of interest receivables and payables on economic hedges are recognized in other income as “Net gain (loss) on derivatives and hedging activities.” Cash flows associated with economic hedges are reflected as cash flows from operating activities in the Statements of Cash Flows.

The FHLBank may issue debt, may make Advances and may purchase financial instruments in which a derivative instrument is “embedded.” Upon execution of these transactions, the FHLBank 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 the FHLBank determines 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 115), or if the FHLBank 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 Statements of Condition at fair value and no portion of the contract is designated as a hedging instrument.

If hedging relationships meet certain criteria specified in SFAS 133, they are eligible for hedge accounting and the offsetting changes in fair value of the hedged items may be recorded in earnings. The application of hedge accounting generally requires the FHLBank to evaluate the effectiveness of the hedging relationships on an ongoing basis and to calculate the changes in fair value of the derivatives and related hedged items independently. This is known as the “long-haul” method of accounting. Transactions that meet more stringent criteria qualify for the “shortcut” method of hedge accounting in which an assumption can be made that the change in fair value of a hedged item exactly offsets the change in value of the related derivative.

Derivatives are typically executed at the same time as the hedged Advances or Consolidated Obligations and the FHLBank designates the hedged item in a qualifying hedge relationship as of the trade date. In many hedging relationships, the FHLBank may designate the hedging relationship upon its commitment to disburse an Advance or trade a Consolidated Obligation in which settlement occurs within the shortest period of time possible for the type of instrument based on market settlement conventions. The FHLBank defines market settlement conventions for Advances to be five business days or less and for Consolidated Obligations to be thirty calendar days or less, using a next business day convention. The FHLBank records the changes in fair value of the derivative and the hedged item beginning on the trade date. When the hedging relationship is designated on the trade date and the fair value of the derivative is zero on that date, the FHLBank meets the criteria within SFAS 133 for applying the shortcut method provided all the other criteria in paragraph 68 are also met.

When hedge accounting is discontinued because the FHLBank determines that the derivative no longer qualifies as an effective fair value hedge of an existing hedged item, the FHLBank continues to carry the derivative on the Statements of Condition at its fair value, ceases to adjust the hedged asset or liability for changes in fair value, and amortizes the cumulative basis adjustment on the hedged item into earnings using the level-yield method over the remaining life of the hedged item.

*Mandatorily Redeemable Capital Stock.* The FHLBank adopted SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150), effective as of January 1, 2004. See Note 14 for more information. In compliance with SFAS 150, the FHLBank reclassifies the stock subject to redemption from equity to liability upon expiration of the “grace period” after a member submits a written redemption request, gives notice of intent to withdraw from membership, or attains non-member status by merger or acquisition, charter termination, or involuntary termination from membership, since the member shares will then meet the definition of a mandatorily redeemable financial instrument. Member shares meeting this definition are reclassified to a liability at fair value. Dividends declared on member shares classified as a liability in accordance with SFAS 150 are accrued at the expected dividend rate and reflected as interest expense in the Statements of Income. The repayment of mandatorily redeemable financial instruments is reflected as cash outflows in the financing activities section of the Statements of Cash Flows once redeemed.

If a member cancels its written notice of redemption or notice of withdrawal, the FHLBank will reclassify mandatorily redeemable capital stock from a liability to equity in compliance with SFAS 150. After the reclassification, dividends on the capital stock will no longer be classified as interest expense.

*Prepayment Fees.* The FHLBank charges a member a prepayment fee when the member prepays certain Advances before the original maturity. The FHLBank records prepayment fees, net of SFAS 133 basis adjustments included in the book value of the Advances, as “Prepayment fees on Advances, net” in the interest income section of the Statements of Income. In cases in which the FHLBank funds a new Advance concurrent with or within a short period of time of the prepayment of an existing Advance, the FHLBank evaluates whether the new Advance meets the accounting criteria to qualify as a modification of an existing Advance or as a new Advance in accordance with EITF Issue No. 01-7, *Creditor’s Accounting for a Modification or Exchange of Debt Instruments*, and SFAS 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (SFAS 91).

If the new Advance qualifies as a modification of the existing Advance, the net prepayment fee on the prepaid Advance is deferred, recorded in the basis of the modified Advance, and amortized over the life of the modified Advance using the level-yield method. This amortization is recorded in Advance interest income.

For prepaid Advances that are hedged and meet the hedge accounting requirements of SFAS 133, the FHLBank terminates the hedging relationship upon prepayment and records the associated fair value gains and losses, adjusted for the prepayment fees, in interest income. If the FHLBank funds a new Advance to a member concurrent with or within a short period of time after the prepayment of a previous Advance to that member, the FHLBank evaluates whether the new Advance qualifies as a modification of the original hedged Advance, including analysis of (i) whether the effective yield on the new Advance is at least equal to the effective yield for a comparable Advance to a similar member that is not refinancing or restructuring and (ii) whether the modification of the original Advance is more than minor. If the new Advance qualifies as a modification of the original hedged Advance, the fair value gains or losses of the Advance and the prepayment fees are included in the carrying amount of the modified Advance, and gains or losses and prepayment fees are amortized in interest income over the life of the modified Advance using the level-yield method. If the modified Advance is also hedged and the hedge meets the hedging criteria in accordance with SFAS 133, it is marked to fair value after the modification, and subsequent fair value changes are recorded in other income. The amortization results in offsetting amounts being recorded in net interest income and in other income as “Net gain (loss) on derivatives and hedging activities.” The basis adjustment amortization amounted to a decrease to net interest income of \$360,000, \$1,254,000, and \$37,560,000 in 2006, 2005 and 2004.

If the FHLBank determines that the transaction does not qualify as a modification of an existing Advance, it is treated as an Advance termination with subsequent funding of a new Advance and the net fees are recorded in interest income as “Prepayment fees on Advances, net.”

*Commitment Fees.* The FHLBank defers commitment fees for Advances and amortizes them to interest income over the life of the Advance using the level-yield method. Refundable fees are deferred until the commitment expires or until the Advance is made. The FHLBank records commitment fees for Standby Letters of Credit as a deferred credit when it receives the fees and amortizes them using the straight-line method over the term of the Standby Letter of Credit. The FHLBank’s management believes that the likelihood of Standby Letters of Credit being drawn upon is remote based upon past experience.

*Concessions on Consolidated Obligations.* The FHLBank defers and amortizes, using the level-yield method, the amounts paid to dealers in connection with the sale of Consolidated Obligation Bonds over the terms to maturity or

estimated cash flows of the Consolidated Obligation Bonds. The Office of Finance prorates the amount of the concession to the FHLBank based upon the percentage of the debt issued that is assumed by the FHLBank. Unamortized Bond concessions were \$18,565,000 and \$24,287,000 at December 31, 2006 and 2005 and are included in other assets. Amortization of such concessions is included in Consolidated Obligation interest expense and totaled \$8,597,000, \$10,125,000, and \$17,736,000 in 2006, 2005, and 2004.

The FHLBank charges to expense as incurred the concessions applicable to Consolidated Obligation Discount Notes because of the short maturities of these Notes. Analyses of the straight-line compared to the level-yield method have been performed by the FHLBank and it has determined that the impact to the financial statements for each period reported, taken individually and as a whole, is not material. Such concessions are included in Consolidated Obligation interest expense and totaled \$3,082,000, \$4,334,000, and \$3,196,000 in 2006, 2005, and 2004.

*Discounts and Premiums on Consolidated Obligations.* The FHLBank amortizes the discounts and premiums on Consolidated Obligation Bonds to expense using the level-yield method over the terms to maturity of the Consolidated Obligation Bonds and expenses the discounts on Consolidated Obligation Discount Notes using the straight-line method over the term of the Notes due to their short-term nature. Analyses of the straight-line compared to the level-yield method have been performed by the FHLBank and the FHLBank has determined that the impact to the financial statements for each period reported, taken individually and as a whole, is not material.

*Finance Board and Office of Finance Expenses.* The FHLBank is assessed for its proportionate share of the costs of operating the Finance Board, the FHLBank's primary regulator, and the Office of Finance, which manages the sale of Consolidated Obligations. The Finance Board allocates its operating and capital expenditures to the FHLBanks based on each FHLBank's percentage of total capital. The Office of Finance allocates its operating and capital expenditures based on each FHLBank's percentage of capital stock, percentage of Consolidated Obligations issued and percentage of Consolidated Obligations outstanding.

*Other Expenses.* The FHLBank classifies third party volume-related mortgage loan costs and amounts awarded under its American Dream Homeownership Challenge and New Neighbors (hurricane relief) grant funds as other expenses.

*Affordable Housing Program (AHP).* The Act requires each FHLBank to establish and fund an AHP (see Note 9). The FHLBank charges the required funding for AHP to earnings and establishes a liability. The AHP funds provide subsidies to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. The FHLBank issues AHP Advances at interest rates below the customary interest rate for non-subsidized Advances. The FHLBank also has the authority to make the AHP subsidy available to members as a grant. When the FHLBank makes an AHP Advance, the present value of the variation in the cash flow caused by the difference in the interest rate between the AHP Advance rate 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. The discount on AHP Advances is accreted to interest income on Advances using the level-yield method over the life of the Advance.

*Resolution Funding Corporation (REFCORP) Assessments.* Although the FHLBanks are exempt from ordinary Federal, state, and local taxation except for local real estate tax, they are required to make quarterly payments to REFCORP to pay toward interest on bonds issued by REFCORP. REFCORP is a corporation established by Congress in 1989 to provide funding for the resolution and disposition of insolvent savings institutions. Officers, employees, and agents of the Office of Finance are authorized to act for and on behalf of REFCORP to carry out the functions of REFCORP. See Note 10 for more information.

*Estimated Fair Values.* Many of the FHLBank's financial instruments lack an available trading market characterized by transactions between a willing buyer and a willing seller engaging in an exchange transaction. Therefore, the FHLBank uses internal models employing significant estimates and present-value calculations when disclosing estimated fair values. Note 18 details the estimated fair values of the FHLBank's financial instruments.

*Cash Flows.* In the Statements of Cash Flows, the FHLBank considers cash and due from banks as cash and cash equivalents. Federal funds sold are not treated as cash equivalents for purposes of the Statements of Cash Flows, but are instead treated as short-term investments and are reflected in the investing activities section of the Statements of Cash Flows.

*Reclassifications.* Certain amounts in the 2005 and 2004 financial statements have been reclassified to conform to the 2006 presentation.

## Note 2—Recently Issued Accounting Standards and Interpretations

SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140* (SFAS 155). The FASB issued SFAS 155 in February 2006. This statement resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets* (DIG Issue D1). SFAS 155 amends SFAS 133 for certain derivatives embedded in other financial instruments (a hybrid financial instrument) by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise required bifurcation, provided that the entire hybrid financial instrument is accounted for on a fair value basis. SFAS 155 also establishes the requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, which replaces the interim guidance in DIG Issue D1. SFAS 155 amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities a replacement of FASB Statement 125* to allow a qualifying special-purpose entity to hold a derivative financial instrument that pertains to beneficial interests other than another derivative financial instrument. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006 (January 1, 2007 for the FHLBank), with earlier adoption allowed. The FHLBank does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

SFAS No. 156, *Accounting for Servicing of Financial Assets, an Amendment of FASB No. 140* (SFAS 156). On March 17, 2006, the FASB issued SFAS 156, which amends SFAS Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* (SFAS 140), with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for fiscal years beginning after September 15, 2006, with earlier adoption permitted. The FHLBank adopted SFAS 156 on January 1, 2007. The management of the FHLBank does not expect SFAS 156 to have a material impact on its results of operations or financial condition at the time of adoption.

SFAS No. 157 *Fair Value Measurements* (SFAS 157). The FASB issued SFAS No. 157 in September 2006. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. The FHLBank does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

SEC Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). On September 13, 2006, the SEC issued SAB 108 to provide guidance in the process of quantifying financial statement misstatements. SAB 108 requires registrants to quantify an error under both the rollover and iron curtain approaches. A registrant's financial statements would require adjustment when either approach results in quantifying a misstatement that is material, after considering all relevant quantitative and qualitative factors. The FHLBank adopted SAB 108 as of December 31, 2006. The adoption of SAB 108 did not have a material impact on the FHLBank's results of operations or financial condition.

SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (SFAS 158). In September 2006, the FASB issued SFAS 158 which reconsiders the guidance in FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. SFAS 158 requires the recognition of a net liability or asset to report the funded status of defined benefit pension and other postretirement benefit plans on the statement of financial position. The FHLBank adopted SFAS 158 as of December 31, 2006. The adoption of SFAS 158 did not have a material impact on the FHLBank's results of operations or financial condition. See Note 15 for further discussion of the adoption of SFAS 158.

SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). The FASB issued SFAS 159 in February 2007. SFAS 159 permits entities to choose, at specified election dates, to measure various financial instruments and certain other items at fair value. SFAS 159 is effective for financial statements issued for fiscal years



beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided that the provisions of SFAS 157 are applied at the same time. The management of the FHLBank has not determined the effect that the implementation of SFAS 159 will have on its results of operations or financial condition.

### Note 3—Cash and Due from Banks

*Compensating Balances.* The FHLBank maintains collected cash balances with commercial banks in return for certain services. These agreements contain no legal restrictions on the withdrawal of funds. The average compensating balances for the years ended December 31, 2006 and 2005 were approximately \$272,000 and \$228,000.

In addition, the FHLBank maintained average required clearing balances with various Federal Reserve Banks and branches of approximately \$1,000,000 for the years ended December 31, 2006 and 2005. These clearing balances represent an average balance required to be maintained over each 14-day cycle and contain no legal restrictions on the withdrawal of the funds. The FHLBank may use earnings credits on these balances to pay for services received from the Federal Reserve Banks.

*Pass-through Deposit Reserves.* The FHLBank acts as a pass-through correspondent for member institutions required to deposit reserves with the Federal Reserve Banks. The amount shown as “Cash and due from banks” includes pass-through reserves deposited with Federal Reserve Banks of approximately \$360,000 and \$264,000 as of December 31, 2006 and 2005. The FHLBank includes the related liability for member reserve balances in “Deposits” on the Statements of Condition.

### Note 4—Securities Purchased Under Agreements to Resell

The FHLBank has entered into purchases of securities purchased under agreements to resell those securities. These amounts represent short-term loans and are assets in the Statements of Condition. One of the Federal Reserve Banks holds the securities purchased under agreements to resell in safekeeping in the name of the FHLBank. Should the market value of the underlying securities decrease below the market value required as collateral, the counterparty must place an equivalent amount of additional securities in safekeeping in the name of the FHLBank or the dollar value of the resale agreement will be decreased accordingly.

### Note 5—Trading Securities

*Major Security Types.* Trading securities as of December 31 were as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Mortgage-backed securities:		
U.S. agency obligations – guaranteed	<u>\$ 4,602</u>	<u>\$ 6,187</u>

Prior to the effective date for SFAS 133, the FHLBank had purchased two mortgage-backed securities and effectively removed the embedded caps and floors by executing interest rate swaps. The provisions of SFAS 133 allowed for a transition redesignation of the mortgage-backed securities from held-to-maturity to trading. The FHLBank did redesignate the hedged mortgage-backed securities from held-to-maturity to trading in order that the changes in fair value of both the mortgage-backed securities and the interest rate swaps would result in a relatively offsetting impact to other income that reflected the economics of these transactions. Both interest rate swaps matured during 2005. The FHLBank did not execute replacement interest rate swaps to continue to economically hedge the two mortgage-backed securities due to their relatively small size at that point in their life cycle.

The FHLBank has never purchased mortgage-backed securities that represent loans purchased directly from and/or securitized by its members or other FHLBanks and therefore the above balances do not include any such purchases.

Net gain (loss) on trading securities for the years ended December 31, 2006, 2005, and 2004 included a change in net unrealized holding gain (loss) (in thousands) of \$17, \$(35), and \$(33) for securities held on December 31, 2006, 2005, and 2004.

**Note 6—Available-for-Sale Securities**

*Major Security Types.* Available-for-sale securities as of December 31, 2006 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Commercial paper	<u>\$ 1,188,981</u>	<u>\$ -</u>	<u>\$ (531)</u>	<u>\$ 1,188,450</u>

Available-for-sale securities as of December 31, 2005 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Commercial paper	<u>\$ 1,149,389</u>	<u>\$ 1,895</u>	<u>\$ (13)</u>	<u>\$ 1,151,271</u>

All securities outstanding with gross unrealized losses at December 31, 2006 and 2005 were short-term securities with terms of less than 12 months.

The FHLBank reviewed its available-for-sale securities and has determined that all unrealized losses reflected above are temporary, based on the creditworthiness of the issuers and the underlying collateral, if applicable. The FHLBank believes it is probable that it will be able to collect all amounts due according to the contractual terms of the individual securities. Based upon the creditworthiness of the issuers, and because the FHLBank has the ability and intent to hold such securities through to recovery of the unrealized losses, it does not consider the investments to be other-than-temporarily impaired at December 31, 2006.

*Redemption Terms.* The amortized cost and estimated fair value of available-for-sale securities by contractual maturity at December 31 are shown below (in thousands). Expected maturities of some securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

<u>Year of Maturity</u>	<u>2006</u>		<u>2005</u>	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	<u>\$ 1,188,981</u>	<u>\$ 1,188,450</u>	<u>\$ 1,149,389</u>	<u>\$ 1,151,271</u>

*Interest Rate Payment Terms.* The following table details additional interest rate payment terms for investment securities classified as available-for-sale at December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Amortized cost of available-for-sale securities other than mortgage-backed securities:		
Fixed-rate	<u>\$ 1,188,981</u>	<u>\$ 1,149,389</u>

*Gains and Losses.* There were no gross gains (in thousands) and gross losses (in thousands) of \$0, \$0, and \$3 were realized on sales of available-for-sale securities for the years ended December 31, 2006, 2005, and 2004.

## Note 7—Held-to-Maturity Securities

Major Security Types. Held-to-maturity securities as of December 31, 2006 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Government-sponsored enterprises	\$ 24,770	\$ 6	\$ -	\$ 24,776
State or local housing agency obligations	23,915	242	(4)	24,153
Mortgage-backed securities:				
U.S. agency obligations – guaranteed	27,599	-	(510)	27,089
Government-sponsored enterprises	11,607,132	2,145	(268,355)	11,340,922
Other	415,932	-	(10,434)	405,498
Total mortgage-backed securities	<u>12,050,663</u>	<u>2,145</u>	<u>(279,299)</u>	<u>11,773,509</u>
Total	<u>\$ 12,099,348</u>	<u>\$ 2,393</u>	<u>\$ (279,303)</u>	<u>\$ 11,822,438</u>

Held-to-maturity securities as of December 31, 2005 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Government-sponsored enterprises	\$ 19,249	\$ 4	\$ -	\$ 19,253
State or local housing agency obligations	31,070	743	-	31,813
Mortgage-backed securities:				
U.S. agency obligations – guaranteed	45,417	-	(703)	44,714
Government-sponsored enterprises	11,713,941	5,551	(249,850)	11,469,642
Other	481,093	-	(9,778)	471,315
Total mortgage-backed securities	<u>12,240,451</u>	<u>5,551</u>	<u>(260,331)</u>	<u>11,985,671</u>
Total	<u>\$ 12,290,770</u>	<u>\$ 6,298</u>	<u>\$ (260,331)</u>	<u>\$ 12,036,737</u>

The FHLBank has never purchased mortgage-backed securities that represent loans purchased directly from and/or securitized by its members or other FHLBanks and therefore the above balances do not include any such purchases.

The following table summarizes the held-to-maturity securities with unrealized losses as of December 31, 2006. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position (in thousands).

	Less than 12 Months		12 Months or more		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
State or local housing agency obligations	\$ 1,886	\$ (4)	\$ -	\$ -	\$ 1,886	\$ (4)
Mortgage-backed securities:						
U.S. agency obligations – guaranteed	-	-	27,089	(510)	27,089	(510)
Government-sponsored enterprises	2,609,254	(12,575)	8,493,601	(255,780)	11,102,855	(268,355)
Other	-	-	405,498	(10,434)	405,498	(10,434)
Total temporarily impaired	<u>\$ 2,611,140</u>	<u>\$ (12,579)</u>	<u>\$ 8,926,188</u>	<u>\$ (266,724)</u>	<u>\$ 11,537,328</u>	<u>\$ (279,303)</u>

The FHLBank reviewed its held-to-maturity securities and has determined that all unrealized losses reflected above are temporary, based on the creditworthiness of the issuers and the underlying collateral, if applicable. The FHLBank believes it is probable that it will be able to collect all amounts due according to the contractual terms of the individual securities. Additionally, the FHLBank has the ability and intent to hold such securities through to recovery of the unrealized losses.

The following table summarizes the held-to-maturity securities with unrealized losses as of December 31, 2005. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position (in thousands).

	Less than 12 Months		12 Months or more		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Mortgage-backed securities:						
U.S. agency obligations – guaranteed	\$ 44,714	\$ (703)	\$ -	\$ -	\$ 44,714	\$ (703)
Government-sponsored enterprises	6,584,919	(117,844)	3,680,584	(132,006)	10,265,503	(249,850)
Other	364,981	(6,600)	106,334	(3,178)	471,315	(9,778)
Total temporarily impaired	<u>\$ 6,994,614</u>	<u>\$ (125,147)</u>	<u>\$ 3,786,918</u>	<u>\$ (135,184)</u>	<u>\$ 10,781,532</u>	<u>\$ (260,331)</u>

*Redemption Terms.* The amortized cost and estimated fair value of held-to-maturity securities by contractual maturity at December 31 are shown below (in thousands). Expected maturities of some securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

Year of Maturity	2006		2005	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 25,490	\$ 25,497	\$ -	\$ -
Due after one year through five years	-	-	20,749	20,756
Due after ten years	23,195	23,432	29,570	30,310
Total other	<u>48,685</u>	<u>48,929</u>	<u>50,319</u>	<u>51,066</u>
Mortgage-backed securities:				
U.S. agency obligations – guaranteed	27,599	27,089	45,417	44,714
Government-sponsored enterprises	11,607,132	11,340,922	11,713,941	11,469,642
Other	415,932	405,498	481,093	471,315
Total mortgage-backed securities	<u>12,050,663</u>	<u>11,773,509</u>	<u>12,240,451</u>	<u>11,985,671</u>
Total	<u>\$ 12,099,348</u>	<u>\$ 11,822,438</u>	<u>\$ 12,290,770</u>	<u>\$ 12,036,737</u>

The amortized cost of the FHLBank's mortgage-backed securities classified as held-to-maturity includes net (discounts) premiums (in thousands) of \$(8,785) and \$7,029 at December 31, 2006 and 2005.

*Interest Rate Payment Terms.* The following table details interest rate payment terms for investment securities classified as held-to-maturity at December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Amortized cost of held-to-maturity securities other than mortgage-backed securities:		
Fixed-rate	\$ 44,955	\$ 46,419
Variable-rate	<u>3,730</u>	<u>3,900</u>
Total other	<u>48,685</u>	<u>50,319</u>
Amortized cost of held-to-maturity mortgage-backed securities:		
Pass-through securities:		
Fixed-rate	5,999,899	5,786,915
Collateralized mortgage obligations:		
Fixed-rate	6,048,732	6,449,032
Variable-rate	<u>2,032</u>	<u>4,504</u>
Total mortgage-backed securities	<u>12,050,663</u>	<u>12,240,451</u>
Total	<u>\$ 12,099,348</u>	<u>\$ 12,290,770</u>

#### Note 8—Advances

*Redemption Terms.* At December 31, 2006 and 2005, the FHLBank had Advances outstanding, including AHP Advances (see Note 9), at interest rates ranging from 0.00 percent to 9.75 percent, as summarized below (dollars in thousands). Advances with interest rates of 0.00 percent are AHP subsidized Advances.

<u>Year of Original Maturity</u>	<u>2006</u>		<u>2005</u>	
	Amount	Weighted Average Interest Rate %	Amount	Weighted Average Interest Rate %
Overdrawn demand deposit accounts	\$ 125	5.42	\$ 1,785	4.54
2006			10,862,185	4.10
2007	14,604,942	5.17	7,784,494	4.31
2008	3,940,640	5.17	4,667,045	4.47
2009	6,779,335	5.32	5,736,701	4.49
2010	5,452,810	5.49	5,002,229	4.82
2011	4,712,975	5.27	1,924,045	4.59
Thereafter	<u>6,451,631</u>	4.89	<u>4,178,593</u>	4.35
Total par value	41,942,458	5.20	40,157,077	4.38
Commitment fees	(1,795)		(2,438)	
Discount on AHP Advances	(33,396)		(30,301)	
Discount on Advances	(919)		(1,815)	
SFAS 133 hedging adjustments	<u>50,190</u>		<u>139,100</u>	
Total	<u>\$ 41,956,538</u>		<u>\$ 40,261,623</u>	

The FHLBank offers Advances to members that may be prepaid on pertinent dates (call dates) without incurring prepayment or termination fees (callable Advances). Other Advances may only be prepaid by paying a fee to the FHLBank (prepayment fee) that makes the FHLBank financially indifferent to the prepayment of the Advance. At December 31, 2006 and 2005, the FHLBank had callable Advances (in thousands) of \$21,221,507 and \$17,967,510.

The following table summarizes Advances at December 31 by year of original maturity or next call date for callable Advances (in thousands):

Year of Original Maturity or Next Call	2006	2005
Overdrawn demand deposit accounts	\$ 125	\$ 1,785
2006		27,849,879
2007	32,639,126	1,996,603
2008	1,461,303	1,577,159
2009	1,498,856	1,454,222
2010	1,582,414	1,873,333
2011	1,296,475	1,896,545
Thereafter	3,464,159	3,507,551
Total par value	\$ 41,942,458	\$ 40,157,077

Through December 2005, the FHLBank offered Convertible Advances. With a Convertible Advance, the FHLBank purchases an option from the member that allows the FHLBank to convert the interest rate from fixed to floating by terminating the fixed Advance, which the FHLBank normally would exercise when interest rates increase, and offering a floating rate Advance. At December 31, 2006 and 2005, the FHLBank had Convertible Advances outstanding totaling (in thousands) \$4,485,200 and \$6,793,700. In January 2006, the FHLBank began offering Puttable Advances. With a Puttable Advance, the FHLBank purchases a put option from the member that allows the FHLBank to terminate the Advance, which the FHLBank normally would exercise when interest rates increase. At December 31, 2006, the FHLBank had Puttable Advances outstanding totaling (in thousands) \$444,000.

The following table summarizes Advances at December 31 by year of original maturity or next convert date for Convertible Advances and next put date for Puttable Advances (in thousands):

Year of Original Maturity or Next Convert/Put Date	2006	2005
Overdrawn demand deposit accounts	\$ 125	\$ 1,785
2006		17,074,385
2007	19,067,142	7,915,994
2008	3,831,140	4,053,545
2009	6,130,635	4,844,001
2010	4,223,310	3,483,229
2011	3,921,475	172,545
Thereafter	4,768,631	2,611,593
Total par value	\$ 41,942,458	\$ 40,157,077

The FHLBank also offers Advances with a prepayment option based on the 12-month average prepayment speed on a Freddie Mac or Fannie Mae mortgage-backed security with a similar coupon rate and term (Mortgage Matched Advances). During each 12-month period beginning with the date of disbursement, the borrower has the option of making one partial payment of principal without incurring a prepayment fee. At December 31, 2006 and 2005, the FHLBank had (in thousands) \$396,743 and \$412,958 of Advances with such coupons which are included in the above tables by original maturity date.

*Security Terms.* The FHLBank lends to financial institutions involved in housing finance within its district according to Federal statutes, including the Act. The Act requires the FHLBank to obtain sufficient collateral on Advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans, cash or deposits, member capital stock in the FHLBank, and other eligible real estate-related assets as collateral on the Advances. Community Financial Institutions (CFIs) are eligible under expanded statutory collateral rules to use secured small business, small farm, and small agricultural loans, and securities representing a whole interest in those secured loans. As additional security, the FHLBank has a statutory lien on each borrower's capital in the FHLBank. At both December 31, 2006 and 2005, the FHLBank had rights to collateral with an estimated value exceeding outstanding Advances by more than \$150 billion. On the basis of the financial condition of the member (or borrower), the type

of security agreement, and other factors, the FHLBank may either:

1. allow a member (or borrower) to retain possession of the collateral assigned to the FHLBank, if the member (or borrower) executes a written security agreement and agrees to hold the collateral for the benefit of the FHLBank; or
2. require the member (or borrower) to deliver physical possession of the collateral to the FHLBank or a third party custodian approved by the FHLBank.

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

*Credit Risk.* While the FHLBank has never experienced a credit loss on an Advance to a member, the expanded collateral available to CFIs provides the potential for additional credit risk for the FHLBank. The management of the FHLBank has adopted policies and procedures that it believes enable it to appropriately manage this credit risk. Accordingly, the FHLBank has not provided any allowances for losses on these Advances.

The FHLBank's potential credit risk from Advances is concentrated in commercial banks and savings institutions. The income from Advances to member institutions holding 5 percent or more of total Advances at December 31, 2006, 2005 and 2004 amounted to \$1,371.3 million, \$896.9 million and \$666.7 million, respectively, during those years. The FHLBank held sufficient collateral to cover the Advances to these institutions, and the FHLBank does not expect to incur any credit losses on these Advances.

The following table shows Advance balances at December 31 to members holding 5 percent or more of total Advances and includes any known affiliates that are members of the FHLBank (dollars in millions):

	2006		2005	
	Principal	% of Total	Principal	% of Total
Charter One Bank, N.A.	\$ 10,772	26%	\$ 9,876	25%
U.S. Bank, N.A.	6,757	16	3,621	9
Fifth Third Bank	4,048	10	3,045	7
Ohio Savings Bank	<u>3,971</u>	<u>9</u>	3,878	10
National City Bank <sup>(1)</sup>			<u>2,008</u>	<u>5</u>
Total	<u>\$ 25,548</u>	<u>61%</u>	<u>\$ 22,428</u>	<u>56%</u>

(1) National City Bank's Advance balance (in millions) was \$1,201, or 3% of total Advances, at December 31, 2006.

*Interest Rate Payment Terms.* The following table details Advances by interest rate payment type at December 31 (in thousands):

	2006	2005
Par amount of Advances:		
Fixed-rate	\$ 18,490,826	\$ 20,159,567
Variable-rate	<u>23,451,632</u>	<u>19,997,510</u>
Total	<u>\$ 41,942,458</u>	<u>\$ 40,157,077</u>

*Prepayment Fees.* The FHLBank records prepayment fees received from members on prepaid Advances net of any associated SFAS 133 hedging fair-value adjustments on those Advances. The net amount of prepayment fees is reflected as interest income in the Statements of Income. Gross Advance prepayment fees received from members (in thousands) were \$10,357, \$337 and \$609,894 for the years ended December 31, 2006, 2005, and 2004.

## Note 9—Affordable Housing Program (AHP)

Section 10(j) of the 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 who 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 the AHP the greater of \$100 million or 10 percent of regulatory income. Regulatory income is defined as GAAP income before interest expense related to mandatorily redeemable capital stock and the AHP assessment, but after the assessment for REFCORP. The exclusion of interest expense related to mandatorily redeemable capital stock is a regulatory calculation determined by the Finance Board. The AHP and REFCORP assessments are calculated simultaneously because of their interdependence. The FHLBank accrues AHP expense monthly based on its income. The FHLBank reduces the AHP liability as members use subsidies. Calculation of the REFCORP assessment is discussed in Note 10.

If the FHLBank experienced a regulatory loss during a quarter, but still had regulatory income for the year, the FHLBank's obligation to the AHP would be calculated based on the FHLBank's year-to-date regulatory income. If the FHLBank had regulatory income in subsequent quarters, it would be required to contribute additional amounts to meet its calculated annual obligation. If the FHLBank experienced a regulatory loss for a full year, the FHLBank would have no obligation to the AHP for the year except in the following circumstance. If the result of the aggregate 10 percent calculation described above is less than \$100 million for all 12 FHLBanks, then the Act requires that each FHLBank contribute such prorated sums as may be required to assure that the aggregate contributions of the FHLBanks equals \$100 million. The pro ration would be made on the basis of the income of the FHLBanks for the previous year.

There was no shortfall in either 2006 or 2005. If an FHLBank finds that its required AHP obligations are contributing to the financial instability of that FHLBank, it may apply to the Finance Board for a temporary suspension of its contributions. The FHLBank has never made such an application. The FHLBank had outstanding principal in AHP-related Advances (in thousands) of \$169,165 and \$159,954 at December 31, 2006 and 2005. An analysis of the AHP liability for the years ended December 31 follows (in thousands):

	<u>2006</u>	<u>2005</u>
Balance at beginning of year	\$ 91,035	\$ 88,919
Expense	29,584	25,890
Subsidy uses, net	<u>(24,379)</u>	<u>(23,774)</u>
Balance at end of year	<u>\$ 96,240</u>	<u>\$ 91,035</u>

## Note 10—Resolution Funding Corporation (REFCORP)

Each FHLBank is required to pay to REFCORP 20 percent of income calculated in accordance with GAAP after the assessment for AHP, but before the assessment for the REFCORP. The AHP and REFCORP assessments are calculated simultaneously because of their interdependence. The FHLBank accrues its REFCORP assessment on a monthly basis. Calculation of the AHP assessment is discussed in Note 9. Each FHLBank provides its net income before AHP and REFCORP to the Resolution Funding Corporation, which, as calculation agent, then performs the calculations for each quarter end.

The FHLBanks will continue to be obligated for these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a \$300 million annual annuity (or a scheduled payment of \$75 million per quarter) 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, selects the appropriate discounting factors to be used in this annuity calculation. The FHLBanks use the actual payments made to determine the amount of the future obligation that has been defeased. The cumulative amount to be paid to REFCORP by the FHLBank is not determinable at this time because it depends on the future earnings of all FHLBanks and interest rates. If the FHLBank experienced a net loss during a quarter, but still had net income for the year, the FHLBank's obligation to REFCORP would be calculated based on the FHLBank's year-to-date net income. The FHLBank would be entitled to a refund of amounts paid for the full year that were in excess of its calculated annual obligation. If the FHLBank had net income in subsequent quarters, it would be required to contribute additional amounts to meet its calculated annual obligation. If the FHLBank experienced a net loss for a full year, the FHLBank would have no obligation to REFCORP for the year.



The Finance Board is required to extend the term of the FHLBanks' obligation to REFCORP for each calendar quarter in which there is a deficit quarterly payment. A deficit quarterly payment is the amount by which the actual quarterly payment falls short of \$75 million.

The FHLBanks' aggregate payments through 2006 exceeded the scheduled payments, effectively accelerating payment of the REFCORP obligation and shortening its remaining term to the third quarter of 2015. The FHLBanks' aggregate payments through 2006 have satisfied \$3.1 million of the \$75 million scheduled payment for the third quarter of 2015 and all scheduled payments thereafter. This date assumes the FHLBanks will pay exactly \$300 million annually after December 31, 2006 until the annuity is satisfied.

The benchmark payments or portions of them could be reinstated if the actual REFCORP payments of the FHLBanks fall short of \$75 million in a quarter. The maturity date of the REFCORP obligation may be extended beyond April 15, 2030 if such extension is necessary to ensure that the value of the aggregate amounts paid by the FHLBanks exactly equals a \$300 million annual annuity. Any payment beyond April 15, 2030 will be paid directly to the Department of Treasury.

### Note 11—Mortgage Loans Held for Portfolio

Under the Mortgage Purchase Program, the FHLBank invests in mortgage loans that it purchases from participating members. Total mortgage loans held for portfolio represent home mortgage loans under the Mortgage Purchase Program that the FHLBank's members originate, service in some cases, credit enhance, and then sell to the FHLBank. Those members participating in the servicing-released program do not service the loans owned by the FHLBank. The servicing on these loans was sold concurrently to a designated mortgage service provider. The following table presents information as of December 31 on mortgage loans held for portfolio (in thousands):

	<u>2006</u>	<u>2005</u>
Real Estate:		
Fixed rate medium-term single-family mortgages <sup>(1)</sup>	\$ 1,414,698	\$ 1,615,684
Fixed rate long-term single-family mortgages	<u>6,963,964</u>	<u>6,708,630</u>
Subtotal fixed rate single-family mortgages	8,378,662	8,324,314
Premiums	98,804	114,014
Discounts	(6,674)	(6,853)
SFAS 133 basis adjustments	<u>(10,076)</u>	<u>(13,336)</u>
Total	<u>\$ 8,460,716</u>	<u>\$ 8,418,139</u>

(1) Medium-term is defined as a term of 15 years or less.

The following table details the par value of mortgage loans held for portfolio outstanding at December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Government-insured loans	\$ 1,563,548	\$ 1,898,524
Conventional loans	<u>6,815,114</u>	<u>6,425,790</u>
Total par value	<u>\$ 8,378,662</u>	<u>\$ 8,324,314</u>

The conventional mortgage loans are supported by primary and supplemental mortgage insurance and the LRA (see Note 1) in addition to the associated property as collateral. The FHLBank has experienced no credit losses on mortgage loans to date and no event has occurred that would cause the FHLBank to believe it will have to absorb any credit losses on these mortgage loans. Accordingly, the FHLBank has not provided any allowances for losses on these mortgage loans.

The following table presents changes in the Lender Risk Account for the years ended December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Lender Risk Account at beginning of year	\$ 42,472	\$ 37,243
Additions	3,779	5,324
Claims	(203)	(95)
Scheduled distributions	<u>(87)</u>	<u>-</u>
Lender Risk Account at end of year	<u>\$ 45,961</u>	<u>\$ 42,472</u>

The FHLBank had no nonaccrual loans at December 31, 2006 and 2005.

Mortgage loans, other than those included in large groups of smaller-balance homogeneous loans, are considered impaired when, based on current information and events, it is probable that the FHLBank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreement. At December 31, 2006 and 2005, the FHLBank had no recorded investments in impaired mortgage loans.

The following table shows unpaid principal balances at December 31 to members supplying 5 percent or more of total unpaid principal and includes any known affiliates that are members of the FHLBank (dollars in millions):

	<u>2006</u>		<u>2005</u>	
	<u>Principal</u>	<u>% of Total</u>	<u>Principal</u>	<u>% of Total</u>
National City Bank	\$ 4,767	57%	\$ 4,530	54%
Union Savings Bank	2,097	25	2,207	27
Guardian Savings Bank FSB	<u>517</u>	<u>6</u>	<u>522</u>	<u>6</u>
Total	<u>\$ 7,381</u>	<u>88%</u>	<u>\$ 7,259</u>	<u>87%</u>

#### Note 12—Deposits

The FHLBank offers demand and overnight interest bearing deposits for members and qualifying non-members. In addition, the FHLBank offers short-term interest bearing deposit programs to members. A member that services mortgage loans may deposit in the FHLBank funds collected in connection with the mortgage loans, pending disbursement of such funds to the owners of the mortgage loans; the FHLBank classifies these items as "Other" interest bearing deposits below.

Certain financial institutions have agreed to maintain compensating balances in consideration for correspondent and other non-credit services. These balances are classified as interest bearing deposits on the accompanying financial statements. The compensating balances held by the FHLBank averaged (in thousands) \$21,938 and \$39,361 during 2006 and 2005.

Deposits classified as demand, overnight, and other pay interest based on a daily interest rate. Term deposits pay interest based on a fixed rate determined at the issuance of the deposit. The average interest rates paid on average interest bearing deposits during 2006, 2005, and 2004 were 4.72 percent, 2.92 percent, and 1.05 percent.

Non-interest bearing deposits represent funds where the FHLBank acts as a pass-through correspondent for member institutions required to deposit reserves with the Federal Reserve Banks.

The following table details interest bearing and non-interest bearing deposits as of December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
<u>Interest bearing:</u>		
Demand and overnight	\$ 826,873	\$ 836,304
Term	88,425	60,375
Other	<u>11,576</u>	<u>13,774</u>
Total interest bearing deposits	<u>926,874</u>	<u>910,453</u>
<u>Non-interest bearing:</u>		
Other	<u>360</u>	<u>264</u>
Total non-interest bearing deposits	<u>360</u>	<u>264</u>
Total deposits	<u>\$ 927,234</u>	<u>\$ 910,717</u>

### Note 13—Consolidated Obligations

Consolidated Obligations consist of Consolidated Bonds and Discount Notes and, as provided by the Act or Finance Board Regulation, are backed only by the financial resources of the FHLBanks. The FHLBanks issue Consolidated Obligations through the Office of Finance as their agent. In connection with each debt issuance, each FHLBank specifies the amount of debt it wants issued on its behalf. The Office of Finance tracks the amount of debt issued on behalf of each FHLBank. In addition, the FHLBank separately tracks and records as a liability its specific portion of Consolidated Obligations for which it is the primary obligor. The Finance Board and the U.S. Secretary of the Treasury have oversight over the issuance of FHLBank debt through the Office of Finance. Consolidated Bonds are issued primarily to raise intermediate and long-term funds for the FHLBanks and are not subject to any statutory or regulatory limits on maturity. Consolidated Discount Notes are issued primarily to raise short-term funds. These notes sell at less than their face amount and are redeemed at par value when they mature.

Although the FHLBank is primarily liable for its portion of Consolidated Obligations (i.e., those issued on its behalf), the FHLBank is also jointly and severally liable with the other eleven FHLBanks for the payment of principal and interest on all Consolidated Obligations of each of the FHLBanks. The Finance Board, at its discretion, may require any FHLBank to make principal or interest payments due on any Consolidated Obligation whether or not the Consolidated Obligation represents a primary liability of such FHLBank. Although it has never occurred, to the extent that an FHLBank makes any payment on a Consolidated Obligation on behalf of another FHLBank that is primarily liable for such Consolidated Obligation, Finance Board Regulations provide that the paying FHLBank is entitled to reimbursement from the non-complying FHLBank for any payments made on its behalf and other associated costs (including interest to be determined by the Finance Board). If, however, the Finance Board determines that the non-complying FHLBank is unable to satisfy its repayment obligations, the Finance Board may allocate the outstanding liabilities of the non-complying FHLBank among the remaining FHLBanks on a pro rata basis in proportion to each FHLBank's participation in all Consolidated Obligations outstanding or in any other manner it may determine to ensure that the FHLBanks operate in a safe and sound manner.

The par amounts of the 12 FHLBanks' outstanding Consolidated Obligations were approximately \$952.0 billion and \$937.5 billion at December 31, 2006 and 2005. Regulations require the FHLBank to maintain unpledged qualifying assets equal to its participation in the Consolidated Obligations outstanding. Qualifying assets are defined as cash; secured Advances; assets with an assessment or rating at least equivalent to the current assessment or rating of the Consolidated Obligations; obligations of or fully guaranteed by the United States; obligations, participations, or other instruments of or issued by Fannie Mae or Ginnie Mae; mortgages, obligations, or other securities which are or have ever been sold by Freddie Mac under the Act; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located.

To provide the holders of Consolidated Obligations issued before January 29, 1993 (prior bondholders) the protection equivalent to that provided under a previous leverage limit of 12 times the FHLBanks' capital stock, prior bondholders have a claim on a certain amount of the qualifying assets [Special Asset Account (SAA)] if capital stock is less than

8.33 percent of Consolidated Obligations. Mandatorily redeemable capital stock is considered capital stock for determining the FHLBanks' compliance with this requirement. At December 31, 2006 and 2005, the FHLBanks' regulatory capital stock was 4.5 percent and 4.6 percent of the par value of Consolidated Obligations outstanding, and the required minimum pledged asset balance was approximately \$26,000 and \$110,000.

The Regulations also require each FHLBank 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 capital-to-assets ratio falls below two percent. As of December 31, 2006 and 2005 no FHLBank had a capital-to-assets ratio less than two percent; therefore no assets were being held in a trust. In addition, no trust has ever been established as a result of this Regulation, as the ratio has never fallen below two percent.

*General Terms.* Consolidated Obligations are issued with either fixed-rate coupon payment terms or variable-rate coupon payment terms that use a variety of indices for interest rate resets, including the London Interbank Offered Rate (LIBOR). To meet the expected specific needs of certain investors in Consolidated Obligations, both fixed-rate bonds and variable-rate bonds may contain features, which may result in complex coupon payment terms and call options. When such Consolidated Obligations are issued, the FHLBank enters into derivatives containing offsetting features that effectively convert the terms of the bond to those of a simple variable-rate bond or a fixed-rate bond.

These Consolidated Obligations, beyond having fixed-rate or simple variable-rate interest payment terms, may also have the following broad terms regarding principal repayment terms:

*Optional Principal Redemption Bonds* (callable bonds) that the FHLBank may redeem in whole or in part at its discretion on predetermined call dates according to the terms of the bond offerings.

*Interest Rate Payment Terms.* The following table details Consolidated Bonds by interest rate payment type at December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Par value of Consolidated Bonds:		
Fixed-rate	\$ 51,445,308	\$ 51,096,155
Variable-rate	<u>1,973,973</u>	<u>2,770,188</u>
Total par value	<u>\$ 53,419,281</u>	<u>\$ 53,866,343</u>

*Redemption Terms.* The following is a summary of the FHLBank's participation in Consolidated Bonds outstanding at December 31 by year of original maturity (dollars in thousands):

<u>Year of Original Maturity</u>	<u>2006</u>		<u>2005</u>	
	Amount	Weighted Average Interest Rate %	Amount	Weighted Average Interest Rate %
2006			\$ 17,845,188	3.22
2007	\$ 20,555,348	4.21	13,823,625	3.65
2008	13,045,230	4.56	6,898,000	4.03
2009	5,057,000	4.49	3,615,000	4.19
2010	3,731,000	4.59	3,079,000	4.43
2011	2,714,750	4.92	1,620,000	4.68
Thereafter	<u>8,315,953</u>	4.93	<u>6,985,530</u>	4.84
Total par value	53,419,281	4.49	53,866,343	3.82
Bond premiums	26,847		37,662	
Bond discounts	(50,505)		(57,390)	
Deferred net loss on terminated hedges	62		119	
SFAS 133 hedging adjustments	<u>(156,441)</u>		<u>(326,455)</u>	
Total	<u>\$ 53,239,244</u>		<u>\$ 53,520,279</u>	

The FHLBank uses fixed-rate callable debt to finance callable Advances (see Note 8), mortgage loans held for portfolio, and mortgage-backed securities. Simultaneous with such a debt issue, the FHLBank may also enter into an interest-rate swap (in which the FHLBank pays variable, and receives fixed, interest) with a call feature that mirrors the option embedded in the debt (a sold callable swap). The combined sold callable swap and callable debt allows the FHLBank to provide members attractively priced variable-rate Advances. The FHLBank's Consolidated Bonds outstanding at December 31 included (in thousands):

	<u>2006</u>	<u>2005</u>
Par amount of Consolidated Bonds:		
Non-callable	\$ 31,267,308	\$ 34,373,155
Callable	<u>22,151,973</u>	<u>19,493,188</u>
Total par value	<u>\$ 53,419,281</u>	<u>\$ 53,866,343</u>

The following table summarizes Consolidated Bonds outstanding at December 31 by year of original maturity or next call date (in thousands):

<u>Year of Original Maturity or Next Call Date</u>	<u>2006</u>	<u>2005</u>
2006		\$ 32,028,188
2007	\$ 35,812,848	9,820,625
2008	7,595,730	4,233,000
2009	2,677,000	1,995,000
2010	2,282,000	2,174,000
2011	1,186,750	645,000
Thereafter	<u>3,864,953</u>	<u>2,970,530</u>
Total par value	<u>\$ 53,419,281</u>	<u>\$ 53,866,343</u>

*Consolidated Discount Notes.* Consolidated Discount Notes are issued to raise short-term funds. Discount Notes are Consolidated Obligations with original maturities up to 365 days. These notes are issued at less than their face amount and redeemed at par value when they mature. The FHLBank's participation in Consolidated Discount Notes was as follows (dollars in thousands):

	<u>Book Value</u>	<u>Par Value</u>	<u>Weighted Average Interest Rate<sup>(1)</sup></u>
December 31, 2006	<u>\$ 21,946,379</u>	<u>\$ 22,021,300</u>	<u>5.22%</u>
December 31, 2005	<u>\$ 17,577,416</u>	<u>\$ 17,634,170</u>	<u>4.12%</u>

(1) The Consolidated Discount Notes weighted average interest rate represents the implied rate.

#### **Note 14—Capital**

The FHLBank is subject to three capital requirements under its Capital Plan and the Finance Board rules and regulations: (1) risk-based capital, (2) total capital and (3) leverage capital. First, under the risk-based capital requirement, the FHLBank must maintain at all times permanent capital defined as Class B stock and retained earnings in an amount at least equal to the sum of its credit risk, market risk, and operations risk capital requirements, all of which are calculated in accordance with the rules and regulations of the Finance Board. The Finance Board may require the FHLBank to maintain a greater amount of permanent capital than is required by the risk-based capital requirements. Second, the FHLBank is required to maintain at all times a total capital-to-assets ratio of at least four percent. Total capital is the sum of permanent capital, Class A stock, any general loss allowance, if consistent with GAAP and not established for specific assets, and other amounts from sources determined by the Finance Board as available to absorb losses. Third, the FHLBank is required to maintain at all times a leverage capital-to-assets ratio of at least five percent. Leverage capital is defined as the sum of (i) permanent capital weighted 1.5 times and (ii) all other capital without a weighting factor. Mandatorily redeemable capital stock is considered capital for determining the

FHLBank's compliance with its regulatory requirements. At December 31, 2006 and 2005, the FHLBank was in compliance with the aforementioned capital rules and requirements.

The following table demonstrates the FHLBank's compliance with these capital requirements at December 31 (dollars in thousands):

	2006		2005	
	Required	Actual	Required	Actual
Regulatory capital requirements:				
Risk based capital	\$ 576,678	\$ 4,050,283	\$ 578,802	\$ 4,129,647
Total capital-to-assets ratio	4.00%	4.98%	4.00%	5.35%
Total regulatory capital	\$ 3,255,467	\$ 4,050,283	\$ 3,087,194	\$ 4,129,647
Leverage capital-to-assets ratio	5.00%	7.46%	5.00%	8.03%
Leverage capital	\$ 4,069,334	\$ 6,075,425	\$ 3,858,993	\$ 6,194,471

The FHLBank currently offers only Class B stock, which is issued and redeemed at a par value of \$100 per share. Class B stock is issued to meet membership and activity stock purchase requirements, to pay dividends, and to pay interest on mandatorily redeemable capital stock. Membership stock is required to become a member of and maintain membership in the FHLBank. The membership stock requirement is based upon a percentage of the member's total assets, currently determined within a range from 0.03 percent to 0.15 percent, that varies inversely to total assets. In addition to membership stock, a member may be required to hold activity stock to capitalize its Mission Asset Activity with the FHLBank.

Mission Asset Activity includes Advances, certain funds and rate Advance commitments, and Mortgage Purchase Program activity that occurred after implementation of the Capital Plan on December 30, 2002. Members must maintain a Class B stock balance at least equal to the minimum activity allocation percentage, which currently is zero percent of Mission Asset Activity for the Mortgage Purchase Program and two percent of Mission Asset Activity for all other Mission Asset Activity. If a member owns more than the maximum activity allocation percentage, which currently is four percent of Mission Asset Activity, the additional stock is that member's excess stock. The FHLBank's unrestricted excess stock is defined as total Class B stock minus membership stock, activity stock calculated at the maximum allocation percentage, shares reserved for exclusive use after a dividend, and shares subject to redemption and withdrawal notices. The FHLBank's excess stock may normally be used by members to support a portion of their activity requirement as long as those members maintain their minimum activity stock allocation percentage.

Class B stock can be redeemed by giving five years' written notice. The FHLBank may also repurchase the excess stock of any stockholder with no less than five calendar days' prior written notice. When the FHLBank repurchases capital stock, it must first repurchase shares for which a redemption or withdrawal notice's five-year redemption period or withdrawal period has expired. Since December 30, 2002, when the new capital structure was implemented, the FHLBank has repurchased, at its discretion, all member shares subject to outstanding redemption or withdrawal notices prior to the expiration of the five-year redemption notice period.

The Gramm-Leach-Bliley Act of 1999 (GLB Act) made membership in the FHLBanks voluntary for all members. Any member that has withdrawn from membership may not be readmitted to membership in any FHLBank until five years from the divestiture date for all capital stock that was held as a condition of membership. That requirement is set out in the FHLBank's capital plan as described in the section below, unless the institution has cancelled its notice of withdrawal prior to that date.

The FHLBank's retained earnings are owned proportionately by the current holders of Class B stock. The holders' interest in the retained earnings is realized at the time the FHLBank periodically declares dividends or at such time as the FHLBank is liquidated. The FHLBank's Board of Directors may declare and pay dividends out of previously retained earnings in either cash or capital stock.

**Mandatorily Redeemable Capital Stock.** The FHLBank applies SFAS 150 based on the characteristics of the FHLBank's stock, SFAS 150's definition of a nonpublic entity, and the definition of an SEC registrant in FASB Staff Position No. SFAS 150-3 (FSP 150-3). The FHLBank is a cooperative whose members and former members own all of the FHLBank's capital stock. Member shares cannot be purchased or sold except between the FHLBank and its members at its \$100 per share par value.

In compliance with SFAS 150, the FHLBank reclassifies stock subject to redemption from equity to liability upon expiration of the “grace period” after a member submits a written redemption request or withdrawal notice, or when the member attains non-member status by merger or acquisition, charter termination, or involuntary termination of membership, since the shares of capital stock then meet the definition of a mandatorily redeemable financial instrument. A member may cancel or revoke its written redemption request or its withdrawal from membership notice prior to the end of the five-year redemption period. Under the FHLBank’s Capital Plan, there is a five calendar day “grace period” for revocation of a redemption request and a 30 calendar day “grace period” for revocation of a withdrawal notice during which the member may cancel the redemption request or withdrawal notice without a penalty or fee. The cancellation fee after the “grace period” is currently two percent of the requested amount in the first year and increases one percent a year until it reaches a maximum of six percent in the fifth year. The cancellation fee can be waived by the FHLBank’s Board of Directors for a bona fide business purpose.

Stock subject to a redemption or withdrawal notice that is within the “grace period” continues to be considered equity because there is no penalty or fee to retract these notices. Expiration of the “grace period” triggers the reclassification from equity to a liability (mandatorily redeemable capital stock) at fair value because after the “grace period” the penalty to retract these notices is considered substantive. Dividends related to capital stock classified as a liability are accrued at the expected dividend rate and reported as interest expense in the Statements of Income. The repayment of these mandatorily redeemable financial instruments is reflected as a cash outflow in the financing activities section of the Statements of Cash Flows.

On January 1, 2004, the FHLBank reclassified (in thousands) \$29,825 of its outstanding capital stock to “mandatorily redeemable capital stock” in the liability section of the Statements of Condition. Upon adoption, the FHLBank also recorded estimated dividends earned as a part of the carrying value of the mandatorily redeemable capital stock. Since the FHLBank pays dividends on the last day of the quarter, the difference between the prior carrying amount and the mandatorily redeemable capital stock was zero; therefore a cumulative effect of a change in accounting principle was not required to be reported in the Statements of Income. For the years ended December 31, 2006, 2005, and 2004 dividends on mandatorily redeemable capital stock in the amount (in thousands) of \$13,162, \$13,335, and \$1,350 were recorded as interest expense.

At December 31, 2006 and 2005, the FHLBank had (in thousands) \$137,109 and \$418,381 in capital stock classified as mandatorily redeemable capital stock in the liability section of the Statements of Condition in accordance with SFAS 150. The balance was comprised of 7 members and 13 former members at December 31, 2006 and 17 former members at December 31, 2005.

The following table shows the amount of mandatorily redeemable capital stock by year of redemption at December 31 (in thousands). Year of redemption in the table is the end of the five-year redemption period. Consistent with the Capital Plan currently in effect, the FHLBank is not required to redeem membership stock until five years after either (i) the membership is terminated or (ii) the FHLBank receives notice of withdrawal. The FHLBank is not required to redeem activity-based stock until the later of the expiration of the notice of redemption or until the activity to which the capital stock relates no longer remains outstanding. If activity-based stock becomes excess stock as a result of an activity no longer remaining outstanding, the FHLBank may repurchase such shares, in its sole discretion, subject to the Statutory and Regulatory Restrictions on Capital Stock Redemption discussed below.

<u>Contractual Year of Redemption</u>	<u>2006</u>	<u>2005</u>
2006		\$ -
2007	\$ 1,252	21,011
2008	595	1,819
2009	573	11,114
2010	36,729	384,437
2011	<u>97,960</u>	<u>-</u>
Total par value	<u>\$ 137,109</u>	<u>\$ 418,381</u>

The FHLBank's activity for mandatorily redeemable capital stock was as follows (in thousands).

	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$ 418,381	\$ 34,344
Capital stock subject to mandatory redemption reclassified from equity:		
Withdrawals	4,600	369,182
Other redemptions	88,164	128,072
Redemption of mandatorily redeemable capital stock:		
Withdrawals	(382,785)	(1,433)
Other redemptions	(894)	(128,072)
Stock dividend classified as mandatorily redeemable	<u>9,643</u>	<u>16,288</u>
Balance, end of year	<u>\$ 137,109</u>	<u>\$ 418,381</u>

As of December 31, 2006, there were no members or former members that had requested redemptions of capital stock whose stock had not been reclassified as mandatorily redeemable capital stock because the "grace periods" had not yet expired on these requests.

*Statutory and Regulatory Restrictions on Capital Stock Redemption.* In accordance with the GLB Act, each class of FHLBank stock is putable by the member. However, there are significant statutory and regulatory restrictions on the FHLBank's obligation or right to redeem outstanding stock.

- The FHLBank may not redeem any capital stock if, following the redemption, the FHLBank would fail to satisfy any of its minimum capital requirements. By law, no FHLBank stock may be redeemed if the FHLBank becomes undercapitalized.
- The FHLBank may not redeem any capital stock without approval of the Finance Board if either its Board of Directors or the Finance Board determines that the FHLBank has incurred or is likely to incur losses resulting or expected to result in a charge against capital while such charges are continuing or expected to continue.

Additionally, the FHLBank may not redeem or repurchase shares of stock from any member if (1) the principal or interest on any Consolidated Obligation has not been paid in full when due; (2) the FHLBank has failed to certify in writing to the Finance Board that it will remain in compliance with its liquidity requirements and will remain capable of making full and timely payment of all of its current obligations; (3) the FHLBank has notified the Finance Board that it cannot provide the foregoing certification, projects it will fail to comply with statutory or regulatory liquidity requirements, or will be unable to timely and fully meet all of its current obligations; or (4) the FHLBank has failed to comply with statutory or regulatory liquidity requirements or to timely and fully meet all of its current obligations, or has entered into or negotiated to enter into an agreement with one or more other FHLBanks to obtain financial assistance to meet its current obligations.

If the FHLBank is liquidated, after payment in full to the FHLBank's creditors, the FHLBank's stockholders will be entitled to receive the par value of their capital stock as well as any retained earnings in an amount proportional to the stockholder's share of the total shares of capital stock. In the event of a merger or consolidation of the FHLBank, the Board of Directors shall determine the rights and preferences of the FHLBank's stockholders, subject to any terms and conditions imposed by the Finance Board.

*Capital Concentration.* The following table presents holdings of 5 percent or more of the FHLBank's total Class B stock, including mandatorily redeemable capital stock, outstanding at December 31 and includes any known affiliates that are members of the FHLBank (dollars in millions):

	<u>2006</u>		<u>2005</u>	
	<u>Balance</u>	<u>% of Total</u>	<u>Balance</u>	<u>% of Total</u>
Charter One Bank, N.A.	\$ 582	15%	\$ 549	14%
U.S. Bank, N.A.	526	14	496	13
Fifth Third Bank	372	10	351	9
Ohio Savings Bank	<u>214</u>	<u>6</u>	<u>202</u>	<u>5</u>
Total	<u>\$ 1,694</u>	<u>45%</u>	<u>\$ 1,598</u>	<u>41%</u>



## Note 15—Employee Retirement Plans

The FHLBank participates in the Pentegra Defined Benefit Plan for Financial Institutions (Pentegra Defined Benefit Plan), a tax-qualified defined benefit pension plan. The plan covers substantially all officers and employees of the FHLBank. Funding and administrative costs of the Pentegra Defined Benefit Plan charged to other operating expenses were \$3,290,000, \$2,969,000 and \$1,982,000 in 2006, 2005 and 2004. The Pentegra Defined Benefit Plan is a multiemployer plan in which assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. As a result, disclosure of the accumulated benefit obligations, plan assets, and the components of annual pension expense attributable to the FHLBank are not made.

The FHLBank also participates in the Pentegra Defined Contribution Plan for Financial Institutions, a tax-qualified defined contribution pension plan. The FHLBank contributes a percentage of the participants' compensation by making a matching contribution equal to a percentage of voluntary employee contributions, subject to certain limitations. The FHLBank contributed \$571,000, \$489,000, and \$451,000 in the years ended December 31, 2006, 2005, and 2004.

The FHLBank has a Benefit Equalization Plan (BEP). The BEP is a non-qualified supplemental retirement plan that restores those pension benefits that would be available under the qualified plans (both defined benefit and defined contribution features) were it not for legal limitations on such benefits. The FHLBank also sponsors a fully insured postretirement benefits program that includes health care and life insurance benefits for eligible retirees. Future retirees are eligible for the postretirement benefits program if they were hired prior to August 1, 1990, are age 55 or older, and their age plus years of continuous service at retirement are greater than or equal to 80. Spouses are covered subject to required contributions. There are no funded plan assets that have been designated to provide benefits from either the BEP or the postretirement benefits plan.

The FHLBank's contributions to the defined contribution feature of the BEP use the same matching rules as the qualified defined contribution plan discussed above plus the related earnings. The FHLBank contributed \$697,000, \$345,000, and \$334,000 in the years ended December 31, 2006, 2005, and 2004.

The FHLBank adopted SFAS No. 158 *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158) as of December 31, 2006. The amounts recognized in the financial statements upon adoption were as follows (dollars in thousands):

	Before Application of SFAS 158	Adjustments	After Application of SFAS 158
Other liabilities	\$ 447,741	\$ 1,752	\$ 449,493
Total liabilities	77,478,069	1,752	77,479,821
Accumulated other comprehensive income: Other	(4,042)	(1,752)	(5,794)
Total capital	3,908,601	(1,752)	3,906,849

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Medicare Act) became law in the United States. The Medicare Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to the Medicare Part D benefit. In May 2004, the FASB issued Staff Position FAS 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, which provides guidance on the accounting and disclosures for the effects of the federal subsidy provided by the Medicare Act. The FHLBank's disclosures regarding its accumulated postretirement benefit obligation and net periodic postretirement benefit cost reflect estimated amounts associated with the federal subsidy. The estimated subsidy reduced the December 31, 2006 benefit obligation by \$492,000.

The obligations and funding status of the defined benefit feature of the FHLBank's BEP and postretirement benefits plan at December 31 were as follows (in thousands):

	BEP		Postretirement Benefits Plan	
	2006	2005	2006	2005
Change in benefit obligation <sup>(1)</sup> :				
Benefit obligation at beginning of year	\$ 15,113	\$ 13,679	\$ 3,161	\$ 3,078
Service cost	383	281	51	49
Interest cost	873	806	178	173
Amendments	(4)	-	-	-
Actuarial loss	756	1,180	239	13
Recognition of Medicare Act retiree drug subsidy	-	-	(492)	-
Benefits paid	(1,336)	(833)	(97)	(152)
Benefit obligation at end of year	<u>15,785</u>	<u>15,113</u>	<u>3,040</u>	<u>3,161</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	-	-	-	-
Employer contribution	1,336	833	97	152
Benefits paid	(1,336)	(833)	(97)	(152)
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Funded status	(15,785)	(15,113)	(3,040)	(3,161)
Unrecognized net actuarial loss	5,691	5,834	107	362
Unrecognized prior service benefit	(4)	(107)	-	-
Net amount recognized in earnings	<u>\$ (10,098)</u>	<u>\$ (9,386)</u>	<u>\$ (2,933)</u>	<u>\$ (2,799)</u>

(1) Represents projected benefit obligation and accumulated postretirement benefit obligation for the BEP and postretirement benefits plan, respectively.

Amounts recognized in accumulated other comprehensive income at December 31, 2006 consist of (in thousands):

	BEP 2006	Postretirement Benefits Plan 2006
Net actuarial loss	\$ 5,691	\$ 107
Prior service benefit	(4)	-
	<u>\$ 5,687</u>	<u>\$ 107</u>

Amounts recognized in the Statements of Condition for the defined benefit feature of the BEP at December 31, 2005 are below (in thousands). This table is not applicable to 2006 as the funded status is reported on the Statement of Condition.

	2005
Accrued benefit liability (accumulated benefit obligation)	\$ (13,472)
Accumulated other comprehensive loss	(4,086)
Net amount recognized	<u>\$ (9,386)</u>

Components of the net periodic benefit cost for the defined benefit feature of the BEP and postretirement benefits plan for the years ended December 31 were (in thousands):

	BEP			Postretirement Benefits Plan		
	2006	2005	2004	2006	2005	2004
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Service cost	\$ 383	\$ 281	\$ 210	\$ 51	\$ 49	\$ 38
Interest cost	873	806	798	178	173	171
Amortization of unrecognized prior service benefit	(108)	(107)	(107)	-	-	-
Amortization of unrecognized net loss	899	1,320	971	3	2	-
Net periodic benefit cost	<u>\$ 2,047</u>	<u>\$ 2,300</u>	<u>\$ 1,872</u>	<u>\$ 232</u>	<u>\$ 224</u>	<u>\$ 209</u>

The measurement date used to determine the current year's benefit obligation was December 31, 2006.

The increase (decrease) in the minimum liability included in other comprehensive income for the defined benefit component of the BEP was (in thousands) \$44, \$53, and \$(417) for the years ended December 31, 2006, 2005 and 2004. Key assumptions and other information for the actuarial calculations for the BEP for the years ended December 31 were (dollars in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rate	5.75%	5.50%	5.75%
Salary increases	4.50%	4.50%	4.50%
Amortization period	6 years	4 years	5 years
Benefits paid during the year	\$ 1,336	\$ 833	\$ 833

Key assumptions and other information for the postretirement benefits plan for the years ended December 31 were:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rate	5.75%	5.75%	6.50%
Weighted average discount rate at the end of the year	6.00%	5.75%	5.75%
Health care cost trend rates:			
Assumed for next year	9.00%	8.00%	8.50%
Ultimate rate	5.25%	5.25%	5.25%
Year that ultimate rate is reached	2017	2014	2014

The effect of a percentage point increase in the assumed health care trend rates would be an increase in net periodic postretirement benefit expense of \$47,000 and in accumulated postretirement benefit obligation (APBO) of \$437,000. The effect of a percentage point decrease in the assumed health care trend rates would be a decrease in net periodic postretirement benefit expense of \$37,000 and in APBO of \$354,000.

The discount rates for the disclosures as of December 31, 2006 were determined by using a discounted cash flow approach, which incorporates the timing of each expected future benefit payment. Estimated future benefit payments are based on each plan's census data, benefit formulae and provisions, and valuation assumptions reflecting the probability of decrement and survival. The present value of the future benefit payments are determined by using weighted average duration based interest rate yields from a variety of highly rated relevant corporate bond indices as of December 31, 2006, and solving for the single discount rate that produces the same present value.

Contributions for the defined benefit feature of the BEP and postretirement benefits plan in 2007 are anticipated to be approximately (in thousands) \$1,088 and \$156, respectively. Estimated future benefits payments reflecting expected future services for the years ended after December 31, 2006 were (in thousands):

<u>Years</u>	<u>BEP</u>	<u>Postretirement Benefit Plan</u>	
		<u>Gross Benefit Payments</u>	<u>Estimated Medicare Retiree Drug Subsidy</u>
2007	\$ 1,088	\$ 156	\$ 16
2008	1,087	161	18
2009	1,037	163	19
2010	1,116	177	20
2011	1,210	183	22
Years 2012 – 2016	7,437	1,013	132

### Note 16—Segment Information

The FHLBank has identified two primary operating segments based on its method of internal reporting: Traditional Member Finance and the Mortgage Purchase Program. These segments reflect the FHLBank’s two primary Mission Asset Activities and the manner in which they are managed from the perspective of development, resource allocation, product delivery, pricing, credit risk management, and operational administration. The segments identify the primary ways the FHLBank provides services to member stockholders. The FHLBank, as an interest rate spread manager, considers a segment’s net interest income, net interest rate spread and, ultimately, net income as the key factors in allocating resources. Resource allocation decisions are made by considering these profitability measures in the context of the historical, current and expected risk profile of each segment and the entire balance sheet, as well as current incremental profitability measures relative to the incremental market risk profile.

Overall financial performance and risk management are dynamically managed primarily at the level of, and within the context of, the entire balance sheet rather than at the level of individual business segments or product lines. Also, the FHLBank hedges specific asset purchases and specific subportfolios in the context of the entire mortgage asset portfolio and the entire balance sheet. Under this holistic approach, the market risk/return profile of each business segment does not correspond, in general, to the performance that each segment would generate if it were completely managed on a separate basis. It is not possible, given this approach, to accurately determine what the performance would be if the two business segments were managed on stand-alone bases. Further, because financial and risk management is a dynamic process, the performance of a segment over a single identified period may not reflect the long-term expected or actual future trends for the segment.

The Traditional Member Finance segment includes products such as Advances and investments and the borrowing costs related to those assets. The FHLBank assigns its investments to this segment primarily because they have historically been used to provide liquidity for Advances and to support the level and volatility of earnings from Advances. Income from the Mortgage Purchase Program is derived primarily from the difference, or spread, between the yield on mortgage loans and the borrowing cost of Consolidated Obligations outstanding allocated to this segment at the time debt is issued. Both segments also earn income from investment of interest-free capital. Capital is allocated proportionate to each segment’s average assets based on the total balance sheet’s average capital-to-assets ratio. Expenses are allocated based on cost accounting techniques that include direct usage, time allocations and square footage of space used. AHP and REFCORP are calculated using the current assessment rates based on the income before assessments for each segment. All interest rate swaps, including their market value adjustments under SFAS 133, are allocated to the Traditional Member Finance segment because the FHLBank has not executed interest rate swaps in its management of the Mortgage Purchase Program’s market risk. All derivatives classified as mandatory delivery commitments and forward-rate agreements are allocated to the Mortgage Purchase Program segment.

The following table sets forth the FHLBank's financial performance by operating segment for the years ended December 31 (in thousands):

	Traditional Member Finance	Mortgage Purchase Program	Total
<b>2006</b>			
Net interest income	\$ 302,319	\$ 84,117	\$ 386,436
Other income	4,801	880	5,681
Other expenses	<u>37,599</u>	<u>8,564</u>	<u>46,163</u>
Income before assessments	<u>269,521</u>	<u>76,433</u>	<u>345,954</u>
Affordable Housing Program	23,345	6,239	29,584
REFCORP	<u>49,235</u>	<u>14,039</u>	<u>63,274</u>
Total assessments	<u>72,580</u>	<u>20,278</u>	<u>92,858</u>
Net income	<u>\$ 196,941</u>	<u>\$ 56,155</u>	<u>\$ 253,096</u>
Average assets	<u>\$ 69,598,701</u>	<u>\$ 9,802,524</u>	<u>\$ 79,401,225</u>
Total assets	<u>\$ 71,455,084</u>	<u>\$ 9,931,586</u>	<u>\$ 81,386,670</u>
<b>2005</b>			
Net interest income	\$ 261,376	\$ 78,612	\$ 339,988
Other income	3,915	(805)	3,110
Other expenses	<u>34,662</u>	<u>7,955</u>	<u>42,617</u>
Income before assessments	<u>230,629</u>	<u>69,852</u>	<u>300,481</u>
Affordable Housing Program	20,188	5,702	25,890
REFCORP	<u>42,088</u>	<u>12,830</u>	<u>54,918</u>
Total assessments	<u>62,276</u>	<u>18,532</u>	<u>80,808</u>
Net income	<u>\$ 168,353</u>	<u>\$ 51,320</u>	<u>\$ 219,673</u>
Average assets	<u>\$ 70,040,700</u>	<u>\$ 9,348,840</u>	<u>\$ 79,389,540</u>
Total assets	<u>\$ 67,408,082</u>	<u>\$ 9,771,768</u>	<u>\$ 77,179,850</u>
<b>2004</b>			
Net interest income	\$ 216,086	\$ 85,879	\$ 301,965
Other income	43,830	(161)	43,669
Other expenses	<u>29,155</u>	<u>7,293</u>	<u>36,448</u>
Income before assessments	<u>230,761</u>	<u>78,425</u>	<u>309,186</u>
Affordable Housing Program	18,975	6,402	25,377
REFCORP	<u>42,357</u>	<u>14,405</u>	<u>56,762</u>
Total assessments	<u>61,332</u>	<u>20,807</u>	<u>82,139</u>
Net income	<u>\$ 169,429</u>	<u>\$ 57,618</u>	<u>\$ 227,047</u>
Average assets	<u>\$ 72,174,510</u>	<u>\$ 8,320,169</u>	<u>\$ 80,494,679</u>
Total assets	<u>\$ 67,842,007</u>	<u>\$ 8,734,521</u>	<u>\$ 76,576,528</u>

## Note 17—Derivatives and Hedging Activities

### Nature of Business Activity

The FHLBank may enter into interest-rate swaps (including callable and putable swaps), swaptions, interest-rate cap and floor agreements, calls, puts, and futures and forward contracts (collectively, derivatives) to manage its exposure to changes in interest rates.

The FHLBank may adjust the effective maturity, repricing frequency, or option characteristics of financial instruments to achieve risk management objectives. The FHLBank uses derivatives in several ways: by designating them as either a fair value of an underlying financial instrument, by acting as an intermediary, or in asset-liability management (i.e., an economic hedge). For example, the FHLBank uses derivatives in its overall interest-rate risk management to adjust the interest-rate sensitivity of Consolidated Obligations to approximate more closely the interest-rate sensitivity of assets (Advances, investments, and mortgage loans) and/or to adjust the interest-rate sensitivity of Advances, investments, or mortgage loans to approximate more closely the interest-rate sensitivity of liabilities.

In addition to using derivatives to manage mismatches of interest rates between assets and liabilities, the FHLBank uses derivatives (1) to manage embedded options in assets and liabilities, (2) to hedge the market value of existing assets and liabilities, (3) to hedge the duration risk of prepayable instruments, (4) to exactly offset other derivatives executed with members (when the FHLBank serves as an intermediary) and (5) to reduce funding costs.

Consistent with Finance Board Regulation, the FHLBank enters into derivatives only to reduce the interest rate risk exposures inherent in otherwise unhedged assets and funding positions, to achieve the FHLBank's risk management objectives, and to act as an intermediary between its members and counterparties. FHLBank management may use derivatives when they are considered to be the most cost-effective alternative to achieve the FHLBank's financial and risk management objectives. Accordingly, the FHLBank may enter into derivatives that do not necessarily qualify for hedge accounting (economic hedges).

An economic hedge is defined as a derivative hedging specific or non-specific underlying assets, liabilities, or a firm commitment that does not qualify or was not designated for hedge accounting, but is an acceptable hedging strategy under the FHLBank'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 caused by the changes in fair value on the derivatives that are recorded in the FHLBank's income but not offset by corresponding changes in the value of the economically hedged assets, liabilities, or firm commitments. As a result, the FHLBank recognizes only the change in fair value of these derivatives 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.

### Types of Assets and Liabilities Hedged

The FHLBank documents all relationships between derivatives designated as hedging instruments and the 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 hedges to assets and liabilities on the Statements of Condition. The FHLBank also formally assesses (both at the hedge's inception and at least quarterly) whether the derivatives that are used in hedging transactions have been effective in offsetting changes in the fair value of the hedged items and whether those derivatives may be expected to remain effective in future periods. The FHLBank currently uses regression analyses to assess the effectiveness of its hedges.

The FHLBank discontinues hedge accounting prospectively when: (1) it determines that the derivative is no longer effective in offsetting changes in the fair value of a hedged item; (2) the derivative and/or the hedged item expires or is sold, terminated, or exercised; or (3) management determines that designating the derivative as a hedging instrument in accordance with SFAS 133 is no longer appropriate.

Consolidated Obligations – While Consolidated Obligations are the joint and several obligations of the FHLBanks, each FHLBank has Consolidated Obligations for which it is the primary obligor. The FHLBank enters into derivatives to hedge the interest rate risk associated with its specific debt issuances.

For instance, in a typical transaction, fixed-rate Consolidated Obligations are issued for one or more FHLBanks, and the FHLBank simultaneously enters into a matching derivative in which the counterparty pays fixed cash flows to the FHLBank designed to mirror in timing and amount the cash outflows the FHLBank pays on the Consolidated Obligation. These transactions are treated as fair value hedges under SFAS 133. In this typical transaction, the FHLBank pays a variable cash flow that closely matches the interest payments it receives on short-term or variable-rate Advances, typically 3-month LIBOR. This intermediation between the capital and derivatives markets permits the FHLBank to raise funds at lower costs than would otherwise be available through the issuance of simple fixed- or floating-rate Consolidated Obligations in the capital markets.

Advances – With issuances of Convertible/Puttable Advances, the FHLBank purchases from the member a put option that enables the FHLBank to convert/terminate the Advance and extend additional credit on new terms, which is normally the case when interest rates increase. The FHLBank hedges a Convertible/Puttable Advance by entering into a cancelable derivative with a counterparty pursuant to which the FHLBank pays a fixed rate and receives a variable rate. This type of hedge is treated as a fair value hedge under SFAS 133. The derivative counterparty may cancel the derivative on the put date, which the counterparty normally would do in a rising rate environment, and the FHLBank can convert/terminate the Advance.

The optionality embedded in certain financial instruments held by the FHLBank can create interest-rate risk. When a member prepays an Advance, the FHLBank could suffer lower future income if the principal portion of the prepaid Advance were invested in lower-yielding assets that continue to be funded by higher-cost debt. To protect against this risk, the FHLBank generally charges a prepayment fee that makes it financially indifferent to a member's decision to prepay an Advance. When the FHLBank offers Advances (other than short-term Advances) that a member may prepay without a prepayment fee, it usually finances such Advances with callable debt or otherwise hedges this option.

Mortgage Loans – The FHLBank invests in fixed rate mortgage loans. The prepayment options embedded in mortgage loans can result in extensions or contractions in the expected repayment of these investments, depending on changes in estimated prepayment speeds. The FHLBank manages the interest-rate and prepayment risk associated with mortgages with issuance of callable debt, non-callable debt, and prepayment linked debt to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans. The FHLBank is permitted to use derivatives to match the expected prepayment characteristics of the mortgages, although to date it has not done so.

Firm Commitment Strategies – In accordance with SFAS 149, certain mortgage purchase commitments entered into after June 30, 2003, are considered derivatives. The FHLBank normally hedges these commitments by selling to-be-announced (TBA) mortgage-backed securities for forward settlement. A TBA represents a forward contract for the sale of mortgage-backed securities at a future agreed upon date for an established price. The mortgage purchase commitment and the TBA used in the firm commitment hedging strategy (economic hedge) are recorded as a derivative asset or derivative liability at fair value, with changes in fair value recognized in the 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.

Investments – The FHLBank invests in U.S. agency obligations, mortgage-backed securities, and the taxable portion of state or local housing finance agency obligations. The interest rate and prepayment risk associated with these investment securities is managed through a combination of debt issuance and, possibly, derivatives. The FHLBank manages the 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, available-for-sale or trading securities.

The FHLBank may also manage the risk arising from changing market prices or cash flows of investment securities classified as trading by entering into derivatives (economic hedges) that offset the changes in fair value or cash flows of the securities. The market value changes of both the trading securities and the associated derivatives are included in other income in the Statements of Income and presented, respectively, as part of the “Net gain (loss) on trading securities” and “Net gain (loss) on derivatives and hedging activities.”

#### Managing Credit Risk on Derivatives

The FHLBank is subject to credit risk due to the risk of nonperformance by counterparties to the derivative agreements. The degree of counterparty risk depends on the extent to which master netting arrangements are included in the contracts to mitigate the risk. The FHLBank manages counterparty credit risk through credit analysis, collateral

requirements and adherence to the requirements set forth in FHLBank policies and Finance Board Regulations. Based on credit analyses and collateral requirements, the management of the FHLBank does not anticipate any credit losses on its derivative agreements.

The contractual or notional amount of derivatives reflects the involvement of the FHLBank in the various classes of financial instruments. The notional amount of derivatives does not measure the credit risk exposure of the FHLBank, and the maximum credit exposure of the FHLBank is substantially less than the notional amount. The FHLBank requires collateral agreements on all derivatives that establish collateral delivery thresholds. The maximum credit risk is the estimated cost of replacing interest-rate swaps, forward-rate agreements, and mandatory delivery contracts for mortgage loans that have a net positive market value, assuming the counterparty defaults and the related collateral, if any, is of no value to the FHLBank. This collateral has not been sold or repledged.

At December 31, 2006 and 2005, the FHLBank's maximum credit risk, as defined above, was approximately \$12,555,000 and \$65,000. These totals include \$38,010,000 and \$0 of net accrued interest receivable. In determining maximum credit risk, the FHLBank considers accrued interest receivables and payables, and the legal right to offset derivative assets and liabilities by counterparty. The FHLBank held \$450,000 and \$0 cash as collateral as of December 31, 2006 and 2005. The FHLBank held no securities as collateral as of December 31, 2006 or 2005. Additionally, collateral with respect to derivatives with member institutions includes collateral assigned to the FHLBank, as evidenced by a written security agreement, and held by the member institution for the benefit of the FHLBank.

The FHLBank transacts most of its derivatives with large banks and major broker-dealers. Some of these banks and broker-dealers or their affiliates buy, sell, and distribute Consolidated Obligations. The FHLBank is not a derivative dealer and thus does not trade derivatives for short-term profit. Note 19 discusses assets pledged by the FHLBank to these counterparties.

The FHLBank has not issued Consolidated Obligations denominated in currencies other than U.S. dollars.

Financial Statement Impact and Additional Financial Information

Net gain (loss) on derivatives and hedging activities recorded in other income for the years ended December 31 were as follows (in thousands):

	<u>Net Gain (Loss) on Derivatives and Hedging Activities</u>		
	For the Year Ended		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Amortization of basis adjustments on modified Advance hedging relationships	\$ 360	\$ 1,254	\$ 37,560
Gains (losses) related to fair value hedge ineffectiveness	643	(1,090)	2,503
Gains (losses) on economic hedges	<u>926</u>	<u>(812)</u>	<u>(508)</u>
Net gain (loss) on derivatives and hedging activities	<u>\$ 1,929</u>	<u>\$ (648)</u>	<u>\$ 39,555</u>



The FHLBank had no transactions that qualified for cash flow hedge accounting, or any derivatives that required bifurcation from a host contract in 2006, 2005, or 2004. The following table represents outstanding notional balances and estimated fair values excluding accrued interest of the derivatives outstanding at December 31 (in thousands):

	2006		2005	
	Notional	Estimated Fair Value	Notional	Estimated Fair Value
Interest-rate Swaps:				
Fair value	\$ 31,769,255	\$ (207,745)	\$ 31,401,325	\$ (468,325)
Economic	20,000	580	10,000	(282)
Forward-rate Agreements:				
Economic	86,000	236	28,000	(15)
Mortgage Delivery Commitments:				
Economic	106,508	(275)	38,758	(7)
<b>Total</b>	<b>\$ 31,981,763</b>	<b>\$ (207,204)</b>	<b>\$ 31,478,083</b>	<b>\$ (468,629)</b>
Total derivatives excluding accrued interest		\$ (207,204)		\$ (468,629)
Accrued interest		112,200		40,967
Net derivative balances		<u>\$ (95,004)</u>		<u>\$ (427,662)</u>
Net derivative asset balances		\$ 12,555		\$ 65
Net derivative liability balances		<u>(107,559)</u>		<u>(427,727)</u>
Net derivative balances		<u>\$ (95,004)</u>		<u>\$ (427,662)</u>

#### Note 18—Estimated Fair Values

The following estimated fair value amounts have been determined by the FHLBank using available market information and the FHLBank's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to the FHLBank as of December 31, 2006 and 2005. Although the FHLBank uses its best judgment in estimating the fair value of its 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 FHLBank'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 FHLBank as a going concern, which would take into account future business opportunities and the net profitability of assets versus liabilities.

*Subjectivity of estimates.* Estimates of the fair value of Advances with options, mortgage instruments, derivatives with embedded options and bonds with options using the methods described below and other methods are highly subjective and require judgments regarding significant matters such as the amount and timing of future cash flows, prepayment speed assumptions, expected interest rate volatility, methods to determine possible distributions of future interest rates used to value options, 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.

*Cash and due from banks.* The estimated fair value approximates the recorded book balance.

*Interest bearing deposits and investment securities.* The estimated fair value is determined based on each security's quoted prices, excluding accrued interest, as of the last business day of the year.

*Securities purchased under agreements to resell.* The estimated fair value approximates the recorded book balance.

*Federal funds sold.* The estimated fair value of overnight Federal funds approximates the recorded book balance. The estimated fair value of term Federal funds is determined by calculating the present value of the expected future cash flows. The discount rates used in these calculations are the rates for Federal funds with similar terms, as approximated by adding an estimated current spread to the LIBOR swap curve for Federal funds with similar terms.

*Held-to-maturity securities.* The estimated fair value for mortgage-backed securities and collateralized mortgage obligations is determined based on each security's indicative market price, obtained from a third-party provider. The estimated fair value excludes accrued interest. The estimated fair value for taxable municipal bonds is determined based on each security's indicative market price obtained from a third-party provider excluding accrued interest.

*Advances and other loans.* The FHLBank determines the estimated fair value of Advances by calculating the present value of expected future cash flows from the Advances and excluding the amount of the accrued interest receivable. The discount rates used in these calculations are the replacement rates for Advances with similar terms, as approximated either by adding an estimated current spread to the LIBOR swap curve or by using current indicative market yields, as indicated by the FHLBank Advance pricing methods for Advances with similar current terms. In accordance with Finance Board Regulations, Advances with a maturity and repricing period greater than six months require a prepayment fee sufficient to make the FHLBank financially indifferent to the borrower's decision to prepay the Advances. Therefore, the estimated fair value of Advances does not assume prepayment risk.

For swapped Advances, the estimated fair value is determined (independently of the related derivative) by the discounted cash flow method based on the LIBOR swap curve and forward rates at year end adjusted for the estimated current spread on new swapped Advances to the swap curve. For swapped Advances with a conversion option, the conversion option is valued by taking into account the LIBOR swap curve and forward rates at year end and the market's expectations of future interest rate volatility implied from current market prices of similar options.

*Mortgage loans held for portfolio.* The estimated fair values for mortgage loans are determined based on quoted market prices offered to approved members as indicated by the FHLBank's Mortgage Purchase Program pricing methods for mortgage loans with similar current terms excluding accrued interest. The quoted prices offered to members are based on Fannie Mae price indications on to-be-announced mortgage-backed securities and FHA price indications on government-guaranteed loans; the FHLBank then adjusts these indicative prices to account for particular features of the FHLBank's Mortgage Purchase Program that differ from the Fannie Mae and FHA securities. These features include, but may not be limited to:

- the Mortgage Purchase Program's credit enhancements;
- marketing adjustments that reflect the FHLBank's cooperative business model, appetite for purchasing mortgage loans given the current net spreads to funding costs relative to their risks and preferences for particular kinds of loans and mortgage note rates.

These prices, however, can change rapidly based upon market conditions and are highly dependent upon the underlying prepayment assumptions.

*Accrued interest receivable and payable.* The estimated fair value approximates the recorded book value.

*Derivative assets/liabilities.* The FHLBank determines the estimated fair value of interest-rate exchange agreements based on current market conditions of interest-rate exchange agreements with similar current terms, including accrued interest receivable and payable. The estimated fair value is based on the LIBOR swap curve and forward rates at year end and, for agreements containing options, the market's expectations of future interest rate volatility implied from current market prices of similar options. The estimated fair value uses standard valuation techniques for interest-rate swap agreements, including discounted cash flow analysis and comparisons to similar instruments. 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.* The FHLBank determines the estimated fair value of FHLBank deposits with fixed rates by calculating the present value of expected future cash flows from the deposits and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of deposits with similar terms.

*Mandatorily redeemable capital stock.* The fair value of capital subject to mandatory redemption is generally par value. Fair value also includes the estimated dividend earned at the time of reclassification from equity to liabilities, until such amount is paid, and any subsequently declared stock dividend. Stocks can only be acquired by members at par value and redeemed at par value. Stock is not traded and no market mechanism exists for the exchange of stock outside the cooperative structure.

*Consolidated Obligations.* The FHLBank determines the estimated fair value for Discount Notes by calculating the present value of expected future cash flows from the Discount Notes excluding accrued interest. The discount rates used in these calculations are current replacement rates for Discount Notes with similar current terms, as approximated by adding an estimated current spread to the LIBOR swap curve. Each month's cash flow is discounted at that month's replacement rate.

The FHLBank determines the estimated fair value for non-callable Consolidated Obligation Bonds (both unswapped and swapped) by calculating the present value of scheduled future cash flows from the bonds excluding accrued interest. The discount rates used in these calculations are estimated current market yields, as indicated by the Office of Finance, for bonds with similar current terms.

The FHLBank determines the estimated fair value of callable Consolidated Obligation Bonds (both unswapped and swapped) by calculating the present value of expected future cash flows from the bonds excluding accrued interest. The estimated fair value is determined by the discounted cash flow method based on the LIBOR swap curve and forward rates adjusted for the estimated spread on new callable bonds to the swap curve and based on the market's expectations of future interest rate volatility implied from current market prices of similar options.

*Commitments.* The estimated fair value of the FHLBank's commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The estimated fair value of Standby Letters of Credit is based on the present value of fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties. The estimated fair value of standby bond purchase agreements is based on the present value of the estimated fees taking into account the remaining terms of the agreements.

The carrying values and estimated fair values of the FHLBank's financial instruments at December 31, 2006 were as follows (in thousands):

2006 FAIR VALUE SUMMARY TABLE

Financial Instruments	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
Assets:			
Cash and due from banks	\$ 4,022	\$ -	\$ 4,022
Interest-bearing deposits	6,535,562	361	6,535,923
Securities purchased under agreements to resell	1,150,000	-	1,150,000
Federal funds sold	9,641,700	(29)	9,641,671
Trading securities	4,602	-	4,602
Available-for-sale securities	1,188,450	-	1,188,450
Held-to-maturity securities	12,099,348	(276,910)	11,822,438
Advances	41,956,538	(80,925)	41,875,613
Mortgage loans held for portfolio, net	8,460,716	(152,163)	8,308,553
Accrued interest receivable	300,555	-	300,555
Derivative assets	12,555	-	12,555
Liabilities:			
Deposits	(927,234)	56	(927,178)
Consolidated Obligations:			
Discount Notes	(21,946,379)	1,352	(21,945,027)
Bonds	(53,239,244)	366,372	(52,872,872)
Mandatorily redeemable capital stock	(137,109)	-	(137,109)
Accrued interest payable	(559,358)	-	(559,358)
Derivative liabilities	(107,559)	-	(107,559)
Other:			
Commitments to extend credit for Advances	-	82	82
Standby bond purchase agreements	-	959	959

The carrying values and estimated fair values of the FHLBank's financial instruments at December 31, 2005 were as follows (in thousands):

2005 FAIR VALUE SUMMARY TABLE

Financial Instruments	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
<b>Assets:</b>			
Cash and due from banks	\$ 4,948	\$ -	\$ 4,948
Interest-bearing deposits	6,284,166	(958)	6,283,208
Securities purchased under agreements to resell	1,000,000	-	1,000,000
Federal funds sold	7,487,900	(43)	7,487,857
Trading securities	6,187	-	6,187
Available-for-sale securities	1,151,271	-	1,151,271
Held-to-maturity securities	12,290,770	(254,033)	12,036,737
Advances	40,261,623	(108,529)	40,153,094
Mortgage loans held for portfolio, net	8,418,139	(139,556)	8,278,583
Accrued interest receivable	238,625	-	238,625
Derivative assets	65	-	65
<b>Liabilities:</b>			
Deposits	(910,717)	119	(910,598)
<b>Consolidated Obligations:</b>			
Discount Notes	(17,577,416)	3,694	(17,573,722)
Bonds	(53,520,279)	411,828	(53,108,451)
Mandatorily redeemable capital stock	(418,381)	-	(418,381)
Accrued interest payable	(436,981)	-	(436,981)
Derivative liabilities	(427,727)	-	(427,727)
<b>Other:</b>			
Commitments to extend credit for Advances	-	830	830
Standby bond purchase agreements	-	1,314	1,314

**Note 19—Commitments and Contingencies**

As described in Note 13, Consolidated Obligations are backed only by the financial resources of the FHLBanks. The joint and several liability Finance Board Regulation authorizes the Finance Board to require any FHLBank to repay all or a portion of the principal and interest on Consolidated Obligations for which another FHLBank is the primary obligor. No FHLBank has had to assume or pay the Consolidated Obligation of another FHLBank.

The FHLBank considered the guidance under FASB 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* (FIN 45), and determined that it was not necessary to recognize a liability for the fair values of its joint and several obligation related to other FHLBanks' Consolidated Obligations at December 31, 2006 or 2005. The joint and several obligations are mandated by Finance Board Regulations and are not the result of arms-length transactions among the FHLBanks. The FHLBanks have no control over the amount of the guaranty or the determination of how each FHLBank would perform under the joint and several obligation. Because the FHLBanks are subject to the authority of the Finance Board as it relates to decisions involving the allocation of the joint and several liability for the FHLBank's Consolidated Obligations, the FHLBank's joint and several obligation is excluded from the initial recognition and measurement provisions of FIN 45. The par amounts of the FHLBanks' outstanding Consolidated Obligations for which the FHLBank is jointly and severally liable were approximately \$952.0 billion and \$937.5 billion at December 31, 2006 and 2005.

Commitments that legally bind and unconditionally obligate the FHLBank for additional Advances totaled approximately (in thousands) \$7,875 and \$254,327 at December 31, 2006 and 2005. Commitments generally are for periods up to 12 months. Standby Letters of Credit are executed for members for a fee. A Standby Letter of Credit is a financing arrangement between the FHLBank and its member. If the FHLBank is required to make payment for a beneficiary's draw, these amounts are converted into a collateralized Advance to the member. Standby Letters of Credit are reflected in the following table:

	<u>2006</u>	<u>2005</u>
Outstanding Notional (in thousands)	\$ 6,498,480	\$ 1,405,886
Original Terms	14 days to 18.5 years	20 days to 18.5 years
Final Expiration Year	2024	2023

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 (in thousands) \$1,229 and \$1,070 at December 31, 2006 and 2005. Based on management's credit analyses and collateral requirements, the FHLBank has not deemed it necessary to record any additional liability on these commitments. Commitments are fully collateralized at the time of Advance issuance (see Note 8). The estimated fair values of commitments as of December 31, 2006 and 2005 are reported in Note 18.

The FHLBank has standby bond purchase agreements with one state housing authority whereby the FHLBank, for a fee, agrees to purchase and hold the authority's bonds until the designated marketing agent can find a suitable investor or the housing authority repurchases the bonds according to a schedule established by the standby agreement. Each standby agreement dictates the specific terms that would require the FHLBank to purchase the bonds. The bond purchase commitments entered into by the FHLBank expire after five years, currently no later than 2010, though some are renewable at the option of the FHLBank. Total commitments for bond purchases were \$243.2 million and \$251.6 million at December 31, 2006 and 2005. During 2006 and 2005, the FHLBank was not required to purchase any bonds under these agreements. The estimated fair values of standby bond purchase agreements as of December 31, 2006 and 2005 are reported in Note 18.

Commitments that unconditionally obligate the FHLBank to purchase mortgage loans totaled \$106.5 million and \$38.8 million at December 31, 2006 and 2005. Commitments are generally for periods not to exceed 90 days. Such commitments are recorded as derivatives at their fair values.

The FHLBank generally executes derivatives with major banks and broker-dealers and generally enters into bilateral collateral agreements. As of December 31, 2006 and 2005, the FHLBank had no securities pledged as collateral to broker-dealers.

The FHLBank charged to operating expenses net rental costs of approximately \$1,807,000, \$1,698,000, and \$1,673,000 for the years ending December 31, 2006, 2005, and 2004. Future minimum rentals at December 31, 2006 were as follows (in thousands):

<u>Year</u>	<u>Premises</u>	<u>Equipment</u>	<u>Total</u>
2007	\$ 882	\$ 132	\$ 1,014
2008	876	132	1,008
2009	837	52	889
2010	845	-	845
2011	853	-	853
Thereafter	<u>2,471</u>	<u>-</u>	<u>2,471</u>
Total	<u>\$ 6,764</u>	<u>\$ 316</u>	<u>\$ 7,080</u>

Lease agreements for FHLBank 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 FHLBank.

At December 31, 2006, the FHLBank was committed to issue \$1,305.6 million in Consolidated Obligations, of which \$1,040.0 million were hedged with associated interest rate swaps. At December 31, 2005, the FHLBank was committed to issue \$59.3 million in Consolidated Obligations, none of which were hedged with an associated interest rate swap.

## Other Developments

The FHLBank is subject to legal proceedings arising in the normal course of business. Management does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the FHLBank's financial condition or results of operations.

Notes 1, 8, 9, 10, 11, 13, 14, 15, and 17 discuss other commitments and contingencies.

### Note 20—Transactions with Other FHLBanks

The FHLBank is a federally chartered corporation, one of 12 District Federal Home Loan Banks (FHLBanks). The Federal Housing Finance Board (Finance Board), an independent agency in the executive branch of the U.S. government, supervises and regulates the FHLBanks and the Office of Finance. The FHLBanks' debt instruments (Consolidated Obligations), issued by the Office of Finance on behalf of the FHLBanks, are backed only by the financial resources of the FHLBanks and are the primary source of funds for the FHLBanks. Additional information concerning the relationship of the FHLBank with the other FHLBanks, the Finance Board, and the Office of Finance, as well as a description of the FHLBank's contingent joint and several liability on Consolidated Obligations of the FHLBanks, is contained in "Background Information" and Note 13 of these Notes to Financial Statements.

Occasionally, the FHLBank loans short-term funds to and borrows short-term funds from other FHLBanks. These loans and borrowings are transacted at then current market rates when traded. The FHLBank has noted such activity on the face of its financial statements. There were no such loans or borrowings outstanding at December 31, 2006, 2005, or 2004. The following table details the average daily balance of lending and borrowing between the FHLBank and other FHLBanks for the years ended December 31 (in thousands).

	Average Daily Balances		
	2006	2005	2004
Loans to other FHLBanks	\$ 9,667	\$ 13,271	\$ 57,434
Borrowings from other FHLBanks	411	-	1,563

The FHLBank may, from time to time, assume the outstanding primary liability for Consolidated Obligations of another FHLBank rather than issue new debt for which the FHLBank is the primary obligor. The FHLBank then becomes the primary obligor on the transferred debt. There are no formal arrangements governing the transfer of Consolidated Obligations between the FHLBanks. These transfers are not investments of one FHLBank in another FHLBank. They reflect, rather, the act of one FHLBank assuming the debt obligation (at then current market rates on the day when the transfer is traded) that was originally issued by another FHLBank. Transferring debt at current market rates enables the FHLBank System to satisfy the debt issuance needs of individual FHLBanks without incurring the additional selling expenses (concession fees) associated with new debt and provides the transferring FHLBanks with outlets for extinguishing debt structures no longer required for their balance sheet management strategies.

There were no Consolidated Obligations transferred to the FHLBank during the year ended December 31, 2006. During the years ended December 31, 2005 and 2004, the par amounts of the liability on Consolidated Obligations transferred to the FHLBank totaled (in thousands) \$87,000, and \$360,000, respectively. All such transfers were from the FHLBank of Chicago. The net discounts associated with these transactions (in thousands) were \$(1,266), and \$(10,458) in 2005 and 2004, respectively. The FHLBank accounts for these transfers in the same manner as it accounts for new debt issuances (see Note 13). The FHLBank did not transfer any Consolidated Obligations to other FHLBanks in 2006, 2005, or 2004.

### Note 21—Transactions with Stockholders

As a cooperative, the FHLBank's capital stock is owned by its members, former members that retain the stock as provided in the FHLBank's Capital Plan or by non-member institutions that have acquired members and must retain the stock to support Advances or other activities with the FHLBank. All Advances are issued to members and all mortgage loans held for portfolio are purchased from members. The FHLBank also maintains demand deposit accounts for

members, primarily to facilitate settlement activities that are directly related to Advances and mortgage loan purchases. The FHLBank may not invest in any equity securities issued by its stockholders and it has not purchased any investment or mortgage-backed securities issued by any of its stockholders. Additionally, the FHLBank has not entered into any interest-rate exchange agreements with any of its stockholders.

For financial statement purposes, the FHLBank defines related parties as those members with more than 10 percent of the voting interests of the FHLBank capital stock outstanding. The Act prescribes the voting rights of the FHLBank's members in the election of directors. In accordance with the Act and Finance Board Regulations, members elect a majority of the FHLBank's Board of Directors. The remaining directors are appointed by the Finance Board. Under the statute and regulations, each elective directorship is designated to one of the three states in the FHLBank's district and each member is entitled to vote only for candidates for the state in which the member's principal place of business is located. A member is entitled to cast, for each applicable directorship, one vote for each share of capital stock that the member is required to hold, subject to a statutory limitation. Under this limitation, the total number of votes that a member may cast is limited to the average number of shares of the FHLBank's capital stock that were required to be held by all members in that state as of the record date for voting. Non-member stockholders are not entitled to cast votes for the election of directors. At December 31, 2006 and 2005, no member owned more than 10 percent of the voting interests of the FHLBank in the election of directors due to statutory limits on members' voting rights as discussed above.

All transactions with members are entered into in the ordinary course of business. The FHLBank does not hold mortgage-backed securities securitized by, or other direct long-term investments in, its members or their affiliates. Finance Board Regulations require the FHLBank to provide the same pricing for Advances and other services to all members regardless of asset or transaction size, charter type, or geographic location. The FHLBank may, in pricing its Advances, distinguish among members based upon its assessment of the credit and other risks to the FHLBank of lending to any particular member, or other reasonable criteria that may be applied equally to all members. The FHLBank's policies and procedures require that such standards and criteria be applied consistently and without discrimination to all members applying for Advances.

*Transactions with Directors' Financial Institutions.* In the ordinary course of its business, the FHLBank may provide products and services to members whose officers or directors serve as directors of the FHLBank (Directors' Financial Institutions). Finance Board Regulations require that transactions with Directors' Financial Institutions be made on the same terms as those with any other member. The following table reflects the balances with Directors' Financial Institutions for the items indicated below as of December 31, 2006 and 2005 (dollars in millions).

	2006		2005	
	Balance	% of Total <sup>(1)</sup>	Balance	% of Total <sup>(1)</sup>
Advances	\$ 11,808	28.2%	\$ 11,194	27.9%
Mortgage Purchase Program	56	0.7	61	0.7
Mortgage-backed securities	-	-	-	-
Regulatory Capital Stock	668	17.6	674	17.2
Derivatives	55	0.2	2	0.1

- (1) Percentage of total principal (Advances), unpaid principal balance (Mortgage Purchase Program), principal balance (mortgage-backed securities), regulatory capital stock, and notional balances (derivatives).



**Concentrations.** The following table shows regulatory capital stock balances, outstanding Advance principal balances, and unpaid principal balances of Mortgage Loans Held for Portfolio at December 31, 2006 and 2005 to members holding 5 percent or more of regulatory capital stock and includes any known affiliates that are members of the FHLBank (dollars in millions):

<u>December 31, 2006</u>	<u>Regulatory Capital Stock</u>		<u>Advance Principal</u>	<u>Mortgage Purchase Program Unpaid Principal Balance</u>
	<u>Balance</u>	<u>% of Total</u>		
Charter One Bank, N.A. <sup>(1)</sup>	\$ 582	15%	\$ 10,772	\$ -
U. S. Bank, N.A.	526	14	6,757	159
Fifth Third Bank	372	10	4,048	19
Ohio Savings Bank	<u>214</u>	<u>6</u>	<u>3,971</u>	<u>-</u>
Total	<u>\$ 1,694</u>	<u>45%</u>	<u>\$ 25,548</u>	<u>\$ 178</u>

  

<u>December 31, 2005</u>	<u>Regulatory Capital Stock</u>		<u>Advance Principal</u>	<u>Mortgage Purchase Program Unpaid Principal Balance</u>
	<u>Balance</u>	<u>% of Total</u>		
Charter One Bank, N.A. <sup>(1)</sup>	\$ 549	14%	\$ 9,876	\$ -
U. S. Bank, N.A.	496	13	3,621	201
Fifth Third Bank	351	9	3,045	21
Ohio Savings Bank	<u>202</u>	<u>5</u>	<u>3,878</u>	<u>-</u>
Total	<u>\$ 1,598</u>	<u>41%</u>	<u>\$ 20,420</u>	<u>\$ 222</u>

- (1) Charles J. Koch, Chairman of the Board of Charter One Bank, was a director of the FHLBank during 2005 and 2006. Advances made to Charter One Bank were on the same terms and rates available to other members for similar transactions.

**Non-member Affiliates.** The FHLBank has a relationship with a non-member affiliate, the Kentucky Housing Corporation. The nature of this relationship is twofold: one as an approved borrower from the FHLBank and one in which the FHLBank invests in the purchase of the Kentucky Housing Corporation bonds. Kentucky Housing Corporation had no borrowings during the years ended December 31, 2006, 2005, or 2004. The FHLBank had investments in the bonds of the Kentucky Housing Corporation of \$13,820,000, \$14,435,000, and \$15,015,000 as of December 31, 2006, 2005, and 2004, respectively.

