
Federal Housing Finance Board Annual Performance Budget



Fiscal Year 2006
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MESSAGE FROM THE CHAIRMAN

The Federal Housing Finance Board (Finance Board) Strategic Plan for fiscal years 2003-2008 identifies three major goals that drive the Finance Board's activities and operations. Those goals are: (1) maintaining a supervision program that fosters safe and sound operation at each Federal Home Loan Bank (FHLBank) and the Office of Finance (OF); (2) ensuring that the FHLBanks serve the nation's housing finance and community investment needs; and (3) aligning the agency's supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision and regulation and housing mission oversight. In fiscal year 2006, the Finance Board pursuit of these goals will concentrate on four major areas: (1) safety and soundness examination and supervision; (2) community investment programs and the Affordable Housing Program (AHP); (3) risk monitoring and risk modeling; and (4) regulatory and supervisory policy initiatives. To achieve its goals, the Finance Board will emphasize the following:

- Using a risk-based system of safety and soundness examinations that focuses the agency's supervisory resources on the specific credit, market, and operational risks presented by the business and operations of each FHLBank.
- Improving financial reporting and disclosure by the FHLBanks and the OF.
- Enhancing the agency's data systems and risk monitoring capabilities.
- Assessing the quality of corporate governance practices by the FHLBanks and means for their improvement.
- Enhancing the agency's regulation and supervision of the housing finance and community investment mission of the FHLBanks.
- Improving supervisory and policy guidance to the examination staff and the FHLBanks.
- Taking supervisory and regulatory actions in response to developments in financial markets and FHLBank operations.
- Enhancing training and development opportunities for Finance Board staff.

This document is the Finance Board's blueprint for implementation of the Strategic Plan for the coming fiscal year. It identifies specific performance goals and measures together with means and strategies that will allow the Finance Board to achieve the goals and objectives articulated in its Strategic Plan.

/s/ Ronald A. Rosenfeld

Ronald A. Rosenfeld
Chairman

MISSION, VISION, AND VALUES

Mission To ensure that the FHLBanks are safe and sound so they can serve as a reliable source of liquidity and funding for the nation's housing finance and community investment needs.

Vision To continue to earn the public's trust, the Finance Board is dedicated to the highest professional standards of accountability and independence to carry out its responsibilities for FHLBank supervision and housing finance mission oversight.

Values The core values underlying the mission and vision of the Finance Board, which guide its organizational decisions and actions, are:

- Independence. The Finance Board is the arm's-length regulator of the FHLBanks and the OF.
- Accountability. The Finance Board is a steward of the public's trust and will use its resources efficiently and in the public interest.
- Responsiveness. The Finance Board aligns its actions with its mission and responds promptly, effectively, and creatively to emerging risks and opportunities in the financial system.
- Integrity. The Finance Board discharges its responsibilities fairly and impartially and adheres to the highest standards of ethical conduct.
- Excellence. The Finance Board strives for excellence in carrying out its responsibilities and recognizes the contributions of employees who demonstrate the highest professional standards in their work.

SUPERVISION OF FHLBANKS

The Finance Board is charged with ensuring that the FHLBanks and the OF operate in a financially safe and sound manner and that the FHLBank System's housing finance mission is met.¹ Monitoring the performance, condition, and risk profile of each FHLBank through on-site examinations is the cornerstone of the Finance Board's safety and soundness supervisory program. During each examination, the examiners (1) assess the FHLBank's management of the credit, market, and operational risks that arise from its business and operations; (2) evaluate the FHLBank's financial condition and performance, capital adequacy, and corporate governance; (3) assess the FHLBank's Affordable Housing and Community Investment Programs; and (4) review compliance with the policies and procedures of the FHLBank, the rules and regulations of the Finance Board, and federal and state laws. Supervisory issues that are identified are reviewed during the next on-site examination or through other supervisory activities.

The Examination and Supervision Division is supported by other divisions within the Office of Supervision. Quantitative methods and statistical, econometric, and financial models are used to estimate the risks that affect each FHLBank, including changes in interest rates, interest rate spreads, and interest rate volatility. In addition, the financial model used by each FHLBank and its ability to respond to changing market and economic circumstances are assessed.

The Office of Supervision also evaluates financial, housing, operational, and mortgage market developments that may affect the FHLBanks. Financial and economic analyses of conditions and trends are prepared, and the effects of these upon the FHLBank System's financial condition, risk profile, profitability, and stability are analyzed.

The table below identifies the strategic goal, strategic objectives, and annual performance goals for supervision of the FHLBanks.

Strategic Goal	Strategic Objectives	Annual Performance Goal
1. Supervision program effectively fosters safe and sound operations at each FHLBank.	1.1 The FHLBanks operate safely and soundly.	1.1 Maintain an effective risk-based examination program.
	1.2 The FHLBanks meet or exceed their minimum capital requirements.	1.2 Each FHLBank satisfies its applicable capital requirements and prudently manages capital and earnings.
	1.3 The FHLBanks raise funds efficiently and are role models for transparency and accountability.	1.3a The FHLBanks maintain a triple A credit rating for their consolidated obligations.
		1.3b Each FHLBank's and the FHLBank System's financial disclosures comply with applicable laws, rules, and regulations.

¹See section 2A(a)(3) of the Federal Home Loan Bank Act (12 U.S.C. § 1422a(a)(3)).

Strategic Goal 1	Supervision program effectively fosters safe and sound operations at each FHLBank.
Strategic Objective 1.1	The FHLBanks operate safely and soundly.
Annual Performance Goal 1.1	Maintain an effective risk-based supervisory program.
Annual Performance Measure 1.1	Conduct all safety and soundness activities, including annual examinations, quarterly reviews, and off-site monitoring on a timely basis.
Means and Strategies	<p><i>On-Site Examinations.</i> The Finance Board will complete on-site examinations of all 12 FHLBanks in 2006. Prior to commencing an examination, the Finance Board establishes the scope of the examination and identifies issues for review. While on-site, the Finance Board's examiners will test systems, controls, and reports for adequacy and accuracy; assess the FHLBank's risk management and operational soundness; identify issues that may affect the risk or operating profile of the FHLBank; review the FHLBank's Affordable Housing Program; evaluate the financial condition, performance, and capital adequacy of the FHLBank; evaluate the quality of corporate governance; and test policies, procedures, and practices of the FHLBank for compliance with Finance Board regulations and policies and federal and state laws.</p> <p>Finance Board staff discusses examination findings² with the FHLBank's senior management. The agency uses reason and moral suasion to influence the practices of the FHLBanks. However, when those methods are unsuccessful, or concerns are raised to a level of significance, the Finance Board may use formal and/or informal enforcement actions to correct practices, conditions, or violations of law and/or regulations. When significant supervisory or compliance issues, including violations of laws or regulations are identified, the Finance Board requires the FHLBank to develop a corrective action plan.</p> <p>At the conclusion of its annual on-site examination, the Finance Board assigns a supervisory conclusion³ to the FHLBank based upon the level of credit, market, and operational risk undertaken, the adequacy of the FHLBank's risk management practices, its financial condition and operating performance, the adequacy of its capitalization, the quality of its corporate governance, and administration of its Affordable Housing and Community Investment Programs.</p>

² Findings are categorized by degree of severity. The categories are: unsafe and unsound practice or condition, violation, weakness, recommendation and referral (*See Advisory Bulletin 2005-AB-01*).

³ Supervisory conclusions for an FHLBank are satisfactory, fair, marginal, and unsatisfactory (*See Advisory Bulletin 2005-AB-01*).

On a quarterly basis, the Examiner-In-Charge (EIC) will draw assistance, as needed, from accountants, financial risk modeling experts, financial analysts, and mortgage specialists to conduct on-site visits at each FHLBank. Finance Board staff will monitor the FHLBank's progress in remedying weaknesses and violations previously identified; evaluate market sensitivity and operating performance; and identify emerging issues.

In 2006, the agency will continue to assess the effectiveness of the FHLBanks' actions taken as a result of the findings in previous examinations and through other supervisory activities, and, if warranted, will take additional informal or formal corrective action.

Staffing. Finance Board examiners have expertise in many areas including accounting, capital markets, lending, financial analysis, information technology, community development and affordable housing, and financial modeling. Supervisory accountants provide technical assessments and analyses on complex accounting issues that affect the FHLBank System and alert the EICs to developing accounting issues. Financial analysts prepare periodic and *ad hoc* reports on the FHLBanks' financial and operating environment and risk profile. Economists develop, document, and review statistical, econometric, and financial models of fixed-income instruments, including mortgages and derivatives. When assessing the FHLBanks' mortgage programs, the mortgage specialists evaluate whether FHLBank policies and procedures, programs, and reports comply with federal laws, Finance Board regulations, and other applicable banking regulatory policies and prudent practices.

Supervisory Guidance and Training. A draft revision of the agency's examination manual will be substantially complete in the fourth quarter of 2005 and will be finalized and disseminated in 2006. The revised manual reflects a risk-focused approach to the conduct of on-site safety and soundness examinations. It will provide a tool for examiners when reviewing and assessing the adequacy of risk management of an FHLBank. Updated examination work programs and workpaper standards were tested in 2005 and will be fully implemented in 2006.

A rating system is being developed to quantify an FHLBank's financial condition and risk management, identify FHLBanks that require special attention, summarize supervisory concerns, encourage remedial action by the FHLBanks and their boards of directors and allocate supervisory resources. In 2005, each FHLBank received a summary conclusion that ranged from satisfactory (a well-run institution) to unsatisfactory (an institution operating in an unsafe and unsound manner). In 2006, the Finance Board will add component risk ratings for individual risk areas, including ratings for corporate governance, condition and performance, market risk, credit risk, operations risk, and the Affordable Housing Program.

In 2006, the Finance Board will continue to develop and issue supervisory guidance to the FHLBanks in the form of Advisory Bulletins, Examiner Guidance Bulletins, and Regulatory Interpretations. Timely guidance will be provided in response to emerging risks, the evolving activities and operations of the FHLBanks, developments in the financial markets, and new supervisory issues. Effective best practices will be incorporated into the supervisory guidance. In recent months, Advisory Bulletins were issued concerning examination findings and conclusions, affordable housing set-aside programs, registration with the U.S. Securities and Exchange Commission (SEC), Statement of Financial Accounting Standard 150, anti-predatory lending policies, and risk management oversight.

In 2006, the Office of Supervision plans to enhance its training and development program through an orientation program, the creation of individual development plans, and cafeteria-style training opportunities through seminars, conferences, and courses. In addition, supervisory staff is encouraged to pursue studies and obtain professional certifications in areas relevant to bank supervision, such as certified public accountant, chartered financial analyst, financial risk manager, and certified information systems auditor. The next Office of Supervision off-site training conference is planned for Spring 2006.

Off-Site Monitoring and Analysis. Bank analysts review activities, financial condition, fiscal and operating performance; track FHLBank regulatory compliance; and assess market developments that may affect the FHLBank System on an on-going basis. Bank analysts work closely with the examination staff to establish the scope of examinations and participate in the annual on-site safety and soundness examination of the FHLBanks. In addition, bank analysts prepare analytical papers on conditions and trends and the effects of these upon the FHLBank System's condition, profitability, and stability.

Risk Measurement and Modeling. The risk modeling staff uses quantitative methods and financial models in the supervision of each FHLBank. Staff reviews proposed changes to the market risk model an FHLBank uses to calculate risk based capital requirements.

To provide analytic support to the examination function, the Finance Board has developed an approach to risk modeling that checks the market value and market value sensitivity of individual positions held by the FHLBanks. This methodology focuses on the positions with the greatest interest-rate sensitivity. It is supplemented with an off-site risk monitoring program consisting of analysis of quarterly data and risk exposure reports prepared by each of the FHLBanks using their own risk modeling systems. The reports include measures of the sensitivity of the FHLBanks' market value of equity to parallel interest rate shocks, including the effects of duration, and convexity.

Strategic Goal 1	Supervision program effectively fosters safe and sound operations at each FHLBank.
Strategic Objective 1.2	The FHLBanks meet or exceed their minimum capital requirements.
Annual Performance Goal 1.2	Each FHLBank satisfies its applicable capital requirements and prudently manages capital and earnings.
Annual Performance Measure 1.2	Each FHLBank continuously meets or exceeds its minimum capital requirement.
Means and Strategies	<p>In December 2000, the Finance Board adopted a regulation that requires the FHLBanks to establish a new risk based capital structure. The new capital structure contains minimum capital standards⁴ and establishes the amount of FHLBank stock members must hold. Under the rule, the FHLBanks submitted and the Finance Board approved all the capital structure plans in 2002, and to date, 10 of the 12 FHLBanks have implemented their plans.</p> <p>The FHLBanks with new capital structures must report their risk-based capital requirement by component amount, as well as their total capital amount and permanent capital amount, at least monthly to the agency. Risk-based capital requirements are imposed upon each FHLBank on the basis of the credit, market, and operations risks undertaken by that institution. If a new capital structure plan has not been implemented, the FHLBank must adhere to the alternative leverage requirement in 12 C.F.R. § 966.3(a).</p> <p>Before each FHLBank's capital structure plan becomes effective, the Finance Board must approve the internal market risk model or internal cash flow model that is used to calculate the credit risk component of the FHLBank's risk-based capital requirement, as well as the risk assessment procedures and controls. The Finance Board must also approve any proposed changes to the FHLBank's internal market risk model or internal cash-flow model. The Finance Board reviews the adequacy of the internal market risk models, as well as the risk assessment procedures as part of the annual on-site safety and soundness examination.</p> <p>In 2006, the Finance Board will continue to assess the progress made by the two FHLBanks that have not implemented their new capital structure plans.</p> <p>Based upon supervisory guidance provided by the Finance Board, each FHLBank must assess its capital management practices and the adequacy of its retained earnings in light of future financial and economic scenarios, at least annually. The agency reviews the retained earnings policy of each FHLBank as part of its annual on-site examination.</p> <p>The Finance Board monitors compliance with applicable capital</p>

⁴ See section 6 of the Federal Home Loan Bank Act (12 U.S.C. § 1426) and 12 C.F.R parts 931, 932, and 933.

requirements and evaluates capital management policies and procedures as part of the on-site examination of the FHLBanks. Issues and concerns regarding the sufficiency or management of capital are communicated to FHLBank management and are included along with management's response in the report of examination. Between annual on-site examinations, capital, including retained earnings, is monitored on a monthly basis using data collected from the FHLBanks.

When an FHLBank seeks to amend its capital structure plan, agency approval is required under section 6 of the Federal Home Loan Bank Act (Bank Act) (12 U.S.C. § 1426). The agency will continue to consider such requests in 2006.

In 2006, the Finance Board will consider modifications to its regulations to strengthen the retained earnings of the FHLBanks and limit each FHLBank's total holding of stock that exceeds its members' required stock purchases.

Strategic Goal 1	Supervision program effectively fosters safe and sound operations at each FHLBank.
Strategic Objective 1.3	The FHLBanks raise funds efficiently and are role models for corporate transparency and accountability.
Annual Performance Goal 1.3a	FHLBanks maintain a triple A credit rating for their consolidated obligations.
Annual Performance Measure 1.3a	Conduct semi-annual assessment of FHLBank System cost of funds and maintain ratings for consolidated obligations and FHLBank credit rating at regulatory requirements.
Means and Strategies	The FHLBanks raise funds in the capital markets through the issuance of consolidated obligations, for which they are jointly and severally liable. The ability of the FHLBanks to issue consolidated obligations at rates slightly above the rates on the obligations of the U.S. Treasury is important to their ability to efficiently fund their operations. Accordingly, section 2A(a)(3)(B)(iii) of the Bank Act (12 U.S.C. § 1422a(a)(3)(B)(iii)) directs the Finance Board to ensure that the FHLBanks remain able to raise funds in the capital markets.

To measure the efficiency of the FHLBanks in raising funds, the agency conducts a semi-annual review of the FHLBanks' funding costs relative to those of the U.S. Treasury and other government sponsored enterprises (GSEs) engaged in housing-related activities. The agency publishes the results of these semi-annual reviews in the mid-year and year-end Profile Books. Comparisons of FHLBank System funding costs to interest rate indices such as LIBOR are also monitored.

Collectively, the FHLBanks are required to obtain from a nationally recognized statistical rating organization (NRSRO)⁵, and at all times maintain, a current credit rating on their consolidated obligations. The FHLBanks are also required to operate in such manner and take any actions necessary to ensure that FHLBank System consolidated obligations receive the highest credit rating from any NRSROs that have rated the obligations.⁶ In addition, each FHLBank is required to operate in such manner and take the actions necessary to ensure that it has and maintains at least the second highest individual issuer credit rating from any NRSRO.⁷

S&P and Moody's have rated long-term FHLBank consolidated obligations "AAA" and "Aaa," respectively, and short-term consolidated obligations "P-1" and "A-1+," respectively, their highest ratings. Each of the FHLBanks has received an individual issuer credit rating of at least "AA" or "Aa," respectively, the second highest such rating awarded by S&P and Moody's.

⁵ Such as Standard & Poor's Ratings Group (S&P) and Moody's Investors Service, Inc. (Moody's).

⁶ See 12 C.F.R. § 966.3(b)(2).

⁷ See 12 C.F.R. § 966.3(c).

In 2006, the Finance Board will continue to monitor the FHLBank System's consolidated obligations' rating and the FHLBanks' ratings individually, through ratings conference calls and other discussions with NSRSOs, as well as through other means.

Strategic Goal 1	Supervision program effectively fosters safe and sound operations at each FHLBank.
Strategic Objective 1.3	The FHLBanks raise funds efficiently in the capital markets and are role models for corporate transparency and accountability.
Annual Performance Goal 1.3b	Each FHLBank's and the FHLBank System's financial disclosures comply with applicable laws, rules, and regulations.
Annual Performance Measure 1.3b	Conduct on-site examination of the OF and review annual and quarterly financial reports issued by the FHLBank System for compliance with disclosure requirements. EICs monitor annual and quarterly financial reports issued by each FHLBank.

Means and Strategies *On-site examination.* The Finance Board conducts an annual on-site examination of the OF. The Finance Board will conduct its next on-site examination of the OF in December 2005. While on site, agency examiners: (i) follow up on issues identified through pre-examination analysis and planning; (ii) test systems, controls, and reports for adequacy and accuracy, including the internal audit function; (iii) assess the OF's risk profile and operational soundness; (iv) identify issues that may affect the risk or operating profile of the OF; (v) evaluate the OF's quality of corporate governance; and (vi) test for compliance with law, regulation, and OF policies, including sales suitability practices by participating underwriters and broker-dealers.

Issues and concerns examiners identify are communicated to OF management and are included, together with management's response, in a report of examination. Thereafter, these issues are processed and monitored in the same manner as supervisory concerns that arise from the examination of an FHLBank.

Annual and Quarterly Reports. Finance Board regulations⁸ require the OF to prepare and issue a combined FHLBank System-wide annual report and three quarterly financial reports (FHLBank System Combined Reports) using financial information submitted by the FHLBanks. The scope, form, and content of the FHLBank System financial reports must be consistent with requirements of Regulations S-K and S-X of the SEC.

In 2006, the Finance Board will continue to review annual and quarterly FHLBank System Combined Reports that are prepared and issued by the OF. The Finance Board also intends to examine the accounting practices of each FHLBank and ascertain the effect of these practices on the FHLBank System's Combined Reports.

⁸ 12 C.F.R. § 985.3(b).

SEC Registration. In 2005, each FHLBank was required to file a registration statement covering a class of equity securities with the SEC, and ensure its effectiveness under section 12(g) of the Securities Exchange Act of 1934 (1934 Act).⁹ After registering a class of equity securities with the SEC, each FHLBank will become subject to the 1934 Act's periodic disclosure requirements, which include the periodic preparation and filing of public disclosures relating to an institution's financial condition, results of operations, trends, or uncertainties affecting its business, and management's assessment of its business and financial condition, including supporting financial information and certifications. These disclosures must be filed with the SEC.

Only two FHLBanks met the deadline for registering their securities with the SEC. The remaining FHLBanks are required to make weekly reports to the Finance Board concerning their progress in completing the SEC registration process. In addition, the Finance Board will continue to monitor future developments with the FHLBanks filings and communications with the SEC.

⁹ See 12 C.F.R. part 998.

FULFILLMENT OF FHLBANKS' HOUSING FINANCE MISSION

Congress established the FHLBank System in 1932 to restore confidence in the nation's financial institutions and to improve the supply of funds to local lenders to finance loans for home purchases. Congress expanded the FHLBank System's public policy mission in 1989 to include affordable housing and community development lending. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 established the Affordable Housing Program (AHP) and a Community Investment Program (CIP) through which the FHLBanks provide funding to support the community and economic development activities of their members.

FHLBanks make secured advances to their members to provide funds for residential housing finance and to provide funds to community financial institutions for small businesses, small farms, and small agricultural businesses. Authorized purposes for advances, limitations upon access to advances based upon member capitalization and condition, eligible collateral to secure advances, documentation requirements, required disclosures in the case of convertible advances, transaction fees, lien priority of advances, member borrowing limits, and all other matters are described in the Bank Act and Finance Board regulations.¹⁰

Acquired Member Assets (AMA) is the comprehensive term for programs through which the FHLBanks acquire whole, single-family, residential mortgage loans or loan pools either by purchasing closed loans or funding loans at time of closing. These loans are originated by members¹¹ in transactions that are functionally equivalent to making an advance in purpose and economic substance in that the member or housing associate can access liquidity for additional mission-related lending, and all or a material portion of the credit risk is borne by the member or housing associate.

The AHP subsidizes the cost of affordable owner-occupied and rental housing. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an FHLBank advance to a member. By statute, each FHLBank must contribute at least 10 percent of its net earnings from the previous year to the AHP, subject to a minimum annual combined contribution by all 12 FHLBanks of \$100 million.

The table below depicts the strategic goal, strategic objectives, and annual performance goals for the Agency's Housing Finance Mission.

Strategic Goal	Strategic Objectives	Annual Performance Goal
2. Ensure that the FHLBanks serve the nation's housing finance and community investment needs.	2.1 The FHLBanks facilitate the housing finance activities of their members.	2.1 FHLBanks adhere to public policy principles and safety and soundness requirements when making advances and acquiring mortgage assets.

¹⁰ See Bank Act sections 7(j), 9, 10, and 10b (12 U.S.C. §§ 1427(j), 1429, 1430, and 1430b), and part 950 of the Finance Board regulations (12 C.F.R. part 950).

¹¹ Mortgage loans or mortgage loan pools can also be originated by an eligible non-member borrower, subsidiary, or an affiliate thereof, from or through the member or eligible non-member borrower. The term "member" in the context of "Acquired Member Assets" represents all these entities.

	2.2 The FHLBanks support affordable housing and promote community investment.	2.2 Supervision of the Affordable Housing and Community Investment Programs.
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Strategic Goal 2	Ensure that the FHLBanks serve the nation's housing finance and community investment needs.
Strategic Objective 2.1	The FHLBanks facilitate the housing finance activities of their members.
Annual Performance Goal 2.1	The FHLBanks adhere to public policy principles and safety and soundness requirements when making advances and acquiring mortgage assets.
Annual Performance Measure 2.1	Review advance and mortgage portfolios of each FHLBank as part of the annual on-site examination for compliance with the Bank Act and Finance Board regulations.
Means and Strategies	<p><i>Advances.</i> As part of the annual on-site examination, examiners evaluate the FHLBanks' advance and collateral policies and practices to ensure compliance with the Bank Act and part 950 of the Finance Board regulations (12 C.F.R. part 950). In addition, the agency assesses the degree of credit, market, and operations risk inherent in the FHLBanks' advance activities and the extent to which they are managed by the FHLBank.</p> <p>Other matters for review include: (1) the use of advances and the pledging of collateral by community financial institutions (which, by statute, may use long-term advances to support small business, small farm, and small agricultural business lending in addition to residential housing lending); (2) standards and criteria employed for differential pricing of advances and collateral evaluation; (3) practices in marketing and disclosure of advance products, in particular those with embedded options such as convertible advances, to assess adequacy of disclosure in the terms and conditions; and (4) purchase of loan pools by members from third-party originators that are subsequently pledged as collateral for FHLBank advances or mortgage banking subsidiaries of members that engage in sub-prime lending. These activities may expose the member or the FHLBank to reputation risk and assignee liability risk if the loans are predatory in nature.</p> <p>Between annual on-site examinations, the agency monitors the size and composition of each FHLBank's advance portfolio on a quarterly basis from data submitted by the FHLBanks. In addition, an annual survey of FHLBanks is conducted of the original term of advances and the types of collateral securing advances.</p> <p>Pursuant to part 980 of the Finance Board regulations (12 C.F. R. part 980), a FHLBank must submit a new business activity notice to the Finance Board before initiating any new advance activity or accepting collateral that entails new risks. In its review of such notices, the Finance Board considers both the safety and soundness implications of the proposal, compliance with law and regulation, product responsiveness to member needs, and product effectiveness in supporting the nation's housing mission.</p>

The Finance Board will examine the advance portfolios of each FHLBank as part of its 2006 annual on-site examination and will conduct quarterly monitoring of the size and composition of the portfolios. The annual survey of the types of collateral securing FHLBank advances will be completed in the third quarter of 2006. Any new business activity notices submitted by the FHLBanks will also be reviewed.

Acquired Member Assets (AMA). As part of the annual on-site examination conducted at each FHLBank, the Finance Board evaluates compliance of each FHLBank's AMA program and activities with the requirements of part 955 of its regulations (12 C.F.R. part 955). The evaluation includes an assessment of the degree of credit, market, and operations risk in an FHLBank's AMA activities and the extent to which the FHLBank successfully manages these risks. Other matters reviewed include: (1) the structures under which mortgages are purchased; (2) practices in the marketing of AMA products and the adequacy of disclosures provided by the FHLBank to participating members and housing associates; (3) compliance with prudent lending policies; and (4) compliance with generally accepted accounting principles.

An FHLBank must submit a new business activity notice to the Finance Board before initiating an AMA program activity or acquiring an AMA program asset that entails new risks. In its review of such notices, the agency considers the safety and soundness implications of the proposal, product compliance with law and regulation, product responsiveness to member needs, and product effectiveness in supporting the nation's housing finance system.

In 2006, examiners will evaluate all aspects of AMA programs and program loans as part of annual on-site examination of each FHLBank. Among other things, the examination will focus on: (1) the risk exposure to the FHLBanks; (2) purchase or funding of predatory loans, manufactured housing, and/or cooperative housing loans; (3) calculation of the credit enhancement; and (4) data collection coding errors.

In 2006, the Finance Board anticipates revising the AMA regulation to ensure that mortgage purchase programs are carried out safely and soundly and in a manner consistent with the FHLBanks housing finance mission.

By January 1, 2006, each FHLBank should have in place a comprehensive anti-predatory lending policy and written procedures to govern the FHLBank's purchase of whole loans and acceptance of pledged collateral. The Finance Board will review each FHLBank's anti-predatory lending asset purchase and collateral policies, its member agreements, and its monitoring procedures and practices during annual examinations.

Strategic Goal 2	Ensure that the FHLBanks serve the nation's housing finance and community investment needs.
Strategic Objective 2.2	The FHLBanks support affordable housing and promote community investment.
Annual Performance Goal 2.2	Supervision of the Affordable Housing and Community Investment Programs.
Annual Performance Measure 2.2	Conduct examinations of the Affordable Housing and Community Investment Programs at each FHLBank
Means and Strategies	In 2006, the Finance Board will conduct on-site reviews of the AHP, CIP, and other Community Investment Cash Advance (CICA) programs of each FHLBank. Examiners review policies, procedures, and controls that address funds reconciliation, board of directors and management oversight, funding award process, and uses of funds.

AHP. A sample of AHP projects will be tested for compliance with the requirements of part 951 of the Finance Board regulations (12 C.F.R. part 951). In 2006, the agency will also revise the examination work programs for AHP and other CICA programs including CIP to reflect the requirements in the revised AHP regulation.

CIP. In its examination of each FHLBank's CIP, the agency reviews program compliance with the requirements of Section 10(i) of the Bank Act,¹² including eligibility of advances, pricing methodology employed, and application of policies and procedures to verify members' appropriate use of advances. In 2006, the Finance Board intends to evaluate the systems used to capture data concerning the CICA and CIP programs and determine if any enhancements are necessary.

CICA. In its examination of a FHLBank's CICA program, the agency reviews program compliance with the requirements of Section 10(j)(10) of the Bank Act (12 U.S.C. § 1430(j)(10)) and part 952 of the agency's regulations (12 C.F.R. part 952), including documentation of compliance with targeting requirements and application of policies and procedures to verify members' appropriate use of funds.

The Finance Board has generally been able to resolve concerns identified during its examination of the AHP, CIP, and, as applicable, other CICA programs, through discussions with FHLBank management and boards of directors. On a quarterly basis, the agency will monitor the FHLBank's progress in resolving such concerns and will confirm that the issues have been corrected.

¹² 12 U.S.C. § 1430(i). Section 10(i) requires each FHLBank to establish a CIP that provides advances to members priced at the cost of funds, plus reasonable administrative costs.

Where warranted, the Finance Board requires an FHLBank to take additional remedial action such as suspending or debaring a member, project sponsor, or project owner from participation in the program. In the case of an FHLBank's CIP and other CICA programs, the Finance Board may require an FHLBank to reclassify advances not adhering to applicable statutory and regulatory requirements as CIP or CICA advances.

Community Support Programs. Each FHLBank is required to adopt an annual community lending plan.¹³ The Finance Board solicits and reviews FHLBank member's community support statements approximately once every two years. In 2006, the Finance Board will assess whether the community lending plans meet the requirements of the regulations. In addition, the Finance Board will review community support statements of approximately one-half of FHLBank members.

¹³ See 12 C.F.R. part 944 and §§ 952.4 and 952.6.

MANAGEMENT OF FINANCE BOARD RESOURCES

The Finance Board recognizes that it must effectively manage its resources to successfully carry out its mission and achieve the annual performance goals that it has established. Initiatives that are planned for 2006 include:

Human Capital Management. Employees are the Finance Board's most important resource. For that reason, the agency seeks to be the employer of choice within the financial regulatory community and to attract, develop, reward, and retain a high-quality, results-oriented workforce.

Information and Systems Technology. The Finance Board seeks to use its information technology resources to improve the efficiency and effectiveness of its operational processes. Several initiatives are underway to allow information technology to function as a strategic business partner to the entire agency.

The table below depicts the strategic goal, strategic objectives, and annual performance goals for the mission fulfillment.

Strategic Goal	Strategic Objectives	Annual Performance Goal
3. Use supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight.	3.1 The Finance Board takes appropriate and timely regulatory and advisory actions.	3.1a Review, revise, and supplement Finance Board regulations to ensure relevance, transparency, and issue-oriented supervisory guidance.
		3.1b Review and respond promptly to new business activities notices filed by the FHLBanks.
	3.2 The Finance Board prudently allocates resources to fulfill its mission effectively and efficiently.	3.2a Use fiscal, physical, and human resources efficiently and effectively to fulfill the Finance Board's fiduciary responsibilities.
		3.2b Maintain and test business continuity and contingency plans.

Strategic Goal 3	Use supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight.
Strategic Objective 3.1	The Finance Board takes appropriate and timely regulatory and advisory actions.
Annual Performance Goal 3.1a	Review, revise, and supplement Finance Board regulations to ensure relevance, transparency, and issue-oriented supervisory guidance.
Annual Performance Measure 3.1a	Review and revise Finance Board regulations, and supplement regulations with advisory bulletins, examiner guidance bulletins, and regulatory interpretations, where appropriate.
Means and Strategies	<p>The Finance Board's highest regulatory priorities during 2006 continue to be to ensure the safety and soundness of the FHLBank System and to ensure that the FHLBanks fulfill their housing finance and community investment missions. To further these statutory mandates, the Finance Board expects to consider regulations that will:</p> <ul style="list-style-type: none">• More clearly delineate the responsibilities and the accountability of the board of directors for governance of an FHLBank, thereby strengthening the role of the boards in the FHLBanks' operations.• Streamline the Finance Board's review of new business activities proposed by an FHLBank to more clearly focus the review process on ensuring that a new product, service, or activity will not endanger the continued safe and sound operation of the FHLBank.• Streamline the community support requirements to eliminate unnecessary regulatory burden while preserving the statutory intent of ensuring that members' access to long-term advances reflects such factors as their performance under the Community Reinvestment Act and their record of lending to first-time homebuyers.• Improve the operations and efficiency of the AHP by more clearly delineating the FHLBanks' responsibilities for program administration and for satisfying the statutory directive that the subsidy benefit very low-income, low-income, and moderate-income households.• Streamline the regulations governing the FHLBanks' AMA programs to make the provisions less prescriptive while preserving the key provisions relating to safety and soundness and advancement of the FHLBanks' housing finance mission.• Update the regulations relating to the capital structure of the FHLBanks to enhance safety and soundness by ensuring that the amount and composition of capital is appropriate in light of the risks undertaken in the course of lines of business.

- Improve the regulations relating to investments made by the FHLBanks to coordinate with the repeal of the provisions of the Financial Management Policy that currently govern FHLBank investment portfolios.

Strategic Goal 3	Use supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight.
Strategic Objective 3.1	The Finance Board takes appropriate and timely regulatory and advisory actions.
Annual Performance Goal 3.1b	Review and respond promptly to new business activities notices filed by the FHLBanks.
Annual Performance Measure 3.1b	Respond to new business activity notices filed by the FHLBanks within 60 days of receipt.
Means and Strategies	Pursuant to part 980 of the Finance Board regulations (12 C.F.R. part 980), an FHLBank intending to engage in a “new business activity” must file a prior notice of its intent to do so with the Finance Board. The regulation requires the Finance Board to respond to the FHLBank within 60 days after receipt of the notice. The Finance Board will review any new business activity notice received in 2006 pursuant to part 980.

In its review of a new business notice submitted by an FHLBank, the Finance Board will assess the legal permissibility of the proposed activity, the risks of the proposal, and the ability of the FHLBank to manage those risks. If the activity is deemed appropriate for the FHLBank, the agency will approve the activity with such conditions as may be appropriate and will make every effort to transmit an appropriate response to the FHLBank within 60 days of receipt of the notice. Alternatively, within 60 days, the agency may issue a notice or provide other communications to the FHLBank disapproving the activity, instructing the FHLBank not to commence the activity pending further agency consideration, declaring an intent to examine the FHLBank, requesting additional information, establishing agency conditions to approval of the activity, or containing other instructions or information deemed appropriate by the agency. Assessments of a new business activity are also conducted by the Finance Board as part of on-site examinations once the activity has been initiated. The agency retains authority to request additional information or impose additional conditions upon the conduct of such activity at any time.

Strategic Goal 3	Use supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight.
Strategic Objective 3.2	The Finance Board prudently allocates resources to fulfill its mission effectively and efficiently.
Annual Performance Goal 3.2a	Use fiscal, physical, and human resources efficiently and effectively to fulfill the Finance Board's fiduciary responsibilities.
Annual Performance Measure 3.2a	Align budgeted resources with projected workloads and business priorities. Recruit, develop, and retain high-achieving professional staff.
Means and Strategies	The Finance Board needs high-achieving professionals in various disciplines. The means and strategies the agency will use in 2006 to develop, maintain, and support a highly qualified, skilled, and diverse workforce are described below.

Human Resources. Recruitment of highly qualified examiners, economists, accountants, mortgage, risk, financial, and systems specialists and analysts will continue to receive priority in 2006. To achieve this goal and promote diversity in the workforce, the agency will solicit, evaluate, and select applicants using a combination of federal and private advertising targeted to the financial services industry, as well as outreach to minorities and persons with disabilities. The agency will also ensure that benefits are competitive with other federal bank regulators. The Finance Board will continue to offer a variety of training options to encourage development of staff skills and abilities in support of the agency mission. The development of a more effective and responsive EEO program will continue in 2006.

In 2006, the Finance Board Information Security Program will continue to focus on compliance with the Federal Information Security Management Act (FISMA). New plans of action and milestone documents will be developed to track continuing improvements to the Information Security Program. Staff will direct specific attention to the monitoring and oversight of the Finance Board's Financial Management System, which was outsourced to the Bureau of Public Debt, Administrative Resource Center, on July 1, 2005.

Data Collection and Management. In 2006, the Finance Board will continue to enhance the agency's data management and information systems, including implementation of a comprehensive set of procedures for application development. These efforts will focus on the continuation of an initiative to develop an enterprise data repository to standardize and link the Finance Board's data collection and management processes across agency platforms and systems. This will facilitate the retrieval and analysis of data across platforms and systems.

The establishment of an enterprise data repository is expected to greatly facilitate access to data and data sets and significantly enhance the agency's monitoring capabilities.

In 2005, the Finance Board determined that stabilizing and providing staff access to existing data platforms and systems was required before a central data repository could be justified. Accordingly, in 2005, the Finance Board: 1) made Call Report System (CRS) data available to users for *ad hoc* reporting and analysis; 2) restructured AMA data and migrated the AMA data to an enterprise-consistent MS SQL platform; 3) recovered AHP data from its current application for migration to an MS SQL database in 2006; 4) developed and communicated to the FHLBanks a specification for a new AHP database to replace the existing AHP system; 5) developed a data dictionary for all Office of Supervision data holdings; and 6) assessed the tools required to permit users to retrieve and use Finance Board data. In 2006, remaining data holdings will be upgraded to similar levels of accessibility and stability. The Finance Board will determine whether the data repository can be created using its existing resources or through a third party contractor.

In 2006, Finance Board will continue to assess data submissions by the FHLBanks to assure that information collected supports the agency's mission. The agency intends to adopt a data quality and timeliness regulation to enhance the timeliness and accuracy of data collection. This regulation is expected to be released through the completion of a Data Reporting Manual in 2006. During 2005, chapters concerning the Call Report System and FHLBank membership data have been completed. The Finance Board will also continue its efforts to integrate, maintain, and improve data from the FHLBanks.

The Finance Board is restructuring its existing AHP data information system by streamlining the data collection process and improving the data quality. The Finance Board estimates that the proposed changes to the AHP database collection will reduce the reporting burden while increasing the utility of the information. The AHP information system will be fully operational by the end of 2006, and the FHLBanks are expected to submit 2005 data on schedule by the end of the second quarter of 2006.

In addition, in 2005, the agency implemented a new internet website that allows users to locate information more efficiently.

Resource Allocation. The continuing availability of financial resources is critical to the ability of Finance Board staff to realize the objectives of the Strategic Plan and fulfill the agency's mission. Enhanced budget and program integration currently underway will assure that resource allocations are aligned with the agency mission and the Strategic Plan.

To fulfill its stewardship responsibilities, the Finance Board employs sound fiscal management techniques and continually seeks ways to implement more efficient and cost-effective business processes in order to reduce its ongoing operational costs. In 2006, the Finance Board will file its second Performance and Accountability Report. As in the past, unaudited quarterly financial statements were submitted to the U.S Office of Management and Budget pursuant to the Accountability of Tax Dollars Act of 2002.

Strategic Goal 3	Use supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight.
Strategic Objective 3.2	The Finance Board makes prudent resource management allocations to fulfill its mission effectively and efficiently.
Annual Performance Goal 3.2b	Maintain and test business continuity and contingency plans.
Annual Performance Measure 3.2b	Review, update, and test the Finance Board's Continuity of Operations Plan (COOP).
Means and Strategies	<p>The COOP is designed to ensure continuity of essential Finance Board functions under all emergency circumstances. The COOP identifies the essential functions that must be continued and the policy and procedures for activating the program. COOP planning is a "good business" practice and is part of the Finance Board's fundamental mission as a responsible and reliable public institution. The Finance Board's COOP is designed to address potential threats, crises, and emergencies, both natural and manmade, and those that occur with or without warning, and during business or non-business hours. The COOP primarily covers operations located at the headquarters facility in Washington DC. However, it also ensures that the support needed for field examinations of the FHLBanks exists. The major components of the COOP include identification of essential functions; delegations of authority; orders of succession; communications processes; vital records, files and databases required and available during an emergency; and a testing and training program that includes formal annual testing of the COOP's different components.</p> <p>The Finance Board tested the COOP in 2005 through an exercise using established activation procedures, requiring emergency personnel to report to the Emergency Operations Center, and testing of programs to ensure that essential functions could be performed. The COOP was also updated to comply with recent directives from the Department of Homeland Security, Federal Emergency Management Agency, that were issued as a result of government wide audits and testing. These efforts will continue in 2006.</p>

APPENDICES

Program Resource Requirements

Finance Board's Planning Process

Program Evaluations

Key External Factors

Performance Results Fiscal Years 2002-2005

Program Resource Requirements

The estimated 2006 operating expenses are approximately \$35.9 million for fiscal year 2006. The agency has allocated approximately \$30 million or 83 percent of its budget in support of its supervision program.

Finance Board's Planning Process

Strategic Plan for Fiscal Years 2003-2008: The mission, vision, and values of the Finance Board were used as a starting point to develop the agency's Strategic Plan. This Plan articulates the agency's strategic goals and objectives, as well as the means and strategies for their achievement. The Strategic Plan covers fiscal years 2003 through 2008 and identifies three strategic goals that support the agency's mission. The goals are: (1) to foster safe and sound operations at each FHLBank; (2) to serve the nation's housing finance and community investment needs; and (3) to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight. In addition to the three strategic goals, the Finance Board has established seven strategic objectives.

The Strategic Plan was developed by a cross-agency working group comprised of representatives from the Offices of the Board of Directors, Supervision, Management, and General Counsel. It was approved by a steering committee consisting of the directors of the Offices of Supervision, Management, and the General Counsel and then by the agency's Board of Directors.

The Annual Performance Plan represents the means by which the Finance Board implements the strategic goals and objectives that are laid out in the Strategic Plan. In addition to providing the blueprint for the annual implementation of the Strategic Plan, it establishes measures against which agency success in achieving its annual performance goals may be judged. Specifically, the annual performance plan establishes annual target levels of performance with which the agency's resources will be aligned, means and strategies for achieving these, and performance measures against which actual performance can be assessed. The Annual Performance Budget for fiscal year 2006 was developed and approved by surveying the cost center managers.

Information and Technology (IT) Strategic Plan for 2004 through 2009: The IT Strategic Plan details the Finance Board's goals in providing effective technology in support of the agency's major program areas. It identifies four major informational initiatives in support of the agency's strategic goals and objectives including: (1) continued operation of the agency's Technology Investment Committee to assure alignment of information technology with the agency's strategic business goals; (2) development and maintenance of an information technology infrastructure supportive of agency operations that anticipates future needs; (3) design, development, and operation of application systems that are supportive of agency operations and provide management information; (4) and development and maintenance of an effective information security program complying with FISMA.

The IT Strategic Plan was developed by the Finance Board's Chief Information Officer and his staff and was approved by the Technology Investment Committee, which consists of the Chief Information Officer and the directors of the Offices of Supervision and Management.

Program Evaluations

The Finance Board communicates its strategic goals and objectives and its annual performance goals, indicators, and targets to agency employees via the agency's intranet and other internal communication mechanisms such as staff meetings and memoranda to the staff. Pay and award/recognition programs are structured to reward employee contributions to the achievement of the agency's annual objectives.

The Finance Board monitors its progress in implementing its goals regularly through its financial accounting and budget system and other internal tracking and reporting mechanisms, as well as internal staff and management meetings. The accounting and budgeting system tracks agency costs against budgeted resources for various agency functions. This allows the effectiveness of current agency programs and activities to be considered when making allocations of agency resources. The agency's annual financial statements are prepared in accordance with generally accepted accounting principles and are subject to an annual audit by an independent accounting firm. After the year ends, the agency submits an Annual Report to Congress. This report compares actual performance to the annual performance goals, and is posted on the Finance Board's website, www.fhfb.gov.

Audits conducted by the Office of the Inspector General and the U.S. General Accounting Office are other means used to determine the quality and effectiveness of agency programs and operations. In addition, the effectiveness, clarity, and adaptability of the Finance Board's regulations and their consistency with current agency priorities and objectives is assessed through the agency's ongoing efforts to identify provisions that should be amended or eliminated because they are no longer relevant, do not achieve their intended purpose, are unreasonably burdensome, or are too complex or ambiguous.

Key External Factors

As is the case with all other financial institution regulators, the Finance Board is affected by macroeconomic conditions. The Finance Board cannot control such factors as the capital markets, interest rates, regional or national recessions or economic expansions, housing prices, financial industry consolidation and restructuring, or banking policies formulated beyond its own jurisdiction.

Legislation. The primary external factor that could affect the Finance Board in the near future is legislation that is now being considered by Congress. Among other things, the legislation would establish a single agency as the regulator for all GSEs involved in the home mortgage market. The new agency would be independent and have the authority to oversee the safety, soundness, and housing mission of Fannie Mae, Freddie Mac, and the FHLBanks. It is anticipated that the legislation would abolish the Finance Board and transfer the agency's functions and current staff to the new agency.

Evolving Banking Industry. The banking industry continually strives to provide products and services in an effective, efficient, and profitable manner. As the industry changes, the focus of the Finance Board examiners must also evolve to ensure that the FHLBanks are being supervised appropriately. Recent areas of concern include:

Predatory Lending. Many states and local jurisdictions have passed laws that prohibit abusive and predatory lending practices.¹⁴ Though the specific provisions vary, in general, the laws prohibit abusive mortgage lending practices and require lenders to provide loan counseling to certain borrowers and ensure that borrowers are reasonably able to meet their loan obligations. These laws most often apply to residential mortgage lenders, loan brokers, loan servicers, loan purchasers, and assignees regardless of loan type, credit quality, type of collateral, loan pricing, or office location.

Predatory lending practices are inconsistent with the FHLBanks' responsibility to operate in a financially safe and sound manner and serve as a source of liquidity for the nation's housing and community investment needs. Each FHLBank is responsible for knowing the state and local laws and ordinances that are germane to the mortgage loans that it funds or acquires through the AMA programs or accepts as collateral for advances. Participation in financial instruments exposed to these abusive lending practices, even if that participation is inadvertent, may present heightened risks for participating parties, including the risk that they will be implicated in lending practices that may expose them to legal liability and reputation risk pursuant to state, local, or federal high-cost lending laws.

Sarbanes-Oxley Act of 2002 (SOX). The goal of SOX is to protect the interests of shareholders and the public by preventing fraudulent practices and accounting inconsistencies. SOX imposes new standards of accountability for the officers and directors of corporations and outside accounting and legal counsel, establishes financial reporting standards, and designates which business records must be held and for how long. SOX also requires the chief executive officer and chief financial officer to certify the appropriateness of the financial statements and disclosures contained in the annual report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer and holds those parties personally responsible for any violations.

¹⁴ States that have adopted comprehensive anti-predatory lending laws include: Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Illinois, Kentucky, Maine, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas, Washington, and West Virginia.

Prepayment Fees for Advances at Failed Institutions. The Federal Deposit Insurance Corporation (FDIC) is concerned that deposit insurance pricing does not consider the effect of secured funding, such as FHLBank advances, on expected Bank Insurance Fund losses. FHLBank advances are well collateralized. However, if a member fails and the collateral is insufficient, the FHLBank can assert a statutory lien priority on other assets. This allows the FHLBank to have a claim that is senior to all unsecured creditors. The FDIC would like to reduce its risk exposure by explicitly linking of FDIC insurance premiums to FHLBank funding and eliminating prepayment penalties for advances at institutions that have failed.

U.S. Economy. Recently, the Federal Reserve's Open Market Committee approved the 10th consecutive rate increase -- by one quarter of a percentage point to 3.50 percent. While short-term rates are rising, long-term rates remain flat. Many economists believe that inflationary expectations are still low, the market expects slower GDP growth, and most importantly, foreign central banks have financed more than 60 percent of the U.S. trade deficit in the past 14 months. This has put downward pressure on long-term rates.

The U.S. economy has grown at a healthy pace in 2005, and even shows signs of gaining momentum, despite rising energy prices. Household spending has led the expansion. Low interest rates and tax cuts have freed up funds. With oil prices at record highs, the big surprise is that consumers have kept spending. On the other hand, the saving rate is low, tax cuts are over, oil prices are high, borrowing is at record levels, and consumer debt is 120% of income.

The housing market remains strong, and there is no sign of a slowdown. The home ownership rate is now 70 percent. However, increased demand has driven home prices up and there is cause for concern about a home price bubble. Home prices have outpaced incomes. To put this in perspective, existing home prices are now 3.1 times the average income, about 2.6 times the historical average. Most economist believe that there is not a national housing bubble but acknowledge that there are local housing bubbles.

One area of concern is the effect that the flattening yield curve is having on the net interest margins of both thrifts and commercial banks. The net interest margin for these institutions is shrinking because longer-term interest rates are not keeping pace with the rising trend of short-term rates. This is critical to thrifts, as the majority of their revenues are generated from their lending activities and net interest income tends to dominant total revenue.

Market conditions are strong for residential adjustable-rate mortgage (ARM) originations, as ARM products continue to increase their share of the mortgage market. This trend continues despite the still-low rates for long-term fixed-rate mortgage loans. The lower start rate on ARMs combined with the current flat yield curve is temporarily suppressing net interest margin of many thrifts.

Since ARMs are gaining more market share, loan growth at many thrifts is outstripping core deposit growth. As a result, these thrifts are increasing their reliance on wholesale deposits and FHLBank advances to fund loan portfolio growth. The move to greater reliance on wholesale funds can drive funding costs higher. Fortunately, asset quality measures remain strong, as the level of credit losses and problem assets remains low and at very manageable levels.

Consolidated Obligations. The ability of the FHLBanks to provide funds to their members by issuing consolidated obligations can be affected by such factors as adverse movements in the international capital markets (such as a major foreign crisis), developments affecting the other GSEs, political factors, and unforeseen events. The FHLBanks' consolidated obligations must compete against such alternative investments as securities issued by the U.S. Treasury, other GSEs, and foreign or domestic corporations.

Information Technology. The FHLBanks operate in an environment characterized by changing financial markets. With the revolutionary changes in information technology, financial markets move more rapidly than ever before. In recent years, the role of the FHLBanks as financial intermediaries has changed considerably and has grown in complexity as innovative financial products and risk management techniques are used to improve the management and control of risks. Moreover, consolidation of the financial services industry has presented challenges to the FHLBank System as its membership base has evolved.

Staffing. In a competitive financial services environment where highly skilled personnel are in great demand, a key challenge for the Finance Board will be to retain a highly competent work force and, as needs dictate, to attract additional highly qualified bank examination and supervision staff with the requisite financial and technological skills to model, monitor, and assess the risks undertaken by the FHLBanks.

Performance Results

The success of the Finance Board in achieving its annual performance goals and “like” performance goals for fiscal years 2005 (through August 31, 2005), 2004, 2003, 2002, and 2001, is set forth below, as well the agency’s anticipated success in achieving such goals in fiscal year 2006. If a similar performance goal did not exist in a prior fiscal year, the annual performance goal is designated to be a “New Performance Goal.”

Annual Performance Goal 1.1	Maintain an effective, risk-based examination program.
Annual Performance Measure 1.1	Conduct all safety and soundness activities, including annual examinations, quarterly reviews and off-site monitoring, on a timely basis.

2006 Projected Performance. Complete annual safety and soundness examinations of the 12 FHLBanks, including their affordable housing programs, and the Office of Finance; add component ratings for individual risk areas to the examination risk rating system; implement revised examination manual with updated examination work programs and work paper standards; provide enhanced examiner guidance and training; and conduct off-site monitoring and analysis of FHLBank condition; annual testing of their interest rate sensitivity; and periodic testing of their market risk models. Also, staff and implement a quality assurance/internal audit program.

2005 Performance through August 31. Examinations of 8 FHLBanks completed or in process; examinations of remaining 4 FHLBanks and the OF will be completed by calendar year-end. Supervisory agreements with the FHLBanks of Seattle and Chicago remained in effect and Finance Board staff monitored FHLBank compliance with those agreements. On a quarterly basis, the EIC along with other Finance Board staff, as needed, conduct on-site visits at each FHLBank. Revision of examination manual continued; a composite examination risk ratings system was implemented; and examiner training continued. Market risk measurement and modeling support was provided in connection with examinations; entered into a contract with a vendor to develop and implement an enterprise-wide risk management system; and development of a standardized market risk data collection system commenced. Continue to perform monthly monitoring of the financial condition of FHLBanks, regulatory compliance, and market developments. Agency data collection and monitoring capabilities, including development of enterprise data repository, continues to be enhanced. During this fiscal year, three examination teams were created with a portfolio manager in charge of each team. Also, 15 new examiners were hired to augment the existing examination staff.

2004 Performance. Executed supervisory agreements with the FHLBanks of Chicago and Seattle. Completed examinations of 12 FHLBanks and the OF during the calendar year. Revision of examination manual continued; development of FHLBank-wide examination ratings framework began; issuance of Examiner Guidance Bulletins initiated; and examiner training continued. Provided market risk measurement and modeling support in connection with examinations; reviewed market risk models of FHLBanks seeking to implement their capital structure plans; contracted with a vendor to develop and implement an enterprise-wide risk management system; and development of standardized market risk data collection system commenced. FHLBank analyst program strengthened through retention of analysts; performed monthly monitoring of FHLBank condition and regulatory compliance and market developments; and agency data collection and monitoring capabilities, including development of enterprise data repository, began to be enhanced.

2003 Performance. Completed examinations of 12 FHLBanks and the OF during the calendar year. Commenced revision of examination manual and provided examiner guidance and training opportunities. Provided market risk measurement and support in connection with examinations and reviewed market risk models of FHLBanks seeking to implement their capital structure plans. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance, and market developments, and enhanced agency data collection and monitoring capabilities.

2002 Performance. Completed examinations of 12 FHLBanks and the OF during the calendar year. Provided examiner guidance and training opportunities. Provided market risk measurement and support in connection with examinations and reviewed market risk models of FHLBanks seeking to implement their capital structure plans. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance and market developments, and enhanced agency data collection and monitoring capabilities.

2001 Performance. Completed examinations of 12 FHLBanks and the OF during the calendar year. Provided examiner guidance and training opportunities. Continued to revise and update the examination manual. Provided market risk measurement and support in connection with examinations. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance and market developments.

Annual Performance Goal 1.2	Each FHLBank satisfies its applicable capital requirements and prudently manages capital and earnings.
Annual Performance Measure 1.2	Each FHLBank continuously meets or exceeds its minimum capital requirement.

2006 Projected Performance. Conduct research on topics such as the risks and public policy purpose of the mortgage purchase programs, appropriate constraints on predatory lending, evaluation of membership benefits for large and small financial institutions, modernization of methodology to determine risk-based capital requirements, and potential effects of different capital structures on the FHLBanks. Assess compliance with applicable capital requirements, as well as management of capital and earnings, during annual examinations and off-site on a monthly basis. Review proposed FHLBank market risk or cash-flow models and risk assessment procedures and controls, and proposed FHLBank capital structure plan amendments, as required.

2005 Performance through August 31. Assessed compliance with applicable capital requirements, as well as management of capital and earnings, during annual examinations and off-site on a monthly basis. Reviewed proposed FHLBank market risk or cash-flow models and risk assessment procedures and controls, and proposed FHLBank capital structure plan amendments.

2004 Performance. Assessed compliance with applicable capital requirements, as well as management of capital and earnings, during annual examinations and off-site on a monthly basis. Reviewed proposed market risk or cash flow models, risk assessment procedures and controls, and capital structure plan amendments for FHLBanks.

2003 Performance. Assessed compliance with applicable capital requirements, as well as management of capital and earnings, during annual examinations and off-site on a monthly basis. Reviewed proposed market risk or cash flow models, risk assessment procedures and controls, and capital structure plan amendments for FHLBanks.

2002 Performance. Assessed compliance with applicable capital requirements, as well as management of capital and earnings, during annual examinations and off-site on a monthly basis. Review of proposed market risk or cash flow models, risk assessment procedures and controls, and capital structure plan amendments for FHLBanks was a new performance goal in 2002.

2001 Performance. Assessed compliance with capital requirements during annual examinations and off-site on a monthly basis.

Annual Performance Goal 1.3a	FHLBanks maintain a triple A credit rating for their consolidated obligations.
Annual Performance Measure 1.3a	Conduct semi-annual assessment of FHLBank System cost of funds and maintain ratings for consolidated obligations and FHLBank credit rating at regulatory requirements.

2006 Projected Performance. Conduct semi-annual review of the FHLBanks' funding costs relative to those of the U.S. Treasury and other GSEs engaged in housing-related activities. Publish the results of these semi-annual reviews in the Mid-Year and Year-End Profile Books. Monitor FHLBank compliance with requirement to ensure that the FHLBank System consolidated obligations receive the highest credit rating from NRSROs. Periodically monitor each FHLBank to ensure that it has and maintains at least the second highest individual issuer credit rating from the NRSROs.

2005 Performance through August 31. Conducted first review of funding costs and published results in Year-End 2004 Profile Book. The second review, including topical papers is expected to be completed by fiscal year-end 2005. Continue to periodically monitor FHLBanks to ensure that they maintain minimum credit ratings by NRSROs.

2004 Performance. Complete year-end 2003 Profile Book and mid-year review for 2004. Monitored FHLBank compliance with Finance Board requirement of maintaining minimum credit ratings by NRSROs.

2003 Performance. Semi-annual review of the FHLBanks' funding costs is a new performance goal beginning in 2004. Monitored FHLBank compliance with Finance Board requirement of maintaining minimum credit ratings by NRSROs.

2002 Performance. Monitored FHLBank compliance with Finance Board requirement of maintaining minimum credit ratings by NRSROs.

2001 Performance. Monitored FHLBank compliance with Finance Board requirement of maintaining minimum credit ratings by NRSROs.

Annual Performance Goal 1.3b	Each FHLBank's and the FHLBank System's financial disclosures comply with applicable laws, rules, and regulations.
Annual Performance Measure 1.3b	Conduct on-site examination of the OF and review annual and quarterly financial reports issued by the FHLBank System for compliance with disclosure requirements. Examiner-in-charge monitors annual and quarterly financial reports issued by each FHLBank.

2006 Projected Performance. Review annual and quarterly combined financial reports of the FHLBank System for compliance with the Finance Board's disclosure requirements. Review annual and quarterly financial reports issued by individual FHLBanks and provide comments or issues to be resolved to the examiner-in-charge for each FHLBank. Conduct annual on-site examination of the OF.

2005 Performance through August 31. The FHLBanks have started the process of registering their capital stock with the SEC. The FHLBank System's Combined Financial Reports for 2004 will not be released until each FHLBank releases its 2004 year-end financial reports. Some FHLBanks are in the process of restating their 2004 year-end financial reports. The FHLBank financial reports that are through the SEC registration process have been reviewed. Annual on-site examination of the OF will be conducted by year-end 2005.

2004 Performance. Reviewed all FHLBank System and FHLBank issued financial reports. Conducted annual on-site examination of the OF.

2003 Performance. Reviewed all FHLBank System and FHLBank issued financial reports. Conducted annual on-site examination of the OF.

2002 Performance. Reviewed all FHLBank System and FHLBank issued financial reports. Conducted annual on-site examination of the OF.

2001 Performance. Reviewed all FHLBank System and FHLBank issued financial reports. Conducted annual on-site examination of the OF.

Annual Performance Goal 2.1	FHLBanks adhere to public policy principles and safety and soundness requirements when making advances and acquiring mortgage assets.
Annual Performance Measure 2.1	Review advance and mortgage portfolios of each FHLBank as part of the annual on-site examination for compliance with the Bank Act and Finance Board regulations.

2006 Projected Performance. Complete review of advance and AMA portfolios of each FHLBank as part of annual on-site safety and soundness examination. Continue to monitor the effect, if any, of acceptance of predatory loans as collateral for FHLBank advances or purchase of predatory loans through AMA programs.

2005 Performance through August 31. Completed review of advance and AMA portfolios of each FHLBank as part of annual on-site safety and soundness examination. Continued to monitor the effect, if any, of acceptance of predatory loans as collateral for FHLBank advances or purchase of predatory loans through AMA programs.

2004 Performance. Completed review of advance and AMA portfolios of each FHLBank as part of annual on-site safety and soundness examination. Continued to monitor the effect, if any, of acceptance of predatory loans as collateral for FHLBank advances or purchase of predatory loans through AMA programs.

2003 Performance. Reviewed advance and AMA portfolios of each FHLBank as part of annual examinations.

2002 Performance. Reviewed advance and AMA portfolios of each FHLBank as part of annual examinations.

2001 Performance. Reviewed advance and AMA portfolios of each FHLBank as part of annual examinations.

Annual Performance Goal 2.2a	Supervision of the Affordable Housing and Community Investment Programs.
Annual Performance Measure 2.2a	Conduct examinations of the Affordable Housing and Community Investment Programs at each FHLBank

2006 Projected Performance. Complete annual examinations of AHP and CIP. Conduct a joint study with the Department of Housing and Urban Development to compare GSE housing goals to the FHLBank System's AHP. Approve and implement revised AHP regulation. Complete annual review of FHLBank Community Lending Plans and biennial review of FHLBank member Community Support Statements.

2005 Performance through August 31. Completed 8 full scale annual, on-site examinations of FHLBank AHPs; expect to complete examinations of the 4 remaining AHPs by calendar year-end 2005. Issued Report of the Horizontal Review of the Affordable Housing Programs of the FHLBanks. Incorporated key findings from this report into the proposed revision of the AHP regulation. This proposal is also expected to require the FHLBanks to conduct a formal housing needs assessment in their districts, and to increase the flexibility of the individual FHLBanks to carry out affordable housing and community development programs based on the needs of their individual district. Strengthened examination of AHPs through the hiring of additional examiners. Completed review of community lending plans of 12 FHLBanks; anticipating completion of review of community support statements of 3,170 FHLBank members by end of fiscal year.

2004 Performance. Completed full-scale examinations of the AHPs at 6 FHLBanks and examinations with a more limited scope for the remaining 6 FHLBanks. Completed review of community lending plans of 12 FHLBanks; anticipating completion of review of community support statements of 2,597 FHLBank members by end of fiscal year.

2003 Performance. Completed examinations of 12 FHLBanks during calendar year. Completed review of community lending plans of 12 FHLBanks; completed review of community support statements of 4,497 FHLBank members by end of fiscal year.

2002 Performance. Completed examinations of 12 FHLBanks during calendar year. Completed review of community lending plans of 12 FHLBanks; completed review of community support statements of 2,913 FHLBanks members by end of fiscal year.

2001 Performance. Completed examinations of 11 FHLBanks during calendar year. Completed review of community lending plans of 12 FHLBanks, completed review of community support statements of 3,225 FHLBanks by end of fiscal year.

Annual Performance Goal 3.1a	Review, revise, and supplement Finance Board regulations to ensure relevance, transparency, and issue-oriented supervisory guidance.
Annual Performance Measure 3.1a	Review and revise Finance Board regulations, and supplement regulations with advisory bulletins, examiner guidance bulletins, and regulatory interpretations, where appropriate.

2006 Projected Performance. Review Finance Board regulations to ensure the safety and soundness of the FHLBank System and to ensure that the FHLBanks fulfill their housing finance and community investment mission. Possible rulemaking initiatives include, but are not limited to: (1) clearly delineating the responsibilities and the accountability of the board of directors for governance of a FHLBank; (2) streamlining Finance Board review of new business activities; (3) streamlining the community support requirements; (4) improving the operations and efficiency of the Affordable Housing Program; (5) streamlining the regulations governing the FHLBanks' acquired member asset programs; (6) updating the capital structure regulations; (7) improving the regulations concerning investments that can be made by the FHLBanks.

Possible supervisory issues to be addressed in fiscal year 2006 include, but are not limited to, capital regulations, AHP, AMA, corporate governance, and eligible investments and financial management policy.

2005 Performance through August 31. Reviewed and revised FHLBank regulations, when necessary, and supplemented regulations where appropriate. Developing a Data Quality and Timeliness Regulation and amendments to Part 951, the Affordable Housing Program regulation. Issued a series of Advisory Bulletins that specify the Finance Board's expectations on the SEC registration process; examination findings and conclusions; the FHLBanks' responsibilities under the AHP Set-Aside Program; regulatory reporting under certain accounting standards, particularly FAS 91 and FAS 150; standards for appropriate management and board risk management oversight; and internal market risk model approvals.

2004 Performance. Continued to review Finance Board regulations; adopted amendments to Parts 900 and 998 (registration of FHLBank stock with SEC); Parts 919 and 913 (Privacy Act and Freedom of Information); amendments to Parts 900, 932, and 955 (FHLBank AMA); amendments to Part 951 (FHLBank AHP) in preparation; and data quality and timeliness regulation in preparation.

Issued supervisory guidance addressing the following issues: risk assessment, management, and modeling; corporate governance; financial disclosure and reporting; examination findings categories; capital management and retained earnings; liability exposure resulting from state predatory lending laws; approval of changes to internal risk models; and the rating of small loan pools.

2003 Performance. Continued to review Finance Board regulations; amendments to Parts 900, 932, and 955 (FHLBank AMA) published for public comment and withdrawn; proposed Part 998 (registration of FHLBank equity securities with SEC) published for public comment; interim amendments to Parts 910 and 913 (Privacy Act and Freedom of Information Act) adopted; amendments to Part 906 (conduct of Monthly Survey of Rates and Terms of Conventional Mortgages) adopted; amendments to Parts 900 and 905 (Finance Board organization and functions) adopted; and proposed amendments to Part 915 (FHLBank board of directors composition) published for public comment.

Issued supervisory guidance issued addressing the following issues: accelerated financial reporting; business continuation contingency planning; expanded financial disclosures; capital structure plan amendments; annual risk assessments; NRSRO ratings methodologies and state predatory lending laws; internal market risk model validation; capital management and retained earnings; calculation of duration of equity and limits in low interest rate environments and related reporting requirements; Value-at-Risk modeling; revisions to safety and soundness examination findings categories; credit risk exposure to supplemental mortgage insurance providers; financial reporting and disclosure; AHP subsidy and recapture and retention agreement and reasonable collection effort requirements; qualification of certain government securities as collateral under the FHLBank Act; application of interim capital requirements; and classification of MAST Bonds.

2002 Performance. Review of Finance Board regulations commenced; amendments to Parts 907 and 908 (Finance Board rules of practice and procedure) adopted; amendments to Section 932.9 (FHLBank unsecured credit limits) adopted; technical amendments to Parts 900, 931, 932, and 933 (FHLBank capital standards and capital structure plans) adopted; amendments to Part 918 (FHLBank board of directors meetings) adopted; amendments to Part 951 (FHLBank AHP) adopted; amendments to Parts 900 and 952 (FHLBank CICA) adopted; technical amendments to various parts adopted; amendments to Part 985 (OF board of directors meetings) adopted; and amendments to Part 966 (System consolidated obligations) adopted.

Supervisory guidance issued addressing the following issues: interest rate modeling; strategic plan reporting; disaster recovery planning; auditor independence and risk assessment; quarterly liquidity certification; unsecured credit reporting requirements; credit watch for unsecured credit; sponsor leasehold interests in AHP rental project buildings and underlying land, status of certain loans within AMA programs; use of mortgage pool insurance in credit enhancement in AMA programs; electronic distribution of combined financial reports; and obligations of state housing finance agencies and unsecured credit limitations.

2001 Performance. Proposed amendments to Parts 907 and 908 (Finance Board rules of practice and procedure) published for public comment; amendments to Parts 900, 930, 931, 932, and 933 (FHLBank capital standards and capital structure plans) adopted proposed amendments to Section 932.9 (FHLBank unsecured credit limits) published for public comment; proposed technical amendments to Parts 900, 931, 932, and 933 (FHLBank capital standards and capital structure plans) published for public comment; interim amendments to Part 918 (FHLBank board of directors meetings) adopted; proposed amendments to Part 951 (FHLBank AHP set-aside) published for public comment; and proposed amendments to Parts 900 and 952 (FHLBank CICA) published for public comment.

Supervisory guidance issued addressing the following issues: data collection and reporting requirements; securing AMA enhancements; short-term unsecured counterparty ratings and Finance Board Financial Management Policy; conflicts of interest; credit underwriting and regulatory compliance and housing associates; AMA data submissions; asset review and classification; vigilance in risk monitoring; Finance Board staffing changes; AMA programs assets held for a valid business purpose; OF audit committee and combined financial statements; elections of FHLBank directors; FHLBank membership eligibility of privately insured credit unions; Finance Board Financial Management Policy applicability to equity option transactions, short-cut method hedge accounting; valid economic hedges and securities carried at fair value; independent auditor review of quarterly financial information; mortgage loan participation interests as advance collateral; mobile home park project treatments under Part 951 of the Finance Board's regulations; Refinancing Corporation financial statement presentation; FHLBank small business grant programs under Part 952 of the Finance Board's regulations; and acceptance of certain mutual funds and collateral.

Annual Performance Goal 3.1b	Review and promptly respond to new business activities notices submitted by FHLBanks.
Annual Performance Measure 3.1b	Respond to new business activity notifications by FHLBanks within 60 days of receipt.

2006 Projected Performance. Promptly respond to New Business Activity notifications.

2005 Performance through August 31. Received two new business activity notifications from FHLBanks. One FHLBank intends to expand eligible Other Real Estate Related Collateral and the other would like to accept small farm loans as collateral.

2004 Performance. Responded to 2 new business activity notices within 60 days of receipt.

2003 Performance. Responded to 5 new business activity notices within 60 days of receipt.

2002 Performance. Responded to 21 new business activity notices within 60 days of receipt.

2001 Performance. Responded to 26 new business activity notices within 60 days of receipt.

Annual Performance Goal 3.2a	Use fiscal, physical, and human resources efficiently and effectively to fulfill the Finance Board's fiduciary responsibilities.
Annual Performance Measure 3.2a	Align budgeted resources with projected workloads and business priorities. Recruit, develop, and retain high-achieving professional staff.

2006 Projected Performance. Use fiscal, physical, and human resources efficiently and effectively fulfill Finance Board's fiduciary responsibilities. The agency intends to implement a training and development program that includes an employee orientation program, individual development plans, and managerial development opportunities. The Finance Board is continuing to develop an enterprise data repository to standardize and link data collection and management processes across agency platforms and systems. The agency will also strengthen the information technology infrastructure used for risk modeling by enhancing systems that incorporate FHLBank terms-and-conditions data into analytical systems, automatically calculate market value and market value sensitivity to the extent feasible, and expand an examiner's access to valuation and risk measurement technology. The internal systems for document management and budget tracking will be enhanced.

2005 Performance through August 31. Recruited 35 people to be examiners, analysts, information technology specialists, an attorney, accountant, and other professional and support staff. The Finance Board continued to outsource functions that had been performed by staff, as appropriate. The Finance Board's Financial Management System was recently outsourced to the Bureau of Public Debt, Administrative Resource Center. The agency physically moved to new, leased office space (72,000 square feet). This space is fully compliant with the Americans with Disabilities Act and other life safety standards. The agency continued to enhance its data management and information

systems. A standardized risk exposure data standard was developed which will improve data integrity and consistency across the FHLBank System. The AHP data information system has been comprehensively restructured and will be fully operational by the end of the calendar year.

2004 Performance. Recruitment of additional examiners, economists, accountants and mortgage, risk, financial, and policy specialists and analysts continued.

2003 Performance. Mortgage analyst and additional examiners recruited.

2002 Performance. Additional examiners recruited.

2001 Performance. Mortgage analyst and additional examiners recruited.

Annual Performance Goal 3.2b	Maintain and test business continuity and contingency plans.
Annual Performance Measure 3.2b	Review, update, and test the Finance Board's Continuity of Operations Plan (COOP).

2006 Projected Performance. Conduct annual review and update the Finance Board's Business Continuity Plan. The agency plans to continue testing the major components of the COOP, such as identification of essential functions; delegations of authority; orders of succession; communications processes; and vital records, files and databases required and available during an emergency. The Finance Board will also develop standardized documentation of its testing and training program, and participate in government-wide exercises, if offered.

2005 Performance through August 31. Conduct annual review and update of Finance Board's COOP. This plan identifies the essential functions that must continue and the policy and procedures for activating the Plan. The COOP was updated to comply with recent directives from the Department of Homeland Security, Federal Emergency Management Agency. The COOP was tested through an exercise that required emergency personnel to report to the Emergency Operations Center, implemented the established activation procedures, and tested the arrangements which ensure that essential functions can be performed.

2004 Performance. Business continuity plan developed, reviewed, and updated. Every employee was provided with a disaster survival kit and an escape hood. Emergency kits with flashlights, extra food, escape hoods, etc. are available on every floor.

2003 Performance. Business continuity plan reviewed and updated.

2002 Performance. Business continuity plan reviewed and updated.

2001 Performance. New performance goal beginning in 2002.