Federal Home Loan Bank of Chicago 2000 Annual Report

Table of Contents

Management Report 2
Statement of Condition 8
Statement of Income 9
Statement of Capital 10
Statement of Cash Flows 11
Notes to Financial Statements 12
Note 1- Summary of Significant Accounting Policies 12
Note 2 - Cash and Due from Banks 15
Note 3 - Securities Purchased Under Agreements to Resell 15
Note 4 - Held-To-Maturity Securities 16
Note 5 - Advances 18
Note 6 - Affordable Housing Program 20
Note 7 - Mortgage Loans 20
Note 8 - Deposits 21
Note 9 - Consolidated Obligations 21
Note 10 - Capital 24
Note 11- Employee Retirement Plans 25
Note 12 - Interest Rate Exchange Agreements 26
Note 13 - Segment Information 28
Note 14 - Estimated Fair Values 29
Note 15 - Commitments and Contingencies 33
Report of Independent Accountants 34
Management Report of Responsibility for Financial Reporting 34
Audit Committee Report 35
Charter for the Audit Committee of the Board of Directors 36

Management Report

The Federal Home Loan Bank of Chicago had a very good year in 2000 as it continued to fulfill its housing mission in Illinois and Wisconsin. Income before REFCORP rose 23.7% to $161.5 million in 2000 from $130.5 million in 1999. Income after REFCORP increased 15.5% to $129.2 million from $111.8 million in 1999.

Prior to 2000, the Federal Home Loan Banks charged their respective REFCORP obligations directly to retained earnings and not as an expense through the income statement. As a result of a provision in the 1999 Gramm-Leach-Bliley Act, effective with 2000 each Federal Home Loan Bank is required to pay 20% of net earnings to REFCORP and directly reflect this expense through the statement of income. The statement of earnings includes this change in presentation.

The Bank achieved higher returns on equity (ROE) during 2000. The ROE before REFCORP in 2000 was 10.12%, up from 9.21% in 1999. Post-REFCORP ROE was 8.10% compared to the prior-years' 7.87% ratio. The Bank's return on assets for 2000 after REFCORP was 0.36%, down from 1999 post-REFCORP ROA of 0.41%. At year-end, housing finance-related assets had increased 31.6% over 1999.

Advances to members set a year-end record of $18.5 billion, 7.5% above the prior year-end. The Bank continued to attract new member financial institutions. Total membership stood at 841 members on December 31, 2000, surpassing the prior-year level of 812 members and establishing a record.

The Mortgage Partnership Finance Program (MPF®) has been accepted by the markets as a valuable means of housing finance. MPF® continued its rapid expansion to member banks and thrifts throughout the district. Nine of the 12 FHLB districts were participating in MPF® as of December 31, 2000. The program ended the year with $15.4 billion in loans outstanding, up from $1.8 billion at the end of 1999.

Improved profitability, combined with the change in the REFCORP formula outlined above, resulted in an increase in the REFCORP charge to $32.3 million in 2000 from $18.7 million in 1999, a 72.7% increase. The Bank paid an annualized average dividend of 7.47%, 172 basis points over the moving average of the one-year US Treasury Bill. Dividends paid in 2000 totaled $113 million, compared to $92 million in 1999.

Results of Operation

Net income before REFCORP of $161.5 million during 2000 was $31.0 million, or 23.7%, over 1999 net income. The $43.7 million, or 25.9%, increase in net interest income to $211.3 million reflected nearly 19.5% growth in average earning assets.

Earning assets yielded 6.62% in 2000 compared to 5.49% in 1999 while costing liabilities increased to 6.28% in 2000 from 5.42% in 1999. The net balance sheet spread was 0.31% in 2000, down from 0.36% in 1999. The net interest margin was 0.65% in 2000, up from 0.64% in 1999.

The Bank continued to press toward improved efficiency. The majority of the increase in non-interest operating expenses was related to MPF®, both due to the continued national development of the program and the increase in MPF® volume. In total, operating expenses rose $5.4 million, to $29.8 million. Salaries and benefits accounted for 57% of operating expenses in 2000, up slightly from 54% in 1999. Total operating expenses as a percentage of average assets remained at 9.0 basis points in 2000, equaling 1999. Operating expenses as a percentage of net income were 23.0% in 2000, increasing from 18.7% in 1999.

Investments in fixed assets increased during the year as the Bank continued to develop the systems and infrastructure for the MPF national program. The Bank anticipates that the need for these investments will continue and has budgeted for a $9.3 million increase in fixed asset expenditures in 2001 as we build for the future of MPF.

The Federal Housing Finance Board, the regulator for the Federal Home Loan Bank System, and the Office of Finance, issuer of the Banks' consolidated obligations, allocate their costs to the 12 Home Loan Banks. The Federal Home Loan Bank of Chicago's share of these expenses totaled $1.6 million in 2000, which equaled our 1999 share. Each System Bank transferred 10% of its income, after REFCORP contribu-

tions, to its Affordable Housing Program (AHP). AHP funds are used to subsidize below-market advances and direct grants for the development of low-income and moderate-income housing within their district.

In 2000, the Bank set aside $14.4 million, compared to $12.5 million in 1999, to fund affordable housing programs in Illinois and Wisconsin. Over the past 10 years, the Bank has awarded approximately $71 million to help over 20,000 families secure affordable housing. The Banks also contributed a collective $553 million, an increase of 84% over 1999, toward interest expense on the debt of the Resolution Funding Corporation (REFCORP).

Financial Condition

Total assets posted 21% growth during 2000, increasing to $35.4 billion at December 31, 2000. Average assets for the year rose to $32.1 billion in 2000, up from $27.1 billion in the prior year, a growth rate of 18.5%. Housing finance-related assets include MPF® loans, advances to members, and investments secured by mortgages and mortgage-backed instruments, and other mission-related investments. Total housing finance-related assets increased $7.5 billion, or 31.6%, to $31.4 billion at year-end 2000. Total housing finance-related assets accounted for 89% of assets at December 31, 2000, an increase from 82% at year-end 1999. As a percentage of consolidated obligations outstanding, housing finance-related assets were 102% at December 31, 2000, up from 99% at December 31, 1999.

The MPF® program posted dramatic growth totaling $15.4 billion at year-end 2000, up from $1.8 billion the prior year-end. Total master commitments grew to $88.1 billion from $8.9 billion over the same period, due in part to the approval of the MPF® government loan program. Funding institutions increased to 121 from 93. The MPF® program has funded loans in all 50 states and the District of Columbia. Nine of the 12 FHLB's districts are now participating in MPF®.

Advances continued to serve the needs of our members as a cost-effective source of funding for housing assets. Advances to members climbed to $18.5 billion by year-end 2000, averaging $18.1 billion, $1.9 billion higher than the 1999 average balance. The Bank originated $8.9 billion in fixed rate advances to its members during 2000. A total of $10.8 billion of term advances were originated during the year. Of this total, 59% matured in one year or less while 41% were longer-termed financing of greater than one year.

The mortgage-backed securities (MBS) portfolio averaged $4.1 billion during 2000, 2.5% higher than the 1999 average portfolio. The MBS-to-equity ratio was 254% compared to 281% in 1999. MBS holdings equal to 300% of capital is the maximum allowed by Federal Housing Finance Board policy. Including other mortgage resales and Housing Development Bonds, total mortgage-backed investments excluding MPF®, averaged $4.6 billion during 2000 compared to the $4.5 billion average in the prior year. Other investments, composed primarily of federal funds, repurchase agreements, commercial paper, and U.S. Treasury securities, decreased, averaging $4.3 billion during 2000. These investments are used to meet the liquidity needs of the Bank as well as to provide incremental net interest income to help satisfy REFCORP and AHP obligations imposed by Congress.

The Bank funds its assets through capital, deposits and the issuance of FHLB consolidated obligations. Average deposits decreased in 2000 to nearly $2.0 billion from $3.4 billion in 1999. In total, deposits funded 6% of average assets in 2000 and 13% of average assets in 1999. FHLB consolidated obligations (CO's) constitute the largest portion of funding. Average consolidated obligations grew $9.3 billion during 2000 to $30.9 billion. CO's financed 87% of average assets in 2000 and 80% of average assets in 1999.

Members are required to purchase capital stock in amounts based on the balance of mortgage assets held by the institution, total asset size, and level of advances. Paid-in capital stock accounted for 96% of total equity as of December 31, 2000. As a result of the growth in total membership, advance levels, and stock dividend, capital stock increased to $1.63 billion on December 31, 2000. On December 31, 1999, capital stock was $1.45 billion. Retained earnings increased 29% to $70.5 million at year-end 2000, up from $54.7 million on December 31, 1999. Total equity increased 13% to $1.7 billion.

In 2000, a new “acquired member asset” rule was implemented by the Federal Housing Finance Board. Among its many features, this rule allows the Banks to operate at a capital-to-asset ratio of as low as 4% (25:1) provided the Banks non-core mission assets (as defined) do not exceed 11% of total assets.

The Chicago Bank's non-core mission asset ratio at year-end was 2.55%. The Bank is committed to the spirit of this rule and intends to maintain its non-core mission asset ratio below this 11% threshold and to operate with the 4% minimum capital to assets ratio, as provided in the rule. The Bank was somewhat more levered at year-end 2000 than year-end 1999. The Bank's year-end capital-to-assets ratio of 4.81% was substantially greater than the required level of 4.00%. At year-end 1999, the Banks capital-to-assets ratio was 5.15%, versus a required level of 4.76%. The Bank's debt-to-capital ratio stood at 18 times total capital. Total risk-based capital stood at 19.2% at year-end.

Risk Management

The Bank maintains a very low risk financial profile. Interest rate risk is the primary risk faced by the Bank. The average spread in 2000 was 31 basis points, which was above the 22 basis point System average. The Bank measures its exposure to changing interest rates in several ways, including testing market value sensitivities, gap analysis, and income simulation. The one-year gap at December 31, 2000, defined as the cumulative difference between assets and liabilities scheduled to reprice within one year, stood at .97% of rate-sensitive assets. The one-year gap at the end of 1999 was 1.4% of rate-sensitive assets.

To achieve these results, the Bank uses financial models to provide market values for all financial instruments and off-balance sheet positions. The models allow the Bank to estimate cash flow patterns and market prices given changes in volatility, rates, spreads, and the term structures of various yield curves.

In addition to extensive modeling to determine the magnitude of interest rate risk, the Bank regularly engages in interest rate exchange agreements in order to reduce exposure to changing interest rates. As of December 31, 2000, the Bank had engaged in agreements totaling $31.4 billion in outstanding notional principal. In addition, the Bank had notional principal of $1,065 million in outstanding interest rate caps and $240 million in interest rate floors. These instruments are used to control and manage interest rate risk and minimize variations in income and the market value of financial instruments. The Bank charges prepayment fees on advances that would otherwise subject the bank to increased interest rate risk should the advance be prepaid prior to its maturity. The bank recorded $14,000 in prepayment fees in 2000 and $55,000 in 1999.

The Bank uses callable debt to mitigate interest rate risk. Excluding discount notes, 19.7% of the Bank's debt at December 31, 2000 was callable by the bank. Further, the Bank frequently issues debt with complex coupon payment terms (structured debt) and call features. At the end of 2000, 63.6% of the Bank's issued debt was in the form of structured debt. When such debt is issued, the Bank simultaneously enters into an interest rate exchange agreement with coupon and call features that offset the structured features of the bond, effectively converting the instrument into a conventional fixed rate or adjustable rate instrument with a coupon tied to a common index, such as LIBOR.

Credit risk is a significantly smaller risk to the Bank. The Bank has never experienced a credit loss on advances. Credit risk on advances is minimized by holding collateral against the outstanding balance. Advances are collateralized by single-family residential mortgages, mortgage-backed securities and other high quality collateral. Based on the collateral held and the repayment history of advances, the Bank has no loan loss reserves for advances and believes no loan loss reserve is necessary. The Bank limits its investments to the highest credit grades. Unsecured credit exposures and the credit quality of borrowing members are regularly monitored by management. With the commencement of MPF® in 1997, the Bank instituted a loan loss provision that is consistent with the loss rates experienced by other government-sponsored enterprises investing in residential loans. This reserve totaled $1.5 million at year-end 2000. At year-end 2000, .08% of MPF® conventional loans were on non-accrual status.

As a continuing part of managing credit risk, the Bank emphasized increasing diversification of borrowers. The top 25 advance borrowers represented 64.2% and 63.8% of borrowers in 1999 and 2000, respectively. During 2000, the Bank had a total of 688 credit customers.

Marketing Performance

The Mortgage Partnership Finance (MPF®) program, which the Chicago Bank launched in June 1997, has been successful. With MPF, member financial institutions and the Bank form a unique partnership.

The members manage the credit risk and all aspects of the customer relationship associated with mortgage lending; and the Bank provides the necessary funding and manages interest rate and other financial risks. On July 17, 2000 the Federal Housing Finance Board removed the $9 billion cap on the MPF® program. As of December 31, 2000, 196 institutions had been approved to participate in MPF®. At year-end 2000, the MPF® program had outstanding loans of $15.4 billion and had accepted $88.1 billion in master commitments.

The Bank remained true to its housing related mission by introducing two new MPF® products during 2000. Early in 2000 the MPF® program began buying government (FHA & VA) insured/guaranteed mortgage loans. This enables the bank to expand on its efforts to assist members who lend to lower income borrowers. At year end, 58% of all MPF loans funded have been to households with income below the MSA median. The MPF program also completed a link to the Banks AHP program. Loans made using an AHP grant are now eligible for funding in the MPF program.

The Bank continues to offer asset/liability modeling of members' balance sheets using FIVES (Financial Instrument Valuation and Engineering System). FIVES is an advanced analytical tool that provides market values for financial instruments and off-balance sheet positions. Additionally, FIVES allows the Bank to reverse engineer financial instruments to estimate cash flow patterns and market prices given changes in rates, volatility, spreads, and the term structure of various yield curves.

Total membership reached an all-time high of 841 members at year-end 2000, up from 812 at year-end 1999. Of those members, 78.8% were commercial banks, 18.4% thrift institutions, 2.4% credit unions, and 0.4% insurance companies. At the end of 2000, 51.5% of all members had less than $100 million in total assets, 44.2% had assets between $100 million and $1 billion, and 4.3% had assets in excess of $1 billion. Since 1991, penetration of the thrift and commercial bank market has increased, from 17% to over 60% of eligible institutions.

Credit customers, defined as the number of members who have used advances, lines of credit, or an off-balance sheet product at any point during the year, increased 15.4% to 688 from 596 during 1999. As a percentage of total membership, credit customers accounted for 81.8% of members in 2000, up from 73.4% in 1999.

Future Challenges

Among the many challenges the Bank faces:

Regulatory Uncertainty - Recent changes in regulation/legislation (Gramm-Leach-Bliley) are in various stages of implementation in the Federal Home Loan Bank system. There remains uncertainty as to whether these changes will be revised further by Congress or the Federal Housing Finance Board, and whether the changes will prove beneficial after full implementation. Moreover, banking regulators continue to question some aspects of the use of advances as a growing source of funding by Federal Home Loan Bank members. The Bank's management believes that Advances play an important role in housing finance in this country. In addition, the credit quality of our borrowers is closely monitored by Bank management.

FAS 133 - The Bank made the transition to FAS 133 in January 2001. As a result, the bank took a $573 thousand credit to January net income. Although the Bank's management continues to believe that the ongoing mark-to-market adjustments are manageable, there remains significant uncertainty as to the exact magnitude of future adjustments.

MPF - The MPF portfolio is a relatively young book of business that will be exposed to future credit or interest rate cycles. The Bank's management believes that these risks are manageable, though uncertainty of future effects remain.

Below is a more descriptive summary of the Bank's assets and government-sponsored debt issued. The ratio of mission assets to consolidated obligations illustrates the Bank's continuing commitment to its housing finance mission.

	December 31, 2000	December 31, 1999
	(In thousands)	
Assets		
Cash and due from banks	$ 4,194	$ 41,435
Housing finance related instruments		
Advances	18,462,288	17,167,291
Mortgage loans held, net of loan loss reserves	8,102,680	1,618,768
Mortgage-backed securities held-to-maturity	4,120,626	4,337,442
Other housing finance related instruments	760,019	779,881
Total housing finance related instruments	31,445,613	23,903,385
Other investments	3,341,636	4,711,390
Accrued interest receivable	578,352	561,201
Bank premises	12,394	7,590
Other Assests	6,589	3,446
Total Assets	$ 35,388,778	$ 29,228,447
Consolidated Obligations, net	$ 30,901,848	$ 24,202,873
Housing Finance Related Instruments as Percent of Consolidated Obligations	101.8%	98.8%

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Financial Statements

Statement of Condition

	December 31,	
	2000	1999
	(In thousands)	
Assets		
Cash and due from banks (Note 2)	$ 4,194	$ 41,435
Securities purchased under agreements to resell (Note 3)	45,685	50,390
Federal funds sold	2,397,000	3,170,000
Held-to-maturity securities (Note 4)	5,779,596	6,608,326
Advances (Note 5)	18,462,288	17,167,291
Mortgage loans (Note 7)	8,104,183	1,619,455
Less: allowance for credit losses on mortgage loans	(1,503)	(687)
Mortgage loans, net	8,102,680	1,618,768
Accrued interest receivable	578,352	561,201
Bank premises and equipment, net	12,394	7,590
Other assets	6,589	3,446
Total Assets	$ 35,388,778	$ 29,228,447
Liabilities and Capital		
Liabilities		
Deposits: (Note 8)		
Demand and overnight	$ 1,654,290	$ 2,026,151
Term	155,075	714,154
Other	200,767	136,774
Total deposits	2,010,132	2,877,079
Consolidated obligations, net: (Note 9)		
Discount notes	4,948,713	6,548,334
Bonds	25,953,135	17,654,539
Total consolidated obligations, net	30,901,848	24,202,873
Accrued interest payable	664,059	573,729
Affordable Housing Program (Note 6)	31,979	26,971
Payable to REFCORP (Note 10)	8,696	4,821
Other liabilities	70,796	38,020
Total Liabilities	33,687,510	27,723,493
Commitments and contingencies (Notes 6, 9, 10, 11 and 15)		
Capital (Note 10)		
Capital stock ($100 par value) issued and outstanding shares: 16,308,053 shares in 2000 and 14,502,825 shares in 1999	1,630,805	1,450,283
Retained earnings (subject to restrictions)	70,463	54,671
Total Capital	1,701,268	1,504,954
Total Liabilities and Capital	$ 35,388,778	$ 29,228,447

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

Statement of Income

	For the Years Ended December 31,		
	2000	1999	1998
		(In thousands)	
Interest Income:			
Advances	$ 1,185,628	$ 871,143	$ 703,970
Advances participated from other FHLBanks	—	—	41
Interest bearing deposits in banks	—	—	542
Securities purchased under agreements to resell	3,775	23,115	38,250
Federal funds sold	155,326	136,615	171,291
Held-to-maturity securities	409,428	351,548	377,091
Mortgage loans, including fees	360,314	81,985	16,951
Loans to other FHLBanks	541	247	127
Total interest income	2,115,012	1,464,653	1,308,263
Interest Expense:			
Consolidated obligations	1,797,074	1,127,748	956,438
Deposits	105,705	168,182	213,790
Borrowings from other FHLBanks	4	—	136
Other borrowings	—	188	130
Total interest expense	1,902,783	1,296,118	1,170,494
Net Interest Income	212,229	168,535	137,769
Provisions for credit losses on mortgage loans	906	452	219
Net Interest Income after Provision for Credit Losses	211,323	168,083	137,550
Other Income:			
Prepayment fees, net	14	55	3,761
Service fees	1,067	1,099	1,180
Other, net	1,326	1,050	(459)
Total other income	2,407	2,204	4,482
Other Expenses:			
Operating	29,844	24,434	19,248
Finance Board and Office of Finance	1,641	1,610	1,544
Other	4,567	1,272	275
Total other expenses	36,052	27,316	21,067
Income before Assessments	177,678	142,971	120,965
Affordable Housing Program	14,355	12,464	10,257
REFCORP (Note 1)	32,299	—	—
Total Assessments	46,654	12,464	10,257
Income before Extraordinary Item	131,024	130,507	110,708
Extraordinary item (loss) gain on early extinguishment of debt	(1,870)	—	59
Net Income	$ 129,154	$ 130,507	$ 110,767

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

Supplemental Disclosure: (unaudited)			
Net Income	$ 129,154	$ 130,507	$ 110,767
REFCORP capital distribution	—	18,718	18,269
Income after REFCORP capital distribution	$ 129,154	$ 111,789	$ 92,498

Statement of Capital

For the Years Ended December 31,
(In thousands of shares and dollars)

	Capital Stock		Retained Earnings (Subject to Restrictions)		
	Shares	Par Value	Restricted	Unrestricted	Total Retained Earnings
1998					
Balance, December 31, 1997	11,381	$ 1,138,083	$ 149	$ 20,754	$ 20,903
Proceeds from sale of capital stock	4,729	472,890			
Redemption of capital stock	(3,462)	(346,187)			
Net income				110,767	110,767
Transfers			1,633	(1,633)	—
Dividends on capital stock				(78,866)	(78,866)
Capital distribution to REFCORP				(18,269)	(18,269)
1999					
Balance, December 31, 1998	12,648	1,264,786	1,782	32,753	34,535
Proceeds from sale of capital stock	3,513	351,307			
Redemption of capital stock	(1,658)	(165,810)			
Net income				130,507	130,507
Transfers			(1,343)	1,343	—
Dividends on capital stock				(91,653)	(91,653)
Capital distribution to REFCORP				(18,718)	(18,718)
2000					
Balance, December 31, 1999	14,503	1,450,283	439	54,232	54,671
Proceeds from sale of capital stock	4,740	474,025			
Redemption of capital stock	(4,066)	(406,643)			
Net income				129,154	129,154
Transfers			(439)	439	—
Dividends on capital stock					
Cash				(222)	(222)
Stock	1,131	113,140		(113,140)	(113,140)
Balance, December 31, 2000	16,308	$ 1,630,805	$ —	$ 70,463	$ 70,463

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

Statement of Cash Flows

	For the Years Ended December 31,		
	2000	1999	1998
	(In thousands)		
Operating Activities:			
Net income	$ 129,154	$ 130,507	$ 110,767
Extraordinary loss (gain) on early extinguishment of debt	1,870	—	(59)
Income before extraordinary item	131,024	130,507	110,708
Adjustments to reconcile net income before extraordinary item to net cash provided by operating activities:			
Depreciation and amortization:			
Net premiums and discounts on consolidated obligations, investments, interest-rate exchange agreements and foreign exchange contracts	318,872	271,153	226,528
Net premiums and discounts on mortgage loans	4,117	1,599	413
Concessions on consolidated obligation bonds	6,502	7,478	10,555
Deferred losses on hedges	1,030	362	945
Bank premises and equipment	2,485	1,471	1,472
Other	(1,467)	—	—
Provision for credit losses on mortgage loans	906	452	219
Net realized gain on disposal of premises and equipment	(6)	(16)	(4)
(Increase)decrease in accrued interest receivable	(17,151)	69,769	(168,857)
(Increase)decrease in other assets	(3,169)	14,926	(13,393)
Net increase in Affordable Housing Program (AHP) liability and discount on AHP advances	5,008	4,595	3,049
Increase (decrease) in accrued interest payable	90,330	(51,464)	176,354
Increase (decrease) in REFCORP liability	3,875	294	(140)
Increase in other liabilities	60,092	2,113	1,001
Total adjustments	471,424	322,732	238,142
Net Cash Provided by Operating Activities	602,448	453,239	348,850
Investing Activities:			
Net decrease in interest bearing deposits in banks	—	—	55,000
Net decrease (increase) in Federal funds	773,000	(904,000)	(345,000)
Net decrease (increase) in securities purchased under agreements to resell	4,705	802,364	(366,621)
Net decrease (increase) in short-term held-to-maturity securities	472,787	(830,127)	856,375
Purchases of long-term held-to-maturity securities	(658,261)	(2,202,814)	(2,342,784)
Proceeds from maturities of long-term held-to-maturity securities	1,017,418	1,734,818	3,083,839
Principal collected on advances	31,172,159	25,650,848	15,464,382
Advances made	(32,467,157)	(27,919,069)	(20,007,890)
Principal collected on mortgage loans	252,699	96,328	27,062
Mortgage loans made	(6,741,634)	(786,680)	(925,229)
Principal collected on advances participated from other FHLBanks	—	—	1,865
Net increase in premises and equipment	(7,261)	(5,119)	(2,516)
Net Cash Used in Investing Activities	(6,181,545)	(4,363,451)	(4,501,517)
Financing Activities:			
Net (decrease) increase in deposits	(866,947)	(1,277,353)	408,944
Net (decrease) increase in other borrowings	—	(200,000)	200,000
Net proceeds from sales of consolidated obligation:			
Discount notes	350,489,157	291,672,750	260,693,442
Bonds	36,697,384	9,258,949	12,385,124
Payments for maturing and retiring consolidated obligations:			
Discount notes	(352,418,742)	(289,227,562)	(260,601,125)
Bonds	(28,398,881)	(6,368,170)	(8,978,739)
Proceeds from issuance of capital stock	474,025	351,307	472,890
Payments for redemption of capital stock	(406,643)	(165,810)	(346,187)
Cash dividends paid	(27,497)	(85,011)	(78,042)
Capital distribution to REFCORP	—	(18,718)	(18,269)
Net Cash Provided by Financing Activities	5,541,856	3,940,382	4,138,038
Net (decrease) Increase in Cash and Cash Equivalents	(37,241)	30,170	(14,629)
Cash and Cash Equivalents at Beginning of year	41,435	11,265	25,894
Cash and Cash Equivalents at End of Year	$ 4,194	$ 41,435	$ 11,265
Supplemental Disclosures:			
Interest paid	$ 1,489,660	$ 1,078,622	$ 778,501
Stock dividends issued	$ 113,140	$ —	$ —

The accompanying notes are an integral part of these financial statements

Notes to Financial Statements

Background Information

The Federal Home Loan Bank of Chicago (the Bank), a federally chartered corporation, exempt from all federal, state and local taxation except for real property taxes, is one of twelve Federal Home Loan Banks (the FHLBanks) which, with the Federal Housing Finance Board (the Finance Board), comprise the Federal Home Loan Bank System (the System). The mission of the FHLBanks and the System is to safely and soundly support residential mortgage finance through a variety of programs and services, primarily credit programs to their financial institution membership, so that their members can provide economical residential mortgage financing, in all phases of widely varying financial and economic cycles. The principal source of credit from the FHLBanks is in the form of advances to members. In addition to advances, the FHLBanks also invest in other mortgage related investments such as mortgage-backed securities. In 1997, the Bank initiated the Mortgage Partnership Finance® (MPF®) program, under which the Bank, in partnership with its members, provides funding for home mortgage loans. These instruments help the FHLBanks accomplish their mission of supporting housing finance throughout America. All regulated depository institutions and insurance companies engaged in residential housing finance are eligible to apply for membership in FHLBanks. All members are required to purchase stock in one or more of the FHLBanks and all stock is owned by the FHLBanks' members.

The FHLBanks are supervised and regulated by the Finance Board which is an independent federal agency in the executive branch of the United States Government. The Finance Board ensures that the FHLBanks carry out their housing finance mission, remain adequately capitalized and are able to raise funds in the capital markets and operate in a safe and sound manner. Each FHLBank operates as a separate entity with its own management, employees, and board of directors. Also, the Finance Board establishes policies and regulations governing the operations of the FHLBanks.

A primary source of funds for the FHLBanks is the proceeds from the sale to the public of System debt instruments (consolidated obligations) which are the joint and several obligations of all the FHLBanks. Additional funds are provided by deposits, other borrowings and the issuance of capital stock. Deposits are received from both member and non-member financial institutions and federal instrumentalities. The FHLBanks also provide members and non-members with correspondent services such as item processing, safekeeping, collection, and settlement.

In accordance with the Finance Board's regulations and the Gramm Leach-Bliley Act of 1999 (1999 Act), the Bank has established a formal policy governing the compensation and travel reimbursement provided its Directors. The goal of the policy is to appropriately compensate members of the Board of Directors for work performed on behalf of the Bank. Under this policy, compensation is comprised of per-meeting fees which are subject to an annual statutory cap. The fees compensate Directors for time spent reviewing materials sent to them on a periodic basis by the Bank, for preparing for meetings, for participating in any other activities for the Bank and for actual time spent attending the meetings of the Board or its committees. Directors are also reimbursed for reasonable Bank-related travel expenses. Total Directors' fees and other travel expenses paid by the Bank during 2000, 1999 and 1998, were $250,535 and $45,789, $293,749 and $53,048, and $306,950 and $54,048, respectively.

Note 1 - Summary of Significant Accounting Policies

Change in Accounting Practice for Capital Distributions to Resolution Funding Corporation (REFCORP) - For years through 1999, the FHLBanks charged the $300 million annual capital distribution to the Resolution Funding Corporation (REFCORP) directly to retained earnings and not as an expense through the Statement of Income. Effective January 1, 2000, each FHLBank is required to pay 20 percent of net earnings to REFCORP and directly reflect the expense through the Statement of Income. The FHLBanks will pay these amounts until the aggregate amounts actually paid by the 12 FHLBanks are equivalent to a $300 million annuity whose final maturity date is April 15, 2030, at which point the required payment of each FHLBank to REFCORP will be fully satisfied.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Investments - Investments which the Bank has both the ability and intent to hold to maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts using a method which approximates the level yield method. In addition, the carrying value of these investments is adjusted for the unamortized costs of, and deferred gains and losses from, associated interest rate exchange agreements.

All investments are held-to-maturity because management has the positive intent and ability to hold these securities until maturity.

Gains and losses on sales of investment securities are computed using the specific identification method and are included in other income. Sales of securities under agreements to repurchase the same or substantially the same securities are treated as collateralized financings.

Advances - Advances to members are net of discounts on advances for the Affordable Housing Program, as discussed below. In addition, the carrying value of advances is adjusted for the unamortized cost of, and deferred gains and losses from,

associated interest-rate exchange agreements. Interest on advances is credited to income as earned. Following the requirements of the Federal Home Loan Bank Act of 1932 (the Act), as amended, the Bank obtains sufficient collateral on advances to protect it from losses. As Note 5 more fully describes, the Act limits eligible collateral to certain investment securities, residential mortgage loans, deposits with the Bank, and other real estate-related assets, but "community financial institutions," (FDIC-insured institutions with assets of $500 million or less) are subject to more liberal statutory collateral rules for small business and agricultural loans. The Bank has not experienced any losses on advances since its inception in 1932. Based upon the collateral held as security on the advances and prior repayment history, no allowance for losses on advances is deemed necessary by management.

Mortgage Loans - The Bank has developed the Mortgage Partnership Finance® (MPF®) program under which the Bank invests in mortgage loans which are funded by the Bank through or purchased from its participating members. The Bank manages the liquidity, interest rate and options risk of the loans, while the members retain the marketing and servicing activities. The Bank and the members share in the credit risk of the loans with the Bank assuming the first loss obligation limited by the First Loss Account (FLA), and the members assuming credit losses in excess of the FLA, up to the amount of the Credit Enhancement obligation as specified in the master agreement.

The Bank classifies loans as held for investment and reports them at their principal amount outstanding net of deferred loan fees and premiums and discounts.

The Bank records non-origination fees, such as credit enhancement fees, delivery commitment extension fees and pair-off fees, in other expense and other income, accordingly.

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

The Bank bases the allowance for credit losses on management's analysis of credit losses inherent in the Bank's mortgage loan portfolio. Actual losses greater than defined levels are offset by the members' credit enhancement up to their respective limits. The analysis includes consideration of various factors such as past performance, current performance, loan portfolio characteristics, collateral valuations, and prevailing economic conditions.

The first loss liability is the responsibility of the Bank and is developed as a predetermined percentage of the unpaid principal balance, net of related charge-offs. The Bank's members bear credit risk of their respective mortgages through a credit enhancement established as a second loss liability. This member credit enhancement may be collateralized under various agreements entered into with the Bank.

Affordable Housing Program - As more fully discussed in Note 6, the Bank is required to establish and fund an Affordable Housing Program (AHP). The required AHP funding of direct subsidies or subsidized advances is charged to earnings and an offsetting liability established. Advances that qualify under the Bank's AHP are made at interest rates below the customary interest rate for non-subsidized advances or contain other forms of subsidies to promote the use of AHP advances. When an AHP advance is made, the subsidy is determined to be the present value of the difference in the interest rates between the AHP advance rate and the System's related cost of funds rate for a funding liability with a comparable maturity.

Prepayment Fees - The Bank charges its members a prepayment fee when certain advances are repaid prior to original maturity. Such fees are credited to income when received.

Commitment Fees - Commitment fees for advances are deferred and amortized to interest income using the straight-line method over the life of the related advance. Refundable fees are deferred until the commitment expires or the advance is made. Commitment fees for letters of credit are recorded as a deferred credit when received and are amortized over the term of the letter of credit.

Interest Rate Exchange Agreements - As more fully discussed in Notes 12 and 14, the Bank enters into interest rate swaps, interest rate cap and floor agreements, and forward contracts (interest rate exchange agreements) as a means of managing exposure to changes in interest rates. These interest rate exchange agreements, when linked with a designated financial instrument, effectively alter the financial characteristics of the designated instrument. They may extend the maturity of certain short-term financial instruments or adjust the effective maturity, repricing frequency, or option-related characteristics of certain long-term financial instruments to achieve certain risk management objectives. Interest rate exchange agreements are used by the Bank in two ways: designated to an underlying financial instrument and when acting as an intermediary.

In general, the differences between the two accounting methodologies described below for interest rate exchange agreements, which correspond to the two ways interest rate exchange agreements are used by the Bank, relate to the timing of income recognition for gains and losses.

The differential of interest payments, received or paid, resulting from designated interest rate exchange agreements associated with financial instruments are recognized when incurred as an adjustment to the yield or expense of the underlying financial instrument.

The differential of interest payments, received or paid, resulting from interest rate exchange agreements with members and associated transactions with counterparties are recognized as other income when earned or incurred.

A designated interest rate exchange agreement's association with a designated underlying financial instrument ceases upon termination (maturity/sell) of the designated underlying financial instrument. Upon termination of the financial instrument, the interest rate exchange agreement is marked-to-market and the resulting gain or loss is included with the gain or loss of the underlying financial instrument. The Bank may then re-designate the remaining interest rate exchange agreement originally designated to the terminated financial instrument to another financial instrument. The Bank may also enter into new interest rate exchange agreements and designate them to existing interest rate exchange agreements to offset the economic effects of the

original interest rate exchange agreements.

Gains and losses on terminated interest rate exchange agreements are deferred and reported as adjustments to the carrying value of the designated financial instrument where the related underlying financial instrument remains outstanding. Deferred gains and losses related to forward contracts are amortized, using the level-yield method, over the remaining life of the associated financial instrument. Deferred gains and losses related to interest rate swaps, caps and floors are amortized over the shorter of the remaining life of the underlying financial instrument or the period ending on the original maturity date of the interest rate swap, cap or floor agreement had it not been terminated. Premiums paid and received for interest rate caps and floors and fees paid or received on interest rate swaps are reported as adjustments to the carrying value of the designated financial instrument and are amortized over the shorter of the life of the underlying financial instrument or the maturity date of the interest rate exchange agreement.

Bank Premises and Equipment - Depreciation is recognized on a straight-line basis over the estimated useful lives of assets ranging from three to ten years. Leasehold improvements are amortized on a straight-line basis over the estimated useful life of the improvement or the remaining term of the lease, whichever is shorter. Improvements and major renewals are capitalized; ordinary maintenance and repairs are expensed as incurred. Gains and losses on disposal are included in other income.

Real Estate Owned - Real estate owned includes assets that have been received in satisfaction of debt. Real estate owned is initially recorded and subsequently carried at the lower of cost or fair value less estimated selling cost. Any valuation adjustments required at the date of transfer are charged to the allowance for credit losses. Subsequently, unrealized gains and losses on sale typically are included in other expense. Operating results from real estate owned are recorded in other expense.

Concessions on Consolidated Obligations - The amounts paid to dealers in connection with the sale of consolidated obligation bonds are deferred and amortized using the straight-line method to the first call date of the bond or over the term to maturity of the bond, whichever term is shorter. The amount of the concession is allocated to the Bank from the Office of Finance based upon the percentage of the debt issued by the Bank. Concessions applicable to the sale of consolidated obligation discount notes are charged to expense as incurred, due to the short-term maturities of these notes.

Discounts and Premiums on Consolidated Obligations - The discounts and premiums on consolidated obligation bonds are amortized to expense using the straight-line method to the first call date or over the term to maturity of the bond issue whichever term is shorter. The discounts on consolidated obligation discount notes are amortized to expense using the straight-line method throughout the term of the related notes due to their short-term maturity.

Assessments - The Bank is assessed for its proportionate share of the costs of operating the Finance Board's operating offices and the Office of Finance, which manages the sale of consolidated obligations.

Estimated Fair Values - The estimated fair value of the Bank's financial instruments is primarily determined by an inhouse pricing system. The fair values are then compared to the secondary market for similar instruments and other indications from dealers. The estimated fair values of the Bank's financial instruments are detailed in Note 14.

Forward Exchange Contracts - The Bank uses forward exchange contracts to manage foreign currency risk associated with certain assets and liabilities. Concurrent with the purchase of the assets or incurrence of the liabilities, the Bank exchanges the foreign denominated interest and principal payments related to the financial instrument for equivalent amounts denominated in U.S. dollars. The financial instrument and related forward exchange contract are translated into U.S. dollars with unrealized gains and losses reported on the statement of condition as an adjustment to the carrying value of the associated financial instrument.

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

Recently Issued Accounting Standards -In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No.133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). In June 1999, the FASB issued SFAS 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133", that amends SFAS 133, deferring its effective date. SFAS 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 (January 1, 2001 for the Bank). SFAS 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in fair value of derivatives are to be recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current-period earnings. In June 2000, the FASB issued SFAS 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which addressed a limited number of implementation issues arising from SFAS 133.

The FHLBanks adopted SFAS 133, as amended by SFAS 138, on January 1, 2001. The transition provisions contained in SFAS 133, as amended, provide that at the date of initial application, an entity may transfer any security classified as "held-to-maturity" to "available-for-sale" or "trading" and any security classified as "available-for-sale" to "trading". On the initial adoption date of SFAS 133, as amended, the Bank transferred held-to-maturity securities with an amortized cost of $702,769,000 and an estimated fair value of $702,167,000 into the "trading" (investments held at fair value, with changes in fair value recognized in earnings) category. The unrealized net loss as of transfer date related to the transfer of certain held-to-maturity securities into the investments held at fair value category was $602,000 and will be shown as a charge to the FHLBank's results of operations in the first quarter of 2001 as a cumulative effect of a change in accounting principle decreasing net income.

The remaining cumulative effect of adjustments related to fair value hedges and derivative transactions either not desig-

nated as hedges under SFAS 133 or not meeting the requirements for fair value or cash flow hedges will be shown as a credit to the FHLBank's results of operations in the first quarter of 2001 as part of the cumulative effect of a change in accounting principle increasing net income by $1,175,000.

Reclassifications - Certain amounts in the 1999 and 1998 financial statements have been reclassified to conform with the 2000 presentation.

Note 2 - Cash and Due from Banks

Compensating Balances - The Bank has agreed to maintain compensating balances based upon average daily collected cash balances with various commercial banks in consideration for certain services. There are no legal restrictions under these agreements as to the withdrawal of funds. The average compensating balances maintained for the years ended December 31, 2000 and 1999 were approximately $679,000 and $775,000, respectively.

In addition, the Bank maintained average collected balances with various Federal Reserve Banks and branches of approximately $2,000,000 for the years ended December 31, 2000 and 1999. The Bank was required to maintain minimum average daily clearing balances of $2,000,000 for the years ended December 31, 2000 and 1999. Earnings credits on these balances may be used to pay for services received from the Federal Reserve.

Pass-through Deposit Reserves - The Bank acts as a pass-through correspondent for member institutions required to deposit reserves with the Federal Reserve Banks. Pass-through reserves deposited with Federal Reserve Banks were approximately $279,000 and $294,000 as of December 31, 2000 and 1999, respectively. Member reserve balances are included in deposits in the statement of condition.

Note 3 - Securities Purchased Under Agreements To Resell

The Bank has entered into purchases of securities purchased under agreements to resell. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the statement of condition. The securities purchased under agreements to resell are held in safekeeping in the name of the Bank by one of the Federal Reserve Banks. Should the market value of the underlying securities decrease below the market value required as collateral, the counterparty is required to place an equivalent amount of additional securities in safekeeping in the name of the Bank or the dollar value of the resale agreement will be decreased accordingly.

Note 4 - Held-To-Maturity Securities

Major Security Types - Held-to-maturity securities as of December 31, 2000 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. Treasury obligations	$ 24,603	$ —	$ (20)	$ 24,583
Commercial paper	297,676	—	(6)	297,670
U.S. agency obligations	377,121	4,739	(4,838)	377,022
Investments in consolidated obligations of other FHLBanks	196,223	1,979	(7,376)	190,826
State or local housing agency obligations	233,331	—	(10,572)	222,759
Other	527,066	104	(1,461)	525,709
	1,656,020	6,822	(24,273)	1,638,569
Mortgage-backed securities	4,120,626	19,512	(24,858)	4,115,280
Total	5,776,646	26,334	(49,131)	5,753,849
Deferred losses on terminated or re-designated interest rate exchange agreements	230	—	(230)	—
Associated interest rate exchange agreements, net	2,720	13,961	(10,095)	6,586
Total with interest rate exchange agreements	$ 5,779,596	$ 40,295	$ (59,456)	$ 5,760,435

Major Security Types - Held-to-maturity securities as of December 31, 1999 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. Treasury obligations	$ 23,971	$ —	$ (82)	$ 23,889
Commercial paper	768,248	402	—	768,650
U.S. agency obligations	403,664	—	(16,453)	387,211
Investments in consolidated obligations of other FHLBanks	291,088	278	(15,020)	276,346
State or local housing agency obligations	234,274	—	(22,676)	211,598
Other	545,610	122	(9,219)	536,513
	2,266,855	802	(63,450)	2,204,207
Mortgage-backed securities	4,337,442	6,974	(107,093)	4,237,323
Total	6,604,297	7,776	(170,543)	6,441,530
Deferred losses on terminated or re-designated interest rate exchange agreements	325	—	(325)	—
Associated interest rate exchange agreements, net	3,704	33,519	(1,591)	35,632
Total with interest rate exchange agreements	$ 6,608,326	$ 41,295	$ (172,459)	$ 6,477,162

Redemption Terms - The amortized cost and estimated fair value of held-to-maturity securities as of December 31, 2000, and 1999, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities as issuers have the right to call or prepay obligations with or without call or prepayment fees:

	2000 (In thousands)		1999 (In thousands)	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 757,749	$ 757,827	$ 1,352,027	$ 1,352,044
Due after one year through five years	347,157	342,896	345,940	329,103
Due after five years through ten years	359,119	355,516	387,759	361,587
Due after ten years	191,995	182,330	181,129	161,473
	1,656,020	1,638,569	2,266,855	2,204,207
Mortgage-backed securities	4,120,626	4,115,280	4,337,442	4,237,323
Total	$ 5,776,646	$ 5,753,849	$ 6,604,297	$ 6,441,530

The amortized cost of the Bank's held-to-maturity securities is net of discounts of $8,392,446 and $13,615,782 at December 31, 2000 and 1999, respectively.

Interest-Rate Payment Terms - Interest rate payment terms for investment securities classified as held-to-maturity and interest rate exchange agreements associated with these securities at December 31, 2000 and 1999 are detailed in the following table:

	2000	1999
	(In thousands)	
Amortized cost of held-to-maturity securities other than mortgage-backed securities:		
Fixed-rate	$ 1,430,147	$ 1,986,052
Variable-rate	225,873	280,803
	1,656,020	2,266,855
Amortized cost of held-to-maturity mortgage-backed securities:		
Pass-through securities:		
Fixed-rate	265,607	144,470
Variable-rate	559,793	526,419
Collateralized mortgage obligations:		
Fixed-rate	2,501,549	2,746,806
Variable-rate	793,677	919,747
	4,120,626	4,337,442
Total	$ 5,776,646	$ 6,604,297
Notional principal of interest rate exchange agreements by class type associated with held-to-maturity securities:		
Interest rate swaps	$ 705,414	$ 846,505
Interest rate caps purchased	465,000	—
Total	$ 1,170,414	$ 846,505

The effect of the Bank's interest-rate exchange agreements on interest income from held-to-maturity securities is disclosed in Note 12.

Note 5 - Advances

Redemption Terms - At December 31, 2000 and 1999, the Bank had advances outstanding to members, including AHP advances (see Note 6), at interest rates ranging from 4.30% to 8.47% and 4.20% to 8.95%, respectively, as summarized below. Advances with an average interest rate of 5.06% are AHP subsidized advances.

	2000		1999	
Year of Maturity	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
	(In thousands)		(In thousands)	
2000	—	—	$ 7,697,403	5.50%
2001	$ 9,385,503	6.45%	1,768,530	5.78
2002	1,648,012	6.57	1,274,837	5.92
2003	1,621,174	6.13	650,631	5.48
2004	1,419,819	5.86	2,285,580	5.58
2005	1,427,611	6.13	322,732	5.14
Thereafter	2,960,913	5.54	3,167,307	6.30
Total par value	18,463,032	6.21%	17,167,020	5.61%
Discount on AHP advances	(452)		(591)	
Deferred gains on interest rate exchange agreements	(350)		(429)	
Associated interest rate exchange agreements, net	58		1,291	
Total with interest rate exchange agreements	$ 18,462,288		$ 17,167,291	

In general, some of the Bank's advances to members are callable at the member's option. Members are charged a prepayment fee when certain advances are prepaid. Other advances may be repaid on pertinent call dates without incurring prepayment fees (Callable Advances). At December 31, 2000 and 1999, the Bank had Callable Advances outstanding totaling $3,000,000.

The following table summarizes advances to member institutions at December 31, 2000 and 1999 by year of maturity or next call date for Callable Advances:

Year of Maturity or Next Call Date	2000	1999
	(In thousands)	
2000	—	$ 7,700,403
2001	$ 9,385,503	1,765,530
2002	1,648,012	1,274,837
2003	1,621,174	650,631
2004	1,419,819	2,285,580
2005	1,427,611	322,732
Thereafter	2,960,913	3,167,307
Total par value	$ 18,463,032	$ 17,167,020

The Bank also issues advances to members in which the Bank has the right to cancel after a specified lockout period, in whole or in part, at par with five calendar days notice. If the Bank exercises the right to cancel the advance, the member may convert the advance to another advance product offered by the Bank at existing market prices for that member on the date of conversion (Convertible Advances). At December 31, 2000 and 1999, the Bank had Convertible Advances outstanding totalling $5,550,938,000 and $5,659,106,000, respectively.

The following table summarizes advances to member institutions at December 31, 2000 and 1999 by year of maturity or next conversion date for Convertible Advances:

Year of Maturity or Next Conversion Date	2000	1999
	(In thousands)	
2000	—	$ 10,803,389
2001	$ 12,670,521	3,235,025
2002	2,034,412	769,387
2003	1,902,199	1,267,556
2004	747,796	465,619
2005	483,111	163,732
Thereafter	624,993	462,312
Total par value	$ 18,463,032	$ 17,167,020

Security Terms - The Bank lends to financial institutions in Illinois and Wisconsin involved in housing finance, in accordance with federal statutes, including the Federal Home Loan Bank Act of 1932, as amended (the Act). The Bank is required by statute to obtain sufficient collateral on advances to protect against losses and to accept certain investment securities, residential mortgage loans, deposits in the Bank, and other real estate related assets as collateral on such advances. However, "community financial institutions" are subject to more liberal statutory collateral provisions dealing with loans to small business and agriculture under the provisions of the 1999 Act. The capital stock of the Bank owned by borrowing members is also pledged as additional collateral on advances. The Act requires that the aggregate advances from the Bank to any single member not exceed 20 times the amount paid by that member for capital stock of the Bank. At December 31, 2000 and 1999, the Bank had rights to collateral with an estimated value in excess of outstanding advances. Based upon the financial condition of the member, the Bank:

1. Allows a member to physically retain collateral assigned to the Bank, provided that the member executes a written security agreement and agrees to hold such collateral for the benefit of and subject to the direction and control of the Bank; or
2. Requires the member to specifically assign or place physical possession of such collateral with the Bank or its safekeeping agent.

Beyond these provisions, Section 10(e) of the Act affords any security interest granted by a member to the Bank priority over the claims or rights of any other party. The only two exceptions are claims that would be entitled to priority under otherwise applicable law or perfected security interest.

Credit Risk - The Bank's potential credit risk from advances is primarily to savings institutions and commercial banks. The Bank has experienced no losses on advances since it was founded, nor does management anticipate any future losses on advances. Accordingly, no allowance for losses on advances has been provided.

The Bank held sufficient collateral to cover the advances to these institutions. The Bank does not expect to incur any credit losses on these advances.

As of December 31, 2000, the Bank had advances of $2,752,000,000 outstanding to one member institution, and this represents 15% of total advances outstanding. The income from advances to this member institution amounted to $146,486,000 during 2000. The Bank held sufficient collateral to cover the advances to this institution, and the Bank does not expect to incur any credit losses on these advances.

Interest Rate Payment Terms - Additional interest rate payment terms for advances and interest rate exchange agreements associated with advances at December 31, 2000 and 1999 are detailed in the following table:

	2000	1999
	(In thousands)	
Par amount of advances:		
Fixed-rate	$ 14,883,360	$ 13,542,331
Variable-rate	3,579,672	3,624,689
Total par value	$ 18,463,032	$ 17,167,020
Notional principal of interest rate exchange agreements by class type associated with advances:		
Interest rate swaps	$ 13,832,304	$ 12,006,630
Interest rate caps purchased	—	2,000
Interest rate floors purchased	240,000	340,000
Total	$ 14,072,304	$ 12,348,630

The estimated fair value of advances, including the estimated fair value and discussion of related interest rate exchange agreements, as of December 31, 2000 and 1999 is disclosed in Notes 12 and 14.

Prepayment Fees - During 2000, 1999, and 1998, the Bank charged its members prepayment fees when the principal on certain advances was prepaid prior to original maturity. Further, some of these advances were associated with interest-rate exchange agreements. Upon termination of these advances, the associated interest rate exchange agreements were either terminated or marked-to-market upon being re-designated and the resulting gains or losses (see Note 12) were recognized as other income on the statement of income. The Bank received prepayment fees, net of gains or losses on associated interest-rate exchange agreements of $13,944, $55,136 and $3,760,991 during the years ended December 31, 2000, 1999 and 1998, respectively. The corresponding principal amount prepaid during the same years was $5,199,000, $5,592,000, and $425,076,000, respectively.

Note 6 - Affordable Housing Program

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) contains provisions for the establishment of an Affordable Housing Program (AHP) by each FHLBank. Each FHLBank provides subsidies in the form of direct grants or below-market interest-rate advances for members who use the funds for qualifying affordable housing projects. Annually, the FHLBanks must set aside for the AHPs the greater of $100 million or ten percent of the current year's income before charges for AHP but after the charge to REFCORP (see Note 10). The amount set aside is charged to income and recognized as a liability. As subsidies are provided, the AHP liability is relieved.

If the results of the aggregate ten percent calculation described above is less than $100 million, the shortfall is allocated among the FHLBanks based on the ratio of each Bank's income before AHP and REFCORP to the sum of the income before AHP and REFCORP of the twelve district FHLBanks. There was no shortfall in either 2000 or 1999.

Note 7 - Mortgage Loans

The Mortgage Partnership Finance® (MPF®) program involves investment by the FHLBank in mortgage loans which are either funded by the FHLBank through or purchased from its participating members. The total loans represent held-for-investment loans under the MPF program whereby the Bank's members create, service and credit enhance home mortgage loans which are owned by the Bank. The following table presents information as of December 31, 2000 and 1999 on mortgage loans:

	2000	1999
	(In thousands)	
Mortgages:		
Fixed medium-term* single-family mortgages	$ 511,241	$ 420,988
Fixed long-term single-family mortgages	7,559,059	1,195,367
Unamortized (discounts) premiums	29,701	(3,191)
Plus: deferred loan costs, net	3,850	6,291
Total mortgage loans	8,103,851	1,619,455
Associated interest rate exchange agreements, net	332	—
Total with interest rate exchange agreements	$ 8,104,183	$ 1,619,455

* medium-term is defined as a term of 15 years or less.

The allowances for credit losses was as follows:

	2000	1999	1998
		(In thousands)	
Allowance for credit loss:			
Balance, beginning of year	$ 687	$ 235	$ 16
Chargeoffs	(90)	—	—
Recoveries	—	—	—
Net chargeoffs	(90)	—	—
Provisions for credit losses	906	452	219
Balance, end of year	$ 1,503	$ 687	$ 235

The estimated fair value of the mortgage loans held as of December 31, 2000 and 1999 is reported in Note 14.

At December 31, 2000 and 1999, the Bank did not have any recorded investment in impaired loan pools.

	2000	1999
	(In thousands)	
Notional principal of interest rate exchange agreements by class type associated with mortgage loans:		
Interest rate swaps	$ 238,178	$ —
Forward and futures contract	2,820,000	—
	$ 3,058,178	$ —

Note 8 - Deposits

The Bank offers demand and overnight deposit programs for members and qualifying non-members. In addition, the Bank offers short-term deposit programs to members. A member that services mortgage loans may deposit in the Bank the funds collected in connection with the mortgage loans pending disbursement of such funds to the owners of mortgage loans; these items are classified as other deposits on the statement of condition.

The Bank had no interest rate exchange agreements associated with deposits at December 31, 2000 and 1999.

Note 9 - Consolidated Obligations

Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated bonds and discount notes. Through December 31, 2000, consolidated bonds were approved for issuance by the Finance Board to raise intermediate and long-term funds for the FHLBanks and range from one year to thirty years in maturity. Through December 31, 2000, discount notes were approved for issuance by the Finance Board to raise short-term funds. These notes are issued at less than their face amount and redeemed at par value when they mature. The Finance Board adopted final rules on June 2, 2000, to govern the issuance of debt for the FHLBanks. Effective January 1, 2001, the Finance Board will no longer be the issuer of debt, instead, the FHLBanks will issue joint debt through the Office of Finance as their agent.

The par value of outstanding consolidated obligation bonds and discount notes for all of the FHLBanks was approximately $614,065,000,000 and $549,400,000,000 at December 31, 2000 and 1999, respectively. Regulations require the Banks to maintain, in the aggregate, unpledged qualifying assets in an amount equal to the consolidated obligations outstanding. Qualifying assets are defined as cash; secured advances; assets with an assessment or rating at least equivalent to the current assessment or rating of the FHLBank consolidated obligations; obligations, participations, mortgages, or other securities of or issued by the United States government or an agency of the United States government; and such securities as fiduciary and trust funds may invest in under the laws of the state in which each FHLBank is located.

On June 2, 2000, the Finance Board adopted a final rule amending the FHLBanks' leverage limit requirements. Effective July 1, 2000, each FHLBanks' leverage limit will be based on a ratio of assets to capital, rather than a ratio of liabilities to capital. The Finance Board's former regulations prohibited the issuance of consolidated obligations if such issuance would bring the System's outstanding consolidated obligations and other unsecured senior liabilities above 20 times the System's total capital. The Finance Board's Financial Management Policy also applied this limit on an FHLBank-by-FHLBank basis. The final rule deletes the System-wide leverage limit from the regulations, but, limits each FHLBank's assets generally to no more than 21 times its capital. Nevertheless, an FHLBank whose non-mortgage assets, after deducting deposits and capital, do not exceed 11% of its assets may have total assets in an amount not greater than 25 times its capital.

In order to provide the holders of consolidated obligations issued prior to January 29, 1993 (prior bondholders) protection equivalent to that provided under the System's previous leverage limit of twelve times FHLBank Capital stock, prior bondholders have a singular claim on a certain amount of the Qualifying Assets (Special Asset Account (SAA)) if capital stock is less than 8.33% of consolidated obligations. At December 31, 2000 and 1999, the System's capital stock was 4.96% and 5.16% of consolidated obligations and the SAA balance was approximately $37,100,000 and $67,300,000. Each FHLBank is required to transfer Qualifying Assets in the amount of its allocated share of the System's SAA balance to a trust for the benefit of the prior bondholders if that FHLBank's capital-to-assets ratio falls below 2%. The Bank's capital-to-assets ratio was greater than 2% at December 31, 2000, and 1999.

General Terms - Consolidated obligations are generally issued with either fixed-rate payment terms or floating-rate payment terms that use a variety of indices for interest rate resets including the London Interbank Offered Rate (LIBOR), Constant Maturity Treasury (CMT), 11th District Cost of Funds, and others. In addition, to meet the specific needs of certain investors in consolidated obligations, fixed-rate bonds and variable-rate bonds may also contain certain embedded features, which may result in complex coupon payment terms and call features. When the Bank issues such consolidated obligations, the Bank concurrently enters into interest rate exchange agreements containing offsetting features, effectively to alter the terms of the bond to a straightforward variable-rate bond tied to an index.

These consolidated obligation bonds have the following broad terms:

Indexed Principal Redemption Bonds (Index Amortizing Notes) - Repay principal according to predetermined amortization schedules that are linked to the level of a certain index. In general, as market interest rates increase (decrease), the maturity of the Index Amortizing Notes extends (contracts).

Optional Redemption Bonds (Callable Bonds) - May be redeemed in whole or in part at the discretion of the Bank on predetermined call dates in accordance with terms of bond offerings.

Variable Principal Bonds - The principal amount of the bond varies based upon a predetermined index linked, for instance, to changes in interest rates for foreign currency exchange rates.

Range Bonds - Pay interest at variable rates provided a specified index (such as stock market indices or foreign currency exchange rates) is within a specified range. The computation of variable interest rate varies for each bond issued but generally pays zero interest if the specified index is outside the specified range.

Step-Up Bonds - Pay interest at increasing fixed rates for specified intervals over the life of the bond. These bonds generally contain provisions enabling the bonds to be called at the Bank's option on the step-up dates.

Inverse Floating Bonds - Coupon rates increase as an index declines and decrease as an index rises.

Comparative-Index Bonds - Coupon rates are determined by the difference between two or more market indices, typically CMT and LIBOR.

Redemption Terms - The following is a summary of the Bank's participation in consolidated obligation bonds at December 31, 2000 and 1999 by year of maturity.

	2000		1999	
Year of Maturity	Amount (In thousands)	Weighted Average Interest Rate	Amount (In thousands)	Weighted Average Interest Rate
2000	—		$ 3,273,495	5.63%
2001	$ 7,541,000	5.94%	5,365,000	5.65
2002	6,413,150	6.28	2,954,460	5.66
2003	4,069,030	6.25	2,329,110	5.48
2004	795,000	6.23	605,000	6.10
2005	2,477,560	6.91	450,560	5.84
Thereafter	4,566,250	6.84	2,573,200	6.21
Total par value	25,861,990	6.33%	17,550,825	5.73%
Concessions	(5,796)		(8,990)	
Bond premiums	11,937		3,165	
Bond discounts	(32,538)		(15,069)	
Forward exchange contracts associated with bonds denominated in foreign currencies	120,800		118,025	
Deferred net loss on terminated interest rate exchange agreements	(6,889)		—	
Associated interest rate rate exchange agreements	3,631		6,583	
Total with interest rate exchange agreements	$ 25,953,135		$ 17,654,539	

The Bank makes significant use of fixed-rate callable debt to finance Callable Advances (see Note 5) and mortgage-backed securities. Contemporaneous with such a debt issue, the Bank may also enter into a swap (in which the Bank pays variable and receives fixed) with a call feature that mirrors the option embedded in the debt (a sold callable swap). The combined sold callable swap and callable debt allows the Bank to provide its members with attractively priced variable-rate advances, while converting its own payment to a variable-rate.

The Bank's consolidated bonds outstanding includes:

	2000		1999	
	Amount (In thousands)	Percentage of Callable/ Non Callable Bonds To Total	Amount (In thousands)	Percentage of Callable Non Callable Bonds To Total
Par amount of consolidated bonds:				
Non-callable or non-putable	$ 20,756,940	80.26%	$ 14,064,825	80.14%
Callable	5,105,050	19.74	3,486,000	19.86
Total par value	$ 25,861,990	100.00%	$ 17,550,825	100.00%

The following table summarizes the Bank's participation in consolidated bonds outstanding at December 31, 2000 and 1999, by year of maturity or next call date:

Year of Maturity or Next Call Date	2000	1999
	(in thousands)	
2000	—	$ 5,153,495
2001	$ 10,018,050	5,575,000
2002	7,555,150	3,464,460
2003	4,139,030	1,974,110
2004	605,000	435,000
2005	2,036,560	85,560
Thereafter	1,508,200	863,200
Total par value	$ 25,861,990	$ 17,550,825

As of December 31, 2000, the Bank had $1,077,000,000 in bonds with in-the-money calls that could be exercised in 2001 based on interest rates prevailing on December 31, 2000. The amount of bonds that will be called in 2001 will depend on the level and volatility of interest rates and other factors.

Interest Rate Payment Terms - Interest rate payment terms for consolidated bonds and interest rate exchange agreements associated with consolidated bonds at December 31, 2000 and 1999 are detailed in the following table. Range bonds are classified as comparative-index bonds.

	2000	1999
	(In thousands)	
Par amount of consolidated bonds:		
Fixed rate	$ 25,369,940	$ 17,003,825
Step-up	—	—
Variable rate	270,000	200,000
Inverse floating rate	50,000	50,000
Fixed that converts to variable	25,000	75,000
Variable that converts to fixed	30,000	30,000
Comparative-index	117,050	192,000
Total par value	$ 25,861,990	$ 17,550,825
Notional principal of interest rate exchange agreements by class type associated with consolidated bonds:		
Interest rate swaps	$ 16,526,200	$ 14,089,700
Interest rate caps purchased	350,000	1,325,000
Total	$ 16,876,200	$ 15,414,700

The effects of the Bank's interest-rate exchange agreement on interest expense from consolidated obligations is disclosed in Note 12.

Bonds Denominated in Foreign Currencies - The System issued bonds denominated in foreign currencies. Concurrent with these issuances, the Banks exchanged the interest and principal payment obligations related to the issues for equivalent amounts denominated in U.S. dollars. These bonds and related exchange contracts are translated into U.S. dollars at the exchange rate as of December 31, 2000 and 1999, respectively, in the preceding tables that presented the Bank's bonds by year of maturity, by year of maturity or next call date, and by interest rate payment terms.

The Bank's participation in bonds denominated in foreign currencies as of December 31, 2000 and 1999 was as follows:

	Amount Denominated in Foreign Currency (In thousands)		Effective Terms of Bonds Combined with Exchange Contracts (In thousands)		
Foreign Currency Description	2000	1999	Year of Maturity	Par Amount in U.S. Dollars	Interest Rate
German Marks	—	418,200	2000	$ 300,000	6.00%
British Pound	300,000	300,000	2002	488,700	6.88%
British Pound	300,000	300,000	2003	507,900	5.63%
British Pound	100,000	100,000	2003	169,300	5.63%

Discount Notes - The Bank's participation in consolidated discount notes, all of which are due within one year, is as follows:

	Book Value	Par Value	Weighted Average Interest Rate
	(In thousands)		
December 31, 2000	$ 4,948,713	$ 4,967,212	6.18%
December 31, 1999	6,548,334	6,581,013	5.23%

Section II of the Act authorizes the Secretary of the Treasury, in his or her discretion, to purchase consolidated obligations of the FHLBanks aggregating not more than $4,000,000,000; terms, conditions, and interest rates are to be determined by the Secretary of the Treasury. There were no such purchases by the U.S. Treasury during the two years ended December 31, 2000 and 1999.

Note 10 - Capital

The 1999 Act will lead to a number of changes in the capital structure of the FHLBanks. On December 20, 2000, the Finance Board approved the final rule implementing a new capital structure for the FHLBanks. The final rule was published on January 30, 2001, and the 1999 Act requires each FHLBank to submit a capital structure plan to the Finance Board for approval within 270 days of the publication of the final rule and provides a transition period to the new capital structure of up to three years from the effective date of each FHLBank's capital structure. Until such time as the FHLBanks fully implement the new capital regulations, which may not be for several years, the current capital rules remain in effect. In particular, the Act requires members to purchase capital stock equal to the greater of 1 percent of their mortgage-related assets or 5 percent of outstanding Bank advances. However, the 1999 Act removed the provision that required, a nonthrift member to purchase additional stock to borrow from its FHLBank if the nonthrift member's mortgage-related assets were less than 65 percent of total assets. Members may, at the Bank's discretion, redeem at par value any capital stock greater than their statutory requirement or sell it to other Bank members at par value.

When the capital structure plans have been approved by the Finance Board and implemented at each FHLBank, the FHLBanks will be subject to risk-based capital rules. Each FHLBank may offer two classes of stock. Providing the Bank is adequately capitalized, members can redeem Class A stock by giving six months notice, and members can redeem Class B stock by giving five years notice. Only "permanent" capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. In addition, the 1999 Act specifies a 5 percent minimum leverage ratio including a 1.5 weighting factor applicable to Class B stock. It also specifies a 4 percent minimum capital ratio that does not include the 1.5 weighting factor applicable to Class B stock used in determining compliance with the 5 percent leverage ratio.

The 1999 Act established voluntary membership for all members. All members may withdraw from membership and redeem their capital six months after giving notice to do so. Members that withdraw from membership may not re-apply for membership for five years.

On June 22, 2000, the Finance Board rescinded its dividend policy applicable to the FHLBanks. This action has the effect of no longer requiring an FHLBank to hold as restricted retained earnings that portion of prepayment fee income that, if prorated over the maturity of the advances prepaid, would be allocated to future dividends. The Bank's board of directors may declare and pay in either cash or capital stock dividends only from retained earnings or current net earnings.

Before the 1999 Act, the Act required the FHLBanks to pay $300 million annually through 2030 to fund part of the interest on REFCORP debt. Before paying dividends, each Bank was assessed up to 20 percent of its net income after AHP contributions to meet these required payments. If 20 percent of net income was less than the $300 million assessment in any year, the Act allocated the shortfall among all the FHLBanks based on the percentage equal to the ratio of each FHLBank's average advances to insured depository institutions, which are Savings Association Insurance Fund (SAIF) members, to the Bank

System's total average advances to SAIF-insured members. If the initial 20 percent assessment calculation exceeded the required $300 million, the $300 million is allocated among the FHLBanks based on their net income after their AHP contribution to the System net income after AHP contributions. There was no shortfall in 1999 or 1998.

The 1999 Act changed these required payments to 20 percent of net earnings for each FHLBank effective January 1, 2000. The Banks will pay these amounts until the aggregate amounts actually paid by the FHLBanks are equivalent to a $300 million annual annuity whose final maturity date is April 15, 2030. The cumulative amount to be paid to REFCORP by the Bank is not determinable at this time due to the interrelationships of all future FHLBanks' earnings. The FHLBanks payments during 2000 defease all future benchmark payments after the first quarter of 2026 and $40 million of the $75.0 million benchmark payment for the first quarter of 2026.

The Finance Board requires all Banks holding MPF 100, 125, and 125 Plus assets to hold retained earnings equal to 1.5% of the balance sheet value of the assets. At December 31, 2000, the Bank's requirement was $11 million, which was fully satisfied with over $70 million in retained earnings.

Note 11 - Employee Retirement Plans

The Bank is a participant in the Financial Institutions Retirement Fund (FIRF), a defined benefit plan. Substantially all officers and employees of the Bank are covered by the plan. The Bank's contributions to FIRF through June 30, 1987 represented the normal cost of the plan. The plan reached the full-funding limitation, as defined by the Employee Retirement Income Security Act, for the plan year beginning July 1, 1987 because of favorable investment and other actuarial experience during previous years. As a result, FIRF suspended employer contributions for all plan years ending after June 30, 1987. Contributions to the plan will resume when the plan is no longer in full-funding status based on annual determinations by FIRF. Pension costs of FIRF charged to operating expenses were approximately $6,000 for each of the years ended December 31, 2000, 1999 and 1998. FIRF does not segregate its assets, liabilities or costs by participating employer. As a result, disclosure of the accumulated benefit obligations, plan assets and the components of annual pension expense attributable to the Bank cannot be made.

The Bank also participates in the Financial Institutions Thrift Plan (FITP), a defined contribution plan. The Bank's contribution is equal to a percentage of participants' compensation and a matching contribution equal to a percentage of voluntary employee contributions, subject to certain limitations. The Bank contributed approximately $360,000, $327,000, and $300,000 for the years ended December 31, 2000, 1999, and 1998 respectively.

In addition, the Bank maintains a deferred compensation plan, available to all employees, which is, insubstance, an unfunded supplemental retirement plan. The plan's liability consists of the accumulated compensation deferrals and accrued earnings on the deferrals. The Bank's minimum obligation from these plans at December 31, 2000 was $2,036,000.

Effective January 1, 1994, the Bank adopted a Benefit Equalization Plan. This plan is an unfunded nonqualified deferred compensation plan providing benefits limited in the other retirement plans by laws governing such plans.

In addition to providing retirement benefits, the Bank provides health care and life insurance benefits for active and retired employees. Substantially all of the Bank's employees with at least five years of full-time employment service, become eligible for postretirement benefits at age 60 or older at retirement date. Under the Bank's current plan, eligible retiree's are entitled to full medical coverage as provided under Medicare. The Bank also provides term life insurance premium payments for eligible employees retiring after age 45.

The estimated status of the post-retirement obligation at December 31, 2000 and 1999, is as follows:

	2000	1999
	(In thousands)	
Fully active participants	$ 1,422	$ 1,079
Retiree's	614	505
Accrued post-retirement benefit costs	$ 2,036	$ 1,584

Net periodic post-retirement benefit cost for the years ended December 31, 2000, 1999 and 1998, included the following:

	2000	1999	1998
		(In thousands)	
Service cost	$ 167	$ 119	$ 96
Interest cost on accumulated postretirement benefit obligation	143	111	101
Expenses	2	1	1
Prior service cost	14	14	14
Amortization of gain on projected benefit obligation	(87)	(101)	(101)
Net periodic postretirement benefit cost	$ 239	$ 144	$ 111

The medical trend rate used in determining the accumulated post-retirement benefit obligation in both 2000 and 1999 was 6.8% compounded for individuals under 65 and 7% for individuals 65 and over. The discount rate used in determining the accumulated post-retirement benefit obligation in 2000 and 1999 was 7%. A 1% trend rate increase in 2000 and 1999 would

increase the post-retirement benefit obligation by 20% and 21%, respectively. A 1% trend rate decrease in 2000 and 1999 would decrease the post-retirement benefit obligation by 16%.

Note 12 - Interest Rate Exchange Agreements

In connection with its interest rate risk management program, the Bank uses various interest rate exchange agreements. Interest rate swap transactions involve the contractual exchange of a floating rate for a fixed or another floating rate interest payment obligation based on a notional principal amount as defined in the agreement. Forward contracts are commitments to buy or sell at a future date a financial instrument or currency at a contracted price and may be settled in cash or through delivery. Interest rate cap and floor agreements, for which either a premium is paid or received, allow the Bank to manage its exposure to unfavorable interest fluctuations over or under a specified rate. For this protection, a premium is paid. Interest rate caps and floors obligate one of the parties to the contract to make payments to the other if an interest rate index exceeds a specified upper “capped” level or if the index falls below a specified “floor” level.

The Bank enters into interest rate exchange agreements to hedge interest rate and embedded option risk on selected advances to members, structured Agency bonds held as investments, and structured debt. These agreements effectively convert long-term financial instruments from a fixed or an indexed rate with embedded options to a variable rate.

The Bank also enters into interest rate exchange agreements to hedge groups of assets and liabilities. These agreements reduce market risk associated with the change in interest rates in conjunction with the Bank’s asset and liability management.

Interest rate exchange agreements involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of condition. The contract or notional amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments; the notional amount does not represent exposure to credit loss. The amounts potentially subject to loss due to credit risks are the book value amounts of the agreements, and not the notional amounts. Maximum credit risk is defined as the estimated cost of replacement for favorable interest rate swaps, forward agreements and purchased caps and floors in the event of counterparty default and the related collateral, if any, proved to be of no value to the Bank. The Bank is subject to credit risk only due to the nonperformance by counterparties to the agreements; however, based on management’s credit analysis and collateral requirements, the Bank does not anticipate any losses on these agreements.

At December 31, 2000 and 1999, the Bank’s maximum credit risk, as defined above, was approximately $257,430,000 and $261,905,000 respectively, including $ 165,118,000 and $234,078,000 of net accrued interest receivable, respectively. Accrued interest receivables and payables and legal right to offset assets and liabilities by counterparty, in which amounts recognized for individual contracts may be offset against amounts recognized for other contracts, are considered in determining the maximum credit risk. The Bank held cash and securities with a market value of approximately $221,728,000 and $219,235,000 as collateral for interest rate exchange agreements as of December 31, 2000 and 1999, respectively.

A significant portion of the Bank’s interest rate exchange agreements are transacted with financial institutions such as major banks and broker-dealers, with no single institution dominating the business. Assets pledged as collateral by the Bank to these counterparties are discussed more fully in Note 15.

The amortized costs and estimated fair values by class type of all interest-rate exchange agreements outstanding at December 31, 2000 and 1999 are disclosed in Note 14.

The notional principal by class type of designated interest-rate exchange agreements associated with held-to-maturity securities, advances, mortgage loans, and consolidated obligations outstanding at December 31, 2000 and 1999 is detailed in Notes 4, 5, 7, and 9, respectively. The notional principal of interest-rate exchange agreements by class in which the Bank is an intermediary is detailed below.

Intermediation - Interest-rate exchange agreements in which the Bank is an intermediary may arise when the Bank: (1) enters into offsetting interest rate exchange agreements with members and other counterparties to meet the needs of their member, or (2) enters into interest rate exchange agreements to offset the economic effect of other interest-rate exchange agreements that are no longer designated to either advances, investments, or consolidated obligations.

The following is a summary at December 31, 2000 and 1999, of the notional principal of interest-rate exchange agreements by class type in which the Bank is an intermediary:

	2000	1999
	(In thousands)	
Interest rate swaps	$ 130,000	$ 80,000
Interstate rate caps purchased	125,000	150,000
Interest rate caps sold	125,000	150,000
Total	$ 380,000	$ 380,000

Income Effect - The effect of the Bank's interest rate exchange agreements for the years ended December 31, 2000, 1999 and 1998, was to increase (decrease) interest income, interest expense and other income as follows:

	2000	1999	1998
		(In thousands)	
Interest income:			
Securities purchased under agreements to resell	$ —	$ (3,857)	$ (4,688)
Advances to members	73,148	(2,196)	9,434
Held-to-maturity securities	5,629	(4,957)	(5,738)
Mortgage loans	7,708	—	—
Total Income	$ 86,485	$ (11,010)	$ (992)
Interest expense:			
Consolidated obligations	$ 74,701	$ (133,781)	$ (141,758)
Deposits	—	—	(44)
Total Expense	$ 74,701	$ (133,781)	$ (141,802)
Other income:			
Unrealized net losses on re-designation of interest-rate change agreements	$ —	$ —	$ (225)
Realized net gains on sales/termination of interest-rate exchange agreements not associated with underlying financial instrument	1,467	—	—
Income on member related interest rate exchange agreements	64	420	137
Total Other Income	$ 1,531	$ 420	$ (88)
Net Extraordinary item	$ (2,575)	$ —	$ 59

The Bank enters into some interest rate exchange agreements that a counterparty may cancel at its option. While the counterparty generally may exercise this option to cancel at any time, the movement of interest rates usually determines whether the option will be exercised. If the interest rate exchange has a negative fair value, the counterparty is likely to exercise the option. For additional detailed information about interest rate exchange agreements see Note 15.

Note 13 - Segment Information

The Bank has identified two main operating segments; MPF and Traditional Member Finance based on its method of internal reporting. The products and services provided reflect the manner in which financial information is evaluated by management. Income is derived primarily from the difference, or spread, between the yield on mortgage loans and the borrowing cost related to those loans. The Traditional Member Finance segment includes products such as advances, investments and consolidated obligations.

The following table sets forth the Bank's financial performance by operating segment for the years ended December 31, 2000, 1999 and 1998.

	MPF	Traditional Member Finance	Total
		(In thousands)	
2000			
Net interest income	$ 26,816	$ 185,413	$ 212,229
Provision for credit losses on mortgage loans	906	—	906
Other income	835	1,572	2,407
Other expenses	16,178	19,874	36,052
Income before assessments	10,567	167,111	177,678
Affordable Housing Program	863	13,492	14,355
REFCORP	1,941	30,358	32,299
Total assessments	2,804	43,850	46,654
Net income before extraordinary item	$ 7,763	$ 123,261	$ 131,024
1999			
Net interest income	$ 9,948	$ 158,587	$ 168,535
Provision for credit losses on mortgage loans	452	—	452
Other income	265	1,939	2,204
Other expenses	7,877	19,439	27,316
Income before assessments	1,884	141,087	142,971
Affordable Housing Program	—	12,464	12,464
Net income before extraordinary item	$ 1,884	$ 128,623	$ 130,507
1998			
Net interest income	$ 1,732	$ 136,037	$ 137,769
Provision for credit losses on mortgage loans	219	—	219
Other income	75	4,407	4,482
Other expenses	4,416	16,651	21,067
Income before assessments	(2,828)	123,793	120,965
Affordable Housing Program	—	10,257	10,257
Net income before extraordinary item	$ (2,828)	$ 113,536	$ 110,708
2000			
Total mortgage loans, net	$ 8,102,680	$ —	$ 8,102,680
Average mortgage loans, net	$ 4,863,128	$ —	$ 4,863,128
1999			
Total mortgage loans, net	$ 1,618,768	$ —	$ 1,618,768
Average mortgage loans, net	$ 1,265,572	$ —	$ 1,265,572

Note 14 - Estimated Fair Values

Cash and Due From Banks - The estimated fair value approximates the carrying value.

Held-To-Maturity Securities - The estimated fair values of held-to-maturity securities have been determined based on quoted prices as of the last business day of the year when those prices are available. However, active markets do not exist for many types of financial instruments. Consequently, fair values for these instruments must be estimated using techniques such as discounted cash flow analysis and comparison to similar instruments. Estimates developed using these methods require judgments regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes.

Advances and Other Loans - For advances with fixed rates and more than three months to maturity, the estimated fair value has been determined by calculating the present value of expected cash flows from the advances. The discount rates used in these calculations are the replacement advance rates for advances with similar terms. Per the Finance Board regulations, advances with a maturity or repricing period greater than six months generally require a fee sufficient to make the Bank financially indifferent to the borrower's decision to prepay the advances. Therefore the estimated fair value of advances does not assume prepayment risk. For advances with floating rates and fixed rates with less than three months to maturity or repricing, the estimated fair value approximates the carrying value.

Mortgage Loans - The estimated fair values for mortgage loans have been determined based on quoted prices of similar mortgage loans available in the market. These prices, however, are highly dependent upon the prepayment assumptions that are used. Changes in the prepayment rates used often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes.

Accrued Interest Receivable and Payable - The estimated fair value approximates the carrying value.

Federal Funds Sold - The estimated fair value has been determined by calculating the present value of expected cash flows from the Federal funds. The discount rates used in these calculations are the rates for Federal funds with similar terms.

Deposits - The estimated fair value has been determined by calculating the present value of expected future cash flows from the deposits. The discount rates used in these calculations are the cost of deposits with similar terms.

Consolidated Obligations - Estimated fair value has been determined by calculating the present value of expected cash flows from the consolidated obligations. The discount rates used in these calculations are the replacement funding rates for liabilities with similar terms.

Borrowings - The estimated fair value has been determined by calculating the present value of expected future cash flows from the borrowings and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of borrowings with similar terms.

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

Interest Rate Exchange Agreements - The estimated fair values of these agreements are based on the cost of interest rate exchange agreements with similar terms or available market prices excluding accrued interest receivable and payable. However, active markets do not exist for many types of financial instruments. Consequently, fair values for derivative instruments were estimated using techniques such as discounted cash flow analysis and comparison to similar instruments. Where modeling techniques did not accurately reflect the nature of specific instruments, market quotes were obtained from dealers. Estimates developed using these methods are highly subjective and require judgments regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes.

The estimated fair values of the Bank's financial instruments at December 31, 2000 were as follows:

Financial Instrument	Amortized Cost	Net Unrecognized Gain or (Loss)	Estimated Fair Value
		(In thousands)	
Financial Assets			
Cash and due from banks	$ 4,194	$ —	$ 4,194
Securities purchased under agreements to resell	45,685	(6)	45,679
Federal funds sold	2,397,000	(309)	2,396,691
Held-to-maturity securities	5,776,876	(23,027)	5,753,849
Interest rate exchange agreements associated with held-to-maturity securities	2,720	3,866	6,586
Held-to-maturity securities, net	5,779,596	(19,161)	5,760,435
Advances to members	18,462,230	109,101	18,571,331
interest rate exchange agreements associated with advances to members	58	(100,218)	(100,160)
Advances	18,462,288	8,883	18,471,171
Mortgage loans	8,103,851	96,419	8,200,270
Allowance for credit losses	(1,503)	1,503	—
Hedges on mortgage loans	332	(8,292)	(7,960)
Mortgage loans, net	8,102,680	89,630	8,192,310
Accrued interest receivable	578,352	—	578,352
Total financial assets	$ 35,369,795	$ 79,037	$ 35,448,832
Financial Liabilities			
Deposits	(2,010,132)	(524)	(2,010,656)
Consolidated obligations:			
Discount notes	(4,948,713)	1,110	(4,947,603)
Bonds	(25,949,504)	(244,062)	(26,193,566)
Interest rate exchange agreements associated with consolidated obligation bonds	(3,631)	(441)	(4,072)
Consolidated obligations, net	(30,901,848)	(243,393)	(31,145,241)
Accrued interest payable	(664,059)	—	(664,059)
Interest rate exchange agreements in which the Bank is an intermediary, net	(47)	294	247
Commitments to extend credit	—	80	80
Hedges of commitments to extend credit	—	(113)	(113)
Total financial liabilities	$ (33,576,086)	$ (243,656)	$(33,819,742)

The Bank enters into some interest rate exchange agreements that a counterparty may cancel at its option. While the counterparty generally may exercise this option to cancel at any time, the movement of interest rates usually determines whether the option will be exercised. If the interest rate exchange agreement has a negative fair value, the counterparty is likely to exercise the option.

The following table categorizes interest rate exchange agreements as non-cancelable, cancelable by counterparty, and cancelable by the Bank at December 31, 2000:

Total by Class Type of Interest Rate Exchange Agreements	Notional Amount	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
			(In thousands)		
Interest rate swaps:					
Non-cancelable:					
Bank pays fixed, receives variable	$ 9,330,781	$ 513	$ 14,053	$ (65,115)	$ (50,549)
Bank pays variable, receives fixed	14,561,328	(3,837)	143,278	(135,833)	3,608
Bank pays variable, receives variable	408,259	5,617	18,903	(7,415)	17,105
Cancelable by counterparty					
Bank pays fixed, receives variable	4,844,728	(3,428)	11,349	(62,545)	(54,624)
Bank pays variable, receives fixed	2,107,000	(664)	7,764	(25,880)	(18,780)
Bank pays variable, receives variable	180,000	—	—	(2,431)	(2,431)
	31,432,096	(1,799)	195,347	(299,219)	(105,671)
Interest rate caps purchased	940,000	2,506	—	(2,089)	417
Interest rate floors purchased	240,000	2	72	—	74
Interest rate caps sold	125,000	(1,607)	1,233	—	(374)
Forward and futures contracts	2,820,000	332	57	(304)	85
Total	$35,557,096	$ (566)	$ 196,709	$ (301,612)	$ (105,469)

The interest rate exchange agreements presented in the above table were entered into to offset fair value changes of interest rate and currency positions of instruments on the balance sheet . As the previous fair value table demonstrates, there are similar, offsetting fair value changes in the associated on-balance sheet items.

The estimated fair values of the Bank's financial instruments at December 31, 1999 were as follows:

Financial Instrument	Amortized Cost	Net Unrecognized Gain or (Loss)	Estimated Fair Value
		(In thousands)	
Financial Assets			
Cash and due from banks	$ 41,435	$ —	$ 41,435
Securities purchased under agreements to resell	50,390	(9)	50,381
Federal funds sold	3,170,000	92	3,170,092
Held-to-maturity securities	6,604,622	(163,092)	6,441,530
Interest rate exchange agreements associated with held-to-maturity securities	3,704	31,928	35,632
Held-to-maturity securities, net	6,608,326	(131,164)	6,477,162
Advances to members	17,166,000	(168,769)	16,997,231
Interest rate exchange agreements associated with advances to members	1,291	161,352	162,643
Advances to members, net	17,167,291	(7,417)	17,159,874
Mortgage loans	1,619,455	(65,426)	1,554,029
Allowance for credit losses	(687)	687	—
Mortgage loans, net	1,618,768	(64,739)	1,554,029
Accrued interest receivable	561,201	—	561,201
Total financial assets	$ 29,217,411	$ (203,237)	$ 29,014,174
Financial Liabilities			
Deposits	(2,877,079)	348	(2,876,731)
Consolidated obligations:			
Discount notes	(6,548,334)	2,931	(6,545,403)
Bonds	(17,647,956)	502,609	(17,145,347)
Interest rate exchange agreements associated with consolidated obligation bonds	(6,583)	(345,629)	(352,212)
Consolidated obligations, net	(24,202,873)	159,911	(24,042,962)
Accrued interest payable	(573,729)	—	(573,729)
Interest rate exchange agreements in which the Bank is an intermediary, net	(66)	307	241
Commitments to extend credit	—	(150)	(150)
Hedges of commitments to extend credit	—	73	73
Total financial liabilities	(27,653,747)	160,489	(27,493,258)

The following table categorizes interest rate exchange agreements as non-cancelable, cancelable by counterparty, and cancelable by the Bank at December 31, 1999:

Total by Class Type of Interest Rate Exchange Agreements	Notional Amount	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
			(In thousands)		
Interest rate swaps:					
Non-cancelable:					
Bank pays fixed, receives variable	$ 6,580,731	$ 614	$ 100,489	$ (462)	$ 100,641
Bank pays variable, receives fixed	11,041,900	(10,406)	—	(263,333)	(273,739)
Bank pays variable, receives variable	1,271,014	7,654	34,599	(9,392)	32,861
Cancelable by counterparty					
Bank pays fixed, receives variable	5,320,920	—	70,058	(105)	69,953
Bank pays variable, receives fixed	2,266,000	(1,473)	—	(93,306)	(94,779)
Bank pays variable, receives variable	542,270	(4,155)	13,722	(2,486)	7,081
	27,022,835	(7,766)	218,868	(369,084)	(157,982)
Interest rate caps purchased	1,477,000	7,066	1,329	(2,651)	5,744
Interest rate floors purchased	340,000	1,278	—	(1,010)	268
Interest rate caps sold	150,000	(2,232)	1,027	(447)	(1,652)
Total	$28,989,835	$ (1,654)	$221,224	$ (373,192)	$ (153,622)

Note 15 - Commitments and Contingencies

Commitments which legally bind and unconditionally obligate the Bank for additional advances totaled $5,000,000 and $8,000,000 at December 31, 2000 and 1999, respectively. Commitments generally are for periods up to twelve months. Outstanding standby letters of credit were approximately $463,000,000 and $299,000,000 at December 31, 2000 and 1999, respectively. Letters of credit are fully collateralized at the time of issuance, in a manner consistent with advances to members (Note 5).

Commitments which unconditionally obligate the Bank to fund/purchase mortgage loans totaled approximately $148,145,000 and $7,149,000 at December 31, 2000 and 1999 respectively. Commitments are generally for periods not to exceed forty-five business days.

The Bank generally executes interest rate exchange agreements with those counterparties with a rating of single-A or better by either Standard & Poor's or Moody's and generally enters into bilateral collateral agreements. As of December 31, 2000 and 1999, the Bank had pledged as collateral securities of $181,025,000 and $156,132,000, respectively, to counterparties who have market risk exposure from the Bank related to interest rate exchange agreements.

Net rental costs for premises and equipment were approximately $3,029,000, $2,518,000, and $2,219,000 for the years ended December 31, 2000, 1999 and 1998, respectively. Future minimum rentals are as follows:

Year	Premises	Services and Equipment	Total
		(In thousands)	
2001	$ 1,878	$ 190	$ 2,068
2002	1,869	47	1,916
2003	2,376	21	2,397
2004	2,482	—	2,482
2005	2,592	—	2,592
Thereafter	17,528	—	17,528
Total	$ 28,725	$ 258	$ 28,983

Lease agreements for Bank premises generally provide for increases in the basic rentals resulting from increased property taxes and maintenance expenses. Such increases are not expected to have a material impact on the Bank.

As described in Note 9, all FHLBanks have joint and several liability for the consolidated obligations issued by each FHLBank. Accordingly, should one or more of the FHLBanks be unable to repay their participation in the consolidated obligations, the other FHLBanks could be called upon to repay a portion of such obligations. The Bank has a contingent liability for consolidated obligations of other FHLBanks of $583,235,798,000 and $525,268,162,000 for the years ended December 31, 2000 and 1999, respectively.

The Bank was subject to no pending legal proceedings as of December 31, 2000.

Report of Independent Accountants

To the Board of Directors and Shareholders of
the Federal Home Loan Bank of Chicago

In our opinion, the accompanying statement of condition and the related statements of income, of capital and cash flows present fairly, in all material respects, the financial position of the Federal Home Loan Bank of Chicago (the "Bank") at December 31, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Bank's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As explained in Note 1, the Bank has changed its method of accounting for REFCORP payments during the year ended December 31, 2000. For the year ended December 31, 2000, the REFCORP payment has been recorded as an expense in the statement of income. During the years ended December 31, 1999, and 1998, REFCORP payments were recorded as deductions from capital.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental disclosure appearing below the statement of income is presented for purposes of additional analysis and is not a required part of the basic financial statements.

February 15, 2001
Chicago, Illinois

Management Report of Responsibility for Financial Reporting

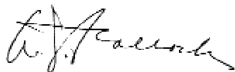
The management of the Federal Home Loan Bank of Chicago (the Bank) prepared the financial statements contained in the Annual Report in accordance with generally accepted accounting principles. Management has primary responsibility for the integrity and objectivity of the financial statements, which include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

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

Management of the Bank has established and maintains an internal control structure designed to provide reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. The internal control structure provides for appropriate division of responsibility and is documented by written policies and procedures that are communicated to employees. Management monitors the internal control structure for compliance, adequacy, and cost effectiveness. Management believes that as of December 31, 2000 the Bank's internal control structure is adequate to accomplish these objectives.

The Bank maintains an internal auditing program that independently assesses the internal control structure and recommends possible improvements to it. The Audit Committee of the Board of Directors is composed of five directors and oversees the Bank's financial reporting and internal control structure. The Audit Committee of the Board meets periodically with management, internal auditors and independent public accountants to review matters relating to financial accounting and reporting policies and control procedures. Both PricewaterhouseCoopers LLP and Internal Audit have full access, with or without management present, to the Audit Committee.

Management's objective is to foster a strong ethical climate so that the Bank's affairs are conducted according to the highest standards of personal and corporate conduct.



Alex J. Pollock
President and Chief Executive Officer

Roger D. Lundstrom
Senior Vice President

Audit Committee Report

February 15, 2001

The Audit Committee of the Board of Directors of the Federal Home Loan Bank of Chicago for 2000 was composed of five Directors, one of whom represent the public sector and four who represent industry members. The Audit Committee members are independent, as defined by the Federal Housing Finance Board .

The Audit Committee oversees the Bank's financial reporting process; oversees Internal Audit's review of compliance with laws, regulations, policies and procedures; and oversees Internal Audit's evaluation of the adequacy of administrative, operating, and internal accounting controls. The Audit Committee has adopted and is governed by a written charter, which is presented below, and satisfied its responsibilities during 2000 in compliance with the charter. In fulfilling its responsibilities, the Audit Committee has reviewed and discussed the audited financial statements with management. The Committee has discussed with the independent auditors the matters required to be discussed by SAS No. 61 and SAS No. 90, Audit Committee Communications. The Committee has also received the written disclosures and the letter from the independent auditors required by ISB Standard No. 1, and has discussed with the auditors the auditor's independence.

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

Raymond S. Stolarczyk, Chairman

Michael D. Meeuwsen

Karl S. Pnazek

H. Lee Swanson

Douglas J. Timmerman, ex officio

Charter for the Audit Committee of the Board of Directors

1.0 OBJECTIVE

The objective of the Audit Committee is to assist the Board of Directors in fulfilling its fiduciary responsibilities regarding the financial statements and reports of the Bank, internal controls, and compliance with laws, regulations and policy.

2.0 RESPONSIBILITIES AND SPECIFIC DUTIES

2.1 The Audit Committee is responsible for:

* Facilitating communication between the Board of Directors and the Bank's internal auditors, external auditors and Federal Housing Finance Board examiners.
* Reviewing and approving annual audit plans of the internal and external auditors.
* Monitoring the accomplishment of audit plans.
* Reviewing and approving audited Bank financial statements and financial statement disclosures.
* Determining that no restrictions are imposed upon audit scope.
* Reviewing key accounting policies.
* Reviewing security for computer systems, facilities, and back-up systems.
* Reviewing management's response to audit findings and reports.
* Reviewing implementation by management of corrective actions.
* Overseeing any investigation of conflicts of interest and unethical conduct.
* Overseeing the selection, compensation, and performance evaluation of the Director of Internal Audit.
* Reviewing and approving the Charters of the Audit Committee and the Director of Internal Audit at least annually.

2.2 The above responsibilities of the Audit Committee will be discharged through discussions with the internal and external auditors and Bank management and review of audit reports.

2.3 The responsibility of the Audit Committee is limited to matters upon which the Board of Directors has the authority to make a final determination.

2.4 The Committee may retain independent outside counsel upon determination that such action is necessary to properly discharge its responsibilities and duties.

3.0 MEMBERS, OFFICERS AND TERMS

3.1 Chairman. A Chairman and a Vice-Chairman of the Committee shall be designated by the Board from time to time, but at least annually. In the event of the absence of the Chairman of the Committee, the Vice-Chairman of the Committee shall act as Chairman.

3.2 Members and Terms. The Committee shall be composed of no less than three Board members. The other members of the Committee (i) shall be chosen from among the remaining directors of the Board, (ii) shall include elective and appointive directors and (iii) shall serve such terms as may, from time to time, be set by the Board. In determining membership of the Committee, the Board will provide for continuity of service.

3.3 Staff. The Director of Internal Audit shall serve as staff to the Committee, and shall conduct such studies, and analyses and make such presentations as the Committee needs to carry out its responsibilities.

4.0 MEETINGS

4.1 Meetings. The Committee shall establish its own procedures and shall meet in accordance with such procedures.

4.2 Required Meetings. The Committee shall meet at least twice annually with the Director of Internal Audit and the external auditors. The Committee shall meet in executive session at its discretion with such participants as it may determine, as often as it desires.

4.3 Telephone Meeting. A Committee meeting may be conducted by conference telephone.

4.4 Special Meeting. The chairman of the Committee or the President & Chief Executive Officer may call a special meeting of the Committee upon not less than one day's notice to the members of the Committee.

4.5 Quorum. At any meeting of the Committee, a majority of the Committee shall constitute a quorum and the affirmative vote of a majority of that quorum shall be necessary to pass any resolution.

4.6 Minutes. Minutes of all meetings of the Committee will be submitted to the Board of Directors and be signed by the chairman of the Committee. The minutes of the meetings shall contain a record of the persons present, significant matters discussed, and resolutions adopted. Minutes of meetings of the Committee shall be preserved by the Bank in minute books in the custody of the Bank's Corporate Secretary. A copy of all minutes shall be for warded to the Federal Housing Finance Board.

Approved by the Board of Directors
December 15, 1998

37