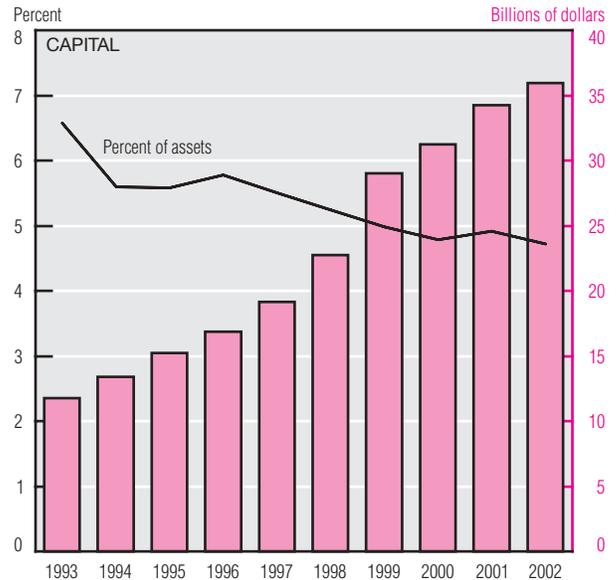
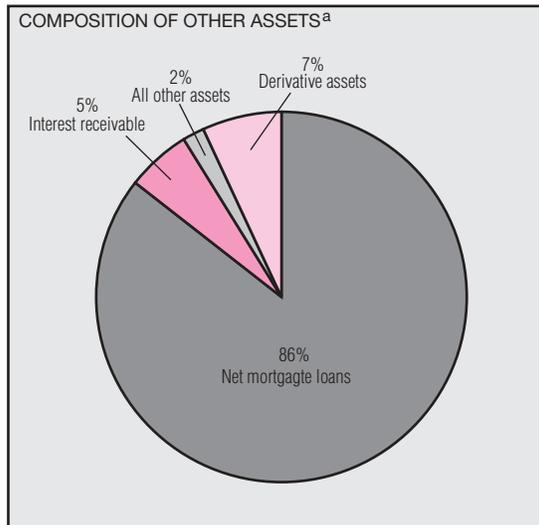
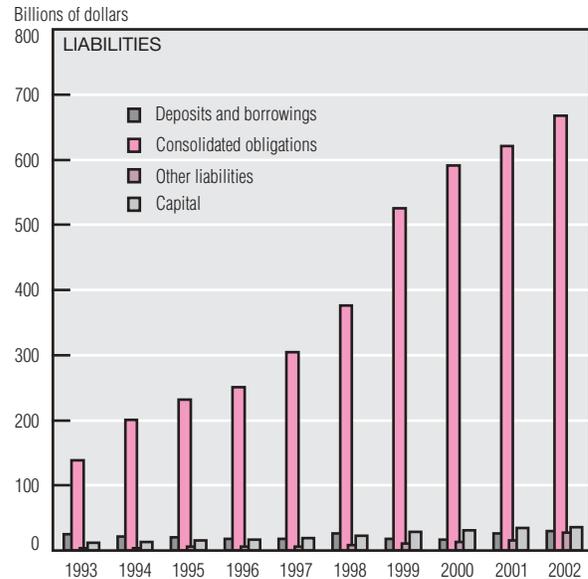
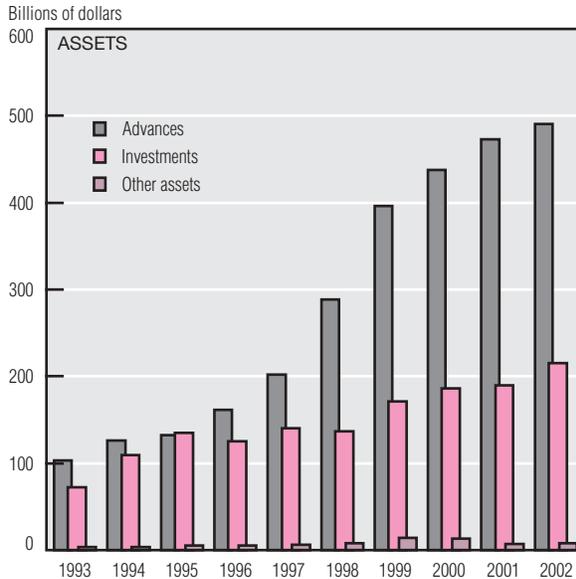


Federal Home Loan Banks



a. Data through 2002:IIIQ.
 SOURCES: Federal Home Loan Bank System, *Quarterly Financial Report*, September 30, 2002; and annual reports.

The 12 Federal Home Loan Banks (FHLBs) are stock-chartered, government-sponsored enterprises whose mission initially was to provide short-term advances to member institutions, funded with deposits from those institutions. Membership was open to specialized housing-finance lenders, mostly savings and loan associations and mutual savings banks. With continued shrinkage of their traditional clientele and the financial system's ongoing consolidation, FHLBs have been reinventing their role in financial markets. Advances—borrowings by FDIC-insured institutions from the FHLB—are an

important source of funding for member institutions' mortgage portfolios. By the end of 2002:IIIQ, advances had risen to \$490.74 billion, far outstripping all other FHLB investments and assets.

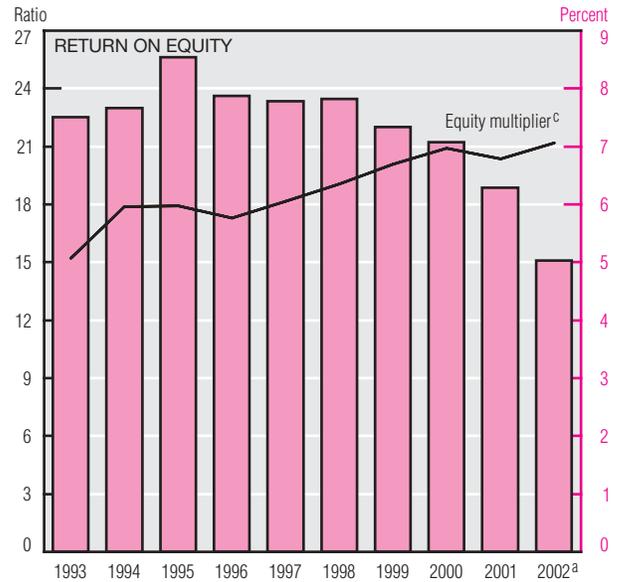
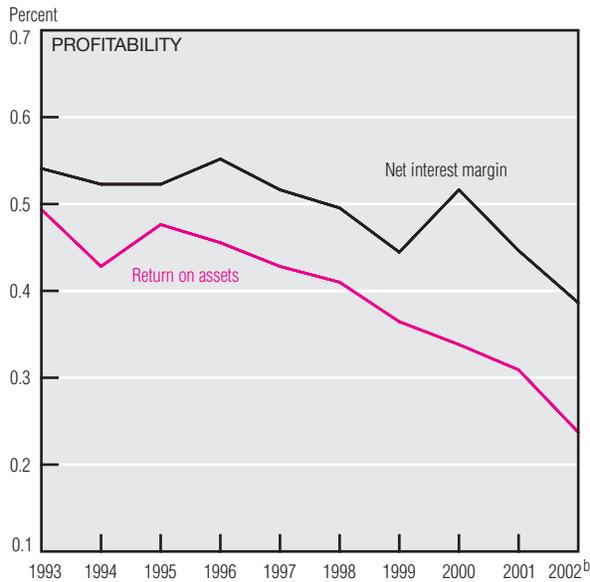
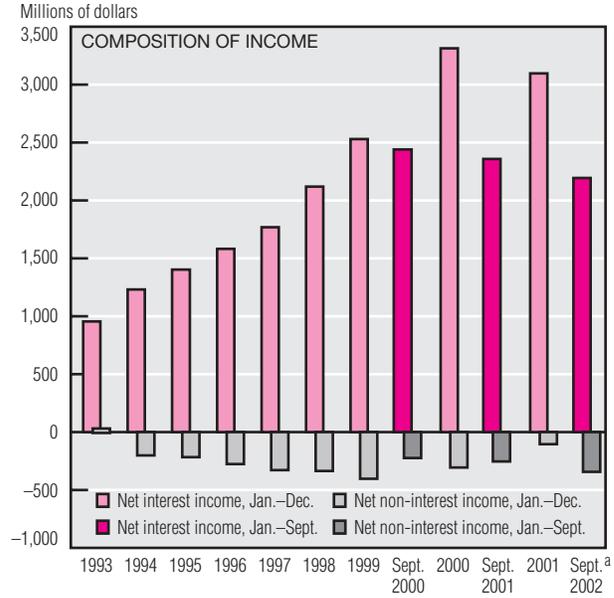
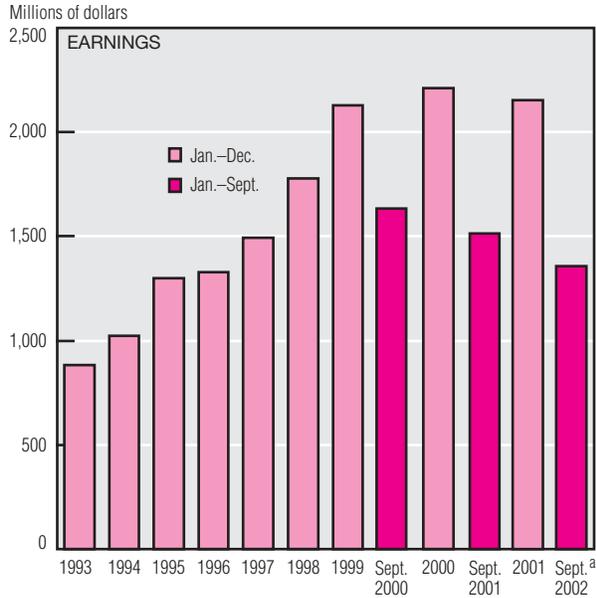
The lion's share of funding for FHLB assets came from \$667.56 billion of consolidated obligations of the Federal Home Loan Bank System—bonds issued on behalf of the 12 FHLBs collectively. The market sees these bonds as implicitly backed by the U.S. government; hence, they allow FHLBs to raise funds at lower rates of return than AAA-rated corporations. Member

institutions' deposits, short-term borrowings, and other liabilities provided only a miniscule amount of funds. FHLBs have added to their capital as they have grown. Since 1996, however, the pace of asset growth has outstripped capital growth; by the end of the 2002:IIIQ, the capital-to-asset ratio had fallen to 4.72%.

In 1997, the Federal Home Loan Bank of Chicago initiated the Mortgage Partnership Finance Program, in which nine of the 12 FHLBs participate. The 12 FHLBs currently have a combined \$47.07 billion in mortgages,

(continued on next page)

Federal Home Loan Banks (cont.)



a. Data through 2002:IIIQ.
 b. Data for 2002:IIIQ are annualized.
 c. The equity multiplier is the ratio of total assets to equity.
 SOURCES: Federal Home Loan Bank System, *Quarterly Financial Report*, September 30, 2002 and annual reports.

more than twice their holdings a year ago. Mortgage portfolios are expected to be a major source of future asset growth.

FHLBs' earnings (income) rose steadily from 1994 through 2000, then fell in 2001. Their \$1,356 million in net income in the first nine months of 2002 was down from \$1,515 million for the same period in 2001.

Breaking down income into interest and non-interest sources shows that FHLBs' primary source of earnings is net interest income (interest income less interest expense). Net interest income grew from \$954 million in

1993 to \$3,096 million in 2001. The net interest income of \$2,194 million for the first nine months of 2002 was down from \$2,358 million for the same period in 2001.

Unfortunately, FHLBs' improvements in earnings and net interest income have resulted from strong asset growth, not improvements in underlying profitability. Return on assets declined from 49 basis points (bp) in 1993 to 31 bp at the end of 2001. The annualized return on assets through 2002:IIIQ is 24 bp. Profitability in 2002 has been hurt by a decline in the net interest margin (net income before loan loss

provisions as a percentage of average earning assets), from 54 bp at the end of 1993 to an annualized 39 bp at the end of 2002. Moreover, FHLBs' net interest margins pale by comparison to the 300–400 bp typical of depository institutions.

Finally, although leverage has increased continually since 1996, return on equity fell slightly to 5.03% for the first nine months of 2002 from 6.29% at the end of 2001. These persistently weak returns on assets and equity put further pressure on FHLBs to undertake nontraditional lines of business in search of higher returns.