

The Chicago Balance Sheet

A Chicago Federal Home Loan Bank Publication

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WASHINGTON WATCH

Fate of GSE Bill Remains Uncertain

When Congress adjourned in December, the fate of legislation to reform the regulatory structure of the three housing GSEs remained uncertain. In October, the House of Representatives approved legislation creating a new Federal regulatory agency for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. A similar bill passed the Senate Banking Committee in July; consideration of the measure on the Senate floor has yet to be scheduled. Significant obstacles remain if the bill is to move forward in 2006, although none involve the Federal Home Loan Banks.

The provisions affecting the FHLBs in both the House and Senate versions are very similar. Both bills would abolish the FHLBs' regulator, the Federal Housing Finance Board, replacing it with a new independent Federal agency with similar authority over the FHLBs. Also, FHLB director terms would be lengthened to four years from three years and the statutory caps on director compensation

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**Chicago
Federal Home Loan Bank**

A Message from Mike Thomas

As we begin the New Year, I would like to thank all of you for your membership. We are proud to have some members with relationships dating back to the 1930's, the time of the inception of the Federal Home Loan Bank System. Whether you represent a thrift that has been with us since the beginning, or an institution that joined this year, we value your relationship as customer and investor.



I would like you to know that our preliminary 2005 results confirm that, despite significant challenges, the Chicago Federal Home Loan Bank is strong and making good progress in resolving issues involving our capital structure. In addition, it is important to reiterate our commitment to increasing our capacity to provide you with products, services, and an appropriate return on investment.

As you are aware, the Bank's Board of Directors decided in October 2005 to discontinue redemptions of members' excess or "voluntary" stock, and the Federal Housing Finance Board, regulator of the Home Loan Banks, agreed to reduce the Bank's minimum capital ratio from 5.1% to 4.5%. In addition, we declared a quarterly stock dividend of 3.75%. At the time of these announcements, we pledged to work as quickly as possible to address the conditions that led to these actions.

Last month, we cleared two significant hurdles:

- On December 13, we submitted a revised Business Plan and Retained Earnings Policy to the Finance Board.
- On December 14, the Bank re-filed its Form 10 registration including third quarter financial statements, with the Securities and Exchange Commission (SEC).

Once approved, the Business Plan and the Retained Earnings Policy will set the course for the Bank and establish the foundation for our relationship with members, including the management of our capital structure and redemption processes for our stock. These are necessary components of our plans to gain flexibility as we move the Bank forward. Resolving these issues is our highest priority, and I look forward to discussing the outcome with you as soon as discussions with the Finance Board are concluded.

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Member Questions Answered

We value our ongoing dialogue with you as an opportunity to gain a better understanding of member concerns and needs. Throughout the course of recent conversations, the following questions have been raised by some of our members, and we would like to share our answers with all of you.

I have read about the actions regarding voluntary stock. Can you tell me when we will be able to redeem voluntary stock?

We are working as quickly as possible to address the conditions that required the discontinuation of redemptions of excess or “voluntary” capital stock. As Mike Thomas’ letter on page one indicates, we are awaiting the Federal Housing Finance Board’s comments on our recently submitted Retained Earnings and Dividend Policy. Obtaining their approval is a necessary first step toward addressing the issue of voluntary capital.

As we continue to work through the challenges related to the discontinuation of redemptions of voluntary capital, we believe that there are many reasons to be optimistic about the Bank and our ability to serve you well today and in the future:

- The Bank achieved good operating results in 2005 despite a challenging interest rate environment and declines in the total volume of MPP® assets on our balance sheet. Future results will, of course, be subject to the structure of our business plan and our effectiveness in executing that plan. Our goal remains to provide value to our members through our services and the return on your investment in the Bank.
- The Bank’s retained earnings (\$517 million as of 9/30/05) ranks first among the Federal Home Loan Banks.
- The Bank continues to pursue growth in our service to members through our major product lines: advances and other credit products, the MPP® Program, and Affordable Housing and Community Investment programs.
- The Bank has initiated a program to increase our investment portfolio significantly to enhance future profitability.

Is the Bank making advances to members?

Yes. In fact, advances continued to be made and volume increased over the year. We have also undertaken several initiatives to support our members and enhance the value of your membership.

- The Bank has lowered pricing 7-20 basis points on most advance products.
- The Bank recently increased the collateral loan value for 1-4 family mortgages, improving the economic benefits of our advances and is exploring ways to expand the eligible collateral pool.

We continue to evaluate new product alternatives in all of our businesses and look forward to sharing our progress with you over the coming months.

Almost 300 members participated in Affordable Housing or Community Investment services in 2005. Community Investment advances increased strongly over 2004 levels. The competitive AHP Program funded 135 projects in 2005, representing almost 6,000 housing units, and the Downpayment Plus® Program provided support to purchasing of almost 2,500 units. In other words, we assisted 8,412 families in achieving the goal of affordable housing – a key component of our Mission.

More of our members and other Participating Financial Institutions (PFIs) are benefiting from the Mortgage Partnership Finance® Program than at any time in the eight-year history of the program and we remain committed to its evolution.

What is the anticipated level of future dividends?

Our goal has always been to provide our members with an adequate return on their investment in the Federal Home Loan Bank; however, we cannot predict future dividend levels. We are working on obtaining approval from the Finance Board for a revised Retained Earnings and Dividend Policy so that we may provide as much clarity as possible as to how these decisions will be made going forward.

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A Message From Mike Thomas

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Our fourth quarter dividend of 3%, which was declared on January 18, will be paid in cash to your DID account on February 15.

We anticipate becoming effective as an SEC registrant on or about February 13, 2006. I recommend that you review our Form 10 and all future filings on our website at www.fhlbc.com and the at the SEC website www.sec.gov/edgar.shtml. I believe that you will find this information useful in assessing the condition and performance of the Bank.

Our relationship with you is our most important asset. You have my assurance and continuing commitment that we are working very hard to ensure that our relationships are long-lasting and mutually beneficial. Your Relationship Manager and I will continue to keep you informed

of our progress toward resolution of the important issues we are addressing.

In this newsletter we have addressed some of your specific questions about the Bank's status and product lines. Please feel free to contact me, your Relationship Manager, or Charlie Huston, Executive Vice President, Member Relationship Management, at (312) 565-5715.

Sincerely,



Mike Thomas
President and CEO
Chicago Federal Home Loan Bank

Member Questions Answered

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What can you tell me about the Bank's commitment to the Mortgage Partnership Finance® Program?

The Bank remains fully committed to the MPF Program, and the number of PFIs continues to grow. The Chicago Federal Home Loan Bank, as architect of the MPF Program and the service provider to eight other Home Loan Banks, continuously develops ways to expand and improve the program. Among the initiatives underway are the development of a risk transfer strategy to enhance the funding of the program and an FHLB System-wide committee of presidents, co-chaired by Mike Thomas, that is investigating alternative ways to coordinate the mortgage programs of the Home Loan Banks.

How are other members dealing with accounting issues raised by the discontinuation of the redemption of voluntary stock?

Ultimately, any question on accounting for capital should be determined by members in consultation with their outside auditors.

As indicated in a July 2005 memorandum from America's Community Bankers, "a fundamental principle in GAAP provides that an investment is impaired if its fair value is less than its cost." While our members have recently realized a lower return on investment than in years past, it is not expected that members will experience a loss on their initial investment, which would result in the stock being categorized as "impaired." In addition to the financial results and progress with the Finance Board discussed above, the Bank is a strong institution with significant retained earnings and ready access to capital markets.

If you have any additional questions about these or other issues, please contact your Relationship Manager, or visit our website at www.fhlbc.com.

THE CHICAGO FHLB WELCOMED 22 NEW MEMBERS IN 2005

Citizens First Bank, Viroqua, WI
Citizens State Bank of Clayton, Clayton, WI
First Trust & Bank of Watseka, Watseka, IL
Foundations Bank, Pewaukee, WI
Harris National Association, Chicago, IL
Lakeview Credit Union, Neenah, WI
Livingston State Bank, Livingston, WI
Madison Credit Union, Madison, IL
Metropolitan Capital Bank, Chicago, IL
North Adams State Bank, Ursa, IL
Olin Community Credit Union, Bethalto, IL

Old Republic Life Insurance Company, Chicago, IL
Polish Women's Alliance of America, Park Ridge, IL
Providence Bank LLC, South Holland, IL
Rockford Bank and Trust Company, Rockford, IL
State Bank of Arthur, Arthur, IL
State Bank of Newberg, Newberg, WI
Texico State Bank, Texico, IL
The Business Bank of the Fox River Valley, Appleton, WI
Timberwood Bank, Wabeno, WI
Washington State Bank, Washington, IL
Waumandee State Bank, Waumandee, WI

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would be eliminated. Both bills would also allow voluntary mergers among the FHLBs, with the approval of the new regulator.

One difference between the two versions is the treatment of Boards of Directors at the individual FHLBs. The House version provides that at least two-fifths of the FHLB directors be independent (non-member) directors appointed by the new regulatory agency. By contrast, the Senate version requires at least one-third of the directors be independent and allows a process for those directors to be elected by the financial institution members of the FHLB at large.

The primary sticking point concerns the huge mortgage portfolios of Fannie Mae and Freddie Mac. The House-approved legislation, sponsored by Rep. Richard Baker, R-La., would give the regulatory agency authority to limit any asset or liability of the government-sponsored enterprises, but does not explicitly require reducing the portfolios. The powers of the new regulator would also include the ability to raise minimum and risk-based capital requirements and to place the GSEs into receivership.

The Bush administration, which has called for shrinking Fannie Mae's and Freddie Mac's portfolios, has said the House bill does not go far enough and supports the Senate bill which is much more restrictive in its treatment of the portfolios.

Work on the legislation is expected to continue in the early months of this year. If the full Senate approves a bill, a joint House-Senate conference committee would attempt to resolve the differences between the two versions. With the upcoming mid-term elections threatening to shorten the time available for legislative work, the chances for eventual passage of the GSE bill grows slimmer with each month.

PRODUCTION NOTES

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Chicago Federal Home Loan Bank Announces Board of Directors Changes

The Chicago Federal Home Loan Bank recently announced changes to its Board of Directors, which became effective on January 1, 2006. **James K. Caldwell**, President and CEO of The First Citizens State Bank of Whitewater, Whitewater, Wisconsin was elected to a two-year term as Chairman by the Board of Directors. **P. David Kuhl**, Chairman of the Board and CEO, Busey Bank, Urbana, Illinois, was elected to a two-year term as Vice Chairman by the Board of Directors.

Thomas M. Goldstein, Chairman and CEO of ABN AMRO Mortgage Group, Inc. and Senior Executive Vice President of LaSalle Bank Corporation, its parent company, was elected to a three-year term and **Richard K. McCord**, CEO, President and Chairman of the Board, Illinois National Bank, Springfield, Illinois, was re-elected to a three-year term on the Board by the Bank's Illinois member financial institutions. **Thomas L. Herlache**, President, CEO and Chairman of the Board, Baylake Bank, Sturgeon Bay, Wisconsin, was elected to a three-year term on the Board by the Bank's Wisconsin member financial institutions.



James K. Caldwell



P. David Kuhl

CONTINUING BOARD MEMBERS

- **Terry W. Grosenheider**
Private Banking Relationship
Manager
U.S. Bank, N.A.
Madison, Wisconsin
Director since 2002
- **Alex J. LaBelle**
Broker-Associate
Smothers Realty Group
LaGrange, Illinois
Director since 2004
- **Roger L. Lehmann**
President, CEO and
Chairman of the Board
The Harvard State Bank
Harvard, Illinois
Director since 2004
- **Gerald J. Levy**
Chairman
Guaranty Bank
Brown Deer Wisconsin
Director since 2005
- **Kathleen E. Marinangel**
President, CEO and
Chairman of the Board
McHenry Savings Bank
McHenry, Illinois
Director since 2002
- **James F. McKenna**
President and CEO
North Shore Bank
Brookfield, Wisconsin
Director since 2004