



FEDERAL
HOME LOAN BANK
DES MOINES

ADVANCING YOUR SUCCESS

2004 Third Quarter Report

September 30, 2004 Quarterly Report

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SELECTED FINANCIAL DATA

	September 30, 2004	December 31, 2003		
Statements of Condition				
(Dollars in millions)				
Money market investments ¹	\$ 3,663	\$ 1,936		
Mortgage-backed securities	3,760	2,494		
Other investments	606	1,094		
Advances	26,775	23,303		
Mortgage loans, net	15,330	15,999		
Total assets	50,340	45,051		
Consolidated obligations	45,768	40,352		
Total liabilities	47,945	42,844		
Capital stock	2,277	2,117		
Retained earnings	122	91		
Capital-to-asset ratio ²	4.76%	4.90%		
	Quarter Ended September 30,	Nine Months Ended September 30,		
	2004	2003	2004	2003
Operating Results and Performance Ratios				
(Dollars in millions)				
Interest income	\$ 266.2	\$ 237.2	\$ 719.6	\$ 741.1
Interest expense	239.4	200.2	634.6	640.5
Net interest income before provision for credit losses on mortgage loans	26.8	37.0	85.0	100.6
Provision for credit losses on mortgage loans	-	1.6	0.1	1.6
Net interest income after provision for credit losses on mortgage loans	26.8	35.4	84.9	99.0
Other income	3.5	20.8	23.8	21.7
Other expense	7.9	6.2	23.0	18.9
Total assessments	5.9	13.3	22.7	27.0
Net income	16.5	36.7	63.0	74.8
Return on average assets	0.13%	0.34%	0.18%	0.24%
Return on average capital	2.76	7.38	3.65	5.14
Net interest margin	0.21	0.34	0.23	0.33
Operating expenses to average assets	0.06	0.05	0.06	0.06
Annualized dividend rate	2.25	3.00	1.93	3.00
Dividend rate spread over average three-month LIBOR ³	0.60	1.86	0.60	1.72

¹ Money market investments include: interest-bearing deposits, securities purchased under agreements to resell, federal funds sold, commercial paper, and U.S. agency obligations. The maximum money market investment term is 273 days.

² Capital-to-asset ratio is capital stock plus retained earnings and accumulated other comprehensive income (loss) as a percentage of total assets at period end.

³ LIBOR represents the London Inter-Bank Offered Rate.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion highlights significant factors influencing our results of operations and financial condition. It should be read in conjunction with the financial statements and related notes included in this report. Average balances are calculated on a daily weighted average basis. Amounts used to calculate percentage variances are based on numbers in thousands. Accordingly, recalculations may not produce the same results when the amounts are disclosed in millions.

Statements contained in this report, including statements describing the objectives, projections, estimates, or future predictions in our operations, may be "forward-looking statements." These statements may be identified by the use of forward-looking terminology, such as "anticipates," "believes," "could," "estimates," "may," "should," "will" or their negatives or other variations on these terms. We caution that, by their nature, forward-looking statements involve risk or uncertainty and that actual results could differ materially from those expressed or implied in these forward-looking statements or could affect the extent to which a particular objective, projection, estimate or prediction is realized. Please refer to "Factors that May Affect Future Results" beginning on page 46 of this report for a discussion of some of the factors that may cause results to differ.

Overview of the Third Quarter of 2004

The Federal Home Loan Bank of Des Moines (the Bank), a federally chartered corporation exempt from all federal, state, and local taxation, except real property taxes, is one of 12 district banks (FHLBanks) created under the authority of the Federal Home Loan Bank Act of 1932, as amended. When used in this report, the terms *we*, *our*, and *us* refer to the Federal Home Loan Bank of Des Moines. The 12 FHLBanks, together with their member institutions and the Office of Finance, operating under the supervision of the Federal Housing Finance Board (Finance Board), comprise the Federal Home Loan Bank System (Bank System).

Each FHLBank is a separate cooperative with its own member institutions, board of directors, management, and employees. Each member institution owns capital stock and is entitled to receive dividends, when declared by the board of directors, on its investment. The FHLBanks serve the public by enhancing the availability of funds for residential mortgage lending and targeted community development. The principal sources of funding provided by the Bank are making advances to members and purchasing home mortgage loans from members.

The Bank's financial policies and practices are designed to support the three key components of a cooperative: attractive product prices, reasonable returns on invested capital, and adequate retained earnings to support safe and sound business operations.

In distributing the value of the cooperative to members, the Board of Directors has established an operating principle that lower product prices are preferred to higher dividends. As a result, the Bank charges low credit prices and pays a target dividend indexed to short-term money market rates. The Bank pays dividends quarterly and its dividend index rate is based on

the average yield of the three-month London Inter-Bank Offered Rate (LIBOR) during the dividend period.

The Board of Directors continued to target a quarterly dividend of average three-month LIBOR plus 60 basis points in the first, second, and third quarters of 2004. In the first quarter of 2004, the Board of Directors removed the dividend floor of 3.00 percent per annum established in 2003 to facilitate the build up of retained earnings. The third quarter 2004 dividend was 2.25 percent or 60 basis points over the LIBOR index compared with the third quarter 2003 dividend that was established at the floor of 3.00 percent or 186 basis points over LIBOR. Our retained earnings policy is discussed in “Capital” beginning on page 27.

In June 2004, the Finance Board approved a rule requiring each of the 12 FHLBanks to register a class of its equity securities with the United States Securities and Exchange Commission (SEC) under section 12(g)(1) of the Securities Exchange Act of 1934, as amended. The rule requires each of the FHLBanks to file its registration statement with the SEC no later than June 30, 2005 to ensure that its registration statement becomes effective by August 29, 2005. In anticipation of registration, we enhanced and expanded disclosures in our 2003 annual report and 2004 quarterly reports. See further discussion in the “Legislative and Regulatory Developments” section of this report beginning on page 30.

Restatement of Financial Statements. Subsequent to the third quarter of 2003 a correction was made to prepayment fees of \$2.9 million. Third quarter 2003 results have been adjusted for that correction.

Conditions in the Financial Markets

The primary external factors that affect net interest income are market interest rates and the general state of the economy. The following tables summarize information on key average market interest rates for the third quarter of 2004 and 2003 and the first nine months of 2004 and 2003, and key market interest rates as of December 31, 2003:

	Third Quarter 2004 3-Month Average	Third Quarter 2003 3-Month Average	Year-to-Date September 30, 2004 9-Month Average	Year-to-Date September 30, 2003 9-Month Average	December 31, 2003 Ending Rate
Fed effective ¹	1.43%	1.00%	1.14%	1.16%	1.00%
3-month LIBOR ¹	1.75	1.13	1.40	1.23	1.15
10-year U.S. Treasury ¹	4.29	4.20	4.29	3.91	4.25
30-year residential mortgage note rate ²	5.82	5.91	5.82	5.64	5.73

¹ Source: Bloomberg

² Average calculated using "The Mortgage Bankers Association Weekly Application Survey" and December 31, 2003 ending rate is from the last week in 2003.

The Federal Reserve Board, through its Federal Open Market Committee, increased the Federal funds rate 25 basis points to 1.50 percent on August 10, 2004 and increased the Federal funds rate an additional 25 basis points to 1.75 percent on September 21, 2004. This represents a total increase of 50 basis points in the third quarter of 2004 and a total increase of 75 basis points for the nine months ended September 30, 2004. In anticipation of the Federal Reserve Board's increase in the Federal funds rate, other short-term interest rates were trending slightly upward. Despite the increases in various rates, interest rates are still near historical lows.

Yields on mortgage assets were similarly affected by volatile, decreasing mortgage rates during certain periods of 2004 and throughout most of 2003 as borrowers took advantage of historic low mortgage rates to refinance their home mortgages, resulting in increased prepayments on mortgage loans. As a result, prepayment projections for mortgage loans increased during these same periods.

Financial Highlights

Net income for the third quarter of 2004 was \$16.5 million, compared with net income of \$36.7 million for the same period in 2003, representing a decrease of \$20.2 million. This decrease resulted primarily from decreased advance prepayment fees, decreased net interest income, and decreased realized and unrealized gains on derivatives and hedging activities.

Net income for the first nine months of 2004 was \$63.0 million compared with \$74.8 million for the same period in 2003, representing a decrease of \$11.8 million. This decrease resulted primarily from decreased advance prepayment fees and decreased net interest income partially offset by increased realized and unrealized gains on derivatives and hedging activities and increased realized gains from the sale of securities.

Each of these factors impacting net income is discussed in more detail in the "Results of Operations" section beginning on page 6.

These lower levels of net income in 2004 relative to 2003 resulted in lower returns on capital. Return on average capital decreased to 2.76 percent for the quarter ending September 30, 2004 compared with 7.38 percent for the same period of 2003. Return on average capital decreased to 3.65 percent for the nine months ended September 30, 2004 compared with 5.14 percent for the same period of 2003.

Net interest income is the primary measure of the performance of our ongoing operations. Fluctuations in average asset, liability, and capital balances and the related yields and rates are the drivers of changes in our net interest income.

Average assets and liabilities, increased in the third quarter of 2004 and during the first nine months of 2004 compared with the same periods in 2003. Average assets were \$49.9 billion in the third quarter of 2004, up \$7.1 billion from 2003. The increase in average assets was primarily attributable to increased mortgage assets and advances. Average liabilities were \$47.5 billion in the third quarter of 2004, up \$6.7 billion from 2003 to support the increased asset balances.

Average capital increased \$0.4 billion during the third quarter of 2004 and the first nine months of 2004 compared with the same periods of 2003. This increase was primarily due to growth in capital stock requirements to support member activities related to advances and mortgage loans.

Results of Operations

Net Interest Income

The following table summarizes net interest income for the quarters ended September 30, 2004 and 2003 and the first nine months of 2004 and 2003 (dollars in millions):

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Total interest income	\$ 266.2	\$ 237.2	\$ 719.6	\$ 741.1
Total interest expense	<u>239.4</u>	<u>200.2</u>	<u>634.6</u>	<u>640.5</u>
Net interest income before provision for credit losses on mortgage loans	26.8	37.0	85.0	100.6
Provision for credit losses on mortgage loans	<u>-</u>	<u>1.6</u>	<u>0.1</u>	<u>1.6</u>
Net interest income after provision for credit losses on mortgage loans	<u>\$ 26.8</u>	<u>\$ 35.4</u>	<u>\$ 84.9</u>	<u>\$ 99.0</u>

Our net interest income before provisions for credit losses declined \$10.2 million in the third quarter of 2004 and \$15.6 million in the first nine months of 2004 compared with the same periods in 2003. These declines were largely attributable to lower earnings on mortgage assets.

Two components of the Bank's net interest income are earnings from asset-liability spread and earnings on capital.

Asset-Liability Spread. Asset-liability spread equals the yield on total assets minus the cost of total liabilities. Asset-liability spread income declined in both the third quarter of 2004 and the first nine months of 2004 compared with the same periods of 2003, primarily because of compressed spreads on mortgage assets attributable to two factors.

First, higher net earnings were recognized in 2003 on the mortgage portfolio funded with fixed-rate bonds. We fund certain mortgage loans with a combination of callable and noncallable fixed-rate bonds of varying maturity and call lockout dates. Each of the bonds has a different cost with the shorter-term noncallable bonds generally having a lower cost and the longer-term callable bonds generally having a higher cost. As a result of these differing bond costs, the cost of funds supporting these mortgage loans will vary over time and interest rate scenarios. The related mortgage loans maintain a relatively constant yield, resulting in changes in the portfolio's interest spread relationship over time.

In a stable to rising interest rate environment, the lower-rate short-term bonds mature while the higher-rate callable bonds remain outstanding, resulting in an increasing cost of funds and a lower income spread as time passes. Conversely, in a falling interest rate environment, many of the higher-rate callable bonds are called away reducing the cost of funds and improving spreads. In addition, during the falling interest rate environments we experienced during early 2003, income spreads were further enhanced when the Bank exercised its option to terminate callable bonds roughly two to three months prior to receiving the related mortgage prepayments.

Second, during the last nine months of 2003, a large portion of our fixed-rate mortgage loan portfolio was hedged with interest rate swaps to reduce the Bank's market risk and avoid the varying income spreads inherent in a mortgage portfolio funded with fixed-rate bonds. Net interest spread income generated by the mortgage portfolio hedged with interest rate swaps is somewhat lower than our historical spreads but tends to be more stable over time. The Bank plans to continue hedging a large portion of the fixed-rate mortgage portfolio with interest rate swaps.

Net interest spread on the advance portfolio for the three and nine months ended September 30, 2004 was impacted by lower profit margins. The Bank implemented a change in pricing on advances on January 1, 2003 as a part of the Bank's strategic plan for allocating value to our members. This lowered profit margins throughout 2003 and 2004 as we originated new advances with lower profit margins and as existing advances were repaid. The impact for both periods was offset by increased advance balances.

Earnings on Capital. Capital is invested to earn the average cost of funds. A considerable portion of our net interest income is derived from the earnings from investment of “interest-free” capital.

Earnings on capital increased in the third quarter of 2004 compared with the same period in 2003 due to higher levels of capital and a slightly higher yield on invested capital. Average capital increased \$0.4 billion in the third quarter of 2004 compared with the same period in 2003 due to growth in capital stock requirements to support member activities related to advances and mortgage loans.

Earnings on capital increased slightly during the first nine months of 2004 compared with the same period in 2003 due to the increase in capital. The effect of the increased capital was offset by a lower yield on invested capital during the period. The Bank’s risk reduction strategy of hedging fixed-rate mortgage loans with interest rate swaps indexed to LIBOR was implemented in the last nine months of 2003. This risk reduction strategy tends to reduce the Bank’s immediate earnings as capital supporting swapped mortgage assets is invested to achieve a return based on floating-rate LIBOR rather than fixed-rate mortgages.

Future asset-liability spreads and earnings on capital could be impacted by increased competition for funding from other FHLBanks and other government-sponsored enterprises. Investors may require increased returns due to perceived political and regulatory risks. These risks generally arise from rating agency actions or negative publicity related to government-sponsored enterprises. Recent investigations into Federal National Mortgage Association regarding accounting irregularities and internal control policies may contribute to higher cost of funds for certain longer term debt in future periods. In addition, members of Congress have voiced a desire to change the regulatory structure for all housing government-sponsored enterprises.

The following tables present average balances and rates of major earning asset and liability categories for the three and nine month periods ending September 30, 2004 and 2003. The tables also present the net interest spread between yield on total earning assets and cost of interest-bearing liabilities and the net interest margin between yield on total assets and the cost of total funding sources (i.e., interest-bearing liabilities plus capital plus other interest-free liabilities) (dollars in millions).

	For the Three Months Ended September 30, 2004			For the Three Months Ended September 30, 2003		
	Average Balance	Yield/ Rate	Interest Income/ Expense	Average Balance	Yield/ Rate	Interest Income/ Expense
Interest-earning assets:						
Advances	\$ 26,260	1.97%	\$ 130.0	\$ 23,242	1.89%	\$ 110.5
Mortgage-backed securities ¹	3,120	3.74%	29.3	2,978	2.85%	21.4
Federal funds sold	2,108	1.45%	7.7	2,654	1.02%	6.8
Securities purchased under agreements to resell	305	1.48%	1.1	301	1.06%	0.8
Other investments ¹	2,398	1.40%	8.4	1,545	1.49%	5.8
Mortgage loans ²	15,356	2.32%	89.7	11,721	3.11%	91.8
Other interest-earning assets	-	-	-	28	1.08%	0.1
Total interest-earning assets	49,547	2.14%	266.2	42,469	2.22%	237.2
Non-interest earning assets	363	-	-	314	-	-
Total assets	<u>\$ 49,910</u>	<u>2.12%</u>	<u>\$ 266.2</u>	<u>\$ 42,783</u>	<u>2.20%</u>	<u>\$ 237.2</u>
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds	37,903	2.18%	208.1	30,863	2.28%	177.0
Discount notes	7,330	1.41%	25.9	6,596	1.03%	17.2
Deposits	925	1.18%	2.7	1,699	0.73%	3.1
Other interest-bearing liabilities	512	2.09%	2.7	552	2.05%	2.9
Total interest-bearing liabilities	46,670	2.04%	239.4	39,710	2.00%	200.2
Non-interest bearing liabilities	861	-	-	1,090	-	-
Total liabilities	47,531	2.00%	-	40,800	1.95%	200.2
Capital	2,379	-	-	1,983	-	-
Total liabilities and capital	<u>\$ 49,910</u>	<u>1.91%</u>	<u>\$ 239.4</u>	<u>\$ 42,783</u>	<u>1.86%</u>	<u>\$ 200.2</u>
Net interest income and spread						
		<u>0.10%</u>	<u>\$ 26.8</u>		<u>0.22%</u>	<u>\$ 37.0</u>
Net interest margin						
		<u>0.21%</u>			<u>0.34%</u>	
Average interest-earning assets to interest-bearing liabilities						
		<u>106.16%</u>			<u>106.95%</u>	
Composition of net interest income:						
Asset-liability spread		0.12%	\$ 14.8		0.25%	\$ 27.3
Earnings on capital		2.00%	12.0		1.95%	9.7
Net interest income			<u>\$ 26.8</u>			<u>\$ 37.0</u>

¹ Available-for-sale investment securities are based on their amortized costs and hedging fair-value adjustments. The yield information does not give effect to changes in fair value that are reflected as a component of capital.

² Nonperforming loans are included in average balances used to determine average rate.

	For the Nine Months Ended September 30, 2004			For the Nine Months Ended September 30, 2003		
	Average Balance	Yield/ Rate	Interest Income/ Expense	Average Balance	Yield/ Rate	Interest Income/ Expense
Interest-earning assets:						
Advances	\$ 24,947	1.81%	\$ 337.8	\$ 23,489	2.04%	\$ 357.9
Mortgage-backed securities ¹	2,541	3.15%	59.9	3,498	3.12%	81.7
Federal funds sold	1,965	1.17%	17.2	3,314	1.21%	29.9
Securities purchased under agreements to resell	305	1.19%	2.7	268	1.21%	2.4
Other investments ¹	2,230	1.14%	19.1	1,945	1.72%	25.0
Mortgage loans ²	15,679	2.41%	282.9	8,433	3.87%	243.9
Other interest-earning assets	3	1.04%	-	31	1.23%	0.3
Total interest-earning assets	47,670	2.02%	719.6	40,978	2.42%	741.1
Non-interest earning assets	328	-	-	297	-	-
Total assets	<u>\$ 47,998</u>	<u>2.00%</u>	<u>\$ 719.6</u>	<u>\$ 41,275</u>	<u>2.40%</u>	<u>\$ 741.1</u>
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds	37,045	2.04%	566.4	29,199	2.57%	560.6
Discount notes	5,919	1.19%	52.9	6,666	1.19%	59.4
Deposits	1,283	0.86%	8.3	1,840	0.89%	12.3
Other interest-bearing liabilities	504	1.85%	7.0	506	2.18%	8.2
Total interest-bearing liabilities	44,751	1.89%	634.6	38,211	2.24%	640.5
Non-interest bearing liabilities	940	-	-	1,118	-	-
Total liabilities	45,691	1.86%	634.6	39,329	2.18%	640.5
Capital	2,307	-	-	1,946	-	-
Total liabilities and capital	<u>\$ 47,998</u>	<u>1.77%</u>	<u>\$ 634.6</u>	<u>\$ 41,275</u>	<u>2.07%</u>	<u>\$ 640.5</u>
Net interest income and spread						
		<u>0.13%</u>	<u>\$ 85.0</u>		<u>0.18%</u>	<u>\$ 100.6</u>
Net interest margin						
		<u>0.23%</u>			<u>0.33%</u>	
Average interest-earning assets to interest-bearing liabilities						
		<u>106.52%</u>			<u>107.24%</u>	
Composition of net interest income:						
Asset-liability spread		0.14%	\$ 53.0		0.22%	\$ 68.9
Earnings on capital		1.86%	32.0		2.18%	31.7
Net interest income			<u>\$ 85.0</u>			<u>\$ 100.6</u>

¹ Available-for-sale investment securities are based on their amortized costs and hedging fair-value adjustments. The yield information does not give effect to changes in fair value that are reflected as a component of capital.

² Nonperforming loans are included in average balances used to determine average rate.

Our net interest income is impacted by changes in the dollar volume of our interest-earning assets and interest-bearing liabilities and changes in the average yield/rate of those interest-earning assets and interest-bearing liabilities. The following table presents the changes in interest income and interest expense for the third quarters of 2004 and 2003 and the first nine months of 2004 and 2003. Changes that cannot be attributed to either rate or volume have been allocated to the rate and volume variances based on their relative size (dollars in millions).

	Variance for the Three Months Ended September 30, 2004 vs September 30, 2003			Variance for the Nine Months Ended September 30, 2004 vs September 30, 2003		
	Total Increase (Decrease) Due to		Total Increase (Decrease)	Total Increase (Decrease) Due to		Total Increase (Decrease)
	Volume	Rate		Volume	Rate	
Interest income:						
Advances	\$ 14.6	\$ 4.9	\$ 19.5	\$ 11.9	\$ (32.0)	\$ (20.1)
Mortgage-backed securities	1.0	6.9	7.9	(32.1)	10.3	(21.8)
Federal funds sold	(1.6)	2.5	0.9	(12.9)	0.2	(12.7)
Securities purchased under agreements to resell	-	0.3	0.3	0.3	-	0.3
Other investments	3.0	(0.4)	2.6	2.4	(8.3)	(5.9)
Mortgage loans	24.3	(26.4)	(2.1)	157.5	(118.5)	39.0
Other interest-earning assets	(0.1)	-	(0.1)	(0.1)	(0.2)	(0.3)
Total interest income	41.2	(12.2)	29.0	127.0	(148.5)	(21.5)
Interest expense:						
Consolidated obligations:						
Bonds	38.5	(7.4)	31.1	127.0	(121.2)	5.8
Discount notes	2.1	6.6	8.7	(14.1)	7.6	(6.5)
Deposits	(1.8)	1.4	(0.4)	(3.6)	(0.4)	(4.0)
Other interest-bearing liabilities	(0.2)	-	(0.2)	-	(1.2)	(1.2)
Total interest expense	38.6	0.6	39.2	109.3	(115.2)	(5.9)
Net interest income	\$ 2.6	\$ (12.8)	\$ (10.2)	\$ 17.7	\$ (33.3)	\$ (15.6)

Net Interest Income by Segment

The Bank manages its operations by grouping its products and services within business segments. We have identified two main business segments: Member Finance and Mortgage Finance.

Each segment earns income from invested capital. We allocate invested capital to the Mortgage Finance segment based on its average asset size and the remaining capital is then allocated to Member Finance.

Member Finance. The Member Finance segment includes products such as advances, investments (excluding mortgage-backed securities), and their related funding and hedging. Income from the Member Finance segment is derived primarily from the spread between the yield on advances and investments and the borrowing and hedging costs related to those assets.

The Member Finance segment net interest income increased \$0.3 million in the third quarter of 2004 compared with the same period of 2003. The increase was attributable to higher returns on invested capital and the benefit of higher capital balances. Lower profit margins on advances were offset by the impact of higher asset balances, as a result, asset-liability spread income decreased only slightly.

The Member Finance segment net interest income decreased \$3.4 million in the first nine months of 2004 compared with the same period of 2003. The decline was attributable to lower profit margins on advances and lower returns on invested capital due to lower interest rates. These impacts were partially offset by higher asset and capital balances. As a result, asset-liability spread income decreased only slightly.

Mortgage Finance. The Mortgage Finance segment includes mortgage loans acquired through the Mortgage Partnership Finance® (MPF®) program¹, mortgage-backed securities, and their related funding and hedging. Income from the Mortgage Finance segment is derived primarily from the spread between the yield on mortgage loans and mortgage-backed securities and the borrowing and hedging costs related to those assets. Premiums and discounts on mortgage loans and mortgage-backed securities are managed together in this segment.

The Mortgage Finance segment net interest income before provision for credit losses on mortgage loans decreased \$10.6 million in the third quarter of 2004 compared with the same period of 2003. Although we had higher asset and capital balances, the decrease was attributable to lower profit margins on mortgage assets and lower returns on invested capital.

The Mortgage Finance segment net interest income before provision for credit losses on mortgage loans decreased \$12.1 million in the first nine months of 2004 compared with the same period of 2003 due mainly to lower profit margins on mortgage assets and lower returns on invested capital.

Average assets and capital for Mortgage Finance during both the third quarter and first nine months of 2004 were greater than for the same periods in 2003 due to the substantial growth in the MPF program that occurred in the last nine months of 2003. Factors influencing the decline in profit margins on mortgages and lower returns on invested capital are discussed in “Results of Operations—Net Interest Income” beginning on page 6.

At September 30, 2004, 71 percent of our fixed-rate mortgage portfolio was hedged with interest rate swaps and funded with variable-rate debt. This funding strategy provides a more stable net income spread across various interest rate scenarios and effectively hedges mortgage loan prepayment risk. Prior to employing the mortgage interest-rate swap hedge strategy in March of 2003, our fixed-rate mortgage portfolio was funded with a mix of fixed-rate callable and noncallable bonds. This funding strategy tended to result in more variability in the earnings than hedging loans with interest rate swaps. See further discussion of this funding strategy in “Results of Operations—Net Interest Income” beginning on page 6.

¹ Mortgage Partnership Finance and MPF are registered trademarks of Federal Home Loan Bank of Chicago.

Other Income

The following table presents the components of other income for the quarters ended September 30, 2004 and 2003 and the first nine months of 2004 and 2003 (dollars in millions):

	Quarter Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Prepayment fees, net	\$ 0.1	\$ 13.0	\$ 0.4	\$ 19.0
Service fees	0.5	0.3	1.7	1.5
Net realized gain on held-to-maturity securities	-	-	4.0	-
Net realized gain on available-for-sale securities	1.4	-	3.9	-
Net gain (loss) on securities held at fair value	0.2	(0.8)	(0.3)	(1.2)
Net realized and unrealized gain on derivatives and hedging activities	0.4	7.6	10.3	0.1
Other, net	0.9	0.7	3.8	2.3
Total other income	<u>\$ 3.5</u>	<u>\$ 20.8</u>	<u>\$ 23.8</u>	<u>\$ 21.7</u>

Because of the type of financial activity reported in other income, it can be volatile from period to period. For instance, advance prepayment activity and associated fees may vary based on the liability restructuring needs of borrowers, merger and acquisitions among member institutions, the level of interest rates, and other factors. In addition, net realized and unrealized gain or loss on derivatives and hedging activities is highly dependent on changes in interest rates.

Other income decreased \$17.3 million for the third quarters of 2004 compared with the same period in 2003. The primary reason for this year over year decrease was to lower advance prepayment fees and decreased gains on derivatives and hedging activities.

Other income increased \$2.1 million for the first nine months of 2004 compared with the same period in 2003. The primary reasons for the increase were increased gains on derivatives and hedging activities and increased realized gains from the sale of securities, partially offset by decreased advance prepayment fees.

Net prepayment fees decreased during the third quarter and for the first nine months of 2004 compared with the same periods in 2003 due to the liability restructuring needs of borrowers. We charge borrowers prepayment fees when they prepay certain advances before the original maturity. These fees are intended to make us financially indifferent to the decisions of borrowers to prepay.

Realized gains on held-to-maturity securities changed due to the sale of \$95.6 million of securities in the first nine months of 2004 compared with no sales in the same period of 2003. We sold fixed and floating rate securities throughout the first nine months of 2004 to increase operational efficiencies. We sold mortgage-backed securities that had less than 15 percent of the acquired principal outstanding and commercial paper near enough to its maturity date that changes in market interest rates would not have a significant effect on the security's fair value. In accordance with GAAP, such sales are considered maturities for the purposes of security classification. This resulted in a gain of \$4.0 million for the nine months ended September 30, 2004. We continue to monitor held-to-maturity securities with minimal remaining principal balances and may sell more securities to achieve operational efficiencies.

We also sold \$513.2 million of available-for-sale agency securities in the first nine months of 2004 and terminated the related derivatives to take advantage of market conditions. This resulted in a gain of \$3.9 million for the nine months ended September 30, 2004. We continue to monitor available-for-sale securities and may sell more securities to take advantage of market conditions.

Net realized and unrealized gain and loss on derivatives and hedging activities decreased \$7.2 million during the third quarter of 2004 and increased \$10.2 million during the first nine months of 2004 compared with the same periods of 2003. The following table summarizes the effect on other income due to derivatives and hedging activities for the three and nine month periods ending September 30, 2004 and 2003 (dollars in millions):

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net realized and unrealized gain (loss) on derivatives and hedging activities:				
Hedge ineffectiveness	\$ 0.7	\$ 6.1	\$ 11.8	\$ 5.0
Economic hedges	(0.3)	1.5	(1.5)	(4.9)
Total	<u>\$ 0.4</u>	<u>\$ 7.6</u>	<u>\$ 10.3</u>	<u>\$ 0.1</u>

Hedge Ineffectiveness. Hedge ineffectiveness gains for the third quarter and nine months ended 2004 were primarily due to mortgage loan and consolidated obligation hedge relationships. Hedge ineffectiveness occurs when changes in fair value for the derivative and hedged item do not perfectly offset.

In 2003, we began using a mortgage interest-rate swap hedge strategy to more effectively manage the market and prepayment risks associated with mortgage loans. This strategy significantly increased our hedge relationships that have potential to generate gains and losses from ineffectiveness.

Included in other income for of the nine months ended September 30, 2004 is a \$2.3 million increase in net unrealized gains on derivatives and hedging activities resulting from a second quarter 2004 change in accounting for certain highly effective hedging relationship transactions

used since the adoption of Statement on Financial Accounting Standards (SFAS) 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) on January 1, 2001. These changes could lead to more variability in reported net income in future periods. However, the cumulative amount of these changes will offset each other if the derivative and hedged item are both held to maturity or their call dates, which is generally the case for the Bank. See additional discussion regarding the accounting adjustment at Note 3 to the accompanying financial statements on page 55.

Economic Hedges. Net gains (losses) in the preceding table related to economic hedges included net interest (expense) income of \$(0.0) million and \$3.2 million in third quarters of 2004 and 2003. Net gains (losses) related to economic hedges included net interest (expense) income of \$(0.7) million and \$6.7 million in the first nine months of 2004 and 2003.

Economic hedges are primarily used in our mortgage loan portfolio and to manage basis risk between our assets and liabilities. These hedges constituted approximately 3 percent of the total notional value of our derivative portfolio at September 30, 2004. We recognize realized and unrealized gains or losses on our economic hedges in current period earnings including the derivative net interest income or expense. However, in all instances, the associated changes in the value of assets being hedged were not afforded similar treatment in the financial statements. As a result, accounting for derivatives and hedging activities changes the timing of income recognition and the financial statement line item classification for economic hedging activities. There is more variability in reported earnings due to changes in market prices and interest rates, and this variability could continue in the future.

Other Expenses

The following table presents the components of other expenses for the quarters ended September 30, 2004 and 2003 and the first nine months of 2004 and 2003 (dollars in millions):

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Salaries and employee benefits	\$ 4.4	\$ 3.9	\$ 13.0	\$ 11.3
Occupancy cost	0.2	0.2	0.5	0.7
Other operating	2.7	1.6	7.6	5.2
Total operating	<u>7.3</u>	<u>5.7</u>	<u>21.1</u>	<u>17.2</u>
Finance Board	0.4	0.3	1.2	1.0
Office of Finance	<u>0.2</u>	<u>0.2</u>	<u>0.7</u>	<u>0.7</u>
Total other expense	<u>\$ 7.9</u>	<u>\$ 6.2</u>	<u>\$ 23.0</u>	<u>\$ 18.9</u>

The increases in salaries and employee benefits in the third quarter of 2004 and the first nine months of 2004 compared with the same periods of 2003 reflect (1) increases from funding our portion of the Financial Institutions Retirement Plan for the first time since 1987, (2) increases for staff additions, and (3) general pay and benefit increases.

The increase in other operating expenses in the third quarter of 2004 compared with the same period of 2003 was primarily due to increased fees for consulting services. The increase in other operating expenses in the first nine months of 2004 compared with the same period of 2003 resulted primarily from the increased fees for consulting services and increased resources required to sponsor the Capitalizing on Rural America symposium.

We increased the use of consulting services in 2004 principally to evaluate the Bank's risk metrics and initiatives related to registration of a class of equity securities with the SEC. We anticipate increased consulting fees will continue throughout 2004 and into 2005 in preparation for SEC registration and compliance.

Affordable Housing Program and Resolution Funding Corporation Assessments

Our Affordable Housing Program and Resolution Funding Corporation assessments decreased for the third quarter of 2004 and the first nine months of 2004 compared with the same periods in 2003. Both assessments fluctuate directly with net income, resulting in lower assessments in 2004.

Statements of Condition

Advances

Our traditional mission asset is our program of advances to members and eligible housing associates (collectively known as borrowers) to provide funds for home mortgage financing, community lending and small business, small farm, and small agribusiness lending. The primary benefit of Bank membership is the value of access to funds for liquidity and lending at competitive terms. Advances increased \$3.5 billion in the first nine months of 2004.

Advance originations in the first nine months of 2004 outpaced repayments by \$3.6 billion. Most of the increase was attributable to increases in fixed and variable rate borrowings and was partially offset by decreases in convertible advances.

Convertible advances are fixed-rate advances in which we purchase put options from borrowers that allow us to terminate the advances on predetermined put dates. These terminations normally occur when interest rates increase. A convertible advance carries an interest rate lower than a comparable maturity advance that does not have the conversion feature.

The composition of our advances, based on remaining term to scheduled maturity, at September 30, 2004 and December 31, 2003 is as follows (dollars in millions):

	September 30, 2004	December 31, 2003
Fixed rate:		
Maturity less than one month	\$ 3,093	\$ 1,794
Maturity one month to one year	2,932	2,148
Maturity greater than one year	6,532	5,489
Variable rate:		
Maturity less than one month	34	169
Maturity one month to one year	4,454	851
Maturity greater than one year	3,129	2,879
Callable advances	394	555
Convertible (putable) advances	5,731	8,789
Total par value	<u>26,299</u>	<u>22,674</u>
Hedging fair value and other adjustments	<u>476</u>	<u>629</u>
Total advances	<u>\$ 26,775</u>	<u>\$ 23,303</u>

The following table presents advance balances¹ for our five largest member borrowers on September 30, 2004 (dollars in millions):

Name	City	State	September 30, 2004
Wells Fargo Bank, N.A.	Sioux Falls	SD	\$ 5,000
Transamerica Life Insurance Company	Cedar Rapids	IA	1,300
TCF National Bank	Minneapolis	MN	1,223
Transamerica Occidental Life Insurance Company	Cedar Rapids	IA	1,100
AmerUs Life Insurance Company	Des Moines	IA	973
			<u>9,596</u>
All other borrowers			16,697
Housing associates			<u>6</u>
Total advances (at par value)			<u>\$ 26,299</u>

¹ Represents par value before considering unamortized commitment fees, premiums and discounts, and hedging fair-value adjustments.

The following table presents advance balances¹ for our five largest member borrowers on December 31, 2003 (dollars in millions):

Name	City	State	December 31, 2003
Wells Fargo Bank Minnesota, N.A.	Minneapolis	MN	\$ 4,535
Transamerica Life Insurance Company	Cedar Rapids	IA	1,300
AmerUs Life Insurance Company	Des Moines	IA	889
TCF National Bank	Minneapolis	MN	773
Bank Midwest, N.A.	Kansas City	MO	<u>713</u>
			8,210
All other borrowers			14,458
Housing associates			<u>6</u>
Total advances (at par value)			<u>\$ 22,674</u>

Mortgage Loans

We acquire single-family mortgage loans from our members through the MPF program. This program provides members an attractive economic alternative to holding mortgage loans in portfolio or selling them in the traditional secondary market. Under the terms of the MPF program, we manage the liquidity, interest rate, and prepayment risks of the mortgage loans while the members retain the customer relationship and loan servicing activities. The Bank and its members share in the credit risk of the loans. During 2003, the MPF program introduced a servicing released program in which those members that do not wish to service loans owned by the Bank can transfer servicing rights to a third-party provider.

¹ Represents par value before considering unamortized commitment fees, premiums and discounts, and hedging fair-value adjustments.

The following table presents information as of September 30, 2004 and December 31, 2003 on mortgage loans held for portfolio (dollars in millions):

	September 30, 2004	December 31, 2003
Single-family Mortgages:		
Fixed-rate conventional loans		
Contractual maturity less than or equal to 15 years	\$ 3,985	\$ 4,282
Contractual maturity greater than 15 years	<u>10,368</u>	<u>10,481</u>
Subtotal	14,353	14,763
Fixed-rate government-insured loans		
Contractual maturity less than or equal to 15 years	5	4
Contractual maturity greater than 15 years	<u>952</u>	<u>1,242</u>
Subtotal	<u>957</u>	<u>1,246</u>
Total par value	15,310	16,009
Premiums	151	181
Discounts	(141)	(149)
Hedging fair-value adjustments	16	(36)
Allowance for credit losses on mortgage loans	<u>(6)</u>	<u>(6)</u>
Total mortgage loans held for portfolio	<u>\$ 15,330</u>	<u>\$ 15,999</u>

Mortgage loans decreased by 4 percent from December 31, 2003. In the first nine months of 2004, we purchased \$1.4 billion of member mortgage loans through the MPF program and received principal repayments of \$2.1 billion. The annualized pay-down rate for mortgage loans in the first nine months of 2004 was approximately 18 percent compared with approximately 36 percent in the first nine months of 2003.

Mortgage loan purchases in 2004 declined due to lower acquisitions of mortgages from large members. This trend is expected to continue into the fourth quarter of 2004.

Hedging fair-value adjustments are made up of market-value adjustments from hedge accounting as well as basis adjustments created from terminated hedge relationships. In 2004, we terminated certain interest rate swaps and established new hedge relationships with mortgage loans to adjust prepayment protection. As of September 30, 2004 the unamortized balance of these basis adjustments resulting from hedge terminations totaled \$206 million compared with \$0 at December 31, 2003. The basis adjustments will amortize to income over the estimated lives of the related mortgage loans.

We either receive or pay an upfront fee on interest rate swaps to generally offset the premium, discount or other book-value adjustments (including the basis adjustment created from terminated hedges) of the hedged loans. This cash payment equates to the initial fair value of the interest rate swap and is amortized over the life of the hedged loans to net interest income

as the book-value adjustments on the mortgage loans are recognized. The fair value of the interest rate swaps hedging the mortgage loans are presented in the “Statements of Condition–Derivatives” section of this report beginning on page 22.

Investments

The following table summarizes investments at September 30, 2004 and December 31, 2003 (dollars in millions):

	September 30, 2004	December 31, 2003
Interest-bearing deposits	\$ 442	\$ 281
Securities purchased under agreements to resell	305	305
Federal funds sold	1,750	1,200
Commercial paper	450	-
U.S. agency discount notes	716	150
Total money market investments	<u>3,663</u>	<u>1,936</u>
U.S. agency mortgage-backed securities	3,265	1,824
Other mortgage-backed securities	495	670
Total mortgage-backed securities	<u>3,760</u>	<u>2,494</u>
U.S. agency bonds	587	1,068
State or local housing agency obligations	11	19
Other	8	7
Total other investments	<u>606</u>	<u>1,094</u>
Total investments	<u>\$ 8,029</u>	<u>\$ 5,524</u>

Investment balances increased approximately 45 percent in the first nine months of 2004. The increase in investment balances was primarily caused by purchases of mortgage-backed securities outpacing our investment pay downs during the first nine months of 2004 and increased short-term investments. The level of short-term investments will vary based on changes in other asset classes, levels of capital, and leverage.

The annualized pay-down rate for mortgage-backed securities in the first nine months of 2004 was approximately 26 percent compared with approximately 56 percent in the same period of 2003. Pay downs were offset by the purchase of \$2.0 billion of agency mortgage-backed securities in the first nine months of 2004. Slower mortgage loan acquisitions led to the capacity to purchase mortgage-backed securities.

Purchases of mortgage-backed securities supported our contingent liquidity requirements. See additional discussion of our contingent liquidity requirements in the “Liquidity” section of this report beginning on page 25.

Consolidated Obligations

Consolidated obligations are the joint-and-several obligations of the 12 FHLBanks, backed by the financial resources of the FHLBanks. Accordingly, should one or more of the FHLBanks be unable to repay their participations in the consolidated obligations, each of the other FHLBanks could be called upon to repay all or part of such obligations.

Consolidated obligations are the primary source of funds to support our advances, mortgage loans, and investments. We make significant use of derivatives to restructure interest rates on consolidated obligations to better match our funding needs and to reduce funding costs. As of September 30, 2004, the Bank's consolidated obligations totaled \$45.8 billion compared with \$40.4 billion at December 31, 2003. Consolidated obligations increased primarily in response to the increase in advances during the first nine months of 2004.

Discount Notes. The following table summarizes the Bank's participation in consolidated discount notes, all of which are due within one year (dollars in millions):

	September 30, 2004	December 31, 2003
Par value	\$ 6,079	\$ 5,483
Discounts	(12)	(11)
Hedging fair-value adjustments	(1)	-
Total discount notes	<u>\$ 6,066</u>	<u>\$ 5,472</u>

Bonds. The following table summarizes the Bank's participation in consolidated bonds based on remaining term to maturity at September 30, 2004 and December 31, 2003 (dollars in millions):

<u>Year of Maturity</u>	September 30, 2004	December 31, 2003
Due in one year or less	\$ 10,892	\$ 4,489
Due after one year through two years	10,410	8,495
Due after two years through three years	5,601	7,836
Due after three years through four years	2,507	2,359
Due after four years through five years	2,993	2,995
Thereafter	<u>7,475</u>	<u>8,789</u>
Total par value	39,878	34,963
Premiums	43	57
Discounts	(15)	(17)
Hedging fair-value adjustments	<u>(204)</u>	<u>(123)</u>
Total bonds	<u>\$ 39,702</u>	<u>\$ 34,880</u>

Substantially all of the hedging fair-value adjustment gains on the bonds are offset by net estimated fair market value losses on the related derivative contracts. See additional discussion regarding our derivative contracts in the “Statements of Condition–Derivatives” section of this report beginning on page 22.

The Bank’s bonds outstanding include the following (dollars in millions):

	September 30, 2004	December 31, 2003
Par amount of bonds:		
Noncallable or nonputable	\$ 21,933	\$ 15,468
Callable	17,945	19,495
Total par value	<u>\$ 39,878</u>	<u>\$ 34,963</u>

Capital

As of September 30, 2004 total capital (including capital stock, retained earnings, and accumulated other comprehensive income) increased \$0.2 billion from \$2.2 billion as of December 31, 2003 to \$2.4 billion as of September 30, 2004. The primary factor contributing to this growth was activity stock supporting increased advance activity. The secondary factor was an increase in retained earnings.

Derivatives

We enter into interest rate swap, cap, floor, and swaption agreements (collectively, derivatives) to manage our exposure to changes in interest rates. We use derivatives in our overall financial risk management to adjust the interest rate sensitivity of liabilities to approximate more closely the interest rate sensitivity of assets and/or to adjust the interest rate sensitivity of assets to approximate more closely the interest rate sensitivity of liabilities.

We use derivatives to manage mismatches of interest rates between assets and liabilities. In addition, we use derivatives to manage embedded options in assets and liabilities, to hedge the market value of existing assets, liabilities, and anticipated transactions, to reduce funding costs and to offer products to members.

The notional amount of derivatives reflects the volume of our hedges, but it does not measure the credit exposure of the Bank because there is no principal at risk. The following table categorizes the notional amount of our derivatives as of September 30, 2004 and December 31, 2003 (dollars in millions):

	<u>September 30, 2004</u>	<u>December 31, 2003</u>
Notional amount of derivatives:		
Interest rate swaps:		
Noncancelable	\$ 22,038	\$ 13,961
Cancelable by counterparty	21,886	25,760
Cancelable by Bank	<u>12,547</u>	<u>10,914</u>
	56,471	50,635
Interest rate caps	625	2,040
Mortgage delivery commitments	61	46
Forward settlement agreements	<u>29</u>	<u>38</u>
Total notional amount	<u>\$ 57,186</u>	<u>\$ 52,759</u>

Derivatives are recorded on the balance sheet at fair value. After netting the fair market values and accrued interest of the derivative instruments by counterparty, positive counterparty balances are classified as derivative assets and negative counterparty balances are classified as derivative liabilities. Derivative assets represent our maximum credit risk to counterparties and derivative liabilities represent counterparties exposures to us. Substantially all of the net estimated fair market value losses on our derivative contracts are offset by net hedging fair-value adjustment gains or other book-value adjustments on the related hedged items.

The following table categorizes the notional amount and the estimated fair value of derivative financial instruments, excluding accrued interest, by product and type of accounting treatment. The category *fair value* represents hedges that qualify for fair-value hedge accounting. The category *cash flow* represents hedges that qualify for cash-flow hedge accounting. The category *economic* represents hedge strategies that do not qualify for hedge accounting. Amounts at September 30, 2004 and December 31, 2003 are as follows (dollars in millions):

	September 30, 2004		December 31, 2003	
	Notional	Estimated Fair Value	Notional	Estimated Fair Value
Advances:				
Fair value	\$ 11,346	\$ (476)	\$ 12,707	\$ (628)
Investments:				
Fair value	1,044	(38)	1,495	(50)
Economic	346	-	810	(1)
Mortgage loans:				
Fair value	12,547	57	10,914	61
Economic	300	-	1,265	9
Mortgage delivery commitment derivatives:				
Cash flow	31	-	8	-
Economic (including forward settlement agreements)	58	-	76	-
Consolidated obligations:				
Fair value	29,621	(147)	24,957	(102)
Economic	1,000	-	-	-
Discount notes:				
Fair value	893	(2)	527	-
Total notional and fair value	<u>\$ 57,186</u>	<u>\$ (606)</u>	<u>\$ 52,759</u>	<u>\$ (711)</u>
Total derivatives, excluding accrued interest		(606)		(711)
Accrued interest		104		62
Net derivative balance		<u>\$ (502)</u>		<u>\$ (649)</u>
Net derivative assets		22		43
Net derivative liabilities		<u>(524)</u>		<u>(692)</u>
Net derivative balance		<u>\$ (502)</u>		<u>\$ (649)</u>

Liquidity

The Bank's day-to-day and contingency liquidity objectives are designed to protect our financial strength and to allow us to withstand market disruption. To achieve these objectives, we establish liquidity management requirements and maintain liquidity in accordance with Finance Board regulations and our own liquidity policy.

Sources and Uses of Liquidity

The Bank's primary source of liquidity is proceeds from the issuance of consolidated obligations (bonds and discount notes) in the capital markets. Because of the FHLBanks' credit quality, efficiency, and standing in the capital markets, the FHLBanks have ready access to funding. In the first nine months of 2004, we received proceeds from the issuance of short-term consolidated discount notes of \$193.9 billion and proceeds from the issuance of intermediate- to long-term consolidated bonds of \$17.6 billion. This compares to proceeds from the issuance of short-term consolidated discount notes of \$327.9 billion and proceeds from the issuance of intermediate- to long-term consolidated bonds of \$30.9 billion during the first nine months of 2003. Intermediate- to long-term consolidated obligation issuances were generally higher during 2003 because interest rates dropped to historic lows, which resulted in a significant amount of consolidated obligations being called and reissued. As interest rates have increased during 2004, call activity and subsequent reissues on consolidated obligations have declined compared with the prior year. In addition, short-term consolidated obligation issuances decreased due to reduced requirements to maintain target leverage and decreased mortgage loan purchases.

Other sources of liquidity include cash, money market investments, payments collected on advances and mortgage loans, fees received on interest rate swaps hedging mortgage loans, member deposits, and the issuance of capital stock. To provide further access to funding, the FHLBank Act authorizes the Secretary of the Treasury, at his or her discretion, to purchase consolidated obligations up to an aggregate principal amount of \$4.0 billion. Additionally, in the event of significant market disruptions or local disasters, the Bank President or his designee are authorized to establish interim borrowing relationships with other FHLBanks, the Federal Reserve, or the United States Treasury as needed. No formal relationships of this kind are currently in place.

We had cash and money market investments with a carrying value of \$3.7 billion at September 30, 2004, compared with \$2.0 billion at December 31, 2003. We manage the level of cash and money market investments based on changes in other asset classes, levels of capital, and leverage targets. Cash and money market investments increased since December 31, 2003 to maintain leverage at our current operating targets. Additionally, our holdings in U.S. agency discount notes have increased as we utilize these investments to secure repurchase agreements.

Our primary use of liquidity is the repayment of consolidated obligations. In the first nine months of 2004, we made payments for maturing and retiring short-term consolidated discount notes of \$193.3 billion and payments for maturing and retiring intermediate- to long-term consolidated bonds of \$12.7 billion. This compares to payments for maturing and retiring short-term consolidated discount notes of \$327.7 billion and payments for maturing and retiring

intermediate- to long-term consolidated bonds of \$30.3 billion during the first nine months of 2003.

Other uses of liquidity include issuance of advances, purchases of mortgage loans and investments, fees paid on interest rate swaps hedging mortgage loans, repayment of member deposits, and redemption of capital stock.

We issue letters of credit on behalf of our members and housing associates to facilitate business transactions with third parties. Letters of credit may be used to facilitate residential housing finance or other housing activities, facilitate community lending, assist with asset-liability management, and provide liquidity or other funding. Members and housing associates must fully collateralize letters of credit with eligible collateral. As of September 30, 2004 and December 31, 2003, we had \$1.1 billion in letters of credit outstanding. If the Bank is required to make a payment for a beneficiary's draw, these amounts may be converted into a collateralized advance to a member.

At September 30, 2004, we had \$63.0 million in outstanding commitments to purchase mortgage loans compared with \$46.9 million at December 31, 2003. We did not have outstanding commitments for additional advances at September 30, 2004 or December 31, 2003.

The Bank does not have any off-balance sheet sources of liquidity. We are not aware of any conditions that would impair our current sources of liquidity for future use. Additionally, we are not aware of any conditions that would result in unplanned uses of liquidity in the future. Accordingly, we believe that our sources of liquidity will cover future liquidity and capital resource requirements. See discussion of liquidity risk management on page 39 of this report.

Liquidity Requirements

Under Finance Board regulations, we are required to maintain minimum liquidity to meet our net funding requirements assuming we are unable to access the consolidated obligation debt market each day for five consecutive business days. We were in compliance with this during the first nine months of 2004.

Finance Board regulations also require us to have available at all times an amount greater than or equal to members' current deposits invested in advances with maturities not to exceed five years, deposits in banks or trust companies, and obligations of the United States Treasury. The amounts available under this regulation totaled \$19.0 billion and \$15.1 billion as of September 30, 2004 and December 31, 2003, compared with member deposits of \$0.8 billion and \$1.0 billion for the corresponding periods.

Bank policy requires that we maintain additional liquidity for day-to-day operational and contingency needs. The policy requires that we maintain overnight investments of at least \$250 million to fund new lending and additional cash needs. Overnight investments amounted to \$1.5 billion at September 30, 2004 and \$1.2 billion at December 31, 2003.

As contingent liquidity, we maintain unencumbered Treasury and agency securities (including mortgage-backed securities) in an amount equal to at least 100 percent of the Bank's capital that can be used as collateral for repurchase agreements. Contingent liquidity as of September 30, 2004 consisted of the following unencumbered securities:

- Agency mortgage-backed securities of \$3.2 billion or 135 percent of capital; and
- Other agency securities of \$0.8 billion or 33 percent of capital.

In June 2004, Standard & Poor's revised the individual counterparty rating outlook of the Bank from stable to negative. Standard & Poor's reaffirmed the Bank's individual AAA counterparty rating. We do not expect a significant change in our business from this action. This change in outlook does not affect the AAA rating of consolidated bonds and discount notes issued jointly by the 12 FHLBanks. As a result, we do not expect an impact to our cost of funds.

Capital

We had 22.8 million shares of stock outstanding at September 30, 2004 compared with 21.2 million shares outstanding at December 31, 2003. We issued 5.7 million shares of capital stock to members and redeemed 4.1 million shares of capital stock from members in the first nine months of 2004. More than 80 percent of our capital stock outstanding at September 30, 2004 and December 31, 2003 is activity-based stock which fluctuates primarily with members' advance and MPF activity. Our capital stock balances increased in the first nine months of 2004 due to increased advance activity.

Our minimum capital stock requirements are designed so that we remain adequately capitalized as member activity changes. These requirements may be adjusted upward or downward by the Bank's Board of Directors within ranges established in our capital plan to ensure necessary liquidity for our operations.

At September 30, 2004, approximately 95 percent of our total capital was capital stock. The Bank was in compliance with all of its capital requirements on September 30, 2004. The following table summarizes the Bank's compliance with the Finance Board's capital requirements as of September 30, 2004 (dollars in millions):

	<u>Required</u>	<u>Actual</u>
Regulatory Capital Requirements:		
Risk-based capital	\$ 497	\$ 2,399
Capital ratio	4.00%	4.77%
Permanent capital	\$ 2,014	\$ 2,399
Leverage ratio	5.00%	7.15%
Weighted leverage capital	\$ 2,517	\$ 3,599

We paid cash dividends of \$31.7 million in the first nine months of 2004. In April 2004, our Board of Directors approved a policy focused on continuing to build retained earnings. The policy strives to further protect our members' investment in the Bank from losses under most plausible stress scenarios, and it provides an amount sufficient to make the next quarterly

dividend payment to our stockholders. We do not believe that our retained earnings policy will impact our ability to pay the target dividend of average three-month LIBOR plus 60 basis points in 2004.

Recently Issued Accounting Standards

SFAS 150. In May 2003, the Financial Accounting Standards Board (FASB) issued Statement No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (SFAS 150), which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Restatement is not permitted. For nonpublic entities, mandatorily redeemable financial instruments are subject to the provisions of this Statement for the first fiscal period beginning after December 15, 2004. Because the Bank is currently a nonpublic entity as defined in SFAS 150 and will not register its stock with the SEC until mid-2005, it is expected that SFAS 150 will apply to the Bank effective January 1, 2005. The Bank is currently in the process of assessing the impact of SFAS 150 on its financial statements.

Emerging Issues Task Force Issue (EITF) 03-1. In March 2004, the FASB reached a consensus on *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-1)*, which clarifies the application of an impairment model to determine whether investments are other-than-temporarily impaired. The provisions of this rule are required to be applied prospectively to all current and future investments accounted for in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. On September 15, 2004, the FASB issued proposed FASB Staff Position (FSP) on *Implementation Guidance for the Application of Paragraph 16 of EITF 03-1*, (FSP EITF 03-1-a) to provide guidance on the application of paragraph 16 of EITF 03-1 to debt securities that are impaired because of interest rate and/or sector spread increases. On September 30, 2004, the FASB issued an FSP on the *Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1 "The Meaning of Other-Than Temporary Impairment and Its Application to Certain Investments"* (FSP EITF 03-1-1), which deferred the effective date of the impairment measurement and recognition provisions contained in specific paragraphs of EITF 03-1 and expanded the scope of proposed FSP EITF 03-1-a to include all securities, not only debt securities. The comment period for proposed FSP EITF 03-1-a ended on October 29, 2004. The deferral of the effective date for paragraphs 10-20 of EITF 03-1 as reported in FSP EITF 03-1-1 will be superseded concurrent with the final issuance of proposed FSP EITF Issue 03-1-a. We do not expect the new rules to have a material impact on our results of operations at the time of adoption.

Critical Accounting Policies

The Bank's accounting policies are fundamental to understanding "Management's Discussion and Analysis" and "Results of Operations and Financial Condition." The Bank has identified certain policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions.

Several of these accounting policies involve the use of estimates that we consider critical as: (1) they are likely to change from period to period because they require significant management judgment and assumptions about highly complex and uncertain matters and (2) the use of a different estimate or a change in estimate could have a material impact on our reported results of operations or financial condition.

Estimates and assumptions that are significant to the results of operations and financial condition include those used in conjunction with:

- Accounting for derivatives and hedging activities
- The use of fair value estimates
- Accounting for the joint and several obligation on consolidated obligations
- Amortization/accretion of mortgage loans, advances, investments, and consolidated obligations
- Provision for credit losses on advances and mortgage loans, and
- Liability for Resolution Funding Corporation assessments

These critical accounting estimates are described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies" beginning on page 50 of our 2003 annual report.

The Bank evaluates its critical accounting policies on an on-going basis. As of September 30, 2004, the Bank had not made any significant changes from its 2003 audited financial statements to its estimates and assumptions used in applying its critical accounting policies. While management believes its estimates and assumptions are reasonable based on historical experience and other factors, actual results could differ from those estimates and differences could be material to the financial statements.

Management is evaluating our method of assessing hedge effectiveness for certain of the Bank's interest rate swap and mortgage loan fair value hedge relationships. In March 2003, we began using interest rate swaps to hedge mortgage loans where the Bank pays fixed rates and receives variable rates, effectively converting the fixed-rate loans to a floating rate indexed to LIBOR. The interest rate swaps are designed to have amortizing notional balances that match the actual pay-down of the mortgage loans within a range of pay-down scenarios. Under this strategy, we generally hedge the first 15 years of cash flows for 30-year loans and the first 10 years of cash flows for 15-year loans and we are hedging the LIBOR benchmark interest rate.

Management believes we have established a reasonable basis for assessing and measuring changes in fair value of the interest rate swap and the hedged item attributable to changes in LIBOR; however we are currently working to evaluate if an alternative valuation method would be more appropriate. If a more appropriate method is identified and adopted, management believes these hedging relationships would continue to be considered highly effective, although our reported earnings could be more or less volatile. If management ultimately determines that an alternative valuation method is more appropriate, the Bank might be required to restate prior results to reflect a new accounting treatment. Management does not believe a restatement will be required, but there can be no assurances that a restatement of previously reported results will not be required.

Legislative and Regulatory Developments

Final Rule on Registration under the Securities Exchange Act of 1934

In June 2004, the Finance Board approved a rule requiring each of the 12 FHLBanks to register a class of its equity securities with the SEC under section 12(g)(1) of the Securities Exchange Act of 1934, as amended. The rule requires each of the FHLBanks to file its registration statement with the SEC no later than June 30, 2005 to ensure that its registration statement becomes effective by August 29, 2005 subject to the possibility of a Finance Board order extending the deadline. Once we have a class of equity securities registered with the SEC, we will file periodic reports with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K. In anticipation of registration, we enhanced and expanded disclosures in our 2003 annual report and 2004 quarterly reports. We expect to complete registration by the required date.

Proposed Changes to Government-Sponsored Enterprise Regulation

On April 1, 2004, a bill that would create a new regulator for Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and the FHLBanks was passed by the Senate Banking Committee; however, the bill has not yet come up for a vote in the full Senate. The bill would combine the Office of Federal Housing Enterprise Oversight and the Finance Board into a new independent regulatory agency. The bill would, among other things, require the FHLBanks to register with the SEC under the Exchange Act, establish a new corporation to be jointly-owned by the FHLBanks that would succeed to the functions of the Office of Finance, revamp the procedures for the election of the FHLBank directors and impose certain operating and other limitations on the FHLBanks should they fall below various capitalization thresholds. It is impossible to predict whether the House and Senate would approve such legislation or similar legislation in the next Congress, whether any such change in regulatory structure ultimately would be signed into law or, if enacted, what effect such legislation would have on the Bank and the FHLBank system.

Changes in Federal Reserve Bank Policy Statement on Payments System Risk

The Federal Reserve Board in September announced, through Docket No.OP-1182, that it has revised its Policy Statement on Payments System Risk concerning interest and redemption payments on securities issued by government-sponsored enterprises and certain international organizations. The Reserve Banks are currently processing and posting these payments to depository institutions' Federal Reserve accounts by 9:15 a.m. Eastern Time, the same posting time as for U.S. Treasury securities' interest and redemption payments, even if the issuer has not fully funded its payments. The revised policy requires that, beginning July 20, 2006, Reserve Banks will release these interest and redemption payments as directed by the issuer provided the issuer's Federal Reserve account contains sufficient funds to cover them. While the issuer will determine the timing of these payments during the day, each issuer will be required to fund its interest and redemption payments by 4 p.m. Eastern Time in order for the payments to be processed that day. Also beginning July 20, 2006, the revised policy will align the treatment of the general corporate account activity of government-sponsored enterprises and certain international organizations with the treatment of activity of other account holders that do not have regular access to the discount window and thus are not eligible for intraday credit. Such treatment will include applying a penalty fee to daylight overdrafts resulting from our general corporate payment activity. The Bank is evaluating the impact of this proposed change on our operations. However, it is not possible to predict what, if any, changes will be made and what effect the changes would have on the Bank.

Risk Management

We have risk management policies that control our exposure to market, liquidity, credit, operational, and business risk. These policies are established by our Board of Directors and, when appropriate, conform with Finance Board regulations. Our primary objective is to manage assets, liabilities, and derivative exposures in ways that protect capital stock from risks, mainly fluctuations in market interest rates, spreads, and volatilities. Our secondary objective is to pay a reasonable rate of return to stockholders.

Market Risk

We define market risk, also known as interest rate risk, as the risk that net interest income or net market value of our capital stock will change as a result of changes in market conditions such as interest rates, spreads, and volatilities. Interest rate risk was the predominant type of market risk incurred in the first nine months of 2004 and 2003. Our financial risk management policy is designed to provide an asset and liability management framework to respond to changes in market conditions without creating undue balance sheet stress. The Board of Directors routinely reviews both the policy limits and the actual exposures to verify the level of interest rate risk in our balance sheet remains at prudent and reasonable levels.

Net Market Value of Capital Stock. Net market value of capital stock, at a point in time, is defined as the present value of assets minus the present value of liabilities plus the net present value of derivatives.

Interest rate risk analysis using net market value of capital stock involves instantaneous parallel shifts in interest rates. The resulting percentage change in market value of capital stock from the base case value is an indication of longer-term repricing risk and option risk embedded in the balance sheet.

These tables summarize our net market value of capital stock at September 30, 2004 and December 31, 2003 (dollars in millions):

<u>As of September 30, 2004</u>	<u>Net Market Value of Capital Stock</u>	<u>Percent Change from Base Case</u>
Base case	\$ 2,269	
Assuming a 100 basis point increase in interest rates	2,263	-0.3%
Assuming a 100 basis point decrease in interest rates	2,200	-3.0%

<u>As of December 31, 2003</u>	<u>Net Market Value of Capital Stock</u>	<u>Percent Change from Base Case</u>
Base case	\$ 2,103	
Assuming a 100 basis point increase in interest rates	2,102	-0.1%
Assuming a 100 basis point decrease in interest rates	2,096	-0.4%

The increase in net market value of capital stock from year-end was primarily due to growth in capital stock and yield curve flattening. Changes in the Bank's market value profile from year-end were principally caused by higher interest rates and hedging activities relating to mortgage loans. To protect the net market value of capital stock we use hedging transactions such as entering into or canceling interest rate swaps on existing debt and altering the funding structures of new mortgage purchases. The percentage change from our base case under all interest rate scenarios has remained relatively neutral, indicating that our risk management activities are currently effective at reducing the exposure of our market value of capital stock to interest rate risk.

Bank policy requires the net market value of capital stock, adjusted for certain factors, to be greater than \$90 per share in the base case interest scenario. The Bank was in compliance with this policy in the first nine months of 2004 and throughout 2003.

Value-at-Risk. In addition to quantifying changes in the net market value of capital stock with instantaneous parallel interest rate changes, management estimates the changes in the market value of total equity using value-at-risk methodology. Our internal value-at-risk calculations use a statistical technique to estimate potential one-month loss in the market value of our total equity. Principal Components Analysis¹ is used to summarize historical yield curve dynamics, and we add a spread risk factor and a volatility risk factor. Spread risk refers to the potential loss due to changes in the difference between our cost of funds curve and the LIBOR-swap curve. Volatility risk refers to the potential loss due to changes in interest rate volatilities.

Our value-at-risk estimate excludes changes resulting from the widening or narrowing of LIBOR option-adjusted spreads (LOAS) on mortgage assets. Fluctuations in LOAS result in changes in liquidation value of the mortgage assets and tend to move back to their average levels over time (mean reversion). We exclude the impact of changes in LOAS from value-at-risk estimates because LOAS tends to be mean reverting and virtually all of our mortgage assets are held to maturity to earn spread income. Bank earnings are impacted by the level of LOAS on mortgage assets at the time of purchase. Subsequent fluctuations in mortgage LOAS do not affect Bank earnings on held-to-maturity assets.

Value-at-risk is useful to establish risk tolerance limits and is commonly used in asset-liability management; however, it does not imply a forecast of future interest rate behavior. We maintain value-at-risk below a level that ranges from 4 percent to 10 percent of total equity depending upon the level of mortgage assets acquired from mortgage purchase programs to total assets, as specified by the Board of Directors. The value-at-risk policy limit was 9.2 percent at September 30, 2004 and 10.0 percent at December 31, 2003. We examine historical changes in prices and market rates for the past 10 years to calculate our value-at-risk. We estimate with 99 percent confidence based on a one-month holding period that our market value of total equity would decline by less than 1.7 percent at September 30, 2004 compared with 1.2 percent at December 31, 2003.

¹ Principal Components Analysis is a statistical technique used to transform a complex set of correlated variables into a new set of independent variables called principal components, e.g. the eight points of the Treasury yield curve (three month, six month, one year, two year, three year, five year, 10 year, and 30 year) are transformed into two principal components, level and slope shifts.

Value-at-risk levels are regularly back-tested to validate the model by comparing predictions with actual results. Stress tests are conducted regularly using stressful market scenarios. The scenarios are reviewed to reflect changing market and economic conditions.

We also report value-at-risk results to the Finance Board as part of risk-based capital. The Finance Board defines its regulatory value-at-risk measure as the potential loss of market value in a six-month holding period at the 99 percent confidence level. The methodology for this calculation is historical simulation¹ using market data of yields, spreads, and volatilities since 1978. We estimate that market value of total equity would, with 99 percent confidence, decline by less than 9.2 percent at September 30, 2004 and 7.4 percent at December 31, 2003 using the regulatory methodology prescribed by the Finance Board. Like management's one-month value-at-risk methodology, this regulatory estimate excludes changes resulting from the widening or narrowing of LIBOR option-adjusted spreads on mortgage assets.

Duration Gap. The net market value of our assets, liabilities, and derivatives is primarily affected by changes in the level of interest rates. Duration measures the sensitivity of an instrument's market value to interest rate changes. Duration is the weighted average life of an instrument's cash flows weighted by the present value of those cash flows. As duration lengthens, sensitivity to changes in interest rates increases.

The duration gap measures the difference between the estimated durations of assets and liabilities and summarizes the extent to which sensitivities to changes in interest rates for assets and liabilities are matched. A duration gap of zero indicates the durations of assets and liabilities are equal. A positive duration gap indicates the duration of assets is longer than the duration of liabilities, which generally creates portfolio exposure in a rising interest rate environment. A negative duration gap indicates the duration of liabilities is longer than the duration of assets, which generally creates portfolio exposure in a declining interest rate environment. The duration gap provides a relatively concise and simple measure of the interest rate risk inherent in the existing balance sheet in terms of market value changes, but it is not directly related to current earnings performance.

¹ Historical simulation involves valuing the Bank's current holdings based on actual market conditions that existed over a specific historical period of time.

This table summarizes our duration gap, in months, at September 30, 2004 and December 31, 2003:

	Rates Decrease 100 Basis Points	Base Case	Rates Increase 100 Basis Points
September 30, 2004	(3.2)	(0.8)	0.1
December 31, 2003	(0.7)	(0.4)	(0.4)

Duration gaps across most interest rate scenarios during the year remained relatively low but indicate some exposure in a declining interest rate environment. Changes in duration gap since year-end are primarily attributed to management's decision to adjust the funding and hedging profile for our mortgage assets to reflect changing market environments and mortgage prepayment projections. We have maintained duration gap within our risk tolerances throughout the period. We accomplished this objective through mortgage hedging activity and strategic asset-liability rebalancing actions.

Bank policy requires that we maintain base case duration gap of the total Bank within a range of plus or minus six months, and the Bank was in compliance with this policy throughout 2003 and in the first nine months of 2004.

We also use a variety of other measurement and monitoring tools including interest-rate gap analysis and basis risk analysis, as well as simulations of income and market value variability. The Bank's financial management guidelines specify ranges for each of these items.

Mortgage Finance Market Risk. On a daily basis, we maintain the duration gap of the Mortgage Finance segment within specified ranges through management of the durations of our assets, liabilities, and derivative agreements. Bank policy limits the duration gap of this business segment to plus or minus six months, and the Asset-Liability Committee operating guidelines further limit the range. The Bank may use hedging transactions to adjust the duration gap within the target range. These transactions may include entering into or canceling interest rate swaps on existing debt. Adjustments to duration may also be accomplished by altering the funding structures of new mortgage purchases. Portfolio duration movements relative to the target range and hedge transactions are documented for monthly review by the Asset-Liability Committee.

Our duration gap for Mortgage Finance was (1.5) months at September 30, 2004 compared with (0.8) months at December 31, 2003. Mortgage Finance duration gaps across most interest rate scenarios during the year remained relatively low, but generally indicated exposure in declining rate environments. Changes in duration gap since year-end are primarily attributed to management's decision to adjust the funding and hedging profile for our mortgage assets to reflect changing market environments and mortgage prepayment projections.

Mortgage Finance Typical Funding Structures. We may hedge against contraction risk by funding some mortgage related investments with consolidated obligations that have call features. We issue both callable and noncallable debt to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans. A combination of bond maturities and call lockout dates are chosen to provide a cash flow match between bond principal pay-downs and mortgage principal pay-downs. As of September 30, 2004, 29 percent of the fixed-rate mortgage asset portfolio was funded with callable and noncallable fixed-rate debt.

During 2003, we began using interest rate swaps to hedge mortgage loans when the Bank pays fixed rates and receives variable rates, effectively converting the fixed-rate loans to floating rate LIBOR. The interest rate swaps are designed to have amortizing notional balances that match the actual pay-down of the mortgage loans within a wide range of pay-down scenarios. We either receive or pay an upfront fee on the interest rate swap to generally offset the premiums, discounts, or other book-value adjustments of the hedged mortgage loans. This cash payment equates to the initial fair value of the interest rate swap and is amortized over the life of the hedged loans to net interest income as the premiums, discounts, or other book-value adjustments on the mortgage loans are recognized. The interest rate swap and hedged item are marked to market through net realized and unrealized gain (loss) on derivatives and hedging activity on the statements of income.

These transactions provide a more stable net income spread across various interest rate scenarios and effectively hedge mortgage loan prepayment risk. The interest-rate swap market tends to provide more flexibility than does the bond market for the structures needed to fund and hedge mortgage assets. As of September 30, 2004, 71 percent of the fixed-rate mortgage asset portfolio was hedged with interest rate swaps and funded with variable rate debt.

At the total mortgage portfolio level, callable bonds and swaps usually represent from 50 percent to 70 percent of the funding and hedging mix, with noncallable bonds and swaps constituting the rest.

Our funding of mortgage assets is designed to be flexible to handle changes in mortgage asset prepayment speeds. The following table summarizes the base case projection of remaining fixed-rate mortgage asset balances assuming a 15 percent constant prepayment rate and the supporting liability balances based on the slowest and fastest contractual pay-down scenarios as of September 30, 2004:

	Projected Remaining Balances as a Percent Of September 30, 2004 Balances					
	<u>1 year</u>	<u>3 years</u>	<u>5 years</u>	<u>10 years</u>	<u>13 years</u>	<u>15 years</u>
Mortgage assets (base case)	83%	58%	40%	15%	8%	5%
Mortgage liabilities ¹ :						
Assuming payoff at maturity (slowest)	89%	74%	61%	25%	12%	1%
Assuming payoff on earliest call date (fastest)	40%	25%	15%	3%	2%	1%

¹ Mortgage liabilities consist of callable and noncallable fixed-rate debt and hedges of the mortgage assets, with the hedges consisting of callable and amortized interest rate swaps funded with a variable-rate debt pool.

- Callable and noncallable fixed-rate debt and hedges are assumed to pay off based on the earliest call date, if applicable, in the fastest scenario and on the final maturity date in the slowest scenario.
- The hedged mortgage assets are funded with a variable-rate debt pool. For this analysis, we assume the debt pool will change based on the size of the hedged mortgage assets being funded.

Derivatives. We enter into derivatives to manage our exposure to changes in interest rates. We use derivatives to adjust the effective maturity, repricing frequency, or option characteristics of financial instruments to achieve risk management objectives. We do not use derivatives for speculative purposes.

Our current hedging strategies relate to hedges of existing assets-liabilities that qualify for fair-value or cash-flow hedge accounting treatment and economic hedges that are used to reduce market risk at the balance sheet or portfolio level. Economic hedges do not qualify for hedge accounting treatment and, as a result, only the derivative instrument is marked to market. For more information on derivatives, see page 64 of the Bank's 2003 annual report.

The following table categorizes the earnings impact of our hedging activities by product for the nine months ended September 30, 2004 and 2003 (dollars in millions):

<u>Nine Months Ended September 30, 2004</u>	<u>Advances</u>	<u>Mortgage Assets</u>	<u>Consolidated Bonds</u>	<u>Total</u>
Amortization/accretion of hedging activities in net margin	\$ (2.2)	\$ 4.6	\$ 11.1	\$ 13.5
Net realized and unrealized gains (losses) on derivatives and hedging activities	2.3	4.7	3.3	10.3
Net gains (losses) on securities held at fair value	-	(0.3)	-	(0.3)
Total	<u>\$ 0.1</u>	<u>\$ 9.0</u>	<u>\$ 14.4</u>	<u>\$ 23.5</u>
<u>Nine Months Ended September 30, 2003</u>	<u>Advances</u>	<u>Mortgage Assets</u>	<u>Consolidated Bonds</u>	<u>Total</u>
Amortization/accretion of hedging activities in net margin	\$ (1.9)	\$ 12.2	\$ 39.1	\$ 49.4
Net realized and unrealized (losses) gains on derivatives and hedging activities	5.1	(4.0)	(1.0)	0.1
Net gains (losses) on securities held at fair value	-	(1.2)	-	(1.2)
Total	<u>\$ 3.2</u>	<u>\$ 7.0</u>	<u>\$ 38.1</u>	<u>\$ 48.3</u>

Consolidated obligation amortization/accretion income (expense) results from the amortization of fees received on interest rate swaps hedging consolidated obligations and basis adjustments on consolidated obligations. Basis adjustments are recorded when a hedge relationship terminates or becomes ineffective. We terminated certain debt hedge relationships to manage our duration gap throughout 2003 and 2004.

Consolidated obligation amortization/accretion income decreased in 2004 primarily because we recognized more income in 2003 from basis adjustments on terminated hedge relationships. As of September 30, 2004, without considering the impact of future basis adjustments created, we expect to generate more interest expense than income from such basis adjustments for the remainder of the year.

Mortgage loan amortization/accretion income decreased in 2004 primarily because we terminated certain interest rate swaps and established new hedge relationships with mortgage loans to adjust prepayment protection in 2004. Basis adjustments created through the termination of the interest rate swaps accrete to income over the estimated lives of the related mortgage loans. We offset much of this impact with upfront cash payments on interest rate swaps which are amortized over the life of the hedged loans to net interest income. See further discussion of hedging mortgage loans with interest rate swaps in “Statements of Condition—Mortgage Loans” beginning on page 18.

Liquidity Risk

Liquidity risk is the risk that we will be unable to meet our obligations as they come due or meet the credit needs of our members and housing associates in a timely and cost efficient manner. Day to day and contingency liquidity objectives are designed to protect our financial strength and to allow us to withstand market disruption. To achieve these objectives, we establish liquidity management requirements and maintain liquidity in accordance with Finance Board regulations and our own liquidity policy. For information on how we manage liquidity risk, see page 68 of the Bank's 2003 annual report.

Credit Risk

We define credit risk as the potential that our borrowers or counterparties will fail to meet their obligations in accordance with agreed upon terms. The Bank's primary credit risks arise from our ongoing lending, investing, and hedging activities. Our overall objective in managing credit risk is to operate a sound credit granting process and to maintain appropriate credit administration, measurement, and monitoring practices.

Advances. We engage in secured lending activities with eligible borrowers. Credit risk arises from the possibility that, in the event a borrower defaults on its obligation to the Bank, the collateral pledged to us is insufficient to cover its obligation.

For information on how we manage advance credit risk, see page 69 of the Bank's 2003 annual report. As of September 30, 2004, four borrowers had outstanding advances greater than \$1 billion. These advance holdings represented approximately 33 percent of the total par value of advances outstanding at September 30, 2004. As of December 31, 2003, two borrowers had outstanding advances greater than \$1 billion. Those advance holdings represented approximately 26 percent of the total par value of advances outstanding at December 31, 2003.

We assign discounted values to collateral pledged to the Bank based on its relative risk. As of September 30, 2004, borrowers reported \$47 billion of collateral (net of applicable discount or margin factors) to support \$27 billion of advances and other activities with the Bank. Borrowers report collateral in excess of their collateral requirement mainly to demonstrate liquidity and to borrow in the future.

The following table shows the dollar and percentage composition (net of applicable discount and margin factors) of collateral pledged to the Bank as of September 30, 2004 and December 31, 2003 (dollars in billions):

Collateral Type	September 30, 2004		December 31, 2003	
	Dollars	Percent	Dollars	Percent
Residential mortgage loans	\$ 28.4	60.0	\$ 32.4	67.2
Other real estate related collateral	11.8	24.9	9.5	19.6
Investment securities/insured loans	6.6	14.0	6.0	12.4
Secured small business, small farm, and small agribusiness loans	0.5	1.1	0.4	0.8

Mortgage Assets. We invest in mortgage-backed securities that are issued or guaranteed by government-sponsored housing enterprises and other mortgage-backed securities; the United States government does not guarantee securities issued by government-sponsored enterprises. We also invest in other mortgage-backed securities that are rated AAA or AA by one of the nationally recognized statistical rating organizations. We are exposed to credit risk to the extent the credit enhancement structures fail to perform adequately. We do ongoing analysis to evaluate the investments and creditworthiness of the issuers, trustees, and servicers for potential credit issues. As of September 30, 2004, we owned \$3.3 billion of mortgage-backed securities rated AAA that were issued or guaranteed by government-sponsored housing enterprises. In addition, we had \$495 million of other mortgage-backed securities; \$492 million rated AAA and \$3 million rated AA by a nationally recognized statistical rating organization.

The Bank also invests in state housing finance agency bonds. As of September 30, 2004, we had \$10.5 million of state agency bonds rated AA or higher.

The Bank acquires mortgage loans from participating members through the MPF program. For information on how we manage credit risk for mortgage loans, see page 71 of the Bank's 2003 annual report. Our MPF portfolio totaled \$15.3 billion par value at September 30, 2004. The portfolio consisted of approximately 94 percent conventional loans and 6 percent government-insured loans. Because our participating members are required to repurchase any government-insured loan from the Bank that is 90 days or more past due, our credit risk is minimal on that segment of the portfolio. The following table summarizes portfolio characteristics of the conventional loan portfolio at September 30, 2004 and December 31, 2003. Portfolio concentrations are calculated based on unpaid principal balances.

Portfolio Characteristics	September 30, 2004	December 31, 2003
Regional concentration ¹		
Midwest	32.1%	31.9%
West	22.2%	22.7%
Southeast	17.3%	17.5%
Southwest	15.1%	14.6%
Northeast	13.3%	13.3%
State concentration		
Minnesota	12.1%	12.1%
California	11.6%	12.1%
Illinois	6.2%	6.6%
Florida	4.2%	4.3%
Washington	4.1%	4.1%
Weighted average FICO® score at funding ²	730	729
Weighted average loan to value at funding	69%	69%
Average loan amount at funding	\$ 161,666	\$ 162,280
Original loan term		
Less than or equal to 15 years	28%	29%
Greater than 15 years	72%	71%

¹ Midwest includes IA, IL, IN, MI, MN, ND, NE, OH, SD, and WI.

West includes AK, CA, Guam, HI, ID, MT, NV, OR, WA, and WY.

Southeast includes AL, District of Columbia, FL, GA, KY, MD, MS, NC, SC, TN, VA and WV.

Southwest includes AR, AZ, CO, KS, LA, MO, NM, OK, TX, and UT.

Northeast includes CT, DE, MA, ME, NH, NJ, NY, PA, Puerto Rico, RI, U.S. Virgin Islands, and VT.

² FICO® is a widely used credit-industry model developed by Fair, Isaac, and Company, Inc. to assess borrower credit quality with scores ranging from a low of 150 to a high of 950.

The allowance for credit losses on mortgage loans totaled \$5.9 million at September 30, 2004 and December 31, 2003, and \$4.9 million at September 30, 2003. Periodically, the Credit Committee reviews the adequacy of the allowance for credit losses on mortgage loans taking into consideration both quantitative and qualitative factors, including historical net charge-off levels for similar assets and adjustments for changes based on current market conditions. Management periodically reports the status of the allowance for credit losses on mortgage loans to the Board of Directors. Management believes we have policies and practices in place to manage this credit risk appropriately.

The allowance for credit losses on mortgage loans is as follows (dollars in thousands):

	Quarter Ended September 30,		Nine Months Ended September 30,	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Balance, beginning of period	\$ 5,941	\$ 3,248	\$ 5,906	\$ 3,255
Charge-offs	(15)	(6)	(98)	(20)
Recoveries	<u>13</u>	<u>-</u>	<u>13</u>	<u>-</u>
Net charge-offs	<u>(2)</u>	<u>(6)</u>	<u>(85)</u>	<u>(20)</u>
Provision for credit losses on mortgage loans	<u>-</u>	<u>1,626</u>	<u>118</u>	<u>1,633</u>
Balance, end of period	<u>\$ 5,939</u>	<u>\$ 4,868</u>	<u>\$ 5,939</u>	<u>\$ 4,868</u>

We place any conventional mortgage loan that is 90 days or more past due on nonaccrual status, meaning interest income on the loan is not accrued and any cash payments received are applied to interest income and a reduction of principal. A government-insured loan that is 90 days or more past due is not placed on nonaccrual status because participating lenders are obligated to repurchase any such loan.

We monitor the delinquency levels of our mortgage loan portfolio on a monthly basis. A summary of our delinquencies at September 30, 2004 follows (dollars in millions):

	<u>Unpaid Principal Balance</u>		
	<u>Conventional</u>	<u>Government- insured</u>	<u>Total</u>
30 days	\$ 104	\$ 35	\$ 139
60 days	15	10	25
90 days	6	3	9
Greater than 90 days	2	1	3
Foreclosures and bankruptcies	34	9	43
Total delinquencies	<u>\$ 161</u>	<u>\$ 58</u>	<u>\$ 219</u>
Total mortgage loans outstanding	<u>\$ 14,353</u>	<u>\$ 957</u>	<u>\$ 15,310</u>
Delinquencies as a percent of total mortgage loans	<u>1.1%</u>	<u>6.1%</u>	<u>1.4%</u>
Delinquencies 90 days and greater as a percent of total mortgage loans	<u>0.3%</u>	<u>1.4%</u>	<u>0.4%</u>

At December 31, 2003, delinquencies as a percentage of total mortgage loans were 1.0 percent for conventional, 7.7 percent for government-insured and 1.5 percent in total. Delinquencies 90 days and greater as a percentage of total mortgage loans at December 31, 2003 were 0.2 percent for conventional, 2.3 percent for government-insured, and 0.4 percent in total.

Investments. We maintain an investment portfolio to provide liquidity and promote asset diversification. Finance Board regulations and policies adopted by the Board of Directors limit the type of investments we may purchase.

The largest unsecured exposure to any single non-agency money market counterparty as of September 30, 2004 was \$250 million. The following table summarizes our unsecured credit exposure to investment counterparties (including accrued interest receivable) as of September 30, 2004 (dollars in millions):

Credit Rating ¹	Certificates of Deposit	Commercial Paper	Overnight Fed Funds	Term Fed Funds	U.S. Government/ Government Agency	Total
AAA	\$ -	\$ 200	\$ -	\$ -	\$ 1,313	\$ 1,513
AA	200	250	255	50	-	755
A	75	-	985	461	-	1,521
Total	<u>\$ 275</u>	<u>\$ 450</u>	<u>\$ 1,240</u>	<u>\$ 511</u>	<u>\$ 1,313</u>	<u>\$ 3,789</u>

¹ Credit rating is the lowest of Standard & Poor's, Moody's, and Fitch, Inc. ratings stated in terms of the Standard & Poor's equivalent.

This compares to total unsecured investment exposure of \$2.4 billion at December 31, 2003. Our unsecured investment portfolio had a credit rating of A or higher at September 30, 2004 and at December 31, 2003.

Derivatives. Most of our hedging strategies use over-the-counter derivative instruments that expose us to counterparty credit risk because the transactions are executed and settled between two parties. When the over-the-counter derivative has a market value above zero, the counterparty owes that value to the Bank over the remaining life of the derivative instrument. Credit risk arises from the possibility the counterparty will not be able to fulfill its commitment to pay the amount owed to us. For information on how we manage the derivative counterparty credit risk, see page 74 of the Bank's 2003 annual report.

Excluding mortgage delivery commitments that are fully collateralized, we had 25 active derivative counterparties as of September 30, 2004, most of which were large highly rated banks and broker-dealers. At September 30, 2004, five counterparties represented approximately 60 percent of the total notional amount of outstanding derivative transactions, and each had a credit rating of A or better. One counterparty with a AA credit rating, UBS AG, represented approximately 75 percent of our net exposure after collateral at September 30, 2004. In addition, we had mortgage delivery commitment derivatives with notional amounts of \$61 million at September 30, 2004. Exposures for mortgage delivery commitments are offset by pair-off fees from the participating lenders.

The following table summarizes our derivative counterparty credit exposure, excluding mortgage delivery commitments, after applying netting agreements and collateral, at September 30, 2004 (dollars in millions):

<u>Credit Rating</u> ¹	<u>Active Counterparties</u>	<u>Notional Amount</u> ²	<u>Total Exposure at Fair Value</u> ³	<u>Value of Collateral Pledged</u>	<u>Exposure Net of Collateral</u> ⁴
AAA	3	\$ 2,970	\$ -	\$ -	\$ -
AA	13	26,880	13	-	13
A	9	27,275	9	5	4
Total	25	\$ 57,125	\$ 22	\$ 5	\$ 17

¹ Credit rating is the lower of the Standard & Poor's and Moody's ratings stated in terms of a Standard & Poor's equivalent.

² Notional amounts serve as a factor in determining periodic amounts to be received and paid and generally do not represent actual amounts to be exchanged or directly reflect our exposure to institutional credit risk.

³ For each counterparty, this amount includes derivatives with a net positive market value including the related accrued interest receivable/payable (net).

⁴ Amount equals "Total Exposure at Fair Value" less "Value of Collateral Pledged" as determined at the counterparty level.

At December 31, 2003, we had \$52.7 billion in notional amount outstanding with 24 counterparties. Of these counterparties, three were rated AAA, 12 were rated AA, and nine were rated A. The total exposure at fair value was \$43 million and exposure net of collateral was \$23 million.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems, or external events. Operational risk is inherent in all of our business activities and processes. Management has established extensive policies and procedures to reduce the likelihood of operational risk and designed our annual risk assessment process to provide ongoing identification, measurement, and monitoring of operational risk. For additional information on operational risk, see page 76 of the Bank's 2003 annual report.

Factors That May Affect Future Results

Actual results may differ from forward-looking statements for many reasons, including, but not limited to:

- economic and market conditions, including changes in interest rates that affect the housing market
- our exposure to market, liquidity, credit, and operations risk and our ability to effectively hedge or manage those risks
- demand for our advances resulting from changes in our members' deposit flows and credit demands
- volatility of market prices, rates, and indices or other factors that could affect the value of investments or collateral we hold as security for the obligations of our borrowers and counterparties to derivatives and other contracts, which could result from the effects of, and changes in, various monetary or fiscal policies and regulations, including those determined by the Federal Reserve Board and the Federal Deposit Insurance Corporation
- political events, including legislative, regulatory, judicial, or other developments that affect us, our members, our regulator, counterparties and/or investors in the consolidated obligations of the Bank System such as changes in the Federal Home Loan Bank Act or Finance Board regulations that affect FHLBank operations and regulatory oversight
- competitive forces, including without limitation: continued consolidation and merger activity in the financial services industry, other sources of funding available to our members, other entities borrowing funds in the capital markets, competitive pressure in the secondary mortgage market and the ability to attract and retain skilled individuals
- technology, information systems and models sufficient to quantify the risks of our business effectively
- changes in investor demand for consolidated obligations and/or derivatives, including without limitation changes in the relative attractiveness of consolidated obligations compared to other investment opportunities
- our ability to introduce new products and services and successfully manage the risks associated with those products and services, including new types of collateral securing advances and new acquired member asset programs
- risk of loss arising from litigation filed against one or more of the FHLBanks
- risk that we may become liable for a portion of the consolidated obligations of other FHLBanks
- the effects of inflation or deflation
- changes in accounting standards and practices and application of such new standards and practices to the manner in which we conduct our business

There can be no assurance that other factors we have not anticipated will materially and adversely affect our results of operations. You are cautioned not to place undue reliance on any forward-looking statements made by us or on our behalf. Forward-looking statements speak only as of the date the statement was made. We undertake no obligation to update or revise any forward-looking statement.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Management’s Discussion and Analysis of Results of Operations and Financial Condition—Market Risk” beginning on page 31 and the sections referenced therein for Quantitative and Qualitative Disclosures about Market Risk.

FEDERAL HOME LOAN BANK OF DES MOINES
STATEMENTS OF CONDITION
(In thousands, except shares)

	September 30, 2004 <u>(Unaudited)</u>	December 31, 2003 <u></u>
ASSETS		
Cash and due from banks	\$ 59,372	\$ 57,118
Interest-bearing deposits	442,220	281,228
Securities purchased under agreements to resell	305,000	305,000
Federal funds sold	1,750,000	1,200,000
Investments:		
Held-to-maturity securities, includes \$303,023 pledged at September 30, 2004 and \$98,641 pledged at December 31, 2003 (Note 4)	4,443,284	2,155,291
Available-for-sale securities, includes \$217,511 pledged at September 30, 2004 and \$407,515 pledged at December 31, 2003	1,067,104	1,546,215
Securities held at fair value	21,082	36,048
Advances (Note 5)	26,774,807	23,302,586
Mortgage loans held for portfolio, net of allowance for credit losses on mortgage loans of \$5,939 at September 30, 2004 and \$5,906 at December 31, 2003	15,329,848	15,998,742
Accrued interest receivable	104,298	97,469
Premises and equipment, net	1,132	2,233
Derivative assets	21,962	43,070
Other assets	19,750	26,001
Total assets	<u>\$ 50,339,859</u>	<u>\$ 45,051,001</u>
LIABILITIES AND CAPITAL		
LIABILITIES:		
Deposits:		
Demand and overnight	\$ 822,244	\$ 968,482
Term	7,670	33,570
Total deposits	<u>829,914</u>	<u>1,002,052</u>
Securities sold under agreements to repurchase	500,000	500,000
Consolidated obligations, net:		
Discount notes	6,065,672	5,472,370
Bonds	39,702,345	34,880,030
Total consolidated obligations	<u>45,768,017</u>	<u>40,352,400</u>
Accrued interest payable	267,829	248,507
Affordable Housing Program	26,374	24,342
Payable to REFCORP	4,044	5,182
Derivative liabilities	523,532	691,785
Other liabilities	25,562	19,595
Total liabilities	<u>47,945,272</u>	<u>42,843,863</u>
Commitments and contingencies (Notes 7 and 8)		
CAPITAL:		
Capital stock—Class B (\$100 par value) issued and outstanding:		
22,771,875 at September 30, 2004 and 21,165,002 at December 31, 2003	2,277,187	2,116,500
Retained earnings	122,227	90,943
Accumulated other comprehensive income (loss):		
Net unrealized (loss) gain on available-for-sale securities	(4,311)	31
Net unrealized loss relating to hedging activities	(516)	(336)
Total capital	<u>2,394,587</u>	<u>2,207,138</u>
Total liabilities and capital	<u>\$ 50,339,859</u>	<u>\$ 45,051,001</u>

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

FEDERAL HOME LOAN BANK OF DES MOINES
STATEMENTS OF INCOME
(In thousands)
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
INTEREST INCOME:				
Advances	\$ 130,029	\$ 110,481	\$ 337,781	\$ 357,893
Interest-bearing deposits	1,740	889	3,035	4,346
Securities purchased under agreements to resell	1,137	803	2,728	2,422
Federal funds sold	7,689	6,827	17,248	29,916
Investments:				
Held-to-maturity securities	30,524	22,951	60,707	91,308
Available-for-sale securities	5,147	2,608	13,930	8,413
Securities held at fair value	313	723	1,247	2,627
Mortgage loans held for portfolio	89,663	91,834	282,893	243,875
Loans to other FHLBanks	-	75	23	282
Total interest income	<u>266,242</u>	<u>237,191</u>	<u>719,592</u>	<u>741,082</u>
INTEREST EXPENSE:				
Consolidated obligations	234,028	194,196	619,273	619,997
Deposits	2,739	3,105	8,296	12,271
Borrowings from other FHLBanks	-	683	3	2,059
Securities sold under agreements to repurchase	2,646	2,162	6,931	6,160
Other borrowings	43	12	52	26
Total interest expense	<u>239,456</u>	<u>200,158</u>	<u>634,555</u>	<u>640,513</u>
NET INTEREST INCOME BEFORE PROVISION FOR CREDIT LOSSES ON MORTGAGE LOANS				
	26,786	37,033	85,037	100,569
Provision for credit losses on mortgage loans	<u>-</u>	<u>(1,626)</u>	<u>(118)</u>	<u>(1,633)</u>
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES ON MORTGAGE LOANS				
	<u>26,786</u>	<u>35,407</u>	<u>84,919</u>	<u>98,936</u>
OTHER INCOME (LOSS):				
Prepayment fees, net	68	13,035	403	18,996
Service fees	542	297	1,652	1,510
Net realized (loss) gain on held-to-maturity securities (Note 4)	(2)	-	4,029	-
Net realized gain on available-for-sale securities	1,381	-	3,845	-
Net gain (loss) on securities held at fair value	207	(785)	(292)	(1,192)
Net realized and unrealized gain on derivatives and hedging activities	361	7,549	10,321	86
Other, net	967	740	3,818	2,298
Total other income	<u>3,524</u>	<u>20,836</u>	<u>23,776</u>	<u>21,698</u>
OTHER EXPENSE:				
Operating	7,282	5,661	21,090	17,190
Finance Board	394	335	1,182	1,006
Office of Finance	206	206	707	678
Total other expense	<u>7,882</u>	<u>6,202</u>	<u>22,979</u>	<u>18,874</u>
INCOME BEFORE ASSESSMENTS				
	<u>22,428</u>	<u>50,041</u>	<u>85,716</u>	<u>101,760</u>
Affordable Housing Program	1,831	4,085	6,997	8,307
REFCORP	4,119	9,192	15,744	18,691
Total assessments	<u>5,950</u>	<u>13,277</u>	<u>22,741</u>	<u>26,998</u>
NET INCOME	<u>\$ 16,478</u>	<u>\$ 36,764</u>	<u>\$ 62,975</u>	<u>\$ 74,762</u>

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

FEDERAL HOME LOAN BANK OF DES MOINES
STATEMENT OF CHANGES IN CAPITAL
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004
(In thousands)
(Unaudited)

	Capital Stock Class B		Capital Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Capital
	Shares	Par Value	Shares	Par Value			
BALANCE, DECEMBER 31, 2003	<u>21,165</u>	<u>\$ 2,116,500</u>	<u>-</u>	<u>\$ -</u>	<u>\$ 90,943</u>	<u>\$ (305)</u>	<u>\$ 2,207,138</u>
Proceeds from issuance of capital stock	5,693	569,256	-	-	-	-	569,256
Redemption of capital stock	(4,086)	(408,569)	-	-	-	-	(408,569)
Comprehensive income:							
Net income	-	-	-	-	62,975	-	62,975
Other comprehensive income:							
Net realized and unrealized loss on available-for-sale securities	-	-	-	-	-	(497)	(497)
Reclassification adjustment for gain included in net income relating to available-for-sale securities	-	-	-	-	-	(3,845)	(3,845)
Net unrealized loss relating to hedging activities	-	-	-	-	-	(244)	(244)
Reclassification adjustment for loss included in net income relating to hedging activities	-	-	-	-	-	64	64
Total comprehensive income (loss)	-	-	-	-	62,975	(4,522)	58,453
Cash dividends on capital stock	-	-	-	-	(31,691)	-	(31,691)
BALANCE, SEPTEMBER 30, 2004	<u>22,772</u>	<u>\$ 2,277,187</u>	<u>-</u>	<u>\$ -</u>	<u>\$ 122,227</u>	<u>\$ (4,827)</u>	<u>\$ 2,394,587</u>

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

FEDERAL HOME LOAN BANK OF DES MOINES
STATEMENT OF CHANGES IN CAPITAL
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003
(In thousands)
(Unaudited)

	Capital Stock Class B		Capital Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Capital
	Shares	Par Value	Shares	Par Value			
BALANCE, DECEMBER 31, 2002	-	\$ -	18,582	\$ 1,858,180	\$ 50,130	\$ (3,370)	\$ 1,904,940
Proceeds from issuance of capital stock	3,639	363,904	4,086	408,637	-	-	772,541
Redemption of capital stock	(2,110)	(211,023)	(4,195)	(419,479)	-	-	(630,502)
Comprehensive income:							
Net income	-	-	-	-	74,762	-	74,762
Other comprehensive income:							
Net unrealized gain on available-for-sale securities	-	-	-	-	-	3,590	3,590
Net unrealized loss relating to hedging activities	-	-	-	-	-	(293)	(293)
Reclassification adjustment for loss included in net income relating to hedging activities	-	-	-	-	-	12	12
Total comprehensive income	-	-	-	-	74,762	3,309	78,071
Conversion to Class B shares	18,473	1,847,338	(18,473)	(1,847,338)	-	-	-
Cash dividends on capital stock	-	-	-	-	(42,019)	-	(42,019)
BALANCE, SEPTEMBER 30, 2003	<u>20,002</u>	<u>\$ 2,000,219</u>	<u>-</u>	<u>\$ -</u>	<u>\$ 82,873</u>	<u>\$ (61)</u>	<u>\$ 2,083,031</u>

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

FEDERAL HOME LOAN BANK OF DES MOINES
STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	<u>2004</u>	<u>2003</u>
OPERATING ACTIVITIES:		
Net income	\$ 62,975	\$ 74,762
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization:		
Net premiums and discounts on consolidated obligations, investments, mortgage loans, and fees received on derivatives	(5,774)	(134,767)
Concessions on consolidated obligation bonds	16,208	25,239
Net deferred loss on derivatives	-	509
Premises and equipment	283	406
Other	(631)	(417)
Provision for credit losses on mortgage loans held for portfolio	118	1,633
Net realized gain on sale of held-to-maturity securities	(4,029)	-
Net realized gain on sale of available-for-sale securities	(3,845)	-
Decrease in securities held at fair value	14,966	23,486
Net change in fair-value adjustment on derivatives and hedging activities	(62,343)	(18,535)
Net realized gain on disposal of premises and equipment	(1,173)	(227)
Increase in accrued interest receivable	(6,829)	(12,981)
Decrease in derivative asset accrued interest	2,685	32,391
(Decrease) increase in derivative liability accrued interest	(45,098)	46,440
Increase in other assets	(9,957)	(25,805)
Net increase in Affordable Housing Program (AHP) liability and discount on AHP advances	1,974	4,013
Increase (decrease) in accrued interest payable	19,322	(15,859)
(Decrease) increase in payable to REFCORP	(1,138)	5,098
Increase in other liabilities	<u>5,967</u>	<u>10,317</u>
Total adjustments	<u>(79,294)</u>	<u>(59,059)</u>
Net cash (used in) provided by operating activities	<u>(16,319)</u>	<u>15,703</u>

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

FEDERAL HOME LOAN BANK OF DES MOINES
STATEMENTS OF CASH FLOWS (Continued from previous page)
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2004	2003
INVESTING ACTIVITIES:		
Net (increase) decrease in interest-bearing deposits	(160,992)	181,528
Net increase in securities purchased under agreements to resell	-	(305,000)
Net (increase) decrease in federal funds sold	(550,000)	4,256,000
Net (increase) decrease in short-term held-to-maturity securities	(1,157,561)	1,181,604
Proceeds from sales of long-term held-to-maturity securities	99,512	-
Proceeds from maturities of long-term held-to-maturity securities	753,961	2,193,880
Purchases of long-term held-to-maturity securities	(1,969,886)	(856,430)
Proceeds from the sale of available-for-sale securities	517,013	-
Purchases of available-for-sale securities	(48,701)	(170,605)
Principal collected on advances	52,775,112	37,614,253
Advances made	(56,399,435)	(37,004,455)
Principal collected on mortgage loans held for portfolio	2,087,318	2,919,281
Mortgage loans held for portfolio originated or purchased	(1,388,020)	(10,912,007)
Recoveries on mortgage loans held for portfolio	13	-
Net decrease in premises and equipment	1,991	4,213
	<u>(5,439,675)</u>	<u>(897,738)</u>
FINANCING ACTIVITIES:		
Net decrease in deposits	(172,138)	(203,283)
Proceeds from issuance of securities sold under agreements to repurchase	-	200,000
Net proceeds from issuance of consolidated obligations:		
Discount notes	193,924,137	327,883,776
Bonds	17,631,734	30,944,970
Payments for maturing and retiring consolidated obligations:		
Discount notes	(193,338,761)	(327,722,929)
Bonds	(12,715,720)	(30,295,102)
Proceeds from issuance of capital stock	569,256	772,541
Payments for redemption of capital stock	(408,569)	(630,502)
Cash dividends paid	(31,691)	(42,019)
	<u>5,458,248</u>	<u>907,452</u>
Net increase in cash and cash equivalents	2,254	25,417
Cash and cash equivalents at beginning of the year	<u>57,118</u>	<u>102,741</u>
Cash and cash equivalents at end of the period	<u>\$ 59,372</u>	<u>\$ 128,158</u>
Supplemental Disclosures:		
Cash paid during the period for:		
Interest	\$ 647,865	\$ 706,392
Affordable Housing Program	4,965	4,184
REFCORP	16,882	13,593

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

FEDERAL HOME LOAN BANK OF DES MOINES

CONDENSED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

Note 1—Basis of Presentation

The accompanying unaudited financial statements for the nine months ended September 30, 2004, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, they do not include all of the information required by GAAP and should be read in conjunction with the audited financial statements for the year ended December 31, 2003, which are contained in the Bank's 2003 annual report.

Descriptions of the significant accounting policies of the Bank are included in Note 1 (Summary of Significant Accounting Policies) to the financial statements in the Bank's 2003 annual report.

Reclassifications. Certain amounts in the 2003 quarterly financial statements have been reclassified to conform to the third quarter 2004 presentation.

Restatement of Financial Statements. Subsequent to the third quarter of 2003 a correction was made to prepayment fees of \$2,926,000. Third quarter 2003 results have been adjusted for that correction.

The results of operations for the interim periods are not necessarily indicative of results to be expected for the year ended December 31, 2004.

Note 2—Recently Issued Accounting Pronouncements

Statement of Financial Accounting Standards (SFAS) 150. In May 2003, the Financial Accounting Standards Board (FASB) issued Statement No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (SFAS 150), which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Restatement is not permitted. For nonpublic entities, mandatorily redeemable financial instruments are subject to the provisions of this Statement for the first fiscal period beginning after December 15, 2004. The Bank will adopt SFAS 150 on January 1, 2005 and is currently in the process of assessing the impact of SFAS 150 on its financial statements.

Emerging Issues Task Force Issue (EITF) 03-1. In March 2004, the FASB reached a consensus on *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-1)*, which clarifies the application of an impairment model to determine whether investments are other-than-temporarily impaired. The provisions of this rule are required to be applied prospectively to all current and future investments accounted for in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. On September 15, 2004, the FASB issued proposed FASB Staff Position (FSP) on *Implementation Guidance for the Application of Paragraph 16 of EITF 03-1*, (FSP EITF 03-1-a) to provide guidance on the application of paragraph 16 of EITF 03-1 to debt securities that are impaired because of interest rate and/or sector spread increases. On September 30, 2004, the FASB issued an FSP on the *Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1 "The Meaning of Other-Than Temporary Impairment and Its Application to Certain Investments"* (FSP EITF 03-1-1), which deferred the effective date of the impairment measurement and recognition provisions contained in specific paragraphs of EITF 03-1 and expanded the scope of proposed FSP EITF 03-1-a to include all securities, not only debt securities. The comment period for proposed FSP EITF 03-1-a ended on October 29, 2004. The deferral of the effective date for paragraphs 10-20 of EITF 03-1 as reported in FSP EITF 03-1-1 will be superseded concurrent with the final issuance of proposed FSP EITF Issue 03-1-a. The Bank does not expect the new rules to have a material impact on our results of operations at the time of adoption.

Note 3—Accounting Adjustments

During the second quarter of 2004, the Bank changed its manner of assessing effectiveness for certain highly effective hedging relationship transactions used since the adoption of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) on January 1, 2001. Under the prior approach, the Bank assumed no ineffectiveness in these hedging transactions while under the new approach the Bank will measure effectiveness at least quarterly. If the Bank had made this change in prior periods with respect to which the adjustments reflected by this change were measured, this change would not have been material to the results of operations or financial condition of the Bank for any of these prior reporting periods. The Bank recorded an increase of \$2,253,000 to income before assessments included in other income in *net realized and unrealized gains (losses) on derivatives and hedging activities* in the second quarter of 2004. This change reflects the accounting as if the Bank had employed the new approach from the date of adoption of SFAS 133 until its implementation of the new approach.

Note 4—Held-to-Maturity Securities

The Bank sold certain securities out of its held-to-maturity portfolio in the first nine months of 2004. The mortgage-backed securities sold had less than 15 percent of the acquired principal outstanding and the commercial paper sold occurred near enough to its maturity date that changes in market interest rates would not have a significant effect on the security's fair value. In accordance with GAAP, such sales are considered maturities for the purposes of security classification. The Bank recognized a gain of \$4,029,000 in other income on the sale and call of held-to-maturity securities in the first nine months of 2004.

Note 5—Advances

Redemption Terms. At September 30, 2004 and December 31, 2003, the Bank had advances outstanding, as summarized below (dollars in thousands):

<u>Year of Maturity</u>	<u>September 30, 2004</u>		<u>December 31, 2003</u>	
	<u>Amount</u>	<u>Weighted Average Interest Rate</u>	<u>Amount</u>	<u>Weighted Average Interest Rate</u>
Due in one year or less	\$10,593,317	2.04%	\$ 5,018,997	1.85%
Due after one year through two years	2,326,389	3.37	2,549,496	2.48
Due after two years through three years	1,562,033	3.53	2,469,964	2.55
Due after three years through four years	2,631,256	4.63	1,040,049	3.67
Due after four years through five years	1,380,047	4.70	3,761,443	3.82
Thereafter	<u>7,805,759</u>	3.86	<u>7,834,489</u>	3.98
Total par value	26,298,801	3.19	22,674,438	3.14
Unamortized commitment fees	(10)		(36)	
Discounts on AHP advances	(195)		(253)	
Premiums on advances	741		858	
Discounts on advances	(226)		(278)	
Hedging fair-value adjustments	<u>475,696</u>		<u>627,857</u>	
Total	<u>\$26,774,807</u>		<u>\$23,302,586</u>	

The Bank offers callable advances to members that may be prepaid on pertinent dates (call dates) without incurring prepayment fees. Other advances may only be prepaid by paying a fee to the Bank (prepayment fee) that makes the Bank financially indifferent to the prepayment of the advance. At September 30, 2004 and December 31, 2003, the Bank had callable advances of \$394,223,000 and \$555,058,000.

The following table summarizes advances at September 30, 2004 and December 31, 2003, by year of maturity or next call date for callable advances (dollars in thousands):

<u>Year of Maturity or Next Call Date</u>	<u>September 30, 2004</u>	<u>December 31, 2003</u>
Due in one year or less	\$ 10,627,818	\$ 5,219,443
Due after one year through two years	2,401,966	2,567,798
Due after two years through three years	1,666,135	2,588,846
Due after three years through four years	2,771,055	1,141,920
Due after four years through five years	1,420,291	3,876,999
Thereafter	<u>7,411,536</u>	<u>7,279,432</u>
Total par value	<u>\$ 26,298,801</u>	<u>\$ 22,674,438</u>

The Bank also offers fixed-rate convertible advances. With a convertible advance, the Bank effectively purchases a put option from the borrower that allows the Bank to terminate the fixed-rate advance on pertinent dates (put dates). Terminations normally occur when interest rates increase and borrowers have the ability to convert the terminated advance to any available advance product at the then current rate. At September 30, 2004 and December 31, 2003, the Bank had convertible advances outstanding totaling \$5,730,550,000 and \$8,788,550,000.

The following table summarizes advances at September 30, 2004 and December 31, 2003, by year of maturity or next put date for fixed-rate convertible advances (dollars in thousands):

<u>Year of Maturity or Next Put Date</u>	<u>September 30, 2004</u>	<u>December 31, 2003</u>
Due in one year or less	\$ 15,704,167	\$ 13,308,347
Due after one year through two years	2,432,089	1,576,996
Due after two years through three years	1,771,533	1,488,664
Due after three years through four years	1,111,256	1,063,549
Due after four years through five years	553,047	704,343
Thereafter	<u>4,726,709</u>	<u>4,532,539</u>
Total par value	<u>\$ 26,298,801</u>	<u>\$ 22,674,438</u>

Interest-rate Payment Terms. The following table details additional interest-rate payment terms for advances at September 30, 2004 and December 31, 2003 (dollars in thousands):

	September 30, 2004	December 31, 2003
Par amount of advances:		
Fixed rate	\$ 18,181,783	\$ 18,775,209
Variable rate	<u>8,117,018</u>	<u>3,899,229</u>
Total	<u>\$ 26,298,801</u>	<u>\$ 22,674,438</u>

Note 6—Segment Information

The Bank has identified two main operating segments for internal reporting purposes: Member Finance and Mortgage Finance. The products and services provided reflect the manner in which financial information is evaluated by management.

The Member Finance segment includes products such as advances, investments (excluding mortgage-backed securities), and their related funding and hedging. Income from the Member Finance segment is derived primarily from the difference, or spread, between the yield on advances and investments and the borrowing and hedging costs related to those assets.

The Mortgage Finance segment includes mortgage loans acquired through the Mortgage Partnership Finance® (MPF®, “Mortgage Partnership Finance” and “MPF” are registered trademarks of the Federal Home Loan Bank of Chicago) program, mortgage-backed securities, and their related funding and hedging. Income from the Mortgage Finance segment is derived primarily from the difference, or spread, between the yield on mortgage loans and mortgage-backed securities and the borrowing and hedging costs related to those assets.

Each segment also earns income from invested capital. The Bank allocates invested capital to the Mortgage Finance segment based on its average asset size and the remaining capital is then allocated to Member Finance.

The following table details the Bank's financial performance by operating segment for the three months ended September 30, 2004 and 2003 (dollars in thousands):

<u>Three months ended September 30,</u>	<u>Member Finance</u>	<u>Mortgage Finance</u>	<u>Total</u>
2004:			
Net interest income	\$ 17,468	\$ 9,318	\$ 26,786
Provision for credit losses on mortgage loans	<u>-</u>	<u>-</u>	<u>-</u>
Net interest income after provision for credit losses on mortgage loans	<u>\$ 17,468</u>	<u>\$ 9,318</u>	<u>\$ 26,786</u>
Average assets	\$31,455,433	\$18,454,290	\$49,909,723
Total assets at period end	\$31,271,538	\$19,068,321	\$50,339,859
2003:			
Net interest income	\$ 17,152	\$ 19,881	\$ 37,033
Provision for credit losses on mortgage loans	<u>-</u>	<u>(1,626)</u>	<u>(1,626)</u>
Net interest income after provision for credit losses on mortgage loans	<u>\$ 17,152</u>	<u>\$ 18,255</u>	<u>\$ 35,407</u>
Average assets	\$28,110,164	\$14,672,209	\$42,782,373
Total assets at period end	\$26,592,200	\$16,369,380	\$42,961,580

The following table details the Bank's financial performance by operating segment for the nine months ended September 30, 2004 and 2003 (dollars in thousands):

<u>Nine months ended September 30,</u>	<u>Member Finance</u>	<u>Mortgage Finance</u>	<u>Total</u>
2004:			
Net interest income	\$ 52,098	\$ 32,939	\$ 85,037
Provision for credit losses on mortgage loans	<u>-</u>	<u>(118)</u>	<u>(118)</u>
Net interest income after provision for credit losses on mortgage loans	<u>\$ 52,098</u>	<u>\$ 32,821</u>	<u>\$ 84,919</u>
Average assets	\$29,801,703	\$18,196,592	\$47,998,295
Total assets at period end	\$31,271,538	\$19,068,321	\$50,339,859
2003:			
Net interest income	\$ 55,503	\$ 45,066	\$ 100,569
Provision for credit losses on mortgage loans	<u>-</u>	<u>(1,633)</u>	<u>(1,633)</u>
Net interest income after provision for credit losses on mortgage loans	<u>\$ 55,503</u>	<u>\$ 43,433</u>	<u>\$ 98,936</u>
Average assets	\$29,373,774	\$11,901,595	\$41,275,369
Total assets at period end	\$26,592,200	\$16,369,380	\$42,961,580

Note 7—Derivatives

The contractual or notional amount of derivatives reflects the involvement of the Bank in the various classes of financial instruments. The notional amount of the Bank's derivatives was \$57,185,539,000 and \$52,759,011,000 at September 30, 2004 and December 31, 2003. The maximum credit exposure of the Bank is substantially less than the notional amount of derivatives.

At September 30, 2004 and December 31, 2003, the Bank's maximum credit risk was \$21,962,000 and \$43,070,000. These totals included \$16,815,000 and \$19,500,000 of net accrued interest receivable. In determining maximum credit risk, the Bank considers accrued interest receivables and payables and the legal right to offset assets and liabilities by counterparty. The Bank held cash of \$4,700,000 and \$20,000,000 as collateral at September 30, 2004 and December 31, 2003.

Management is evaluating the Bank's method of assessing hedge effectiveness for certain of the Bank's interest rate swap and mortgage loan fair value hedge relationships. In March 2003, the Bank began using interest rate swaps to hedge mortgage loans where the Bank pays fixed rates and receives variable rates, effectively converting the fixed-rate loans to a floating rate indexed to LIBOR. The interest rate swaps are designed to have amortizing notional balances that match the actual pay-down of the mortgage loans within a range of pay-down scenarios. Under this strategy, the Bank generally hedges the first 15 years of cash flows for 30-year loans and the first 10 years of cash flows for 15-year loans and the Bank is hedging the LIBOR benchmark interest rate.

Management believes the Bank has established a reasonable basis for assessing and measuring changes in fair value of the interest rate swap and the hedged item attributable to changes in LIBOR; however the Bank is currently working to evaluate if an alternative valuation method would be more appropriate. If a more appropriate method is identified and adopted, management believes these hedging relationships would continue to be considered highly effective, although our reported earnings could be more or less volatile. If management ultimately determines that an alternative valuation method is more appropriate, the Bank might be required to restate prior results to reflect a new accounting treatment. Management does not believe a restatement will be required, but there can be no assurances that a restatement of previously reported results will not be required.

Note 8—Commitments and Contingencies

The Federal Home Loan Banks (FHLBanks) have joint-and-several liability for all the consolidated obligations issued on their behalf. Accordingly, should one or more of the FHLBanks be unable to repay their participation in the consolidated obligations, each of the other FHLBanks could be called upon to repay all or part of such obligations, as determined or approved by the Federal Housing Finance Board. The Bank does not recognize a liability for its joint-and-several obligations related to other FHLBanks' consolidated obligations. The Bank has never been required to pay any consolidated obligation on behalf of another FHLBank.

There were no commitments that legally bind and unconditionally obligate the Bank for additional advances at September 30, 2004 or December 31, 2003. Commitments generally are for periods up to 12 months.

Standby letters of credit are executed on behalf of members for a fee. A standby letter of credit is a financing agreement between the Bank and its member. If the Bank is required to make payment for a beneficiary's draw, these amounts may be converted into a collateralized advance to the member. Outstanding standby letters of credit were \$1,142,565,000 and \$1,053,370,000 at September 30, 2004 and December 31, 2003. Standby letters of credit had original terms of 14 days to five years with a final expiration in 2008 at September 30, 2004. Unearned fees on standby letters of credit as well as the value of the guarantees related to standby letters of credit are recorded in *other liabilities* and amounted to \$539,000 and \$549,000 at September 30, 2004 and December 31, 2003.

Based on management's credit analyses and collateral requirements, the Bank does not deem it necessary to have any provision for credit losses on advance commitments and letters of credit. Advance commitments and letters of credit are fully collateralized throughout the life of the agreements.

Commitments which unconditionally obligate the Bank to fund/purchase mortgage loans totaled \$62,954,000 and \$46,914,000 at September 30, 2004 and December 31, 2003. Commitments are generally for periods not to exceed forty-five business days. In accordance with *SFAS 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, certain commitments entered into after June 30, 2003 were recorded as derivatives at their fair values on the statements of condition.

The Bank generally executes derivative contracts with large highly rated banks and broker-dealers and enters into bilateral collateral agreements. The Bank had cash pledged as collateral to broker-dealers of \$167,000,000 and \$281,080,000 at September 30, 2004 and December 31, 2003 for derivatives. Cash pledged as collateral is classified as *interest-bearing deposits* on the statements of condition.

The Bank has executed a lease for 20 years with Wells Fargo Financial, Inc., an affiliate of a member. Construction of the new building began in mid 2004, and the Bank expects its new headquarters to be ready for occupancy by no later than February 2007. The Bank has agreed to an annualized cost of \$20.00 per square foot for the first 10 years and \$22.00 per square foot in years 11 through 20. The Bank expects to lease approximately 40,000 square feet. A third party representative negotiated the transaction on behalf of the Bank.

Note 7 discusses other commitments and contingencies.