A Range of Possibilities

Federal Home Loan Bank of San Francisco

2002 ANNUAL REPORT

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Your

customers

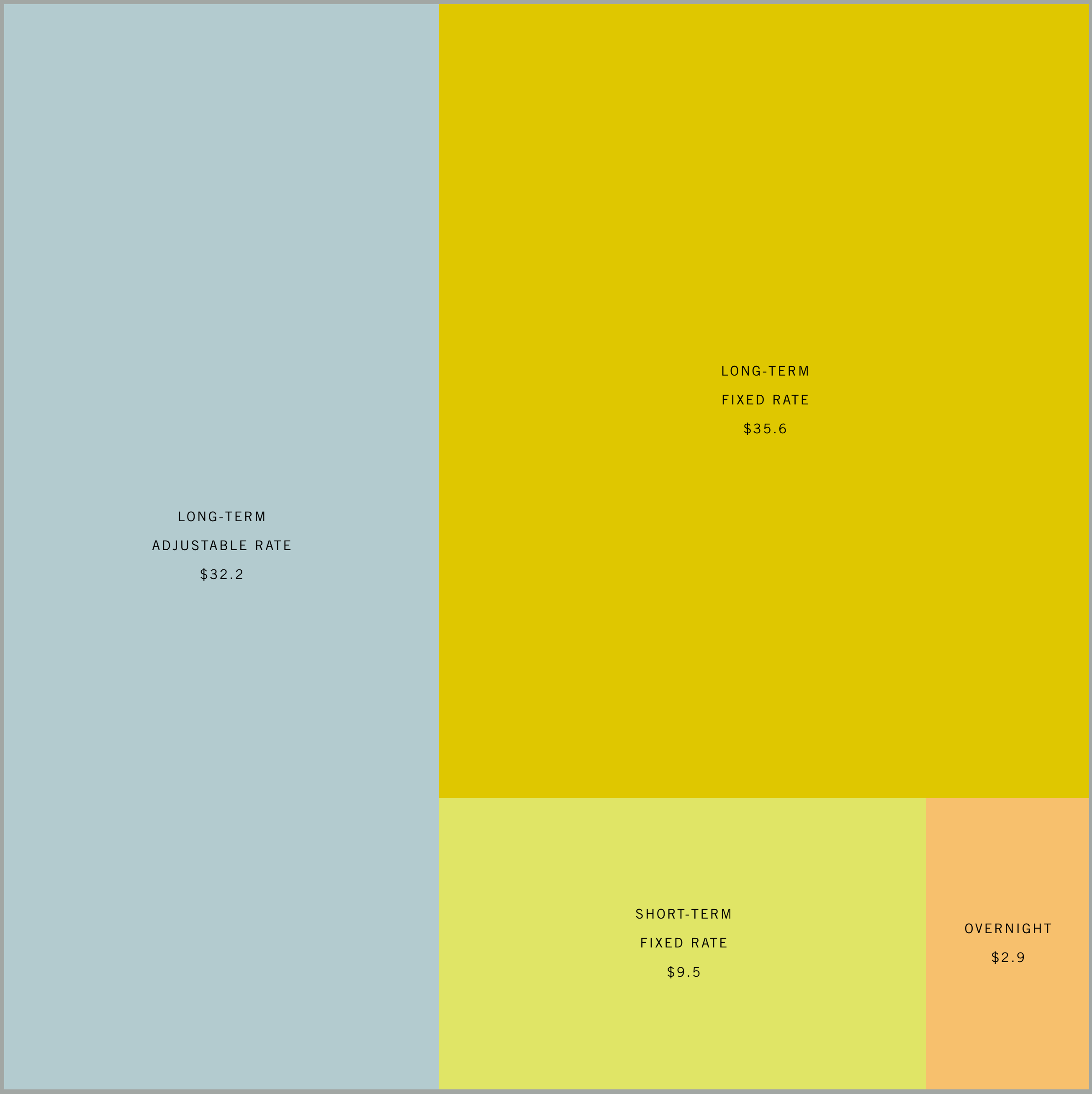
have

many

different

needs.

The Federal Home Loan Bank of San Francisco delivers a wide array of credit products and pledging options to help you meet those needs.



Advances Outstanding

DECEMBER 31, 2002 (IN BILLIONS)

JENNIFER BURLISON

VICE PRESIDENT, MORTGAGE PURCHASES

FEDERAL HOME LOAN BANK OF SAN FRANCISCO

"A community bank that focuses on customer service, Gateway Bank is reluctant to sell its mortgage loans servicing released. The Mortgage Partnership Finance® Program allows Gateway to retain and build on its customer relationships safely and profitably."

"We value our customer relationships and believe we have the expertise to manage the credit risk of our loans. The Bank's MPF® Program provides us with liquidity, excellent execution, greater servicing revenue, and almost instantaneous settlement. It's impressive."

POPPI METAXAS

PRESIDENT AND CHIEF EXECUTIVE OFFICER

GATEWAY BANK, SAN LEANDRO, CA

"MORTGAGE PARTNERSHIP FINANCE" AND "MPF" ARE REGISTERED TRADEMARKS OF THE FEDERAL HOME LOAN BANK OF CHICAGO.

MARILYN
HARDIN

VICE PRESIDENT,
COLLATERAL
PRODUCT
DEVELOPMENT

FEDERAL HOME
LOAN BANK OF
SAN FRANCISCO

"We worked with staff at Mesa Bank to understand their experience in originating small business loans, which helped us refine our program to make it easier for community financial institutions to pledge this new collateral type."

DAVID
FORTUNE

EXECUTIVE VICE
PRESIDENT AND
CHIEF CREDIT
OFFICER

MESA BANK,
MESA, AZ

"We want to continue to grow, so it's an advantage to be able to pledge our small business loans to obtain economical financing. The Bank's flexibility has made it a very positive experience."

JOHN
McCORMACK

VICE PRESIDENT,
MORTGAGE FINANCE

FEDERAL HOME
LOAN BANK OF
SAN FRANCISCO

"Fremont Investment & Loan uses the Variable Rate Credit Advance to fund the nonconforming residential mortgage loans they originate for sale. Each day, Fremont can adjust the advance amount as loans are accumulated or sold."

"The VRC Advance is critical to our sales process. It's the least expensive source of short-term funding available to us. The product's flexibility adds tremendous value. It's a perfect fit."

MURRAY
ZOOTA

PRESIDENT AND
CHIEF EXECUTIVE
OFFICER

FREMONT
INVESTMENT & LOAN,
ANAHEIM, CA

"Orange County Teachers Federal Credit Union wanted to hold more fixed rate residential mortgages in portfolio without adding interest rate risk. Using a strip of Fixed Rate Credit advances addressed the problem."

JAMES ZABEL

ASSISTANT VICE PRESIDENT, MORTGAGE FINANCE

FEDERAL HOME LOAN BANK OF SAN FRANCISCO

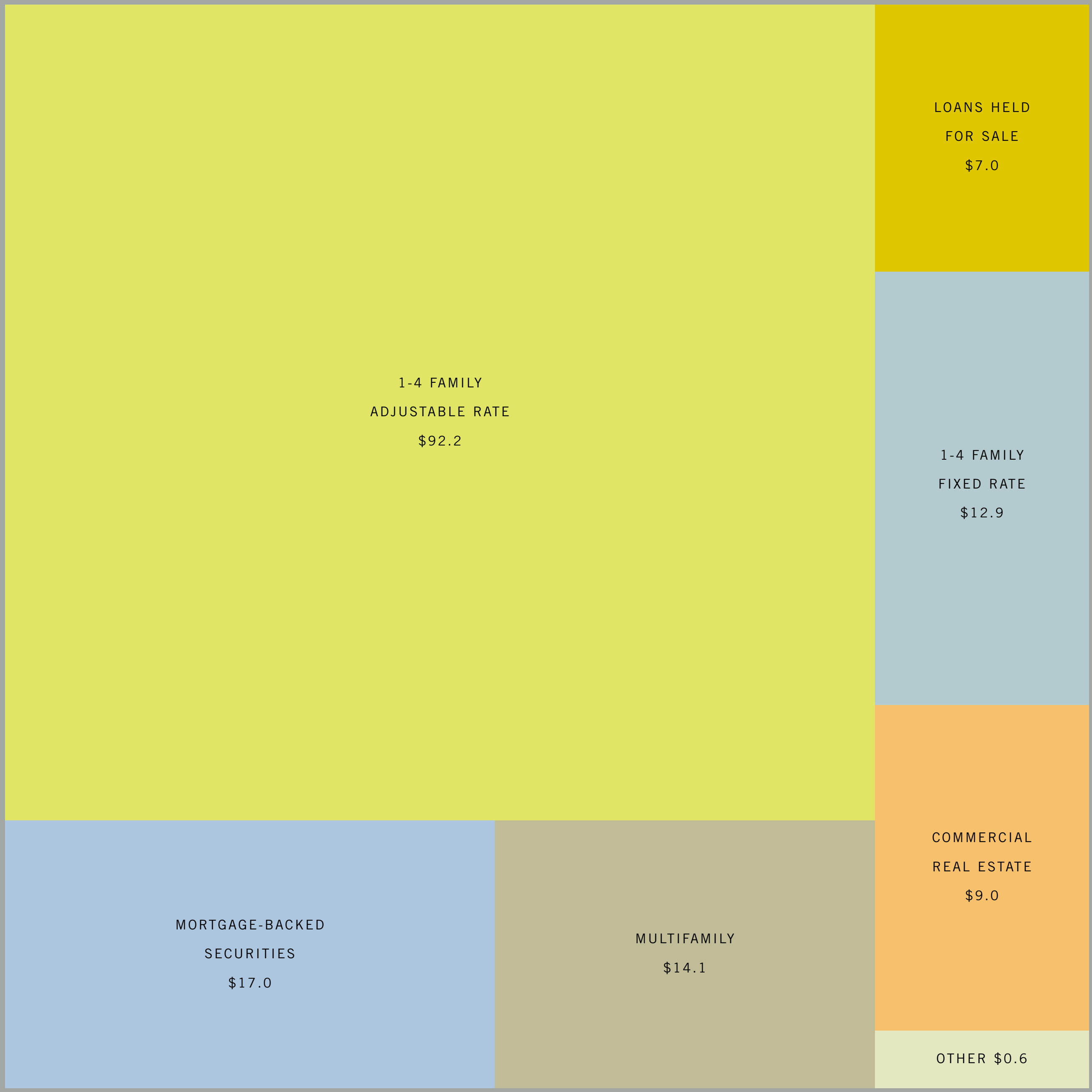
MICHAEL FAULWELL

DIRECTOR, INVESTMENTS

ORANGE COUNTY TEACHERS FEDERAL CREDIT UNION, SANTA ANA, CA

"We took down four advances in maturities of 3, 5, 7, and 10 years. This laddered approach enabled us to mirror the average life of our loans, while locking in a reasonable spread. It was very successful."

By offering you more choices, we make it possible for you to get the precise funding you need – when you need it, how you need it – to serve your customers better.



Composition of Pledged Collateral

DECEMBER 31, 2002 (IN BILLIONS)

FRANCINE
CONSTABLE

VICE PRESIDENT,
SECONDARY
MARKETING

FEDERAL HOME
LOAN BANK OF
SAN FRANCISCO

"To meet the needs of individual members, we developed several different approaches to allow them to pledge loans held for sale. First National Bank worked with us to develop our guidelines and was one of the first to use the program."

"Last year, we originated over $3 billion in single-family mortgages for sale in the secondary market. We have a number of Wall Street funding sources, but because of the cost and efficiency, we prefer using the Bank."

DAN
CHEEVER

CHIEF FINANCIAL
OFFICER

FIRST NATIONAL
BANK OF ARIZONA
AND FIRST NATIONAL
BANK OF NEVADA,
SCOTTSDALE, AZ

“One of Yolo Community Bank’s lending partners, a nonprofit that provides SBA 504 loans to small businesses in underserved communities, was frustrated with having to maintain reserve accounts at several banks to obtain deposit insurance coverage.”

TOM WILSON

ASSISTANT VICE PRESIDENT, MORTGAGE FINANCE

FEDERAL HOME LOAN BANK OF SAN FRANCISCO

“Using the Bank’s Standby Letter of Credit to guarantee the deposits enabled our customer to consolidate the accounts with us. Without the Bank, we wouldn’t have been able to attract these funds to lend in our community.”

JOHN DiMICHELE

PRESIDENT AND CHIEF EXECUTIVE OFFICER

YOLO COMMUNITY BANK, WOODLAND, CA

STEVE
CIBULL

ASSISTANT VICE
PRESIDENT,
MORTGAGE FINANCE

FEDERAL HOME
LOAN BANK OF
SAN FRANCISCO

"The Advances for Community Enterprise program provides discounted funding to support a variety of lending activities, including SBA loans. Alliance Bank has used ACE advances and other Bank credit products to achieve several financial objectives."

"Falling interest rates have squeezed margins recently. Using Bank advances has lowered our cost of funds and given us an excellent opportunity to do a better job of match-funding and leveraging our assets."

CURTIS
REIS

CHAIRMAN AND
PRESIDENT

ALLIANCE BANK,
CULVER CITY, CA

"Understanding our members' individual business strategies is crucial to enhancing our products and programs. IndyMac Bank was instrumental in developing our loans held for sale program and refining our second mortgage pledging program."

PATRICIA REMCH

VICE PRESIDENT AND MANAGING DIRECTOR, MORTGAGE FINANCE

FEDERAL HOME LOAN BANK OF SAN FRANCISCO

TERRIN ENSSLE

SENIOR VICE PRESIDENT AND TREASURER

INDYMAC BANK, FSB, PASADENA, CA

"We haven't been shy about expressing our needs. For us, that's the beauty of the relationship – that we can bounce ideas off each other and come up with solutions. The Bank has been extremely flexible and responsive."

Working together, we can make your membership in the Bank more valuable to you – our customers and shareholders – and to the people and communities you serve. Explore the full range of possibilities...

COMPETITIVELY PRICED ADVANCES IN MATURITIES FROM ONE DAY TO 30 YEARS TO HELP YOU CONTROL FUNDING COSTS AND MANAGE INTEREST RATE RISK

OPPORTUNITY TO LEVERAGE ASSETS WITH THE BANK'S EXPANDING ARRAY OF ELIGIBLE LOAN COLLATERAL

ABILITY TO PLEDGE LOANS HELD FOR SALE OR BORROW SHORT-TERM TO FUND MORTGAGE PIPELINES

AN ALTERNATIVE WAY TO SELL CONFORMING MORTGAGE LOANS THAT REWARDS YOU FOR YOUR CREDIT EXPERTISE

INTEREST RATE SWAPS, CAPS, AND FLOORS THAT HELP YOU ACHIEVE ASSET-LIABILITY MANAGEMENT GOALS

STANDBY LETTERS OF CREDIT DESIGNED TO FACILITATE A WIDE VARIETY OF THIRD-PARTY TRANSACTIONS

GRANT PROGRAMS AND DISCOUNTED ADVANCES THAT SUPPORT AFFORDABLE HOUSING AND COMMUNITY ECONOMIC DEVELOPMENT

Financial Highlights

(DOLLARS IN THOUSANDS)	2002	2001	2000	1999	1998
SELECTED ITEMS AT YEAREND					
Total Assets	$116,129,481	$135,383,872	$140,197,534	$115,921,738	$81,135,514
Advances	81,237,041	102,254,552	110,031,641	90,513,829	63,989,305
Mortgage-Backed Securities	16,000,994	13,769,033	10,762,539	7,048,793	5,670,246
Resale Agreements	4,400,000	2,150,000	400,000	2,558,885	2,226,625
Federal Funds Sold	6,068,000	8,445,000	8,376,000	8,636,000	4,894,000
Other Non-MBS Investments	7,244,940	7,814,726	7,460,154	5,035,236	2,705,565
Consolidated Obligations	108,268,613	125,967,885	129,470,565	107,412,126	73,972,212
Capital	5,684,698	6,809,464	6,292,145	5,438,399	4,435,302
Tangible Capital to Assets Ratio	4.90%	5.03%	4.49%	4.69%	5.47%
AVERAGE ANNUAL MARGINS AND COSTS					
Net Interest Margin	0.41%	0.41%	0.44%	0.41%	0.49%
Other Operating Expenses as a Percent of Average Assets	0.04	0.04	0.03	0.04	0.05
ANNUAL OPERATING RESULTS					
Net Interest Income	$ 495,790	$ 554,307	$ 554,573	$ 386,956	$ 331,281
Net Income	292,177	424,589	376,589	332,553	294,066
Return on Average Assets	0.23%	0.31%	0.29%	0.35%	0.43%
Return on Average Equity	4.73	6.49	6.37	6.87	7.54
Dividend Rate	5.45	5.99	7.17	5.36	5.76
ADJUSTED ANNUAL OPERATING RESULTS*					
Adjusted Net Income	$ 324,316	$ 375,933	$ 381,380	$ 289,422	$ 231,422
Adjusted Net Interest Margin	0.41%	0.41%	0.45%	0.42%	0.51%
Adjusted Return on Average Assets	0.26	0.27	0.30	0.30	0.34
Adjusted Return on Average Equity	5.30	5.75	6.46	5.98	5.93
Potential Dividend Yield	5.37	5.80	6.57	6.10	6.03
Dividend Benchmark	3.36	4.69	6.01	5.36	5.77
Spread of Potential Dividend Yield to Dividend Benchmark	2.01	1.11	0.56	0.74	0.26
RECONCILIATION OF NET INCOME TO ADJUSTED NET INCOME					
Net Income	$ 292,177	$ 424,589	$ 376,589	$ 332,553	$ 294,066
Net Nonrecurring Items, Net of Amortization	493	1,390	4,791	4,563	(14,141)
Fair Value Adjustments, Net	31,646	(50,046)	—	—	—
REFCORP Assessments	—	—	—	(47,694)	(48,503)
Adjusted Net Income	$ 324,316	$ 375,933	$ 381,380	$ 289,422	$ 231,422

*The Bank uses certain adjusted financial performance measures to provide more meaningful comparisons of the Bank's performance over time. Adjusted financial performance measures reflect earnings before nonrecurring items (advance prepayment fees, certain extraordinary gains and losses associated with the early retirement of debt, and certain other material nonrecurring gains and losses), net of the amortization of current and prior period nonrecurring items, in accordance with the Bank's retained earnings policy. Adjusted financial performance measures also exclude any current period fair value adjustments (net of applicable assessments) resulting from the adoption of SFAS 133 on January 1, 2001, which include adjustments made in accordance with SFAS 133 and adjustments on held-at-fair-value securities reclassified from held-to-maturity securities upon the adoption of SFAS 133. In addition, as a result of the Gramm-Leach-Bliley Act of 1999, beginning in 2000 the REFCORP assessment is classified as an expense and is included on the Bank's income statement. Before 2000, the REFCORP assessment was a charge to capital and did not appear on the income statement. These adjusted financial performance measures show the Bank's operating results after subtracting the REFCORP assessments for 1998 and 1999.

Reclassifications: Certain amounts have been reclassified to conform to the 2002 presentation.

To Our Members

We are very pleased to deliver this annual report to our members. During 2002, the Federal Home Loan Bank of San Francisco successfully managed its balance sheet to accommodate declining advance demand, increased its mortgage-backed securities portfolio, returned value to members through remaining an ever-present source of liquidity, provided advantageous advance pricing, and paid an excellent dividend.

We are very proud of what the Bank achieved in 2002, and we hope you will read the discussion and analysis immediately following this letter for a more detailed understanding of the year's activities and results.

In this letter we will discuss some trends and possible outcomes of real significance to all stakeholders in the Federal Home Loan Bank System, and particularly to the System's members. If you use the System and the Bank, or benefit from it in some less direct way, now is the time to consider how changes to the System could enhance or diminish the value of the Bank to your organization or institution. If you want to ensure the System's ongoing utility to your company, you should also give serious thought to participating in the current debates about the System's future.

For more than 70 years now, in one of those rare occasions when unintended consequences have not overwhelmed original intent, the System has aided housing lenders in making mortgages. It has done this through a unique structure of cooperative entities. There are 12 separate corporations that make up the System. They are joined together when they issue debt in the capital markets, debt on which all 12 are jointly and severally liable, through the Office of Finance. To some, this 12-cooperative structure may appear cumbersome and inefficient when compared to the concept of a single Federal Home Loan Bank for the entire country. But it has the profound advantage of having worked for those 70 years, and very nearly flawlessly. Neither the investors in the System bonds nor the stockholders of the individual FHLBanks have ever suffered a credit loss on their investment in the System. And member financial institutions do not fear that it is competing with them. That is an unparalleled record.

All of this may be changing. There are numerous forces at work that may drive the System to consolidation into a single, massive, and very powerful government-sponsored enterprise, one that is engaged in a business and serving a function very different from the business and function it has historically performed, and more like those performed by the other two housing GSEs. By eliminating local control of the FHLBanks and undermining the regional nature of the System, it seems likely that such consolidation would reduce the System's responsiveness to the needs and priorities of local businesses and communities. While there may not be visible political support for consolidation at this time, it may become more attractive as other changes take place.

The System is facing several critical issues right now: the role of mortgage purchase programs, securitization authority for the FHLBanks, SEC registration, and multidistrict membership. The purpose of this letter is to ask you, the members of the Bank and the other stakeholders and beneficiaries of the present System structure, to step back and take a clear look at all of these issues in a global and integrated way. Rather than thinking about each incremental issue on a stand-alone basis and examining the incremental impact it may have on an individual FHLBank, look at what may happen to the System as a whole if these issues are decided in a way that takes the System away from its current structure and mission.

Commentators have pointed out that the role played by the System has been changing. While for years the FHLBanks played a narrowly defined role – that of accessing the capital markets to raise funds to lend to their members, who in turn made mortgage loans to their customers – the FHLBanks are now involved in a much wider range of activities. Some of these activities result from legislative changes over the years. Others have occurred without explicit legislative authorization, but instead from regulatory or judicial action, or simply because the FHLBanks have done them, unchecked.

The most significant of these relatively new activities is the ownership of mortgage loans that have been purchased from members. This is a business that is likely to grow because there are strong economic incentives for FHLBanks to own mortgages and there are economic incentives for members to sell loans to FHLBanks. These incentives have led all 12 FHLBanks to establish mortgage purchase programs. Assuming the FHLBanks manage their mortgage portfolios well, mortgages should, in most circumstances, provide much higher returns than advances. However, with the higher returns come higher risks and earnings volatility from the significant prepayment risk inherent in mortgage assets. Nevertheless, an FHLBank that buys loans from its members will probably, over time, be able to pay higher dividends or charge lower prices for credit.

A possible outcome of this situation is that mortgages, as opposed to advances, will become favored on FHLBank balance sheets and will become favored for funding. Another possible outcome is that it will become increasingly necessary to construct a single, nationwide way to participate in the mortgage purchase business, i.e., there will be pressure for some form of operational consolidation of the FHLBanks. If your company is an advance user, you may want to be on the alert for changes that could make advances less attractive in the future.

Directly related to the mortgage purchase programs is the drive to get securitization authority for the FHLBanks. The FHLBanks do not issue capital into the markets like normal private corporations; they must raise capital from their members. They will need capital to support mortgage purchases. At the same time, if an FHLBank is in the business of purchasing mortgages, it is important to maintain that business in an ongoing manner. In other words, customers will expect to be able to sell loans when they choose. In anticipation of the eventuality that capital will not be available when needed, some FHLBanks are seeking authority to securitize mortgages. Is it likely that 12 separate FHLBanks will get into the business of securitizing mortgages, or will the System move to consolidation to create and sell the securities more efficiently?

In addition to examining the implications of changes in FHLBank balance sheets, the System is debating several other major issues.

As we write this letter, it is unresolved whether the FHLBanks will register their stock with the Securities and Exchange Commission, and whether the System as a whole, presumably through the Office of Finance, will register its debt in some form. Registration of FHLBank stock was urged by the U.S. Department of the Treasury as a means of improving the flow of information to investors in FHLBank System-issued debt. No FHLBank is resisting enhanced disclosure; instead all support it. However, if the purpose of registration is enhanced disclosure, then let it come about through a disclosure regime managed and administered by the Federal Housing Finance Board. The benefit of that approach is that safety and soundness and disclosure regulation would be administered by the same regulator, a regulator that is already familiar with the unique structure of the System.

However, the primary concern for some FHLBanks, including this one, is that it is not clear how SEC registration may affect the System. Will complying with the SEC's requirements for registration allow the FHLBanks to do business in the future as they do it today? Will bondholders' need to receive combined financial information on the System as a whole force the System toward consolidation?

Another critical issue is that of multidistrict membership. The Bank has opposed multidistrict membership because we have concerns about increasing competition among the FHLBanks. Competition is a good thing when governed by the checks and balances inherent in a true market system, where success is rewarded through increases in the value of an enterprise's equity. Competition among the FHLBanks is more problematic, since they do not have equity that is priced at market, and they share joint and several liability for all debt issued by the System. FHLBanks that win this competition may ultimately lose, as they pay the debts of the FHLBanks that were less successful.

In addition, given that all FHLBanks raise funds the same way, no FHLBank can have a lasting pricing advantage over any other FHLBank. Because the FHLBanks won't be able to compete effectively on price, we are concerned that competition will occur in collateral and credit standards, increasing risk throughout the System. Proponents of multidistrict membership argue that regulation and self-regulation can address this issue. We are not so sure.

Multidistrict membership again raises the issue of consolidation. If membership is separated from charter location, what reason is there for 12 FHLBanks? In the absence of a regional focus based on member charters, isn't it more likely that administrative difficulties and other issues will render the current structure irrelevant?

The mortgage purchase programs are here to stay, and the forces set in motion by those programs will have a lasting effect on the System. The other three issues are under debate right now, but each one is being discussed as a separate, independent issue. However, if they are all decided in the direction of change from the existing structure, we will end up with a very different System. The question is, how radically do we want the System to change? By examining the issues before us in an integrated way and looking at their long-term implications, we may find good reasons for seeking to accommodate change within the existing structure.

The point we wish to make to you – the members, borrowers, and stakeholders in the System – is that as the System evolves, you must be vigilant to protect what you find valuable in your relationship with the Bank. By working together to define the issues clearly, to anticipate possible unintended consequences, and to explore alternate ways to maintain the value of the System to its members, we may be able to preserve the essential benefits that the System now delivers to local financial institutions and their communities.

In closing, we thank the Bank's directors for their leadership of the Bank. In particular, we would like to acknowledge the contributions of outgoing directors Roberta Achtenberg, Daniel R. Ortega, Jr., Charles R. Rinehart, Herbert M. Sandler, and Richard H. Terzian, and welcome new board members Timothy R. Chrisman, Frank P. Pekny, Connie R. Wilhelm, and Charlene Gonzales Zettel.

We thank the members of our Affordable Housing Advisory Council, who contribute so much to the accomplishment of the Bank's fundamental purpose of serving our communities. We also thank the Bank's employees for their dedication and hard work.

Finally, we thank you, the Bank's members, for using Bank resources to provide credit to your customers and neighborhoods, for working with us to improve those resources, and for taking an interest in protecting the long-term value of the Federal Home Loan Bank System to you and to the communities you serve.

D. Tad Lowrey
VICE CHAIRMAN OF THE BOARD

Mary Lee Widener
CHAIRMAN OF THE BOARD

Dean Schultz
PRESIDENT AND CEO



2002 HIGHLIGHTS

The net income of the Federal Home Loan Bank of San Francisco (Bank) was $292.2 million in 2002, a decrease of $132.4 million, or 31%, from $424.6 million in 2001. This decrease was partially due to an $81.7 million decrease associated with the effects of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133) (see "Interest Rate Exchange Agreements" on page 27). In accordance with SFAS 133, the Bank recognized a net loss of $31.6 million in 2002 compared to a net gain of $50.1 million in 2001 (net of applicable Resolution Funding Corporation [REFCORP] and Affordable Housing Program [AHP] assessments). The net loss and net gain reflected the net impact from fair value adjustments and other changes made under SFAS 133, and from fair value adjustments made on held-at-fair-value securities reclassified from held-to-maturity securities upon the adoption of SFAS 133. Net interest income decreased $58.5 million, or $43.0 million after assessments, primarily due to lower earnings on invested member capital resulting from the lower interest rate environment in 2002 compared to 2001, combined with a reduction in total member capital. These decreases were partially offset by improved earnings from the Bank's mortgage-backed securities (MBS) portfolio, which resulted from higher investment balances and profit spreads. Also contributing to the decrease in net income for 2002 was an expense of $6.9 million, after assessments, associated with an arbitration award to a member. The Bank's return on equity (ROE) decreased 176 basis points, to 4.73% in 2002 from 6.49% in 2001. The Bank's annual dividend rate was 5.45% for 2002, compared to 5.99% in 2001.

Since the cumulative net gains or losses from fair value adjustments made in accordance with SFAS 133 and on held-at-fair-value securities are primarily a matter of timing, the net gains or losses will generally be reversed over the remaining contractual terms to maturity of the financial instruments and associated interest rate exchange agreements. Therefore, in accordance with the Bank's retained earnings policy, the Bank restricts retained earnings for any cumulative net gains (net of applicable assessments) resulting from cumulative fair value adjustments. Excluding the impact of SFAS 133 in 2002, net income for the year would have been $323.8 million, a decrease of $50.7 million relative to 2001, and ROE for the year would have been 5.29%, a decrease of 44 basis points relative to 2001. These declines are primarily a result of the significant decline in interest rates and lower total member capital during 2002, which together reduced earnings on invested member capital, partially offset by improved earnings from the Bank's MBS portfolio.

Total assets declined $19.3 billion, or 14%, to $116.1 billion as of December 31, 2002. This decrease was primarily due to a $21.0 billion, or 21%, decrease in advances to $81.2 billion. On an average basis, in 2002 the Bank's advances decreased $17.5 billion, or 16%, to $90.1 billion, and total assets decreased $13.9 billion, or 10%, to $125.2 billion, relative to 2001. In contrast, average held-to-maturity securities increased $2.8 billion, or 19%, to $17.7 billion, and average securities purchased under agreements to resell (resale agreements) increased $1.2 billion, or 77%, to $2.7 billion.

FINANCIAL PERFORMANCE

The Bank seeks to maintain a balance between its public policy mission and its ability to provide adequate returns on the capital supplied by its members. The Bank achieves this balance by delivering low-cost financing to help members meet the credit needs of their communities while paying members a market-rate dividend. The dividends paid by the Bank are largely the result of the Bank's earnings on invested member capital, while net earnings on member credit, MBS, and other investments are generally used to pay the Bank's operating expenses and assessments (with additional earnings, if any, also contributing to the dividend).

Reflecting the Bank's nature as a cooperative, the Bank's financial strategies are designed to enable the Bank to expand and contract in response to member credit needs. The Bank invests member capital in high-quality, short- and intermediate-term financial instruments. This strategy reduces the risk of loss if investments have to be liquidated to redeem excess capital stock.

To measure its financial performance, the Bank compares the "potential dividend yield" on its capital stock to a dividend benchmark. The "potential dividend yield" is current

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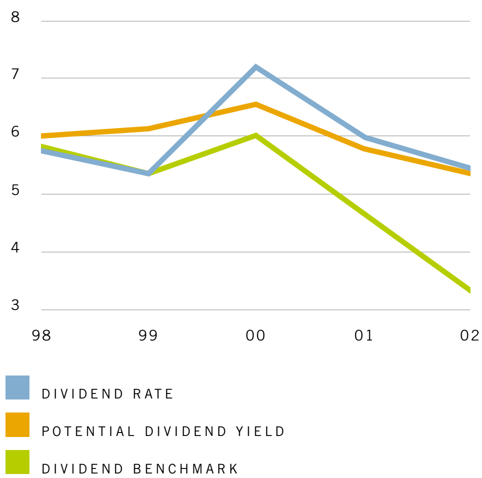
Statements contained in this report, including statements describing the objectives, projections, estimates, or predictions of the future of the Bank, may be "forward-looking statements." These statements may use forward-looking terms, such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or their negatives or other variations on these terms. The Bank cautions that, by their nature, forward-looking statements involve risk or uncertainty and that actual results could differ materially from those expressed or implied in these forward-looking statements or could affect the extent to which a particular objective, projection, estimate, or prediction is realized. These forward-looking statements involve risks and uncertainties including, but not limited to, the following: economic and market conditions; volatility of market prices, rates, and indices; political, legislative, regulatory, or judicial events; a new capital structure; membership changes; competitive forces; changes in investor demand for consolidated obligations and/or the terms of interest rate exchange agreements and similar agreements; and timing and volume of market activity. Management's discussion and analysis of financial condition and results of operations should be read in conjunction with the Bank's financial statements and notes, which begin on page 37.

period earnings (excluding nonrecurring items and fair value adjustments) as a percentage of capital stock. The dividend benchmark reflects the Bank's capital investment strategy and is calculated as the average of two yields: the daily average of the overnight Federal funds effective rate and the four-year moving average of the four-year Treasury note yield. The spread between the potential dividend yield and the dividend benchmark represents the financial return on the members' investment in Bank capital stock relative to the return on a comparable investment in Federal funds and intermediate-term Treasury investments.

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

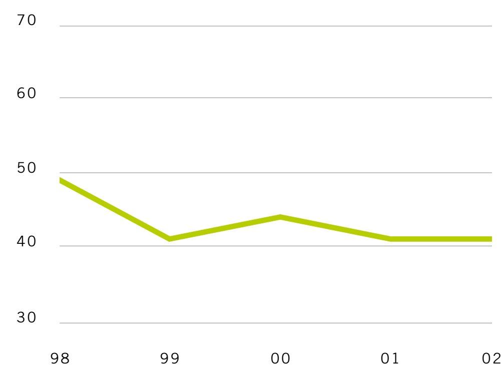


The spread to the dividend benchmark was 201 basis points for 2002 compared to 111 basis points for 2001. The Bank's potential dividend yield was 5.37% for 2002, a decrease of 43 basis points from 5.80% for 2001. The dividend benchmark was 3.36% for 2002, a decrease of 133 basis points from 4.69% for 2001. The dividend spread increased because of higher balances, leverage, and profit spreads on the MBS portfolio and the decline in market interest rates, as reflected in the dividend benchmark. Because of the effects of the REFCORP and AHP assessments, lower interest rates in 2002 resulted in a smaller decline in the post-assessment yield on invested capital relative to the decline of the dividend benchmark. This contributed to the increase in the spread of the potential dividend yield to the dividend benchmark in 2002 relative to 2001. An increase in interest rates would result in a corresponding reduction in the potential dividend spread. As a result of higher assessments, the increase in the potential dividend yield would be smaller than the increase in the dividend benchmark.

RESULTS OF OPERATIONS

Net Interest Income. Net interest income was $495.8 million in 2002, a decrease of $58.5 million, or 11%, from $554.3 million in 2001. The decrease was primarily due to lower earnings on invested member capital resulting from lower interest rates in 2002 compared to 2001 and lower member capital, and, to a lesser degree, narrower profit spreads on advances and non-MBS investments. In addition, the effect of a $14.4 billion decrease in average interest-earning assets contributed to the decrease in net interest income. These decreases were partially offset by improved earnings from the Bank's MBS portfolio resulting from higher investment balances and profit spreads. The net interest margin in 2002 remained unchanged at 41 basis points. The average yield on interest-earning assets in 2002 was 2.36%, compared to 4.50% in 2001, a decrease of 214 basis points. The average cost of interest-bearing liabilities decreased 226 basis points, to 2.06% in 2002 from 4.32% in 2001.

NET INTEREST MARGIN (BASIS POINTS)



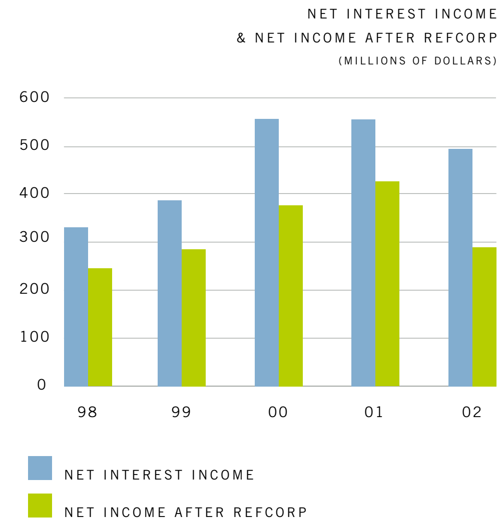
Other (Loss)/Income. Other (loss)/income was a net loss of $27.7 million in 2002, a decrease of $109.2 million compared to income totaling $81.5 million in 2001. This decline was primarily due to fair value adjustments associated with derivatives and hedging activities, which decreased $127.6 million, from a net gain of $64.0 million in 2001 to a net loss of $63.6 million in 2002. This decrease was partially offset by an increase of $15.1 million resulting from fair value adjustments related to the Bank's held-at-fair-value securities and an increase of $3.1 million in prepayment fees, as members prepaid $7.5 billion of advances in 2002 compared to $1.9 billion in 2001. Other (loss)/income includes the amortization of deferred gains resulting from the 1999 sale of the Bank's office building in San Francisco, which totaled $2.1 million in both 2002 and 2001, and fees earned on letters of credit of $1.4 million in both 2002 and 2001. The remaining unamortized amount of the deferred gain on the sale of the building at December 31, 2002, was $13.3 million.

Other Expenses. Other expenses were $70.4 million in 2002, an increase of $14.9 million, or 27%, from $55.5 million in 2001. This increase primarily resulted from a final court order confirming an arbitration decision awarding a member a refund of $7.9 million in prepayment fees paid to the Bank in 1998 plus interest for a total amount of $9.4 million. In addition, operating expenses increased $4.8 million, or 10%, to $53.6 million, in 2002, while average assets decreased 10%, to $125.2 billion in 2002, leading to an increase in the Bank's ratio of operating expenses to average assets to 4.3 basis points in 2002 from 3.5 basis points in 2001.

REFCORP and AHP Assessments. Effective January 1, 2000, the annual REFCORP obligation of the FHLBanks was modified by the Gramm-Leach-Bliley Act (GLB Act) from a fixed annual assessment of $300 million for the 12 FHLBanks combined to 20% of each FHLBank's net earnings (after AHP assessments). With the new assessment, the amount of the Bank's REFCORP payments will rise and fall with its earnings. To the extent that the FHLBanks' annual REFCORP payments are higher or lower than $300 million, the term of the REFCORP obligation will be shortened or lengthened, respectively, so that the value of all payments made by the FHLBanks is equivalent to a $300 million annual annuity with a final maturity date of April 15, 2030. The Bank was assessed $73.0 million in 2002 compared to $106.1 million in 2001, reflecting lower earnings in 2002. The FHLBanks' payments in 2002 shortened the remaining term of the REFCORP obligation to the third quarter of 2021.

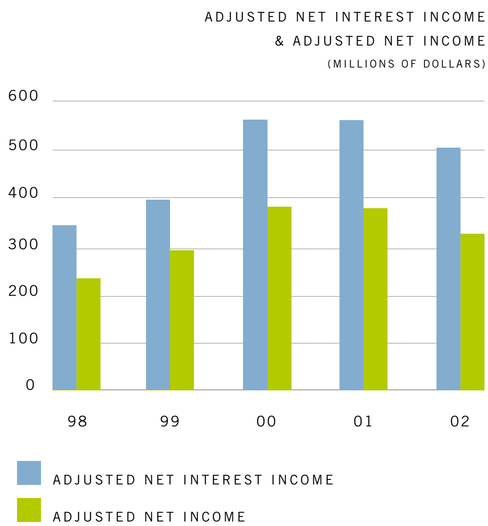
Annually, the FHLBanks must set aside for their AHPs, in the aggregate, the greater of $100 million or 10% of each year's net income before charges for the AHP but after the assessment for REFCORP. To the extent that the aggregate 10% calculation is less than $100 million, the shortfall is allocated among the FHLBanks based on the ratio of each FHLBank's net income before AHP and REFCORP to the sum of the net incomes before AHP and REFCORP of the 12 FHLBanks combined. There were no shortfalls in 2002 or 2001. The Bank set aside $32.5 million for the AHP in 2002, compared to $47.2 million in 2001, reflecting the lower earnings in 2002.

The Bank's total REFCORP and AHP assessments equaled $105.5 million in 2002, compared with $153.3 million in 2001, reflecting the Bank's effective "tax" rate on pre-assessment income of 27%.



Net Income. Net income was $292.2 million in 2002, a decrease of $132.4 million, or 31%, from $424.6 million in 2001, and return on equity (ROE) was 4.73% in 2002, a decrease of 176 basis points from 6.49% in 2001. After adjusting for the total net effect of SFAS 133 for 2002 and 2001 (a net loss of $31.6 million and a net gain of $50.1 million, respectively, net of applicable assessments), net income for 2002 would have been $323.8 million, a decrease of $50.7 million, or 14%, from $374.5 million in 2001. As a result, ROE would have been 5.29% in 2002, a decrease of 44 basis points from 5.73% in 2001. Without the net effect of SFAS 133, the decline in ROE was primarily attributable to lower earnings on member capital resulting from the lower interest rates in 2002 compared to 2001, partially offset by improved earnings from the Bank's MBS portfolio resulting from higher investment balances and profit spreads.

Adjusted Financial Performance. The Bank also calculates adjusted financial performance measures to provide a more meaningful comparison of the Bank's financial results over time. These measures reflect earnings before advance prepayment fees and certain nonrecurring gains and losses associated with advance prepayments, including certain gains and losses associated with the early retirement of debt, net of the current amortization of current and prior period nonrecurring items collectively (net nonrecurring items, net of amortization), in accordance with the Bank's retained earnings policy. These adjustments are made in order to recognize prepayment fees, debt retirement gains and losses, and other nonrecurring transactions over the periods remaining through the related instruments' original maturity dates. In addition, adjusted financial performance measures exclude the effects of any current period adjustments (net of applicable assessments) resulting from the adoption of SFAS 133, because these effects are generally expected to reverse over time. These adjustments include fair value adjustments and the effects of other changes made in accordance with SFAS 133 and fair value adjustments on held-at-fair value securities reclassified from held-to-maturity securities upon the adoption of SFAS 133. In addition, as a result of the GLB Act, beginning in 2000 the REFCORP assessment is classified as an expense and is included on the Bank's income statement. Before 2000, the REFCORP assessment was a charge to capital and did not appear on the income statement. Adjusted financial performance measures present the Bank's operating results after subtracting the REFCORP assessments for 1998 and 1999.



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

RECONCILIATION OF NET INCOME TO ADJUSTED NET INCOME

(IN MILLIONS)	2002	2001	2000
Net income	$ 292.2	$ 424.6	$ 376.6
Net nonrecurring items, net of amortization	0.5	1.4	4.8
Fair value adjustments, net	31.6	(50.1)	—
Adjusted net income	$ 324.3	$ 375.9	$ 381.4

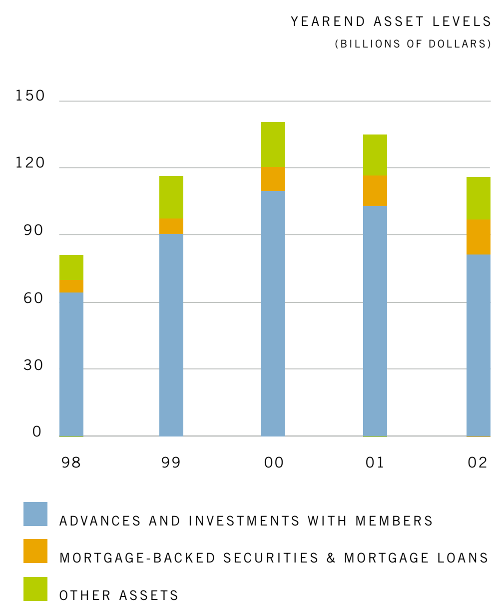
Dividends. The Bank's annual dividend rate was 5.45% for 2002, compared to 5.99% in 2001. The decline in the dividend rate was primarily attributable to lower earnings on member capital resulting from the continued lower interest rate environment in 2002, partially offset by improved earnings from the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

In accordance with the retained earnings policy of the Bank, the Bank restricts retained earnings for that portion of income from prepayment fees that, if allocated on a pro rata basis over the original term to maturity of the advances prepaid, would be allocated to future dividend periods. Other gains and losses related to the termination of interest rate exchange agreements and the early retirement of consolidated obligations associated with prepaid advances are similarly treated. Retained earnings restricted in accordance with these policies totaled $6.6 million, $6.5 million, and $7.1 million at December 31, 2002, 2001, and 2000, respectively.

Also in accordance with the retained earnings policy of the Bank, as of January 1, 2001, the Bank restricts retained earnings for any cumulative net fair value gains in earnings (net of applicable assessments) resulting from SFAS 133. Since these cumulative net gains are primarily a matter of timing, the gains will generally reverse over the remaining contractual terms to maturity of the financial instruments and associated interest rate exchange agreements. Restricted retained earnings will be adjusted as these cumulative net gains are reversed, resulting in substantially the same possible dividend payout as there would have been without the effects of SFAS 133 provided that the cumulative net effect of SFAS 133 since inception is positive. Retained earnings restricted in accordance with this policy totaled $18.8 million and $50.8 million at December 31, 2002 and 2001, respectively. The decrease in 2002 was due to the payout of $32.0 million from restricted retained earnings to offset the net losses associated with SFAS 133 during 2002. This payout contributed 53 basis points to the dividend.

FINANCIAL CONDITION

Total assets were $116.1 billion at December 31, 2002, a decrease of $19.3 billion, or 14%, from $135.4 billion at December 31, 2001. Average total assets were $125.2 billion in 2002, a decrease of $13.9 billion, or 10%, compared to $139.1 billion in 2001.



AVERAGE BALANCE SHEETS

(DOLLARS IN MILLIONS)	2002 AVERAGE BALANCE	2002 INTEREST INCOME/ EXPENSE	2002 AVERAGE RATE	2001 AVERAGE BALANCE	2001 INTEREST INCOME/ EXPENSE	2001 AVERAGE RATE	2000 AVERAGE BALANCE	2000 INTEREST INCOME/ EXPENSE	2000 AVERAGE RATE
Assets									
Interest-earning assets:									
Interest-bearing deposits in banks	$ 4,405.0	$ 78.3	1.78%	$ 3,636.0	$ 142.4	3.92%	$ 2,007.0	$ 131.1	6.53%
Resale agreements	2,731.8	47.9	1.75	1,544.9	63.9	4.13	1,523.9	93.9	6.16
Federal funds sold	6,787.9	119.2	1.76	8,436.0	349.3	4.14	8,564.7	549.1	6.41
Held-to-maturity securities	17,748.7	819.7	4.62	14,896.3	828.9	5.56	13,710.6	898.0	6.55
Held-at-fair-value securities[1]	513.3	10.8	2.10	584.3	27.7	4.74	—	—	—
Mortgage loans	31.6	1.6	5.07	—	—	—	—	—	—
Advances[1]	90,095.3	1,815.4	2.01	107,605.3	4,735.9	4.40	99,959.9	6,431.3	6.43
Loans to other FHLBanks	18.9	0.3	1.59	26.8	0.8	3.15	10.1	0.7	6.91
Total interest-earning assets	122,332.5	2,893.2	2.36	136,729.6	6,148.9	4.50	125,776.2	8,104.1	6.44
Other assets[2]	2,860.2			2,382.4			2,592.7		
Total Assets	$125,192.7	$2,893.2	2.31%	$139,112.0	$6,148.9	4.42%	$128,368.9	$8,104.1	6.31%
Liabilities and Capital									
Interest-bearing liabilities:									
Consolidated obligations:									
Bonds[1]	$ 99,395.1	$2,076.2	2.09%	$ 94,383.3	$4,064.3	4.31%	$ 86,917.2	$5,527.1	6.36%
Discount notes[1]	16,192.3	313.6	1.94	34,783.2	1,514.0	4.35	31,740.8	1,996.8	6.29
Deposits	503.3	7.2	1.43	480.2	16.0	3.33	221.5	13.5	6.10
Borrowings from other FHLBank	3.8	0.1	2.60	2.1	0.1	3.80	—	—	—
Other borrowings	9.2	0.1	1.08	6.1	0.2	3.58	202.7	12.1	5.92
Total interest-bearing liabilities	116,103.7	2,397.2	2.06	129,654.9	5,594.6	4.32	119,082.2	7,549.5	6.34
Other liabilities[2]	2,914.7			2,912.1			3,379.1		
Total Liabilities	119,018.4	2,397.2	2.01	132,567.0	5,594.6	4.22	122,461.3	7,549.5	6.16
Capital	6,174.3			6,545.0			5,907.6		
Total Liabilities and Capital	$125,192.7	$2,397.2	1.91%	$139,112.0	$5,594.6	4.02%	$128,368.9	$7,549.5	5.88%
Net Interest Income		$ 496.0			$ 554.3			$ 554.6	
Net Interest Spread			0.30%			0.18%			0.10%
Net Interest Margin[3]			0.41%			0.41%			0.44%
Total Average Assets/Capital Ratio	20.3x			21.3x			21.7x		
Interest-Earning Assets/ Interest-Bearing Liabilities	1.1x			1.1x			1.1x		

[1] Interest income/expense and average rates include the effect of associated interest rate exchange agreements.
[2] Includes forward settling transactions and fair value adjustments in accordance with SFAS 133 for hedged cash items.
[3] Net interest margin is net interest income divided by average interest-earning assets.

CHANGE IN NET INTEREST INCOME: RATE/VOLUME ANALYSIS

2002 COMPARED TO 2001

(IN MILLIONS)	INCREASE/ (DECREASE)	ATTRIBUTABLE TO CHANGES IN[1] AVERAGE VOLUME	AVERAGE RATE
Interest-earning assets:			
Interest-bearing deposits in banks	$ (64.1)	$ 12.2	$ (76.3)
Resale agreements	(16.0)	20.4	(36.4)
Federal funds sold	(230.1)	(33.8)	(196.3)
Held-to-maturity securities	(9.2)	131.7	(140.9)
Held-at-fair-value securities[2]	(16.9)	(1.9)	(15.0)
Mortgage loans	1.6	1.6	—
Advances[2]	(2,920.5)	(412.5)	(2,508.0)
Loans to other FHLBanks	(0.5)	(0.1)	(0.4)
Total interest-earning assets	(3,255.7)	(282.4)	(2,973.3)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds[2]	(1,988.1)	31.6	(2,019.7)
Discount notes[2]	(1,200.4)	(387.3)	(813.1)
Deposits	(8.8)	0.1	(8.9)
Other borrowings	(0.1)	—	(0.1)
Total interest-bearing liabilities	(3,197.4)	(355.6)	(2,841.8)
Net Interest Income Before Mortgage Loan Loss Provision	$ (58.3)	$ 73.2	$ (131.5)

2001 COMPARED TO 2000

(IN MILLIONS)	INCREASE/ (DECREASE)	ATTRIBUTABLE TO CHANGES IN[1] AVERAGE VOLUME	AVERAGE RATE
Interest-earning assets:			
Interest-bearing deposits in banks	$ 11.3	$ 64.1	$ (52.8)
Resale agreements	(30.0)	2.3	(32.3)
Federal funds sold	(199.8)	(7.1)	(192.7)
Held-to-maturity securities	(69.1)	65.2	(134.3)
Held-at-fair-value securities[2]	27.7	26.5	1.2
Advances[2]	(1,695.4)	292.2	(1,987.6)
Loans to other FHLBanks	0.1	0.5	(0.4)
Total interest-earning assets	(1,955.2)	443.7	(2,398.9)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds[2]	(1,462.8)	284.2	(1,747.0)
Discount notes[2]	(482.8)	121.3	(604.1)
Deposits	2.5	8.7	(6.2)
Borrowings from other FHLBanks	0.1	0.1	—
Other borrowings	(11.9)	(7.3)	(4.6)
Total interest-bearing liabilities	(1,954.9)	407.0	(2,361.9)
Net Interest Income	$ (0.3)	$ 36.7	$ (37.0)

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

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

Advances. Advances outstanding were $81.2 billion at December 31, 2002, a decrease of $21.0 billion, or 21%, from $102.2 billion at December 31, 2001. Average advances were $90.1 billion in 2002, a decrease of $17.5 billion, or 16%, from $107.6 billion in 2001. Advances outstanding at December 31, 2002 and 2001, included fair value adjustments of $1.0 billion and $0.9 billion, respectively. The decline in advances outstanding was primarily the result of several members' strong retail deposit growth and mortgage prepayments. The Bank's largest members accounted for most of the decline in advances. Under current economic conditions, the Bank anticipates that this trend could continue in the near future. In total, 148 members increased their advance borrowings from yearend 2001 to yearend 2002, while 59 members decreased their advance borrowings.

Mortgage Partnership Finance® (MPF®) Program. In 2001, the Bank began offering members the opportunity to participate in the MPF Program to provide them with a competitive alternative to the traditional secondary mortgage market. ("Mortgage Partnership Finance" and "MPF" are registered trademarks of the Federal Home Loan Bank of Chicago.) Under this program, the Bank buys conventional conforming and government-guaranteed fixed rate mortgage loans from members and pays them a monthly credit enhancement fee for managing the credit risk of the loans. At December 31, 2002, the Bank held conventional fixed rate conforming mortgage loans totaling $0.3 billion that were purchased from four participating financial institutions (PFIs). At December 31, 2002, all loans were current, and the Bank had an allowance for loan losses of $0.2 million. No loans were purchased in 2001. As the MPF Program matures, the Bank anticipates that activity in the program may increase substantially.

The Bank analyzes the duration, convexity, and earnings risk of the mortgage loans at the time of purchase and of the outstanding mortgage loan portfolio on a regular basis under various interest rate scenarios. The Bank manages the interest rate and prepayment risk associated with mortgage loans through a combination of debt issuance and derivatives. The Bank issues both callable and non-callable debt to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans.

Options may also be used to hedge prepayment risk on the mortgage loans, many of which are not designated as hedges of specific mortgage loans and, therefore, do not receive fair value or cash flow hedge accounting treatment. The options are marked to market through current earnings. The Bank purchases callable swaps to manage the prepayment risk embedded in the mortgage loans. Although these derivatives are economic hedges against the prepayment risk of the loans, they are not specifically linked to individual loans or liabilities and, therefore, do not receive either fair value or cash flow hedge accounting treatment. The derivatives are marked to market through earnings.

Investments. The Bank invests in both short- and long-term instruments to maintain liquidity and provide additional earnings. The short-term investment portfolio is primarily composed of Federal funds sold, resale agreements, negotiable certificates of deposit (interest-bearing deposits in banks), and commercial paper. In determining the amount of assets to invest in each class of securities, the Bank considers the yield, liquidity, and credit quality of each instrument. The long-term investment portfolio, which is composed of MBS and, to a lesser degree, other housing-related investments, provides the Bank with higher returns than those available in the short-term money markets. Some of the fixed and adjustable rate MBS in which the Bank invests are guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and are collateralized by residential mortgages. The Bank also invests in publicly registered, AAA-rated non-agency MBS that are also collateralized by residential mortgages. In addition, the Bank invests in housing finance agency bonds, all of which are AAA-rated indexed floating rate mortgage revenue bonds (federally taxable) that are collateralized by pools of residential mortgages. The fixed rate, long-term investments are subject to prepayment risk, and the adjustable rate long-term investments are subject to interest rate cap risk. The Bank has managed these risks by (1) funding the fixed rate MBS with non-callable and callable debt, and (2) purchasing certain investments that are structured with interest rate exchange agreements, creating synthetic, floating rate assets that may have lifetime interest rate caps but do not have periodic interest rate caps. This structure provides the Bank with a relatively stable income stream over a range of interest rates.

In accordance with the provisions of SFAS 133, interest rate exchange agreements associated with held-to-maturity securities are non-hedge qualifying. The transition provisions of SFAS 133 allowed the Bank to transfer any security classified as held-to-maturity to trading (or "held-at-fair-value"). Therefore, the Bank transferred its portfolio of economically hedged MBS to the held-at-fair-value securities category so that fair value gains or losses on the MBS will partly offset the losses or gains on the associated interest rate exchange agreements. During 2002 and 2001, this designation allowed the Bank to mark certain MBS to fair value (for a $22.7 million gain and a $7.7 million gain, respectively) to offset the mark-to-fair value of the associated interest rate exchange agreements (a $26.2 million loss and a $6.6 million loss, respectively), for a net loss of $3.5 million and a net gain of $1.1 million, respectively.

The Bank's MBS portfolio, including MBS held at fair value, increased 16% in 2002, to $16.0 billion, or approximately 281% of capital, at December 31, 2002, from $13.8 billion, or approximately 202% of capital, at December 31, 2001. The Bank took advantage of the surge in MBS supply resulting from the increase in mortgage refinancings to increase its MBS portfolio in 2002. The increase in the MBS portfolio and the decline in member capital resulted in balances slightly below the maximum authorized level of 300% of capital.

The Bank's total non-MBS investment portfolio decreased to $17.7 billion as of December 31, 2002, from $18.4 billion as of December 31, 2001. Interest-bearing deposits in banks increased $0.3 billion, resale agreements increased $2.3 billion, and housing finance agency bonds increased $0.3 billion, while Federal funds sold decreased $2.4 billion and commercial paper decreased $1.2 billion.

Borrowings. The Bank funds its assets through the use of FHLBank consolidated obligation bonds and discount notes, which are the joint and several obligations of the 12 FHLBanks. These instruments financed 92% and 93% of the Bank's average total assets in 2002 and 2001, respectively. Consolidated obligation bonds are long-term, while discount notes are short-term instruments. The Bank uses interest rate exchange agreements to change the effective interest rate terms on many of its consolidated obligation bonds and discount notes to better match the interest rate terms of the Bank's assets.

Consistent with the decline in the Bank's total assets, total consolidated obligations outstanding decreased $17.7 billion, or 14%, in 2002, to $108.3 billion at December 31, 2002, from $126.0 billion at December 31, 2001. Average consolidated obligations in 2002 were $115.6 billion, 11% below the $129.2 billion average in 2001, consistent with the trend for average advances noted above. Consolidated obligations outstanding at December 31, 2002 and 2001, included fair value adjustments of $1.1 billion and $0.9 billion, respectively.

To meet the specific needs of certain investors, fixed and adjustable rate consolidated obligation bonds may contain embedded call options or other features that result in complex coupon payment terms. When such consolidated obligation bonds are issued, the Bank simultaneously enters into interest rate exchange agreements with features that offset the complex features of the bonds and, in effect, convert the bonds to conventional adjustable rate instruments tied to an index, such as the London Interbank Offered Rate (LIBOR). During 2002 and 2001, the Bank used fixed rate callable bonds that were usually offset with interest rate exchange agreements with a call feature mirroring the option embedded in the callable bond. This combined structure enabled the Bank to meet its funding needs at costs not generally attainable solely through the issuance of non-callable debt. The Bank also uses fixed rate callable bonds to finance fixed rate callable advances and fixed rate MBS.

Capital and Capital Ratios. Each member is required to purchase Bank stock based on the amount of either (i) its residential mortgage loans or (ii) its outstanding Bank advances and mortgage loans sold to and held by the Bank. Average capital during 2002 was $6.2 billion, a 6% decrease from $6.5 billion in 2001. This decrease included redemptions of capital stock, which primarily resulted from the Bank's surplus capital stock redemption policy. Surplus capital is defined as any excess stock holdings above 115% of a member's minimum capital stock requirement, generally excluding stock dividends earned and credited for the current year. As advance balances declined in 2002, the minimum capital stock requirements for many members declined as well. In accordance with this policy, the Bank redeemed $1,687.7 million and $363.4 million in surplus capital stock during 2002 and 2001, respectively.

On June 2, 2000, the Finance Board adopted a final rule amending the FHLBanks' leverage limit requirements. Effective July 1, 2000, each FHLBank's leverage limit is based on a ratio of assets to capital, rather than a ratio of liabilities to capital. The final rule generally limits each FHLBank's assets to no more than 21 times capital unless the FHLBank has non-mortgage assets, after deducting deposits and capital, that do not exceed 11% of its assets. In that case, the FHLBank's total assets cannot exceed 25 times its capital. As of December 31, 2002 and 2001, the Bank's total assets to capital and non-mortgage assets to total assets ratios were 20.4x and 9.8%, and 19.9x and 8.1%, respectively. The Bank's advances and mortgage-related assets averaged 17.3 times capital and 18.4 times capital in 2002 and 2001, respectively. In addition, the Bank's non-mortgage investments and other non-interest-bearing, non-mortgage assets averaged 3.0 times capital and 2.9 times capital in 2002 and 2001, respectively. The Bank's average ratio of total assets to capital was 20.3x in 2002 compared to 21.3x in 2001. The 11%-of-assets limit that applies to non-mortgage assets when total assets exceed 21 times capital has not restricted the Bank's ability to maintain the target amount of liquid investments necessary to meet its operating needs and the credit needs of members.

The GLB Act imposes new minimum leverage and risk-based capital requirements on the 12 FHLBanks and requires each FHLBank to implement a new capital structure to replace the current structure. The Bank's capital plan was approved by the Bank's Board of Directors on May 31, 2002, and approved by the Finance Board on June 12, 2002. The plan may be amended by the Bank's Board of Directors with the approval of the Finance Board. The plan provides that it will be implemented by the Bank within the three-year period following Finance Board approval. The Board of Directors will consider implementing the plan in 2003 or early in 2004. Until the Bank fully implements its capital plan, the existing capital requirements will remain in effect. (See "Recent Developments" on page 31.)

Letters of Credit. The Bank issues standby letters of credit on behalf of members to support their obligations to third parties. The contractual amounts of letters of credit are not recorded as assets or liabilities on the balance sheet. The amounts outstanding as of December 31, 2002 and 2001, were $1.4 billion and $0.8 billion, respectively. The fees earned by the Bank in connection with letters of credit are recorded as other income when received.

Interest Rate Exchange Agreements. The Bank enters into various types of transactions that involve interest rate exchange agreements (interest rate swap, cap, and floor agreements) to adjust the interest rate sensitivity of consolidated obligations to more closely approximate the interest rate sensitivity of assets (both advances and investments) or to adjust the interest rate sensitivity of advances or investments to more closely approximate the interest rate sensitivity of liabilities. In addition, the Bank uses interest rate exchange agreements to manage embedded options in assets and liabilities, to hedge the market value of existing assets and liabilities and anticipated transactions, to hedge the prepayment risk of prepayable instruments, and to reduce funding costs. The Bank also provides a variety of products to meet the specific needs of members. Because the financial characteristics of many of these products may not be consistent with the Bank's desired interest rate risk profile, the Bank uses interest rate exchange agreements to modify the financial characteristics of its products to meet the Bank's specific interest rate risk objectives. These instruments are generally negotiated, with terms tailored to meet the specific needs of the Bank and the member. The Bank may also act as an intermediary between members and third parties for interest rate exchange agreement transactions.

Interest income and expense from interest rate exchange agreements used for risk management purposes are recorded with interest on the associated instrument whether or not the transactions qualify for hedge accounting treatment under SFAS 133. Interest income and expense from interest rate exchange agreements in which the Bank acts as an intermediary are recorded as other income.

On January 1, 2001, the Bank adopted SFAS 133, which requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on derivative instruments that are designated as cash flow hedges are reported in other comprehensive income and will be recognized as earnings in the periods in which earnings are affected by the cash flows of the hedged items. The ineffective portion of all hedges is recognized in current period earnings.

The following table categorizes the notional amounts and estimated fair values of the Bank's interest rate exchange agreements, excluding accrued interest, and related hedged items by product and type of accounting treatment as of December 31, 2002 and 2001. The categories "Fair value" and "Cash flow" represent hedges that qualify for hedge accounting in accordance with SFAS 133. The category "Economic" represents hedge strategies that do not qualify for hedge accounting under the rules of SFAS 133, but are acceptable hedging strategies under the Bank's risk management program.

SUMMARY OF DERIVATIVES AND HEDGED ITEMS

AT DECEMBER 31, 2002

(IN THOUSANDS)	NOTIONAL AMOUNT	ESTIMATED FAIR VALUE GAIN/(LOSS)	HEDGED ITEM FAIR VALUE GAIN/(LOSS)	NET GAIN/(LOSS)
Advances:				
Fair value	$ 36,119,097	$ (987,821)	$ 983,956	$ (3,865)
Economic	1,225,600	(99)	—	(99)
Total associated with advances	37,344,697	(987,920)	983,956	(3,964)
Held-at-fair-value securities:				
Economic	491,104	(41,798)	37,532	(4,266)
Bonds:				
Fair value	61,154,397	1,090,957	(1,071,502)	19,455
Cash flow	155,000	(1,652)	—	(1,652)
Economic	22,507,900	33,549	(29,924)	3,625
Total associated with bonds	83,817,297	1,122,854	(1,101,426)	21,428
Discount notes:				
Fair value	1,992,000	870	(870)	—
Economic	100,000	(967)	—	(967)
Total associated with discount notes	2,092,000	(97)	(870)	(967)
Intermediated:				
Economic	904,200	291	—	291
Total	$124,649,298	93,330	$ (80,808)	$12,522
Accrued interest		79,539		
Net Interest Rate Exchange Agreements		$ 172,869		
Derivative assets		$ 518,734		
Derivative liabilities		(345,865)		
Net Interest Rate Exchange Agreements		$ 172,869		

AT DECEMBER 31, 2001

(IN THOUSANDS)	NOTIONAL AMOUNT	ESTIMATED FAIR VALUE GAIN/(LOSS)	HEDGED ITEM FAIR VALUE GAIN/(LOSS)	NET GAIN/(LOSS)
Advances:				
Fair value	$ 43,532,034	$ (919,377)	$ 914,278	$ (5,099)
Cash flow	27,000	102	—	102
Economic	1,258,100	(435)	—	(435)
Total associated with advances	44,817,134	(919,710)	914,278	(5,432)
Held-at-fair-value securities:				
Economic	513,084	(15,555)	14,787	(768)
Bonds:				
Fair value	69,986,293	937,789	(878,894)	58,895
Cash flow	—	—	—	—
Economic	25,201,900	13,044	(15,151)	(2,107)
Total associated with bonds	95,188,193	950,833	(894,045)	56,788
Discount notes:				
Fair value	3,382,000	3,887	(3,887)	—
Intermediated:				
Economic	820,200	241	—	241
Total	$144,720,611	19,696	$ 31,133	$50,829
Accrued interest		87,352		
Net Interest Rate Exchange Agreements		$ 107,048		
Derivative assets		$ 479,860		
Derivative liabilities		(372,812)		
Net Interest Rate Exchange Agreements		$ 107,048		

The ongoing impact of SFAS 133 on the Bank cannot be predicted, and the Bank's retained earnings in the future may not be sufficient to offset the impact of SFAS 133. As a result, the effects of SFAS 133 may lead to increased volatility in future earnings and dividends.

SEGMENT INFORMATION

Management analyzes financial performance based on the net interest income of two operating segments: Mortgage-Related Business and Advances-Related Business.

The Mortgage-Related Business consists of MBS investments and mortgage loans acquired through the MPF Program and the consolidated obligations specifically identified as funding those assets. Net interest income for this segment is derived primarily from the difference, or spread, between the yield on the MBS securities and mortgage loans and the cost of the consolidated obligations funding those assets, including the cash flows from associated interest rate exchange agreements, less the provision for credit losses on mortgage loans. Net interest income was $135.3 million in 2002, an increase of $47.9 million, or 55%, from $87.4 million in 2001. The increase was primarily due to higher investment balances and higher spreads. Investment balances grew to $16.2 billion, an increase of $2.5 billion, or 18%, from $13.7 billion. This segment represented 27% and 16% of net interest income for 2002 and 2001, respectively.

The Advances-Related Business consists of all other business activities, including advances and investments other than MBS and the consolidated obligations funding those assets, other borrowings, and member capital. Net interest income for this segment, including the cash flows from associated interest rate exchange agreements, was $360.5 million in 2002, a decrease of $106.4 million, or 23%, from $466.9 million in 2001. This decrease was primarily due to the lower interest rate environment in 2002 relative to 2001 and lower member capital, which resulted in lower earnings on member capital, and to a lesser degree, narrower profit spreads on advances and investments. Balances associated with this segment decreased to $99.9 billion, a decrease of $21.7 billion, or 18%, from $121.6 billion. This segment represented 73% and 84% of net interest income for 2002 and 2001, respectively.

RISK MANAGEMENT

Liquidity. The Bank is required to maintain liquidity in accordance with certain regulations, with the Finance Board's Financial Management Policy, and with the Bank's own liquidity policy. The Bank needs liquidity to satisfy member demand for short- and long-term funds, repay maturing consolidated obligations, and meet other obligations. In their asset/liability management planning, members may look to the Bank to provide standby liquidity. The Bank seeks to be in a position to meet its customers' credit and liquidity needs without maintaining excessive holdings of low-yielding liquid investments or being forced to incur unnecessarily high borrowing costs. The Bank's primary sources of liquidity are short-term investments and the issuance of new consolidated obligation bonds and discount notes. Other short-term borrowings, such as Federal funds purchased, securities sold under agreements to repurchase, and loans from other FHLBanks, also provide liquidity. The Bank maintains contingency liquidity plans designed to enable it to meet its obligations and the liquidity needs of members in the event of operational disruptions at the Bank or the Office of Finance (the FHLBanks' fiscal agent for issuing consolidated obligations) or short-term capital market disruptions.

Interest Rate Risk. The Bank manages the potential effects of interest rate movements on earnings and the market value of equity within prescribed policy limits. The Bank also complies with the duration of equity limits and other limits set forth in the Finance Board's Financial Management Policy.

One measure of interest rate risk is the extent to which the interest rates on the Bank's assets and liabilities reprice at different times. The following table shows the interest rate sensitivity of assets and liabilities by repricing periods. The periodic gaps shown in this table represent the net difference between total asset and liability repricings, including the impact of interest rate exchange agreements, for a specified time period. For example, the periodic gap for the "6 months or less" time period indicates that as of December 31, 2002, there were $4.3 billion more assets than liabilities repricing during the 6-month period beginning on December 31, 2002. As shown in this table, the Bank's repricing gaps, by design, are concentrated in the "6 months or less" category.

INTEREST RATE SENSITIVITY

AS OF DECEMBER 31, 2002	INTEREST RATE SENSITIVITY PERIOD			
(IN MILLIONS)	6 MONTHS OR LESS	6 MONTHS TO 1 YEAR	1 TO 5 YEARS	OVER 5 YEARS
Assets				
Investments	$ 17,771	$ —	$ —	$ —
MBS/Mortgage loans	8,523	2,346	4,244	1,150
Advances	56,113	9,528	12,883	2,713
Other assets	858	—	—	—
Total Assets	83,265	11,874	17,127	3,863
Liabilities				
Consolidated obligations:				
Bonds	40,569	18,560	32,122	4,571
Discount notes	11,276	1,171	—	—
Deposits	407	—	—	—
Other borrowings	525	—	—	—
Other liabilities	1,061	—	—	183
Total Liabilities	53,838	19,731	32,122	4,754
Interest rate exchange agreements	(25,102)	9,214	16,227	(339)
Periodic Gap/Invested Capital	$ 4,325	$ 1,357	$ 1,232	$ (1,230)

The following table shows the estimated percentage change in the market value of equity (the net value of all assets, liabilities, and off-balance sheet items) that would result from a 100-basis-point change in interest rates under different interest rate scenarios. At December 31, 2002, the estimated percentage change in the Bank's market value of equity was

1.9%. If interest rates rose 100 basis points, the Bank's market value of equity would be expected to decline approximately 1.9%, and if interest rates fell 100 basis points, the Bank's market value of equity would be expected to increase approximately 1.9%. If interest rates had been 200 basis points higher at December 31, 2002, a 100-basis-point additional shift in interest rates would be expected to either decrease or increase (depending on the direction of the interest rate movement) the Bank's market value of equity by 2.7%. If interest rates had been 200 basis points lower at December 31, 2002, a 100-basis-point additional shift in interest rates would be expected to alter the Bank's market value of equity by approximately 1.1%.

MARKET VALUE OF EQUITY SENSITIVITY

AS OF DECEMBER 31, 2002

INTEREST RATE SCENARIO	AVERAGE PERCENTAGE CHANGE IN THE MARKET VALUE OF EQUITY PER 100-BASIS-POINT CHANGE IN INTEREST RATES
Actual rates at December 31, 2002	1.9%
Rates start 200 basis points higher	2.7%
Rates start 200 basis points lower	1.1%

The Bank's duration gap, the difference between the duration or market value sensitivity of its assets and liabilities (including the impact of derivatives) was 0.8 months as of December 31, 2002. This low risk profile reflects the Bank's conservative asset-liability mix and its commitment to providing value to its members without subjecting their capital to significant interest rate risk.

The Bank's two business segments have different risk profiles. The Advances-Related Business reflects the Bank's core interest rate risk position from investing 50% of member capital in short-term financial instruments and 50% in a laddered portfolio of financial instruments with maturities of one month to four years. The Mortgage-Related Business segment has a much more complex interest rate risk profile resulting from the prepayment risk of fixed rate MBS investments. These risks are managed primarily by using callable and non-callable bonds. The interest rate risks of both business segments are managed within prescribed policy limits.

Credit Risk. The Bank closely monitors the creditworthiness of the institutions to which it lends funds. The Bank also places great importance on the quality of the assets that are pledged as collateral by its customers. The Bank emphasizes credit monitoring and collateral asset review and valuation to manage the credit risk associated with its lending activities. It also has procedures to assess the mortgage underwriting and documentation standards of its borrowing members. In addition, the Bank has collateral policies and restricted lending procedures in place to manage its exposure to those customers that experience difficulty in meeting their capital requirements or other standards of creditworthiness. The Bank has never experienced any credit losses on credit extended to any member since its inception. Based on the collateral held as security and prior repayment history, no allowance for losses is deemed necessary by management.

The Bank bases the allowance for credit losses in the Bank's mortgage loan portfolio on management's estimate of credit losses inherent in the portfolio as of the balance sheet date. Actual losses greater than defined levels are offset by the member's credit enhancement up to their respective limits. The Bank 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.

The Bank has adopted exposure limits for investments that promote diversification and liquidity. These policies restrict the amounts and terms of the Bank's investment holdings according to the Bank's own capital position as well as the capital and creditworthiness of the counterparty. In addition, the Bank's investments include AAA-rated non-agency MBS; MBS that are guaranteed by government-sponsored enterprises (Fannie Mae, Freddie Mac, and Ginnie Mae); and housing finance agency bonds, which are AAA-rated mortgage revenue bonds (federally taxable) that are collateralized by pools of residential mortgages.

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

Concentration Risk. At December 31, 2002, the Bank had a concentration of advances totaling $58.1 billion outstanding to three members, representing 72% of total advances outstanding (41%, 17%, and 14%, respectively). At December 31, 2001, the Bank had a concentration of advances totaling $79.0 billion outstanding to three members, representing 78% of total advances outstanding (45%, 22%, and 11%, respectively). Of the total capital stock outstanding at December 31, 2002, three members held 38.5 million shares, representing 69% of total capital stock outstanding (38%, 18%, and 13%, respectively). At December 31, 2001, three members held 50.2 million shares, representing 74% of total capital stock outstanding (41%, 22%, and 11%, respectively). The Bank manages concentration risk by, among other things, closely monitoring the credit and collateral quality and financial trends of the institutions to which it lends funds, charging market-based prepayment fees on most advances, and monitoring and managing the risks associated with any potential departure of a large member and the resulting capital redemption.

RECENT DEVELOPMENTS

Multiple Federal Home Loan Bank Memberships. In 2001, the Finance Board published a solicitation of comments addressing the issue of multiple memberships in FHLBanks and the implications for the FHLBank System. The solicitation was prompted by the submission of petitions requesting that the Finance Board permit a single depository institution to become a member of two FHLBanks concurrently. In December 2002, the Finance Board adopted a resolution requesting comments from the FHLBanks concerning FHLBank membership and changes in the financial services industry and indicating that the Finance Board will conduct a public process if it determines that regulatory action is appropriate.

Capital Requirements for FHLBanks. The final capital rule published by the Finance Board to implement a new capital structure for the FHLBanks, as required by the GLB Act, established risk-based and leverage capital requirements for the FHLBanks, addressed different classes of stock that an FHLBank may issue and the rights and preferences that may be associated with each class of stock, and required each FHLBank to submit a capital plan to the Finance Board for approval. The Bank's capital plan was approved by the Bank's Board of Directors on May 31, 2002, and was approved by the Finance Board on June 12, 2002. The plan may be amended by the Bank's Board of Directors with the approval of the Finance Board.

The plan provides that it will be implemented by the Bank within the three-year period following Finance Board approval. The Board of Directors will consider implementing the plan in 2003 or early in 2004. Upon implementation, the Bank will exchange current shares for new shares. Any member that does not wish to participate in the exchange must provide the Bank with a written notice of intention to withdraw from membership as provided in the plan.

When an FHLBank's capital plan has been implemented by the FHLBank, the FHLBank will be subject to risk-based capital rules. Under the Bank's capital plan, the Bank will issue only Class B stock, which has a par value of $100 per share and may be redeemed upon five years' notice, subject to certain conditions. The stock may be issued, exchanged, redeemed, and repurchased only at its stated par value. Only "permanent" capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. In addition, the GLB Act specifies a 5% minimum leverage capital ratio with a 1.5 weighting factor for permanent capital, and a 4% minimum leverage capital ratio without the 1.5 weighting factor.

The statute and regulations require that the minimum stock requirement for members must be sufficient to enable the Bank to meet its own regulatory requirements for total capital, leverage capital, and risk-based capital. Currently, the new capital plan provides for a minimum stock requirement based on a membership stock requirement and an activity-based stock requirement.

The activity-based stock purchase requirement will apply to all outstanding transactions, including those executed before the plan is implemented that are still outstanding when the plan becomes effective. (This requirement will apply even to members that elect not to continue their membership in the Bank under the new capital plan.) In addition, members that sell loans to the Bank will be required to maintain Bank capital stock in connection with any loans sold to the Bank as long as the Bank retains any interest in the loans, even if the institution ceases to be a member of the Bank.

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

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

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

The GLB Act established voluntary membership for all members. All members may withdraw from membership and redeem their capital stock after giving the required notice. Members that withdraw from membership may not re-apply for membership for five years.

Discussions of Enhanced Financial Disclosures. The FHLBanks, the Finance Board, the Division of Corporation Finance of the Securities and Exchange Commission (SEC), and the U.S. Department of the Treasury are considering the possible expansion of the financial disclosure reporting of the FHLBanks. The Office of Finance prepares the combined financial reports of the FHLBanks, which under current Finance Board regulations generally must be consistent with SEC Regulations S-K and S-X, subject to certain exceptions contained in the Finance Board regulations. Also under current Finance Board regulations, any financial statements contained in an annual or quarterly financial report issued by the FHLBanks must be consistent in both form and content with the combined financial reports prepared by the Office of Finance. Although changes in disclosure requirements for the FHLBanks, if any, have not yet been determined, possible measures range from an enhanced disclosure regime administered by the Finance Board to registration of securities under the Securities Exchange Act of 1934.

COMPARISON OF 2001 TO 2000

Net income was $424.6 million in 2001, compared to $376.6 million in 2000. Net interest income decreased slightly to $554.3 million in 2001 from $554.6 million in 2000 as a result of a 3-basis-point decrease in the net interest margin, partially offset by an $11.0 billion increase in average interest-earning assets outstanding during 2001. The decrease in the net interest margin was primarily due to lower earnings on capital resulting from the significant drop in interest rates during 2001 and, to a lesser degree, narrower profit spreads on advances and investments. The narrower profit spreads were mainly due to the higher cost of discount notes relative to other market interest rates primarily because of an increase in the issuance of similar debt by other federal agencies and the U.S. Department of the Treasury.

Other income increased $74.8 million to $81.5 million in 2001 from $6.7 million in 2000. In 2001, other income consisted primarily of net gains on derivatives and hedging activities of $64.0 million and net gains on held-at-fair-value securities of $7.7 million, both results of the adoption of SFAS 133. In addition, prepayment fees increased $5.6 million in 2001 as members prepaid $1.9 billion of advances in 2001, compared to $0.9 billion in 2000.

Other expenses increased to $55.5 million in 2001 from $48.7 million in 2000, primarily as a result of a $6.0 million increase in operating expenses. While operating expenses increased 14% in 2001, average assets increased only 8%, leading to a slight increase in the Bank's ratio of operating expenses to average assets from 3.3 basis points in 2000 to 3.5 basis points in 2001.

The Bank's total REFCORP and AHP assessments equaled $153.3 million in 2001 and $136.0 million in 2000. These amounts reflect the Bank's effective "tax" rate on income of 27%. The Bank set aside $47.2 million for the AHP in 2001, compared to $41.8 million in 2000. The increase in the AHP assessment reflected higher earnings in 2001.

Adjusted net income decreased 1%, to $375.9 million in 2001 from $381.4 million in 2000, reflecting lower earnings in invested member capital resulting from the significant drop in interest rates during 2001.

In 2001, the Bank paid a total of $386.6 million in dividends, an average annual rate of 5.99%. In 2000, dividends totaled $416.3 million and the average annual rate was 7.17%. The decline in the dividend rate was primarily attributable to lower earnings on invested member capital and to supplemental payouts of retained earnings totaling $36.9 million in 2000. All dividends except fractional shares were paid in the form of capital stock.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Accounting for Derivatives. SFAS 133 requires that all derivatives be recorded on the statement of condition at their fair values. Changes in the fair value of derivatives are recorded each period in current period earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on derivative instruments that are designated as cash flow hedges and reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. 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 from the variability in the cash flows of the forecasted transaction) is recorded in current period earnings. For a derivative designated as a fair-value hedge, the transition adjustment for the derivative was reported as a cumulative effect adjustment of net income in 2001. Concurrently, any fair value gain or loss on the hedged instrument was recognized as an adjustment of the hedged item's carrying amount, but only to the extent of the offsetting transition adjustment of the derivative, and was also reported as a cumulative effect adjustment of net income in 2001. Changes in the fair value of a non-SFAS 133 hedge of an asset or liability (economic hedge) for asset-liability management are recorded in current period earnings. As discussed in more detail below, the adoption of SFAS 133 has led to volatility in the statement of income because of changes in market prices and interest rates. The transition provisions of SFAS 133 also provide that at the date of initial application an entity may transfer any security classified as "held-to-maturity" to "available- for-sale" or "trading" (herein referred to as held-at-fair-value securities), and any security classified as "available-for-sale" to "trading" (held-at-fair-value securities).

By regulation, derivatives are only permitted to be used by an FHLBank in order to mitigate identifiable risks. All of the Bank's derivatives are positioned to offset some or all of the risk exposure inherent in its member lending, investment, and funding activities. Under SFAS 133, the Bank is required to recognize unrealized losses or gains on derivative positions regardless of whether offsetting gains or losses on the underlying assets or liabilities being hedged are permitted to be recognized in a symmetrical manner. Therefore, the new accounting framework imposed by SFAS 133 introduces the potential for a considerable mismatch between the timing of income and expense recognition from assets or liabilities and the income effects of hedge instruments positioned to mitigate market risk and cash flow variability. As a result, during periods of significant changes in interest rates, the Bank's reported GAAP earnings may exhibit considerably greater variability than in years prior to 2001. The Bank has generally continued its practice of utilizing the most cost-efficient hedging techniques available, viewing the resulting accounting consequences to be an important but secondary consideration. The Bank anticipates that this approach will result in enhanced long-term performance at the expense of increased variability in earnings as reported under the new requirements of SFAS 133. Given that the Bank manages derivatives with primary emphasis on economic cost-effectiveness as opposed to evenness of accounting results, the adoption of SFAS 133 has led to more volatility in the reported earnings for the Bank because of changes in market prices and interest rates.

Fair Values. At December 31, 2002, certain of the Bank's assets and liabilities, including investments classified as held-at-fair-value securities and all derivatives and associated hedged items accounted for in accordance with SFAS 133, are presented in the statement of condition at fair value. Many of these financial instruments lack an available liquid trading market as characterized by frequent transactions between a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant assumptions and present value calculations have been used by the Bank for the purpose of determining estimated fair values. Changes in these assumptions and calculations could significantly affect the Bank's financial position and results of operations. Thus, the fair values may not represent the actual values of the financial instruments that could have been realized as of yearend or that will be realized in the future. The Bank continually refines its assumptions and present value calculations to better reflect market indications.

Management also estimates the fair value of the collateral that members pledge against advance borrowings to confirm that the Bank has sufficient collateral to protect it from loss. Based on the collateral valuations and the credit evaluation of borrowing members, management has determined that an allowance for advance losses is not warranted.

Carrying value is assumed to approximate fair value for financial instruments with three months or less to repricing or maturity. Fair values are based on quoted prices, market rates, or replacement rates for similar financial instruments as of the last business day of the year.

Consolidated Obligations. The Bank does not recognize a liability for its joint and several obligation related to the other FHLBanks' consolidated obligations. Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated bonds and discount notes. Accordingly, should one or more of the FHLBanks be unable to repay their participation in the consolidated obligations, each of the other FHLBanks could be called upon to repay all or part of such obligations, as determined or approved by the Finance Board. No liability is recorded for the joint and several obligation related to the other FHLBanks' consolidated obligations under FIN 45 because of the high credit quality of each FHLBank and the remote possibility that an FHLBank would be unable to repay its participation.

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

FINANCIAL STATEMENTS

The management of the Federal Home Loan Bank of San Francisco (Bank) prepared the financial statements contained in the Annual Report in accordance with generally accepted accounting principles. Management has primary responsibility for the integrity and objectivity of the financial statements, which include amounts that are based on management's best estimates and judgments. Other information in the Annual Report is consistent with that contained in the financial statements.

The Bank's financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants. Management has made available to PricewaterhouseCoopers LLP all the Bank's financial records and related data, as well as the minutes of the meetings of the Bank's Board of Directors. The report of the independent accountants expresses an opinion as to the fairness of the financial position and results of operations of the Bank based on their audit conducted in accordance with generally accepted auditing standards.

INTERNAL CONTROL SYSTEMS

In meeting its responsibility for the integrity and objectivity of the financial statements, management of the Bank has established and relies upon a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. The system of internal controls provides for appropriate division of responsibility and is documented by written policies and procedures that are communicated to employees with significant roles in the financial reporting process. Management monitors the system of internal controls for compliance, adequacy, and cost-effectiveness. Management believes that as of December 31, 2002, the Bank's system of internal controls was adequate to accomplish the objectives discussed herein.

The Bank maintains an internal auditing program and the Federal Housing Finance Board performs an examination function that independently assess the effectiveness of the Bank's internal controls and recommend possible improvements thereto. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The Audit Committee of the Board of Directors is composed of independent directors and oversees the Bank's financial reporting and system of internal controls. In addition to meeting regularly with the Bank's management, the Committee met with the Bank's Director of Internal Audit, Federal Housing Finance Board examiners, and independent accountants, without management present, to discuss the results of their audits, their evaluations of the system of internal controls, and the overall quality of the Bank's financial reporting.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system can change with circumstances.

The Bank assesses its internal control system in relation to, among other things, criteria for effective internal control over financial reporting described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the Bank believes that, as of December 31, 2002, its system of internal controls over financial reporting met those criteria.

CODE OF CONDUCT

Management also recognizes its responsibility for fostering a strong ethical climate so that the Bank's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the Bank's code of corporate conduct, which is communicated to employees.

Dean Schultz
President and Chief Executive Officer

Ross Kari
Executive Vice President and Chief Operating Officer

Steven T. Honda
Senior Vice President and Chief Financial Officer

Vera Maytum
Senior Vice President and Controller

February 21, 2003

The Audit Committee of the Board of Directors of the Federal Home Loan Bank of San Francisco (Bank) for 2003 is currently composed of seven directors, two of whom were appointed to the Board by the Federal Housing Finance Board and five of whom were elected to the Board by the members of the Bank. The Finance Board has appointed two new members to the Board of Directors and is expected to appoint one more, and two of these appointed members will also be appointed to serve on the Audit Committee.

The Audit Committee oversees the Bank's financial reporting process; reviews the programs and policies of the Bank designed to ensure compliance with applicable laws, regulations, and policies and monitors the results of these compliance efforts; and advises and assists the Board in fulfilling its oversight responsibilities relating to risk management, internal controls, the accounting policies and financial reporting and disclosure practices of the Bank, and the audit and examination of the Bank.

The Audit Committee has reviewed and discussed the audited financial statements with management. The Committee has discussed with the independent auditor the matters required to be discussed by Statement on Auditing Standards (SAS) No. 61, *Communications with Audit Committees,* and SAS No. 90, *Audit Committee Communications.* The Committee has also received the written disclosures and the letter from the independent auditor required by Independent Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, and has discussed the auditor's independence with the auditor.

Based on the review and discussions referred to above, the Audit Committee recommends to the Board of Directors that the financial statements be included in the Annual Report.

Rick McGill, Chairman

Robert N. Barone

Craig G. Blunden

Kenneth R. Harder

Frank P. Pekny

Scott C. Syphax

David T. C. Wright

February 21, 2003

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

In our opinion, the accompanying statements of condition and the related statements of income, capital, and cash flows present fairly, in all material respects, the financial position of the Federal Home Loan Bank of San Francisco (Bank) at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Bank'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 auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the 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. Also, in accordance with those standards and as part of our audit of the Bank's financial statements, we issued a separate report on compliance and on internal control over financial reporting. 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.

As discussed in Note 2, the FHLBank adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended by Statement of Financial Accounting Standards No. 138, on January 1, 2001.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
San Francisco, California

February 21, 2003

Statements of Condition

(IN THOUSANDS-EXCEPT PAR VALUE)	DECEMBER 31, 2002	DECEMBER 31, 2001
ASSETS		
Cash and due from banks	$ 8,759	$ 1,889
Deposits for mortgage loan program with other Federal Home Loan Bank	58,113	—
Interest-bearing deposits in banks	4,834,000	4,487,000
Securities purchased under agreements to resell	4,400,000	2,150,000
Federal funds sold	6,068,000	8,445,000
Held-to-maturity securities ($250,007, $1,222,976, respectively, were pledged as collateral)	17,878,844	16,543,889
Held-at-fair-value securities ($0, $226,461, respectively, were pledged as collateral)	533,090	527,870
Advances	81,237,041	102,254,552
Mortgage loans, net of allowance for credit losses on mortgage loans of $180	262,426	—
Loans to other Federal Home Loan Banks	—	25,000
Accrued interest receivable	285,055	418,606
Premises and equipment, net	7,343	5,529
Derivative assets	518,734	479,860
Other assets	38,076	44,677
Total Assets	$ 116,129,481	$ 135,383,872
LIABILITIES AND CAPITAL		
Liabilities:		
Deposits:		
Demand and overnight	$ 352,344	$ 443,344
Term	34,510	36,000
Other	19,785	272,273
Total deposits	406,639	751,617
Other borrowings	525,000	200,000
Consolidated obligations, net:		
Bonds	95,821,797	104,684,833
Discount notes	12,446,816	21,283,052
Total consolidated obligations	108,268,613	125,967,885
Accrued interest payable	715,620	1,080,127
Affordable Housing Program	131,706	127,038
Payable to REFCORP	14,012	36,875
Derivative liabilities	345,865	372,812
Other liabilities	37,328	38,054
Total Liabilities	110,444,783	128,574,408
Commitments and Contingencies: Note 19		
Capital:		
Capital stock ($100 par value) issued and outstanding: 55,860 shares in 2002 and 67,519 shares in 2001	5,585,988	6,751,941
Retained earnings	100,978	62,269
Accumulated other comprehensive loss:		
Unrecognized net loss related to hedging activities	(2,268)	(4,746)
Total Capital	5,684,698	6,809,464
Total Liabilities and Capital	$ 116,129,481	$ 135,383,872

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

Statements of Income

(IN THOUSANDS)	2002	2001	2000
	FOR THE YEARS ENDED DECEMBER 31,		
INTEREST INCOME:			
Advances	$ 1,815,439	$ 4,735,896	$ 6,431,349
Interest-bearing deposits in banks	78,309	142,429	131,077
Deposits for mortgage loan program with other Federal Home Loan Bank	59	—	—
Securities purchased under agreements to resell	47,853	63,861	93,891
Federal funds sold	119,213	349,341	549,093
Held-to-maturity securities	819,607	828,862	898,047
Held-at-fair-value securities	10,815	27,704	—
Mortgage loans	1,600	—	—
Loans to other Federal Home Loan Banks	250	843	662
Total Interest Income	2,893,145	6,148,936	8,104,119
INTEREST EXPENSE:			
Consolidated obligations	2,389,826	5,578,339	7,523,902
Deposits	7,148	15,994	13,514
Securities sold under agreements to repurchase	—	—	11,887
Borrowings from other Federal Home Loan Banks	68	78	82
Other borrowings	133	218	161
Total Interest Expense	2,397,175	5,594,629	7,549,546
NET INTEREST INCOME BEFORE MORTGAGE LOAN LOSS PROVISION	495,970	554,307	554,573
Provision for credit losses on mortgage loans	180	—	—
NET INTEREST INCOME	495,790	554,307	554,573
OTHER (LOSS)/INCOME:			
Prepayment fees	9,032	5,953	392
Services to members	851	904	899
Net gain on held-at-fair-value securities	22,745	7,653	—
Net (loss)/gain on derivatives and hedging activities	(63,582)	63,951	—
Other, net	3,248	3,061	5,366
Total Other (Loss)/Income	(27,706)	81,522	6,657
OTHER EXPENSE:			
Operating expense	53,561	48,803	42,818
Federal Housing Finance Board	4,596	4,134	3,731
Office of Finance	2,846	2,526	2,102
Arbitration award	9,395	—	—
Total Other Expense	70,398	55,463	48,651
INCOME BEFORE ASSESSMENTS AND CUMULATIVE EFFECT OF ADOPTING SFAS 133	397,686	580,366	512,579
REFCORP assessments	73,045	106,147	94,147
Affordable Housing Program assessments	32,464	47,177	41,843
Total Assessments	105,509	153,324	135,990
INCOME BEFORE CUMULATIVE EFFECT OF ADOPTING SFAS 133	292,177	427,042	376,589
Cumulative effect of adopting SFAS 133	—	(2,453)	—
NET INCOME	$ 292,177	$ 424,589	$ 376,589

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

Statements of Capital Accounts

(IN THOUSANDS)	CAPITAL STOCK SHARES	CAPITAL STOCK PAR VALUE	RETAINED EARNINGS RESTRICTED	RETAINED EARNINGS UNRESTRICTED	RETAINED EARNINGS TOTAL	ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)	TOTAL CAPITAL
Balance, December 31, 1999	53,744	$5,374,359	$ 38,632	$ 25,408	$ 64,040	$ —	$5,438,399
Issuance of capital stock	9,763	976,356					976,356
Redemption of capital stock	(4,991)	(499,141)					(499,141)
Net income				376,589	376,589		376,589
Transfers from restricted retained earnings			(14,453)	14,453	—		—
Dividends on capital stock (7.17%)							
Cash payment				(58)	(58)		(58)
Stock issued	4,163	416,285		(416,285)	(416,285)		—
Balance, December 31, 2000	62,679	6,267,859	24,179	107	24,286	—	6,292,145
Issuance of capital stock	6,655	665,502					665,502
Redemption of capital stock	(5,680)	(567,965)					(567,965)
Comprehensive income:							
Net income				424,589	424,589		424,589
Other comprehensive income:							
Cumulative effect of adopting SFAS 133						(17,065)	(17,065)
Net amounts recognized as earnings						12,217	12,217
Net change in period relating to hedging activities						102	102
Total comprehensive income							419,843
Transfers to restricted retained earnings			38,015	(38,015)	—		—
Dividends on capital stock (5.99%)							
Cash payment				(61)	(61)		(61)
Stock issued	3,865	386,545		(386,545)	(386,545)		—
Balance, December 31, 2001	67,519	6,751,941	62,194	75	62,269	(4,746)	6,809,464
Issuance of capital stock	5,025	502,535					502,535
Redemption of capital stock	(19,219)	(1,921,905)					(1,921,905)
Comprehensive income:							
Net income				292,177	292,177		292,177
Other comprehensive income:							
Net amounts recognized as earnings						4,189	4,189
Net change in period relating to hedging activities						(1,711)	(1,711)
Total comprehensive income							294,655
Transfers from restricted retained earnings			(36,710)	36,710	—		—
Dividends on capital stock (5.50%)							
Cash payment				(51)	(51)		(51)
Stock issued	2,534	253,417		(253,417)	(253,417)		—
Balance, December 31, 2002	55,859	$5,585,988	$ 25,484	$ 75,494	$ 100,978	$(2,268)	$5,684,698

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

Statements of Cash Flows

(IN THOUSANDS)	2002	2001	2000
	FOR THE YEARS ENDED DECEMBER 31,		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	$ 292,177	$ 424,589	$ 376,589
Cumulative effect of adopting SFAS 133	—	2,453	—
Income before cumulative effect of adopting SFAS 133	292,177	427,042	376,589
Adjustments to reconcile net income before cumulative effect of adopting SFAS 133 to net cash provided by operating activities:			
Depreciation and amortization:			
Net discounts on consolidated obligations and investments	(117,013)	(422,974)	(112,954)
Net premiums on mortgage loans	128	—	—
Concessions on consolidated obligations	45,096	50,326	14,032
Bank premises and equipment	1,694	1,602	1,163
Deferred net losses on interest rate exchange agreements	2,208	9,712	13,830
Provision for credit losses on mortgage loans	180	—	—
Increase in Affordable Housing Program (AHP) liability and discount on AHP advances	4,527	17,260	18,493
(Decrease)/increase in REFCORP liability	(22,863)	11,560	14,131
Gain on non-monetary transfer of advances	—	—	(443)
Loss/(gain) due to change in net fair value adjustment on derivative and hedging activities	59,296	(45,527)	—
Increase in held-at-fair-value securities, net of transfers and transition adjustments	(22,745)	(7,653)	—
Decrease/(increase) in derivative asset accrued interest	119,925	(231,041)	—
(Decrease)/increase in derivative liability accrued interest	(112,676)	143,690	—
Decrease/(increase) in accrued interest receivable	133,551	2,718,170	(1,037,154)
(Decrease)/increase in accrued interest payable	(364,507)	(2,808,127)	1,281,713
Decrease/(increase) in other assets	2,923	(2,555)	(54)
(Decrease)/increase in other liabilities	(1,120)	2,287	915
Total adjustments	(271,396)	(563,270)	193,672
Net cash provided by/(used in) operating activities	20,781	(136,228)	570,261
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net increase in interest-bearing deposits in banks	(347,000)	(1,789,000)	(996,000)
Net decrease/(increase) in Federal funds sold	2,377,000	(69,000)	260,000
Net (increase)/decrease in securities purchased under agreements to resell	(2,250,000)	(1,750,000)	2,158,885
Net decrease/(increase) in short-term held-to-maturity securities	934,907	1,593,196	(1,129,643)
Purchases of mortgage-backed securities	(10,383,477)	(7,907,250)	(5,555,607)
Maturities of mortgage-backed securities	8,181,738	4,922,365	1,843,641
Principal collected on advances	353,940,025	343,437,997	316,900,500
Advances made	(332,850,038)	(334,746,482)	(336,419,740)
Principal collected on mortgage loans	3,057	—	—
Purchases of mortgage loans	(265,791)	—	—
Net increase in deposits for mortgage loan program with other Federal Home Loan Bank	(58,113)	—	—
Net decrease/(increase) in loans to other Federal Home Loan Banks	25,000	(25,000)	—
Net increase to premises and equipment	(3,508)	(2,805)	(1,165)
Net cash provided by/(used in) investing activities	19,303,800	3,664,021	(22,939,129)

Statements of Cash Flows

(IN THOUSANDS)	FOR THE YEARS ENDED DECEMBER 31, 2002	2001	2000
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease)/increase in deposits	(344,978)	375,204	49,460
Net increase in other borrowings	325,000	200,000	—
Net proceeds from sale of consolidated obligations:			
Bonds	71,761,000	92,897,300	54,749,561
Discount notes	96,800,665	196,443,370	252,743,176
Payments for maturing and retiring consolidated obligations:			
Bonds	(80,889,105)	(86,604,445)	(34,167,370)
Discount notes	(105,550,872)	(206,939,393)	(251,479,956)
Proceeds from issuance of capital stock	502,535	665,502	976,356
Payments for redemption of capital stock	(1,921,905)	(567,965)	(499,141)
Cash dividends paid	(51)	(61)	(58)
Net cash (used in)/provided by financing activities	(19,317,711)	(3,530,488)	22,372,028
Net increase/(decrease) in cash and cash equivalents	6,870	(2,695)	3,160
Cash and cash equivalents at beginning of year	1,889	4,584	1,424
Cash and cash equivalents at end of year	$ 8,759	$ 1,889	$ 4,584
SUPPLEMENTAL DISCLOSURES:			
Interest paid during the year	$ 2,164,114	$ 7,134,631	$ 6,197,314
Stock dividends issued during the year	$ 253,417	$ 386,545	$ 416,285
Non-monetary transfer of advances	$ —	$ —	$ 180,000

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

YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(DOLLARS IN THOUSANDS)

BACKGROUND INFORMATION

The Federal Home Loan Bank of San Francisco (Bank), a federally chartered corporation exempt from ordinary federal, state, and local taxation except real property taxes, is one of 12 District Federal Home Loan Banks (FHLBanks). The FHLBanks serve the public by enhancing the availability of credit for residential mortgages and targeted community development by providing a readily available, low-cost source of funds to their member institutions. Each FHLBank is operated as a separate entity with its own management, employees, and board of directors. The Bank does not have any special purpose entities or any other type of off-balance sheet conduits. The Bank is a cooperative whose member institutions own the capital stock of the Bank and receive dividends on their investments. Regulated financial depositories and insurance companies engaged in residential housing finance and community financial institutions are eligible to apply for membership. Community financial institutions are defined for 2002 as FDIC-insured depository institutions with average total assets over the preceding three-year period of $527 million or less. All members are required to purchase stock in the Bank.

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

A primary source of funds for the FHLBanks is the proceeds from the sale to the public of the FHLBanks' debt instruments (consolidated obligations), which are the joint and several obligations of all FHLBanks that are sold to the public through the Office of Finance. Other funds are provided by deposits, other borrowings, and the issuance of capital stock to members.

In accordance with the Finance Board's regulations, the Bank has established a formal policy governing the compensation and expense reimbursement provided to its directors. Directors are compensated based on the level of responsibility assumed. Fees are paid for attendance at certain meetings. Directors are also reimbursed for reasonable and necessary Bank-related travel, subsistence, and other related expenses under a policy similar to the Bank's travel policy for employees. During 2002, meeting fees totaled $217 and reimbursed travel and related expenses totaled $149.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

In addition, the Bank adjusted the carrying value of these investments for the unamortized costs and deferred gains and losses from associated interest rate exchange agreements for periods prior to the adoption of Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of Effective Date of FASB Statement No. 133*, and as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* (together referred to as "SFAS 133"). As more fully discussed in Note 2, on January 1, 2001, the Bank transferred certain held-to-maturity securities to "trading" ("held-at-fair-value securities" for the Bank's purposes) as allowed under the transition provisions contained in SFAS 133. Held-at-fair-value securities are carried at fair value based on quoted prices, market rates, or replacement rates for similar financial instruments. The Bank records changes in the fair value of the investments through other income.

The Bank treats resale agreements as collateralized investments.

Advances. The Bank presents advances, net of unearned fees and advances for the Affordable Housing Program (AHP) net of discounts, as discussed below. In addition, prior to the adoption of SFAS 133 in 2001, the Bank adjusted the carrying value of advances for the unamortized balance of deferred net gains and losses from associated interest rate exchange agreements. Interest on advances is credited to income as earned. Following the requirements of the Federal Home Loan Bank Act of 1932, as amended (FHLB Act), the Bank obtains sufficient collateral for advances to protect the Bank from losses. The FHLB Act limits eligible collateral to secure advances to certain investment securities, residential mortgage loans, cash or deposits with the Bank, and other eligible real estate-related assets. As more fully discussed in Note 7, the Bank may also accept secured small business, small farm, and small agribusiness loans as collateral from members that are community financial institutions (CFIs). The Bank has never experienced any credit losses on advances. Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no allowance for losses on advances is deemed necessary by management.

Mortgage Loans. The Bank is participating in the Mortgage Partnership Finance® (MPF®) Program, under which the Bank purchases mortgage loans from its participating members. ("Mortgage Partnership Finance" and "MPF" are registered trademarks of the Federal Home Loan Bank of Chicago.) The Bank manages the liquidity, interest rate, and options risk of the loans, while the member retains the marketing and servicing activities. The Bank and the member share in the credit risk of the loans as specified in the master agreement.

The Bank classifies mortgage loans as held for investment and, accordingly, reports them at their principal amount outstanding net of premiums and discounts.

The Bank defers and amortizes premiums and discounts as interest income over the average life of the related mortgage loan. Actual prepayment experience and estimates of future principal prepayments are used in calculating the average lives of the mortgage loans. The Bank aggregates the mortgage loans by similar characteristics (type, maturity, and acquisition date) in determining prepayment estimates.

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

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

The Bank bases the allowance for credit losses on management's estimate of credit losses inherent in the Bank's mortgage loan portfolio as of the balance sheet date. Actual losses greater than defined levels are offset by the members' credit enhancement up to their respective limits. The Bank 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.

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

Prepayment Fees. The Bank charges its members a prepayment fee when certain advances are paid prior to original maturity. The Bank credits prepayment fees to other income. Prior to 2001, the Bank netted gains or losses on interest rate exchange agreements associated with prepaid advances with prepayment fees in other income.

Other Fees. Other fees for advances are deferred and amortized to interest income using the straight-line method. The Bank defers refundable fees until the commitment expires or until the advance is funded if material. Issuance fees for letters of credit are recorded as other income when received.

Derivatives. All derivatives are recognized on the balance sheet at their fair value, and those not used for intermediary purposes are designated as (1) a hedge of the fair value of (a) a recognized asset or liability or (b) an unrecognized firm commitment (a "fair value" hedge); (2) a hedge of (a) a forecasted transaction or (b) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a "cash flow" hedge); or (3) a non-SFAS 133-qualifying hedge of an asset or liability (an "economic" hedge) for asset-liability management purposes. Changes in the fair value of a derivative that is effective as and is designated and qualifies as a fair value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk (including changes that reflect losses or gains on firm commitments), are recorded in current period earnings. Changes in the fair value of a derivative that is effective as and is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, a component of capital, until earnings are affected by the variability of the cash flows of the hedged transaction (i.e., until periodic settlements of a variable-rate asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the change in the fair value of the derivative differs from the change in the fair value of the hedged item or the variability in the cash flows of the forecasted transaction) is recorded in current period earnings. Changes in the fair value of a stand-alone derivative designated as an economic hedge are recorded in current period earnings with no fair value adjustment to an asset or liability. Hedge ineffectiveness and changes in the fair value of stand-alone derivatives are recorded in other income as "Net gain/(loss) on derivatives and hedging activities."

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

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

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

When hedge accounting is discontinued because the Bank determines that the derivative no longer qualifies as an effective fair value hedge, the Bank will continue to carry the derivative on the balance sheet at its fair value, cease to adjust the hedged asset or liability for changes in fair value, and begin amortizing the cumulative basis adjustment on the hedged item into earnings over the remaining life of the hedged item. When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Bank will continue to carry the derivative on the balance sheet at its fair value, removing from the balance sheet any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current period earnings. When the Bank discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is recognized as earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within two months thereafter, the gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings. When hedge accounting is discontinued because the Bank determines that the derivative no longer qualifies as an effective cash flow hedge of an existing hedged item, the Bank will continue to carry the derivative on the balance sheet at its fair value and will amortize the cumulative other comprehensive income adjustment to earnings when earnings are affected by the original forecasted transaction. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value of the derivative in current period earnings.

Derivative assets and liabilities, comprising derivative fair values and related net accrued interest, are reported on a net-by-counterparty basis on the Statements of Condition provided that a legal right of setoff exists under an enforceable netting agreement. Prior to January 1, 2001, the date of the adoption of SFAS 133 and Financial Accounting Standards Board Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts* (FIN 39), accrued interest receivable and payable on interest rate exchange agreements were reported on a gross basis.

Hedging Activities.

General – The Bank enters into interest rate swaps, swaptions, cap and floor agreements, calls, and puts (collectively, interest rate exchange agreements) to manage its exposure to changes in interest rates. These interest rate exchange agreements, when linked with a designated financial instrument, effectively alter the financial characteristics of the designated instrument. They may adjust the effective maturity, repricing frequency, or option characteristics of financial instruments to achieve risk management objectives. The Bank uses interest rate exchange agreements in three ways: as a fair value or cash flow hedge of an underlying financial instrument or a forecasted transaction, as an economic hedge for general asset and liability management (a non-SFAS 133 economic hedge), or when acting as an intermediary. For example, the Bank uses interest rate exchange agreements in its overall management of interest rate risk to adjust the interest rate sensitivity of consolidated obligations to approximate more closely the interest rate sensitivity of assets (advances and investments), and/or to adjust the interest rate sensitivity of advances or investments to approximate more closely the interest rate sensitivity of liabilities. In addition to using interest rate exchange agreements to manage mismatches of interest rates between assets and liabilities, the Bank also uses interest rate exchange agreements to manage embedded options in assets and liabilities, to hedge the market value of existing assets and liabilities and anticipated transactions, to hedge the prepayment risk of prepayable instruments, and to reduce funding costs.

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

The Bank is not a derivatives dealer and does not trade derivatives for profit.

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

Investments – The Bank may invest in U.S. agency securities, mortgage-backed securities and the taxable portion of state or local housing finance agency securities. The interest rate and prepayment risk associated with these investment securities is managed through a combination of debt issuance and derivatives. The Bank may manage prepayment and duration risk by funding investment securities with consolidated obligations that have call features or by adjusting the duration of the securities by using interest rate exchange agreements to modify the cash flows of the securities. These securities may be classified as held-to-maturity or held-at-fair-value.

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

Advances – With the issuance of a putable advance, the Bank purchases from the member a put option that enables the Bank to convert the advance from fixed rate to floating rate or to terminate the advance and extend replacement credit on new terms, at the Bank's option, on specified put dates. The Bank may hedge a putable advance by entering into a cancelable interest rate exchange agreement under which the Bank pays a fixed rate and receives a variable rate. This type of hedge is treated as a fair value hedge under SFAS 133. The swap counterparty can cancel the interest rate exchange agreement on the put date, which would normally occur in a rising rate environment, and the Bank can convert the advance to a floating rate advance or terminate it, depending on the terms of the advance.

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

Mortgage Loans – The Bank invests in mortgage assets. The prepayment options embedded in mortgage assets can result in extensions or contractions in the expected maturities of these investments, depending on changes in estimated prepayment speeds. The Finance Board's Financial Management Policy limits this source of interest rate risk by restricting the types of mortgage assets the Bank may own to those with limited average life changes under certain interest rate shock scenarios and establishing limitations on duration of equity and changes to market value of equity. The Bank manages the interest rate and prepayment risk associated with mortgages through a combination of debt issuance and derivatives. The Bank issues both callable and non-callable debt to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans. Net income could be reduced if the Bank replaces the mortgages with lower-yielding assets and the Bank's higher funding costs are not reduced accordingly.

Options may also be used to hedge prepayment risk on the mortgages, many of which are not designated as hedges of specific mortgages and, therefore, do not receive fair value or cash flow hedge accounting treatment. The options are marked to market through current earnings. The Bank purchases callable swaps to minimize the prepayment risk embedded in the mortgage loans. Although these derivatives are economic hedges against the prepayment risk of the loans, they are not specifically linked to individual loans or liabilities and, therefore, do not receive either fair value or cash flow hedge accounting treatment. The derivatives are marked to market through earnings.

The Bank analyzes the duration, convexity, and earnings risk of the mortgage portfolio on a regular basis under various interest rate scenarios.

Consolidated Obligations – The Bank manages the risk arising from changing market prices and the volatility of a consolidated obligation by matching the cash inflow on the interest rate exchange agreement with the cash outflow on the consolidated obligation. In addition, the Bank requires collateral agreements on all interest rate exchange agreements. While consolidated obligations are the joint and several obligations of the FHLBanks, FHLBanks individually are counterparties to interest rate exchange agreements associated with specific debt issues.

In a typical transaction, fixed rate consolidated obligations are issued with proceeds distributed to one or more FHLBanks, and each of those FHLBanks simultaneously enters into a matching interest rate exchange agreement in which the counterparty pays fixed cash flows to the FHLBank designed to closely match in timing and amount the cash outflows the FHLBank pays on the consolidated obligation. Such transactions are treated as fair value hedges under SFAS 133. In this typical transaction, the Bank pays a variable cash flow that closely matches the interest payments it receives on short-term or variable-rate advances. This intermediation between the capital and swap markets permits the Bank 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.

Firm Commitments – The Bank may hedge the market value of purchase commitments on fixed rate mortgage loans by using derivatives that would have similar market value characteristics. The Bank may hedge these commitments by selling mortgage-backed securities to be announced (TBA MBS) or other derivatives for forward settlement. When the derivative settles, the current market value of the commitments is included with the basis of the mortgage loans and amortized accordingly. This transaction would be treated as a fair value hedge.

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

Anticipated Debt Issuance – The Bank may enter into swaps for the anticipated issuance of debt to lock in a spread between an earning asset and the cost of funding. The swap is terminated upon issuance of the debt instrument, and amounts reported in accumulated other comprehensive income are recognized as earnings in the periods in which earnings are affected by the cash flows of the debt that was issued.

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

Premises and Equipment. The Bank records premises and equipment at cost less accumulated depreciation and amortization, which totaled approximately $7,343 and $5,529 at December 31, 2002 and 2001, respectively. Depreciation is computed on the straight-line method over the estimated useful lives of assets ranging from 3 to 10 years, and leasehold improvements are amortized on the straight-line method over the estimated useful life of the improvement or the remaining term of the lease, whichever is shorter. Improvements and major renewals are capitalized; ordinary maintenance and repairs are expensed as incurred. Gains and losses on disposal are included in other income.

Concessions on Consolidated Obligations. The amounts paid to dealers in connection with the sale of consolidated obligation bonds are deferred and amortized using a method approximating the level-yield method over the term of the obligations or estimated life of the bonds. The amount of the concession is allocated to the Bank by the Office of Finance based on the percentage of the debt issued for which the Bank is the primary obligor. Concessions applicable to the sale of consolidated obligation discount notes are generally charged to interest expense as incurred because of the short-term maturities of these notes. Unamortized concessions are included in "Other assets."

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

Resolution Funding Corporation Assessments. Although the FHLBanks are exempt from ordinary federal, state, and local taxation except local real estate tax, they are required to make payments to the Resolution Funding Corporation (REFCORP). Each FHLBank is required to pay 20% of net earnings (after AHP contributions) to REFCORP. The FHLBanks will expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a $300 million annual annuity whose final maturity date is April 15, 2030, at which point the required payment of each FHLBank to REFCORP will be fully satisfied. The Finance Board in consultation with the Secretary of the Treasury will select the appropriate discounting factors to be used in this annuity calculation. The cumulative amount to be paid to REFCORP by the Bank is not determinable at this time because it depends on the future earnings of the Bank and the other FHLBanks. The FHLBanks' payments through 2002 defease all future benchmark payments after the third quarter of 2021 and $70,995 of the $75,000 benchmark payment for the third quarter of 2021.

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

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

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

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

Reclassifications. Certain amounts in the 2001 and 2000 financial statements have been reclassified to conform to the 2002 presentation.

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

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

Adoption of FIN 45. FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and recission of FASB Interpretation No. 34* (FIN 45) on November 25, 2002. FIN 45 expands existing disclosure requirements at December 31, 2002, for guarantees and provides initial recognition and measurement provisions to be applied on a prospective basis for guarantees issued or modified after December 31, 2002.

Adoption of SFAS 133. The Bank adopted SFAS 133 on January 1, 2001. SFAS 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on derivative instruments that are reported in other comprehensive income will be recognized as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current period earnings. Changes in the fair value of a non-SFAS hedge of an asset or liability (economic hedge) for asset/liability management are recorded each period in current earnings.

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

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

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

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

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

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

As a result of SFAS 133, for the years ended December 31, 2002 and 2001, the Bank recorded net (losses)/gains on derivatives and hedging activities of ($63,582) and $63,951, respectively, in other income. Net (losses)/gains on derivatives and hedging activities for the years ended December 31, 2002 and 2001, were as follows:

	2002	2001
(Losses)/gains related to fair value hedge ineffectiveness	$(47,797)	$70,400
Losses on economic hedges	(16,540)	(6,449)
Gains related to cash flow hedge ineffectiveness	755	—
Net (losses)/gains on derivatives and hedging activities	$(63,582)	$63,951

For the years ended December 31, 2002 and 2001, there were no material amounts that were reclassified into earnings as a result of the discontinuance of cash flow hedges because it became probable that the original forecasted transactions would not occur by the end of the originally specified time period or within a two-month period thereafter. As of December 31, 2002, the deferred net gains/(losses) on derivative instruments accumulated in other comprehensive income expected to be reclassified to earnings during the next 12 months is not material. The maximum length of time over which the Bank is hedging its exposure to the variability in future cash flows for forecasted transactions, excluding those forecasted transactions related to the payment of variable interest on existing financial instruments, is less than three months.

NOTE 3 – CASH AND DUE FROM BANKS

Compensating Balances. The Bank maintains average collected cash balances with commercial banks in consideration for certain services. There are no legal restrictions under these agreements as to the withdrawal of these funds. The average compensating balances for the years ended December 31, 2002 and 2001, were approximately $1,920 and $1,686, respectively.

In addition, the Bank maintained average collected balances with the Federal Reserve Bank of San Francisco as required clearing balances and to facilitate the movement of funds to support the Bank's activities. There are regulations governing the withdrawal of these funds; however, earnings credits on these balances may be used to pay for services received. The average balances for this account for the years ended December 31, 2002 and 2001, were approximately $1,848 and $4,261, respectively.

NOTE 4 – SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

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

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
December 31, 2002	$4,400,000	$ —	$ —	$4,400,000
December 31, 2001	$2,150,000	$ —	$ —	$2,150,000

Redemption Terms. The amortized cost and estimated fair value of resale agreements by contractual maturity as of December 31, 2002 and 2001, are shown below.

	2002		2001	
YEAR OF MATURITY	AMORTIZED COST	ESTIMATED FAIR VALUE	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	$4,400,000	$4,400,000	$2,150,000	$2,150,000

The Bank engages in resale agreements with securities dealers, all of which are "primary dealers" as designated by the Federal Reserve Bank of New York. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the Statements of Condition. The collateral from resale agreements, all of which is highly rated, is held by the Bank's safekeeping custodian. If the market value of the underlying securities decreases below the market value required as collateral, the counterparty is required to place additional securities in safekeeping in the name of the Bank. The Bank had rights to securities collateral with an estimated value in excess of the resale agreements outstanding at December 31, 2002 and 2001.

Resale agreements averaged $2,731,781 and $1,544,875 during 2002 and 2001, respectively. The maximum amounts outstanding at any monthend during 2002 and 2001 were $4,550,000 and $2,350,000, respectively.

Interest Rate Payment Terms. The amortized cost of resale agreements, all with fixed rate interest payment terms, were $4,400,000 and $2,150,000 with average yields of 1.33% and 1.91% at December 31, 2002 and 2001, respectively.

NOTE 5 – HELD-TO-MATURITY SECURITIES

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

DECEMBER 31, 2002	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Commercial paper	$ 1,297,450	$ —	$ —	$ 1,297,450
Housing finance agency bonds	1,113,490	2,380	(4,059)	1,111,811
Subtotal	2,410,940	2,380	(4,059)	2,409,261
Mortgage-backed securities	15,467,904	205,065	(25,309)	15,647,660
Total	$17,878,844	$207,445	$(29,368)	$18,056,921

DECEMBER 31, 2001	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Commercial paper	$ 2,465,646	$ —	$ —	$ 2,465,646
Housing finance agency bonds	837,080	—	(1,219)	835,861
Subtotal	3,302,726	—	(1,219)	3,301,507
Mortgage-backed securities	13,241,163	154,676	(1,273)	13,394,566
Total	$16,543,889	$154,676	$(2,492)	$16,696,073

Redemption Terms. The amortized cost and estimated fair value of certain securities by contractual maturity and mortgage-backed securities as of December 31, 2002 and 2001, are shown below. Expected maturities of certain securities and mortgage-backed securities will differ from contractual maturities because borrowers generally have the right to prepay obligations without prepayment fees.

	2002		2001	
	AMORTIZED COST	ESTIMATED FAIR VALUE	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	$ 1,297,450	$ 1,297,450	$ 2,465,646	$ 2,465,646
Due after ten years	1,113,490	1,111,811	837,080	835,861
Subtotal	2,410,940	2,409,261	3,302,726	3,301,507
Mortgage-backed securities	15,467,904	15,647,660	13,241,163	13,394,566
Total	$17,878,844	$18,056,921	$16,543,889	$16,696,073

The average yields on held-to-maturity securities due in one year or less were 1.40% and 2.09%, due after 10 years were 1.95% and 2.64%, and on mortgage-backed securities were 4.60% and 5.47% for the years ended December 31, 2002 and 2001, respectively. The amortized cost of the Bank's mortgage-backed securities classified as held-to-maturity included net premiums of $30,578 and net discounts of $20,211 at December 31, 2002 and 2001, respectively.

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

	2002	2001
Amortized cost of held-to-maturity securities other than mortgage-backed securities:		
Fixed rate	$ 1,297,450	$ 2,465,646
Adjustable rate	1,113,490	837,080
Subtotal	2,410,940	3,302,726
Amortized cost of held-to-maturity mortgage-backed securities:		
Passthrough securities:		
Fixed rate	3,260,332	984,694
Adjustable rate	381,733	522,636
Collateralized mortgage obligations:		
Fixed rate	7,554,676	8,505,740
Adjustable rate	4,271,163	3,228,093
Subtotal	15,467,904	13,241,163
Total	$17,878,844	$16,543,889

NOTE 6 – HELD-AT-FAIR-VALUE SECURITIES

At December 31, 2002 and 2001, held-at-fair-value securities, consisting of certain mortgage-backed securities, totaled $533,090 and $527,870, respectively. Net gains on held-at-fair-value securities during the years ended December 31, 2002 and 2001, included a change in net unrealized holding gains of $22,745 and $7,653 for securities held on December 31, 2002 and 2001, respectively. The average yields on held-at-fair-value securities were 6.24% and 6.64% for the years ended December 31, 2002 and 2001, respectively.

NOTE 7 – ADVANCES

Redemption Terms. At December 31, 2002 and 2001, the Bank had advances outstanding, including AHP advances (see Note 8), at interest rates ranging from 1.01% to 8.75% and 1.51% to 8.75%, respectively, as summarized below. AHP-subsidized advances had interest rates ranging from 3.30% to 6.11% in 2002 and from 3.30% to 7.00% in 2001.

DECEMBER 31, 2002 YEAR OF MATURITY	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
Overdrawn demand deposit accounts	$ 765	3.16%
2003	49,645,412	2.49
2004	16,749,023	3.10
2005	7,945,379	2.40
2006	1,748,357	3.94
2007	1,005,284	4.38
Thereafter	3,158,543	5.36
Subtotal	80,252,763	2.77%
Discount on AHP advances	(321)	
SFAS 133 valuation adjustments	983,956	
Deferred net loss on terminated interest rate exchange agreements	643	
Total	$ 81,237,041	

DECEMBER 31, 2001 YEAR OF MATURITY	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
Overdrawn demand deposit accounts	$ 13,053	3.52%
2002	55,334,607	3.03
2003	29,084,048	3.51
2004	10,740,979	3.83
2005	1,565,130	4.24
2006	1,622,270	3.80
2007	121,621	6.49
Thereafter	2,858,149	5.57
Subtotal	101,339,857	3.36%
Discount on AHP advances	(461)	
SFAS 133 valuation adjustments	914,278	
Deferred net loss on terminated interest rate exchange agreements	878	
Total	$ 102,254,552	

Many of the Bank's advances are prepayable at the member's option. However, when advances are prepaid, the member is generally charged a prepayment fee that makes the Bank financially indifferent to the prepayment. Some advances may be repaid on pertinent call dates without incurring prepayment fees (callable advances). At December 31, 2002 and 2001, the Bank had callable advances outstanding totaling $1,524,057 and $1,443,079, respectively.

The following table summarizes advances at December 31, 2002 and 2001, by the earlier of the year of contractual maturity or next call date for callable advances:

EARLIER OF YEAR OF CONTRACTUAL MATURITY OR NEXT CALL DATE	2002	2001
Overdrawn demand deposit accounts	$ 765	$ 13,053
2002	—	56,761,607
2003	49,735,412	27,716,048
2004	16,777,023	10,740,979
2005	7,870,379	1,525,130
2006	1,723,357	1,622,270
2007	987,284	106,621
Thereafter	3,158,543	2,854,149
Total par value	$80,252,763	$101,339,857

The Bank also provides below-market fixed rate advances in exchange for the right of the Bank to retain a put option. At the Bank's discretion, on pertinent put dates, the Bank may terminate the advance (Putable Advance/Termination Option) or convert the advance to an Adjustable Rate Credit advance of predetermined index and spread for the remaining term to maturity (Putable Advance/Conversion Option). The Bank's advances at December 31, 2002 and 2001, included $1,991,700 and $2,037,700, respectively, of Putable Advances/Termination Option. There were no Putable Advances/Conversion Option outstanding as of December 31, 2002 and 2001.

The following table summarizes advances to members at December 31, 2002 and 2001, by the earlier of the year of contractual maturity or next put date for putable advances:

EARLIER OF YEAR OF CONTRACTUAL MATURITY OR NEXT PUT DATE	2002	2001
Overdrawn demand deposit accounts	$ 765	$ 13,053
2002	—	56,476,107
2003	51,150,812	29,443,948
2004	16,718,523	10,680,479
2005	7,802,379	1,422,130
2006	1,640,757	1,514,670
2007	961,284	121,621
Thereafter	1,978,243	1,667,849
Total par value	$80,252,763	$101,339,857

Security Terms. The Bank lends to member financial institutions involved in housing finance that have a principal place of business in Arizona, California, or Nevada. The Bank is required by the FHLB Act to obtain sufficient collateral for advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans or mortgage-backed securities, cash or deposits in the Bank, and other eligible real-estate-related assets as collateral for advances. The Bank may also accept secured small business, small farm, and small agribusiness loans as collateral from members that are CFIs.

The Bank requires each borrowing member to execute a written Advances and Security Agreement. The capital stock of the Bank owned by each borrowing member is pledged as additional collateral for the member's indebtedness to the Bank. The FHLB Act requires that aggregate advances from the Bank to a member may not exceed 20 times the amount paid by the member for capital stock of the Bank. At December 31, 2002 and 2001, the Bank had a security interest in collateral pledged by each borrowing member with an estimated value in excess of outstanding advances for that member. Based on the financial condition of the borrowing member, the Bank may either (i) allow the member to physically retain mortgage collateral assigned to the Bank, provided that the member agrees to hold the collateral for the benefit of the Bank, or (ii) require the member to deliver physical possession of the mortgage collateral to the Bank or its safekeeping agent. All securities collateral is delivered to the Bank's safekeeping agent.

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

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

The Bank's potential credit risk from advances is concentrated in savings institutions. As of December 31, 2002, the Bank had a concentration of advances totaling $58,069,985 outstanding to three members, representing 72% of total outstanding advances (41%, 17%, and 14%, respectively). The interest income from advances to these members amounted to approximately $1,885,937 during 2002. The Bank held collateral with an estimated value in excess of advances to these institutions, and the Bank does not expect to incur any credit losses on these advances.

Interest Rate Payment Terms. Interest rate payment terms for advances at December 31, 2002 and 2001, are detailed below:

	2002	2001
Par amount of advances:		
Fixed rate	$45,081,308	$ 61,696,838
Adjustable rate	35,171,455	39,643,019
Total	$80,252,763	$101,339,857

Prepayment Fees, Net. During 2002, 2001, and 2000, the Bank charged its members prepayment fees when the principal on certain advances was paid prior to original maturity. In addition, some of these advances were associated with interest rate exchange agreements. Upon termination of these advances, prior to January 1, 2001, the associated interest rate exchange agreements were either marked to market and redesignated as hedges of other advances or terminated, and the resulting gains or losses were netted with the prepayment fees on the Statements of Income. Starting January 1, 2001, the resulting gains or losses were recognized in accordance with SFAS 133 (see Note 2). These transactions during the years ended December 31, 2002, 2001, and 2000, are summarized in the following table:

	2002	2001	2000
Prepayment fees received	$ 9,032	$ 5,953	$ 811
Net losses on interest rate exchange agreements associated with prepaid advances	—	—	(419)
Prepayment fees, net	$ 9,032	$ 5,953	$ 392
Advance principal prepaid	$7,491,982	$1,859,685	$854,135

NOTE 8 – AFFORDABLE HOUSING PROGRAM

Section 10(j) of the FHLB Act requires each FHLBank to establish an AHP. Each FHLBank provides subsidies in the form of direct grants and below-market interest rate advances to members, which use the funds to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Annually, the FHLBanks must set aside for their AHPs, in the aggregate, the greater of $100 million or 10% of the current year's income before charges for the AHP but after the assessment for REFCORP (see Note 1). To the extent that the aggregate 10% calculation is less than $100 million, the shortfall is allocated among the FHLBanks based on the ratio of each FHLBank's income before AHP and REFCORP to the sum of the net incomes before AHP and REFCORP of the 12 FHLBanks. There was no AHP shortfall in 2002, 2001, or 2000. The Bank set aside $32,464, $47,177, and $41,843, during 2002, 2001, and 2000, respectively, for the AHP. These amounts were charged to earnings each year and recognized as a liability. As subsidies are disbursed, the AHP liability is reduced. The Bank had $12,873 and $19,909 in outstanding AHP-related advances at December 31, 2002 and 2001, respectively.

NOTE 9 – MORTGAGE LOANS

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

	2002
Fixed rate medium-term mortgage loans	$180,064
Fixed rate long-term mortgage loans	77,640
Unamortized net premiums	4,902
Total mortgage loans	$262,606

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

The allowance for credit losses on these loans was as follows:

	2002
Balance at January 1, 2002	$ —
Chargeoffs	—
Recoveries	—
Provision for credit losses	180
Balance at December 31, 2002	$180

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 Bank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreements. At December 31, 2002, the Bank did not have loans classified as nonaccrual or impaired.

NOTE 10 – DEPOSITS

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

Interest Rate Payment Terms. Interest rate payment terms for deposits at December 31, 2002 and 2001, are detailed in the following table:

	2002	2001
Deposits:		
Fixed rate	$ 34,510	$ 36,000
Adjustable rate	372,129	715,617
Total	$406,639	$751,617

NOTE 11 – BORROWINGS

At times the Bank enters into sales of securities under agreements to repurchase (repurchase agreements) with securities dealers, all of which are "primary dealers" as designated by the Federal Reserve Bank of New York. The amounts received under these agreements represent short-term borrowings and are reflected as liabilities in the Statements of Condition. The securities sold under agreements to repurchase are delivered to the purchasing primary dealers or their custodians. Should the market value of the underlying securities decrease below the market value required by the repurchase agreements, the Bank is required to deliver additional securities to the dealers. There were no repurchase agreements outstanding during 2002 or at December 31, 2001.

The Bank had other borrowings due to commercial banks at December 31, 2002, of $525,000, bearing interest at the overnight Federal funds rate, and other borrowings due to a member at December 31, 2001, of $200,000, bearing interest at the overnight Federal funds rate.

NOTE 12 – CONSOLIDATED OBLIGATIONS

Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated obligation bonds and discount notes. Through December 31, 2000, the Finance Board issued consolidated bonds through the Office of Finance. The Finance Board adopted final rules on June 2, 2000, to govern the issuance of debt for the FHLBanks. Effective January 1, 2001, the Finance Board discontinued issuing consolidated obligations on behalf of the FHLBanks; instead, all new consolidated obligations are jointly issued by the FHLBanks through the Office of Finance, which serves as their agent. Consolidated obligation bonds are issued primarily to raise intermediate- and long-term funds for the FHLBanks. Usually the maturity of consolidated obligation bonds ranges from one year to ten years, but the maturity is not subject to any statutory or regulatory limits. Consolidated obligation discount notes are primarily used to raise short-term funds. These notes are issued at less than their face amount and redeemed at par when they mature.

The par amount of the outstanding consolidated obligations of all the FHLBanks, including consolidated obligations held by other FHLBanks, was approximately $680,695,058 and $637,331,833 at December 31, 2002 and 2001, respectively. Regulations require the FHLBanks to maintain, in the aggregate, unpledged "Qualifying Assets" in an amount equal to the consolidated obligations outstanding. "Qualifying Assets" are defined as cash; secured advances; assets with an assessment or credit rating at least equivalent to the current assessment or credit rating of the consolidated obligations; obligations, participations, mortgages, or other securities of or issued by the United States or an agency of the United States; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located.

On June 2, 2000, the Finance Board adopted a final rule amending the FHLBanks' leverage limit requirements. Effective July 1, 2000, each FHLBank's leverage limit is based on a ratio of assets to capital, rather than a ratio of liabilities to capital. The Finance Board's former regulations prohibited the issuance of consolidated obligations if such issuance would bring the FHLBanks' outstanding consolidated obligations and other unsecured senior liabilities above 20 times the FHLBanks' total capital. The Finance Board's Financial Management Policy also applied these limits on an FHLBank-by-FHLBank basis. The final rule generally limits each FHLBank's assets to no more than 21 times its capital unless an FHLBank has non-mortgage assets, after deducting deposits and capital, that do not exceed 11% of its assets. In that case, an FHLBank's total assets cannot exceed 25 times its capital. At December 31, 2002, the Bank's total assets to capital and non-mortgage assets to total assets ratios were 20.4x and 9.8%, respectively.

To provide the holders of consolidated obligations issued prior to January 29, 1993 (prior bondholders), protection equivalent to that provided under the FHLBanks' previous leverage limit of 12 times the FHLBanks' aggregate capital stock, prior bondholders have a claim on a certain amount of the Qualifying Assets (Special Asset Account or SAA) if the FHLBanks' aggregate capital stock is less than 8.33% of consolidated obligations outstanding. At both December 31, 2002 and 2001, the FHLBanks' capital stock was 5.2% of the par value of consolidated obligations outstanding, and the minimum SAA balance was approximately $24,004 and $28,343 respectively. The Bank's share of this SAA balance was approximately $3,975 and $5,899 at December 31, 2002 and 2001, respectively. Further, each FHLBank is required to transfer Qualifying Assets in the amount of its allocated share of the FHLBanks' SAA to a trust for the benefit of the prior bondholders if its individual capital to assets ratio falls below 2.0%.

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

Consolidated obligations, in addition to having fixed rate or simple adjustable rate coupon payment terms, may also include "callable bonds," which the Bank may redeem in whole or in part at its discretion on predetermined call dates according to the terms of the bond offerings; "step-up bonds," which generally pay interest at increasing fixed rates for specified intervals over the life of the bond and can be called at the Bank's option on the step-up dates; "conversion bonds," which have coupon rates that convert from fixed to adjustable or from adjustable to fixed; "comparative index bonds," which have coupon rates that are determined by the difference between two or more market indices; "zero-coupon bonds," which are long-term discounted instruments that earn a fixed yield to maturity or to the optional principal redemption date, and for which all principal and interest are paid at maturity or at the optional principal redemption date, if exercised prior to maturity; and "index amortizing notes," which repay principal according to predetermined amortization schedules that are linked to the level of a certain index. As of December 31, 2002, most of the index amortizing notes had fixed rate coupon payment terms. Usually, as market interest rates fall, the maturity of the index amortizing notes contracts.

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

DECEMBER 31, 2002 YEAR OF MATURITY	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
2003	$50,179,130	2.51%
2004	18,295,000	3.76
2005	9,493,400	3.79
2006	6,147,500	4.58
2007	5,050,750	4.08
Thereafter	5,483,030	5.28
Index amortizing notes	76,805	5.05
Total par value	94,725,615	3.26%
Bond premiums	66,732	
Bond discounts	(71,976)	
SFAS 133 valuation adjustments	1,101,426	
Total	$95,821,797	

DECEMBER 31, 2001 YEAR OF MATURITY	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
2002	$ 36,128,780	3.96%
2003	31,208,625	3.46
2004	15,110,800	4.73
2005	6,389,600	5.29
2006	8,048,200	5.06
2007	2,558,990	5.68
Thereafter	4,209,900	5.75
Index amortizing notes	180,000	5.30
Total par value	103,834,895	4.21%
Bond premiums	17,860	
Bond discounts	(61,968)	
SFAS 133 valuation adjustments	894,046	
Total	$104,684,833	

The Bank's participation in consolidated obligation bonds outstanding at December 31, 2002 and 2001, includes callable bonds of $36,271,005 and $36,859,640, respectively. Contemporaneous with such callable bond issuance, the Bank usually enters into an interest rate swap (in which the Bank pays a variable rate and receives a fixed rate) with a call feature that mirrors the option embedded in the bond (a sold callable swap). The combined sold callable swap and callable bond enable the Bank to meet its funding needs at costs not otherwise directly attainable solely through the issuance of non-callable debt while converting the Bank's own payment to an adjustable rate. The Bank also uses fixed rate callable bonds to finance fixed rate callable advances (see Note 7) and fixed rate mortgage-backed securities.

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

	2002	2001
Par amount of consolidated obligation bonds:		
Non-callable	$58,454,610	$ 66,975,255
Callable	36,271,005	36,859,640
Total par value	$94,725,615	$103,834,895

The following is a summary of the Bank's participation in consolidated obligation bonds outstanding at December 31, 2002 and 2001, by the earlier of the year of contractual maturity or next call date:

EARLIER OF YEAR OF CONTRACTUAL MATURITY OR NEXT CALL DATE	2002	2001
2002	$ —	$ 56,575,120
2003	70,761,135	33,408,800
2004	15,662,700	9,968,500
2005	4,806,400	618,900
2006	2,105,500	2,062,500
2007	424,750	291,750
Thereafter	888,325	729,325
Index amortizing notes	76,805	180,000
Total	$94,725,615	$103,834,895

Interest Rate Payment Terms. Interest rate payment terms for consolidated obligations at December 31, 2002 and 2001, are detailed in the following table:

	2002	2001
Par amount of consolidated obligations:		
Bonds:		
Fixed rate	$ 66,205,205	$ 73,477,155
Adjustable rate	23,766,000	25,205,000
Step-up	3,227,000	2,805,000
Fixed rate that converts to adjustable rate	286,900	266,900
Adjustable rate that converts to fixed rate	580,000	315,000
Comparative index	478,705	1,195,840
Zero-coupon	105,000	390,000
Index amortizing notes	76,805	180,000
Total bonds, par	94,725,615	103,834,895
Discount notes, par	12,483,980	21,362,047
Total consolidated obligations, par	$107,209,595	$125,196,942

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

	2002		2001	
	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
Par value	$12,483,980	1.53%	$21,362,047	2.37%
Discounts	(38,034)		(82,882)	
SFAS 133 valuation adjustments	870		3,887	
Total	$12,446,816		$21,283,052	

Section 11(i) of the FHLB Act authorizes the Secretary of the Treasury, at his discretion, to purchase certain obligations issued by the FHLBanks aggregating not more than $4.0 billion; terms, conditions and interest rates are to be determined by the Secretary of the Treasury. There were no such purchases by the U.S. Treasury during the two-year period ended December 31, 2002.

NOTE 13 – CAPITAL

The Gramm-Leach-Bliley Act (GLB Act) will lead to a number of changes in the capital structure of the FHLBanks. On January 30, 2001, the Finance Board published a final capital rule requiring each FHLBank to submit a capital plan to the Finance Board for approval. The Bank's capital plan was approved by the Bank's Board of Directors on May 31, 2002, and was approved by the Finance Board on June 12, 2002. The plan may be amended by the Bank's Board of Directors with the approval of the Finance Board.

The plan provides that it will be implemented by the Bank within the three-year period following Finance Board approval. The Board of Directors will consider implementing the plan in 2003 or early in 2004. Any member that does not opt to participate in the exchange must provide the Bank with a written notice of its intention to withdraw from membership as provided in the plan.

To implement the capital plan, the Bank will exchange current shares for new shares. Under the capital plan, the Bank will issue only Class B stock, with a par value of $100 per share, which may be redeemed by giving five years' notice, subject to certain conditions. The stock may be issued, exchanged, redeemed, and repurchased only at its stated par value.

When an FHLBank's capital plan has been implemented by the FHLBank, the FHLBank will be subject to risk-based capital rules. Only "permanent" capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. In addition, the GLB Act specifies a 5% minimum leverage capital ratio with a 1.5 weighting factor for permanent capital, and a 4% minimum leverage capital ratio without the 1.5 weighting factor. The statute and regulations require that the minimum stock requirement for members must be sufficient to enable the Bank to meet its own regulatory requirements for total capital, leverage capital, and risk-based capital.

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

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

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

The GLB Act established voluntary membership for all members. All members may withdraw from membership and redeem their capital stock after giving the required notice. Members that withdraw from membership may not re-apply for membership for five years.

In accordance with the retained earnings policy of the Bank, the Bank restricts retained earnings for that portion of income from prepayment fees that, if allocated on a pro rata basis over the original term to maturity of the advances prepaid, would be allocated to future dividend periods. Other gains and losses related to the termination of interest rate exchange agreements and early retirement of consolidated obligations associated with the prepaid advance are similarly treated. Retained earnings restricted in accordance with these policies totaled $6,604, $6,496, and $7,079, at December 31, 2002, 2001, and 2000, respectively.

In accordance with the retained earnings policy of the Bank, the Bank retains in restricted retained earnings any cumulative net gains in earnings (net of applicable assessments) and any cumulative net gains in other comprehensive income resulting from SFAS 133. Retained earnings restricted in accordance with this policy totaled $18,785 and $50,805 at December 31, 2002 and 2001, respectively. The Bank's retained earnings in the future may not be sufficient to offset the full impact of SFAS 133. As a result, the effect of SFAS 133 may lead to increased volatility in future earnings and dividends.

The Bank's Board of Directors may declare and pay dividends, either in cash or capital stock, only from retained earnings or current net earnings.

Effective April 1999, the Bank implemented its surplus capital stock redemption policy. Surplus capital stock is defined as any excess stock holdings above 115% of a member's statutory capital stock requirement, excluding stock dividends earned and credited for the current year. In accordance with this plan, the Bank redeemed $1,687,674 and $363,390 in surplus capital stock in 2002 and 2001, respectively. In January 2003, the Bank redeemed $437,540 of surplus capital stock that was subject to redemption as of December 31, 2002.

As of December 31, 2002, the Bank had a concentration of capital stock totaling 38,536 shares outstanding to three members, representing 69% of total capital stock outstanding (38%, 18%, and 13%, respectively).

NOTE 14 – EMPLOYEE RETIREMENT PLANS

The Bank provides retirement benefits through a Bank-sponsored Cash Balance Plan, a defined benefit plan. The Cash Balance Plan covers all employees who have completed six months of Bank service. Under the plan, each eligible Bank employee accrues benefits annually equal to 6% of the employee's annual pay, plus 6% interest on the benefits accrued to the employee through the prior yearend. The Cash Balance Plan is funded through a trust established by the Bank. The projected benefit obligation and the accrued benefit cost of the Cash Balance Plan were $5,695 and $1,140, respectively, at December 31, 2002, and $4,466 and $1,132, respectively, at December 31, 2001. The periodic pension cost for the years ended December 31, 2002 and 2001, totaled $987 and $843, respectively.

Prior to January 1, 2002, the Bank participated in the Financial Institutions Thrift Plan, a defined contribution savings plan. Contributions to this plan consisted of elective participant contributions and a Bank matching contribution of up to 6% of those participant contributions (based on compensation). The Bank contributed approximately $634 and $572 in 2001 and 2000, respectively, to the plan. Effective January 1, 2002, the Bank withdrew its participation in the Financial Institutions Thrift Plan and implemented a successor defined contribution savings plan, the Federal Home Loan Bank of San Francisco Savings Plan. Contributions to the successor plan also consist of elective participant contributions and a Bank matching contribution of up to 6% of those participant contributions (based on compensation). The Bank contributed approximately $990 in 2002.

The Bank also provides the Benefit Equalization Plan (BEP). The BEP is a non-qualified retirement plan restoring those benefits offered under the qualified plans that have been limited by laws governing such plans. The Bank's projected benefit obligation and accrued benefit cost for this plan was $1,408 and $1,224, respectively, at December 31, 2002, and $1,175 and $1,160, respectively, at December 31, 2001.

In addition, the Bank maintains a deferred compensation plan that is available to all officers and directors. The plan liability consists of the accumulated compensation deferrals and accrued earnings on the deferrals. The Bank's obligation for this plan at December 31, 2002 and 2001, was $9,825 and $8,082, respectively.

NOTE 15 – SEGMENT INFORMATION

Management analyzes financial performance based on the net interest income of two operating segments: Mortgage-Related Business and Advances-Related Business. The Mortgage-Related Business consists of MBS investments and mortgage loans acquired through the MPF Program and the consolidated obligations specifically identified as funding those assets. Net interest income for this segment is derived primarily from the difference, or spread, between the yield on the MBS securities and mortgage loans and the cost of the consolidated obligations funding those assets, including the cash flows from associated interest rate exchange agreements, less the provision for credit losses on mortgage loans. In 2002, the provision for credit losses on mortgage loans totaled $180. The Advances-Related Business consists of all other business activities, including advances and investments other than MBS and the consolidated obligations and member capital funding those assets. Net interest income for this segment is derived primarily from the difference, or spread, between the yield on all business activities in this segment and the cost of funding those activities, including earnings on invested member capital and the cash flows from associated interest rate exchange agreements.

The following table sets forth the Bank's financial performance by operating segment for the years ended December 31, 2002, 2001, and 2000.

NET INTEREST INCOME	MORTGAGE-RELATED BUSINESS	ADVANCES-RELATED BUSINESS	TOTAL
2002	$ 135,339	$ 360,451	$ 495,790
2001	$ 87,427	$ 466,880	$ 554,307
2000	$ 28,528	$ 526,045	$ 554,573
TOTAL ASSETS			
2002	$16,225,888	$ 99,903,593	$116,129,481
2001	$13,754,246	$121,629,626	$135,383,872
2000	$10,762,539	$129,427,469	$140,190,008

NOTE 16 – INTEREST RATE EXCHANGE AGREEMENTS

The contractual or notional amounts of interest rate exchange agreements reflect the extent of the Bank's involvement in particular classes of financial instruments. The notional amount does not represent the exposure to credit loss. The amount potentially subject to credit loss is the estimated cost of replacing the favorable interest rate exchange agreement if the counterparty defaults and is substantially less than the notional amount. The Bank is subject to credit risk relating to the nonperformance by a counterparty to a non-exchange-traded interest rate exchange agreement. However, based on management's credit analyses of its counterparties and on the Bank's netting arrangements and collateral requirements, no allowance for losses is deemed necessary by management.

Maximum credit risk is defined as the estimated cost of replacement for favorable interest rate exchange agreements in the event of counterparty default if the related collateral proves to be of no value to the Bank. At December 31, 2002 and 2001, the Bank's maximum credit risk, as defined above, was approximately $518,734 and $479,860, respectively, including $111,117 and $231,041 of net accrued interest receivable, respectively. Accrued interest receivables and payables, and the legal right to offset assets and liabilities by counterparty, in which amounts recognized for individual transactions may be offset against amounts recognized for other transactions with the same counterparty, are considered in determining the maximum credit risk. The Bank held investment grade securities with a fair value of $428,300 and $421,000 as collateral from counterparties as of December 31, 2002 and 2001, respectively. This collateral has not been sold or repledged.

A significant number of the Bank's interest rate exchange agreements are transacted with financial institutions such as major banks and broker-dealers. Some of these banks and dealers or their affiliates buy, sell, and distribute consolidated obligations. Assets pledged as collateral by the Bank to these counterparties are more fully discussed in Note 19.

Intermediation. Interest rate exchange agreements in which the Bank is an intermediary may arise when the Bank enters into offsetting interest rate exchange agreements with members and other counterparties to meet the needs of members or when the Bank enters into interest rate exchange agreements to offset the economic effect of other interest rate exchange agreements that are no longer designated to advances, investments, or consolidated obligations. The notional principal of the interest rate exchange agreements in which the Bank is an intermediary at December 31, 2002 and 2001, was $904,200 and $820,200, respectively.

NOTE 17 – ESTIMATED FAIR VALUES

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

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

Held-to-Maturity and Held-at-Fair-Value Securities. The estimated fair value of these instruments, including mortgage-backed securities with more than three months to maturity or repricing, has been determined based on quoted prices or by calculating the present value of expected cash flows as of the last business day of the year excluding accrued interest. The discount rates used in these calculations are the replacement rates for securities with similar terms. For instruments with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

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

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

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

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

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

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

Consolidated Obligations. The estimated fair value has been determined based on the estimated cost of raising comparable term debt. The estimated cost of issuing debt is determined daily based on the primary market for debt of government-sponsored enterprises and other indications from securities dealers; the estimated cost of issuing debt includes non-interest selling costs.

Commitments. The estimated fair value of the Bank's commitments to extend credit, including letters of credit, was immaterial at December 31, 2002 and 2001.

The estimated fair values of the Bank's financial instruments at December 31, 2002 and 2001, were as follows:

FAIR VALUE OF FINANCIAL INSTRUMENTS – 2002

	CARRYING VALUE	NET UNREALIZED GAINS/(LOSSES)	ESTIMATED FAIR VALUE
ASSETS			
Cash and due from banks	$ 8,759	$ —	$ 8,759
Deposits for mortgage loan programs	58,113	—	58,113
Interest-bearing deposits in banks	4,834,000	—	4,834,000
Securities purchased under agreements to resell	4,400,000	—	4,400,000
Federal funds sold	6,068,000	—	6,068,000
Held-to-maturity securities	17,878,844	178,077	18,056,921
Held-at-fair-value securities	533,090	—	533,090
Advances	81,237,041	226,992	81,464,033
Mortgage loans, net of allowance for credit losses on mortgage loans	262,426	1,406	263,832
Accrued interest receivable	285,055	—	285,055
Derivative assets	518,734	—	518,734
Other assets	45,419	(24,457)	20,962
Total	$116,129,481	$ 382,018	$116,511,499
LIABILITIES			
Deposits	$ 406,639	$ (2)	$ 406,641
Other borrowings	525,000	—	525,000
Consolidated obligations:			
Bonds	95,821,797	(270,774)	96,092,571
Discount notes	12,446,816	(3,042)	12,449,858
Accrued interest payable	715,620	—	715,620
Derivative liabilities	345,865	—	345,865
Other liabilities	183,046	—	183,046
Total	$110,444,783	$(273,818)	$110,718,601

FAIR VALUE OF FINANCIAL INSTRUMENTS – 2001

	CARRYING VALUE	NET UNREALIZED GAINS/(LOSSES)	ESTIMATED FAIR VALUE
ASSETS			
Cash and due from banks	$ 1,889	$ —	$ 1,889
Interest-bearing deposits in banks	4,487,000	—	4,487,000
Securities purchased under agreements to resell	2,150,000	—	2,150,000
Federal funds sold	8,445,000	—	8,445,000
Held-to-maturity securities	16,543,889	152,184	16,696,073
Held-at-fair-value securities	527,870	—	527,870
Advances	102,254,552	115,123	102,369,675
Loans to other Federal Home Loan Banks	25,000	—	25,000
Accrued interest receivable	418,606	—	418,606
Derivative assets	479,860	—	479,860
Other assets	50,206	(28,134)	22,072
Total	$135,383,872	$ 239,173	$135,623,045
LIABILITIES			
Deposits	$ 751,617	$ (8)	$ 751,625
Other borrowings	200,000	—	200,000
Consolidated obligations:			
Bonds	104,684,833	(52,335)	104,737,168
Discount notes	21,283,052	(26,868)	21,309,920
Accrued interest payable	1,080,127	—	1,080,127
Derivative liabilities	372,812	—	372,812
Other liabilities	201,967	—	201,967
Total	$128,574,408	$ (79,211)	$128,653,619

NOTE 18 – ARBITRATION AWARD

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

NOTE 19 – COMMITMENTS AND CONTINGENCIES

As indicated in Note 12, all FHLBanks have joint and several liability for the consolidated obligations issued on their behalf. Accordingly, should one or more of the FHLBanks be unable to repay its participation in the consolidated obligations, the other FHLBanks could be called on to repay all or a portion of such obligations as determined or approved by the Finance Board. The Bank does not recognize a liability for its joint and several obligation related to other FHLBanks' consolidated obligations.

Commitments that legally bind and obligate the Bank for additional advances totaled approximately $29,483 and $67,786 at December 31, 2002 and 2001, respectively. Commitments are generally for periods up to 12 months. Outstanding standby letters of credit were approximately $1,391,652 and $841,483 at December 31, 2002 and 2001, respectively, and had original terms of 39 days to 10 years, with a final expiration in 2012. Standby letters of credit are generally issued for a fee on behalf of members to support their obligations to third parties. If the Bank is required to make payment for a beneficiary's drawing, the amount is charged to the member's demand deposit account with the Bank or converted into a collateralized advance to the member. Based on management's credit analyses and collateral requirements, no allowance for losses is deemed necessary by management on these advance commitments and letters of credit. Advances funded under these advance commitments and letters of credit are fully collateralized at the time of issuance in a manner consistent with advances to members (see Note 7). The estimated fair value of commitments and letters of credit was immaterial as of December 31, 2002 and 2001.

Commitments that unconditionally obligate the FHLBank to purchase mortgage loans totaled $15,426 at December 31, 2002. Commitments are generally for periods not to exceed 45 days.

The Bank executes interest rate exchange agreements with major banks and broker-dealers that have long-term credit ratings of single-A or better from both Standard & Poor's and Moody's Investors Service. The Bank enters into bilateral security agreements with all counterparties. As of December 31, 2002 and 2001, the Bank had pledged as collateral securities with a fair value of $261,442 and $296,230, respectively, to broker-dealers that have market risk exposure to the Bank related to interest rate exchange agreements. In 2001, the Bank had also pledged as collateral securities with a fair value of $1,177,650 to the Federal Reserve Bank of San Francisco as part of the Bank's contingent borrowing plans at that time.

The Bank charged operating expenses for net rental costs of approximately $3,360, $3,382, and $3,004 for the years ending December 31, 2002, 2001, and 2000, respectively. Future minimum rentals at December 31, 2002, were as follows:

YEAR	PREMISES	EQUIPMENT	TOTAL
2003	$ 2,970	$214	$ 3,184
2004	3,117	203	3,320
2005	3,218	207	3,425
2006	3,242	1	3,243
2007	3,475	—	3,475
Thereafter	5,098	—	5,098
Total	$21,120	$625	$21,745

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

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

The Bank entered into $3,315,000 and $2,356,400 of par value and notional amounts, respectively, of consolidated obligations and interest rate exchange agreements, respectively, that had traded but not yet settled at December 31, 2002.

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

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