Federal Home Loan Bank of Seattle

2003
annual report

Financial Highlights

in millions, except per share data

	2003	2002	2001	2000	1999
Statements of Condition					
Total assets	$51,164	$46,684	$43,372	$45,398	$41,702
Cash and investments[1]	20,052	17,189	17,049	18,127	14,796
Advances	19,653	20,036	24,252	26,240	26,284
Mortgage loans held for portfolio	11,172	9,112	1,728	418	
Deposits and other borrowings	1,317	1,755	2,159	947	1,186
Consolidated obligations	46,518	41,569	38,280	41,671	37,874
Class B(1)/B(2) stock or capital stock	2,399	2,345	2,391	2,154	2,084
Total capital	2,456	2,382	2,426	2,168	2,098
Statements of Income					
Interest income	$ 1,562	$ 1,671	$ 2,232	$ 2,761	$ 2,034
Net interest income	197	250	243	203	192
Other income	32	(24)	26	5	4
Other expense	33	26	23	18	15
Income before assessments[2]	196	200	246	190	181
Assessments	52	53	64	51	16
Net income[3]	144	147	178	139	165
Earnings per share	$ 6.01	$ 6.05	$ 7.81	$ 6.47	$ 8.51
Dividends					
Dividends paid in cash and stock	$ 123	$ 145	$ 157	$ 140	$ 143
Annualized dividend rate[4]	5.15%	5.97%	6.88%	6.50%	7.37%
Capital stock		6.00%	6.88%	6.50%	7.37%
Class B(1) stock	5.56%	6.38%			
Class B(2) stock	0.71%	1.05%			
Dividend payout ratio[5]	85.65%	98.70%	88.15%	100.45%	86.52%
Financial Ratios					
Return on average equity	5.86%	5.93%	7.67%	6.37%	8.35%
Return on average assets	0.31%	0.33%	0.41%	0.32%	0.45%
Equity to assets ratio[6]	5.24%	5.63%	5.36%	5.04%	5.42%
Total capital ratio[7]	4.80%	5.10%	5.59%	4.78%	5.03%
Net interest margin[8]	0.42%	0.57%	0.57%	0.47%	0.53%

1 Investments also include interest-bearing deposits in banks, securities purchased under agreements to resell, and federal funds sold.

2 Prior to 2000, the Seattle Bank charged its REFCORP obligations directly to retained earnings and not as an expense through the income statement. REFCORP obligations charged directly to retained earnings during 1999 were $23.6 million. Presentation of operating results for years before 2000 have not been restated. Therefore, net income, return on average equity, and return on interest-earning assets for 2003, 2002, 2001, and 2000 are not comparable to 1999.

3 The Seattle Bank adopted SFAS 133 as of January 1, 2001, and recorded a $3.4 million loss for the cumulative effect of accounting change on earnings, including a net gain of $170,000 on securities held at fair value and a net loss of $3.5 million on derivatives and hedging activities.

4 Annualized dividend rates are dividends paid in cash and stock divided by the average of capital stock eligible for dividends.

5 Dividend payout ratio is dividends paid in cash and stock per share divided by earnings per share.

6 Equity to assets ratio is average capital stock, retained earnings, and accumulated other comprehensive income divided by the total average assets.

7 Total capital ratio is capital stock plus retained earnings and accumulated other comprehensive income divided by the total assets at yearend.

8 Net interest margin is net interest income divided by the average earning assets.

Cover: Bitterroot Valley, Montana

The Federal Home Loan Bank of Seattle exists to provide value to our members and the communities they serve. Our programs and initiatives are guided by the collective needs of our member institutions, and we define ourselves by what is important to them.

This is my community.

Our customers are the business owners and families of the communities we serve. They are the heart of who we are, and our goal is to provide them with the most competitive products and services possible. We do that, day in and day out, because we're a community bank.

Alan Bradley
President and Chief Executive Officer
Bitterroot Valley Bank, Lolo, Montana

This is my island.

Most of the people here don't live in luxury condos or expensive homes.
Just the opposite. They struggle to find
affordable housing that's a reasonable distance from where they work.
That's our job—finding the partners who can help us build more of it—because that makes
the Big Island a safer, stronger community for those who live here,
as well as for our visitors.

Keith Kato, Executive Director
Hawaii Island Community Development Corporation
Hilo, Hawaii

This is my home.

Not many teachers and artists can afford to live in the heart of a large city, close to their work. Neither can I—not without some help. I'm fortunate to live in a community where so many believe in creating neighborhoods where people from different walks of life and different economic backgrounds can live and work together.

Sofia Gorder, Teacher and Dancer
Salt Lake City, Utah

A community bank serving businesses
and families across Montana's Bitterroot Valley.
A nonprofit community development corporation building
affordable housing for low-income families and
seniors in Hilo, Hawaii.
A teacher living and working in urban Salt Lake City.

All very powerful stories,
and all woven together with a common thread—
the Federal Home Loan Bank of Seattle.

It doesn't matter how diverse the needs of a neighborhood might be, or how big or small the community bank, ***our partnership role doesn't change.*** *We're here to deliver value to our shareholders and the communities and the people they serve—and we do it across a region that stretches from the Pacific Islands to the Western United States.*

Our office is in downtown Seattle, Washington, but our true base of operations is the thousands of local communities where our member financial institutions do business every day.

That's our storefront.

It's Lolo, Montana, a town of 2,500 people in the historic Bitterroot Valley.

It's Hilo, Hawaii, where residents work the resort-based Big Island economy, yet struggle to find affordable housing.

It's urban Salt Lake City, one of the nation's largest metropolitan centers.

By connecting local financial institutions to the capital markets, the Seattle Bank gives its members critical access to a stable source of low-cost funds that they can use in their communities to support homebuyers, business owners, farmers, schoolteachers, social service agencies and many, many others.

That's our story—providing value and funding that make our neighborhoods, businesses, families and economies healthier and safer. *That's what we do in a cooperative, where our shareholders—community financial institutions—partner with us to move critically needed funding from the Seattle Bank to the people, businesses and neighborhoods that need it most.*

We do that through three primary products and services: customer funding, our Mortgage Purchase Program, and our affordable housing and economic development grants and low-interest loans.

In 2003, the Seattle Bank provided its member financial institutions with more than ***$38 billion in advances, purchased $6.6 billion of mortgage loans*** *and contributed more than* ***$20.1 million in Affordable Housing Program (AHP) grants*** *to finance 3,402 apartments and homes.*

In Montana's Bitterroot Valley, the Seattle Bank's advances help to ensure the availability of working capital for small businesses and loans to homebuyers.

"Our bank is a community lending institution, primarily serving small businesses and homebuyers," explains Alan Bradley, president and CEO of Bitterroot Valley Bank, "but we still compete with the large regional banks that have direct access to the capital markets. The Seattle Bank's advances and Mortgage Purchase Program are critical to our business because they provide the ***low-cost funding and flexibility*** *that allow our bank to compete—to offer our customers the funding they need to build their businesses and purchase their homes."*

In Hilo, Hawaii, the Seattle Bank's AHP funds have been instrumental in helping create affordable housing for the elderly and others with special needs.

"In Hawaii, there are very few options for funding affordable housing," says Keith Kato, Executive Director, Hawaii Island Community Development Corporation, which provides affordable housing for low- and very-low income families. "It's not easy

meeting the growing housing needs of the Big Island, but we get a lot of help from the Federal Home Loan Bank of Seattle. ***It's been instrumental in helping us pursue—and fund—a range of building projects that have helped our communities."***

In Salt Lake City, the Seattle Bank's AHP helped the arts and community-building nonprofit Artspace build the Bridge Projects, a housing development providing affordable downtown apartments for working professionals, artists and others.

"I love my home, and I love being part of the arts community of Salt Lake City," explains Sofia Gorder, a dance teacher who has lived at the Bridge Projects for almost two years. "I love the diversity of my neighborhood and living so close to the schools where I teach. To me, this is what a community is all about."

In addition, the Seattle Bank's Community Investment Program and Economic Development Fund issued—through our member financial institutions—another **$142 million in low-interest loans** *that provided much-needed support to communities, businesses and families across our region.*

Bottom line? The Seattle Bank creates financial partnerships that help to build affordable houses, apartments and a greater sense of community and economic health.

That's why we're here.

We're a rock-solid $51 billion bank with one purpose—joining hands with our shareholders and their communities to accomplish great things.

Just ask the people of Lolo, Hilo and Salt Lake City.

Letter to Our Members

What we do at the Federal Home Loan Bank of Seattle affects many people in many different ways. Our region is diverse, geographically and economically. So is our membership, and so are the communities we serve. Our members include local community banks serving smaller urban and rural areas, as well as large financial institutions doing business across the U.S. Each is unique, but all find significant value in their investment in the Seattle Bank.

Why? We're a cooperative.

At the Seattle Bank, our products and services deliver tangible value to ALL of our members—regardless of their location or size:

- Our advance fundings—which totaled more than *$38.7 billion* in 2003—provide financial liquidity and flexibility for all of our members, large and small, and are critically important for community financial institutions with limited access to the financial markets.
- Our growing Mortgage Purchase Program (MPP)—which has acquired *$16.6 billion* in mortgage loans since its inception just three years ago—offers large and small members alike a highly competitive return on the sale of their mortgage assets and the ability to provide more attractive financing to the homebuyers in their communities.
- Our community investment programs, which have improved the economic vitality of our communities and the quality of life for thousands of individuals and families, are a leading source of private housing subsidies in our region. In 2003, we provided more than *$163.1 million* in affordable housing and economic development funding for our communities.

These numbers illustrate that what we do at the Seattle Bank is not about Wall Street; it's about Main Street. Ours is a cooperative enterprise, and we partner with our members—our shareholders—to create real results in our communities. We like the fact that, at the end of any given year, we can point to the products, services and grants that we've provided to our members—and to the businesses, homes and jobs they've created for the individuals and families in their communities.

Our goal is to deliver value, year in and year out, whatever the economic conditions. We call that being "rock solid." And in 2003, it was good to be rock solid—and innovative—given the tremendous change in the financial services industry and in our political and regulatory environment.

Our Strength in Challenging Times

We're pleased to report that, in 2003, the Seattle Bank provided a highly competitive return on our shareholders' investments in our cooperative, relative to general market interest rates. Our Class B(1) stock dividend was an annualized 5.0 percent in the fourth quarter of 2003 and 5.56 percent for the year. Net income was $34.5 million for the fourth quarter and $143.8 million for the year.

We also increased retained earnings by approximately $5.7 million during the fourth quarter of 2003. Now totaling approximately $57.2 million, or 2.3 percent of total capital, retained earnings exceeded our Board of Directors' goal of 2.0 percent of total capital by yearend.

Average advances outstanding remained stable as compared with 2002, and the Seattle Bank had $19.7 billion in outstanding advances as of December 31, 2003.

At the same time, 2003 was another milestone year for our Mortgage Purchase Program. The launch of our servicing-released program in September increased new member applications for program participation. At the end of December, 44 members were approved to trade, 25 members were actively trading, and 10 members had applications pending. All told, the Seattle Bank held $11.2 billion in MPP mortgage assets at the end of December 2003.

Our net income provided $16.0 million in funding for our Affordable Housing Program in 2003, and the program disbursed a total of $20.1 million during the year. In addition, our Community Investment Program and Economic Development Fund provided $142.5 million in reduced-rate advances for community development.

We delivered these positive results despite formidable challenges:

- The continuing low-interest-rate environment and historically high prepayments of mortgage-based assets pressured earnings at the Seattle Bank and at other banks in the system.
- Accounting issues at Freddie Mac and performance issues at several Federal Home Loan Banks fueled debates in Congress and in the banking and financial press regarding regulatory oversight of the housing government-sponsored enterprises (GSEs) and registration of the FHLBanks' stock with the Securities and Exchange Commission (SEC). Possible legislation regarding GSE regulatory oversight is under consideration on Capitol Hill, while SEC registration remains an ongoing issue for Congress and the Federal Housing Finance Board, which has issued a proposed regulation that, if adopted, would require registration.
- While Moody's Investors Service made no change in its ratings of the Seattle Bank, Standard & Poor's (S&P) revised the counterparty ratings outlook for the FHLBanks of Chicago, Indianapolis and Seattle from stable to negative in November 2003. Despite reaffirming the Seattle Bank's and the Bank System's AAA debt ratings, S&P cited the growth of our mortgage portfolio as changing our risk profile. An S&P statement said that a higher balance of fixed-rate mortgage loans in our asset mix, combined with sizable investments in fixed-rate, mortgage-backed securities, had increased the bank's interest-rate risk exposure.

Our Investment for the Future

In 2003, we worked diligently to address these challenges by building our infrastructure to help ensure the safety and soundness of our operations, the transparency of our financial reporting and the future growth of our product lines.

The challenging economic environment underscored the importance of our MPP as the driver of our strategic plan. The growth of that program in 2003 further reinforced its relevance to our members' businesses, its value as an investment for our cooperative and our need to grow its supporting infrastructure. A mid-year budget adjustment began the process of adding staff in key areas.

In 2004, we'll focus on building volume and participation among our small- and mid-sized members, as we further develop MPP to address the needs of our larger members. The volumes our larger members generate are important to delivering value to our cooperative, but greater volumes can create a different set of risks. In 2004, we intend to add the staff and systems needed to expand our capacity and expertise and prudently manage that risk. By so doing, we intend to ensure that our MPP more broadly—and reliably—supports all of our members' needs and returns even greater value to our cooperative and our communities.

We're also actively preparing our organization to meet the expanded financial reporting and disclosure standards associated with SEC registration. As we've stated many times, we're strongly committed to meeting the disclosure standards that apply to other corporations to the extent that they are appropriate for our cooperative.

In September 2003, our Board of Directors unanimously approved a resolution expressing the Seattle Bank's intent to register with the SEC, subject to satisfactory resolution of important disclosure, reporting and accounting issues. Regardless of the result of the political and regulatory debate on this issue, we believe we are moving in the right direction to be able to provide the highest level of public disclosure and transparency in a timely manner—and in a way that maintains our ability to carry out our congressionally mandated housing finance mission.

Over the past few months, our testimony before Congress has focused on the issues of safety and soundness within the housing GSEs and the possibility of regulatory restructuring. We've played a large, visible role in this process, speaking on behalf of our cooperative and other FHLBanks. We also outlined four principles that frame the Bank System's needs regarding any new regulatory structure for the housing GSEs. They include:

- Preserving and reaffirming the Bank System's mission, which is to create housing opportunities for low- and moderate-income families in our region
- Ensuring that any new regulatory agency is truly independent, with free and unfettered authority to determine policy, rulemaking, application, adjudicative and budget matters
- Ensuring that nothing is done to increase the Bank System's cost of funds and, correspondingly, increase costs for consumers and our members
- Preserving the cooperative ownership of the 12 FHLBanks and the joint-and-several liability that is the underpinning of the Bank System

The Value of Partnership

In a time of rapid change and challenge, it's critical that we work closely with our members, so that we can continue creating products and services that are relevant to their businesses and their communities. With that goal in mind, we've significantly expanded our member outreach.

- Our highly successful *Strategies for Success* consultative financial workshops focus on helping our members create and implement meaningful business strategies. Follow-up on-site visits by our financial advisory services staff help participating members evaluate and refine the strategies developed in the workshops.

- Our investment management consultations help our members identify potential investment opportunities in the fixed-income markets.
- Our interest-rate risk-management consultations help our members measure and analyze their interest-rate risk exposure, better understand their interest-rate risk profile, identify opportunities for improvement, meet regulatory requirements and enhance their business decision-making processes.
- Our new, online financial strategies newsletter, *What Counts,* offers our members innovative strategies and ideas for managing the financial challenges they face every day.

These outreach programs not only provide value to our members, but also strengthen our understanding of their businesses, so that we can continue to be their strong financial partner. That's our job at the Federal Home Loan Bank of Seattle: helping our members—our shareholders—work more efficiently and more profitably. That's the value of our cooperative.

Our Confidence for the Future

Our ability to anticipate and manage the rapid change in our industry and within the Bank System requires the commitment of our management team and Board of Directors, the support of our staff and the ongoing partnership of all our members—large and small.

We encourage our members to take an active role in our cooperative in the coming year, as we continue to safeguard and enhance their investment in the Seattle Bank. We'll continue to consistently communicate the pressing issues and challenges facing the Seattle Bank and work to bring our members' concerns and ideas to our management team, our board, our regulators and Congress.

Thank you for your ongoing partnership and support of the Seattle Bank. We look forward to working with you in 2004.

Norman B Rice

Norman B. Rice
President and Chief Executive Officer

Michael P. Radway

Michael P. Radway
Chairman of the Board

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2003 Report of Financial Performance

BUSINESS

Overview

The Federal Home Loan Bank of Seattle (Seattle Bank), a federally chartered corporation organized in 1964, is a member-owned cooperative. Our mission is to build financial partnerships that enhance the success of our members and make our communities better places to work and live. We do this through two business segments: traditional member finance and our Mortgage Purchase Program (MPP). Through our traditional member finance segment, we provide our 376 financial institution members with low-cost loans (i.e., advances), thereby enhancing the availability of residential mortgage and community investment credit to the public. Our MPP provides participating members with a vehicle through which they can sell mortgage loans, which in turn enables them to make additional home mortgages available to the public.

In addition, we work with our members and a variety of nonprofit organizations to provide affordable housing and community economic development funds, in the form of grants and low- or no-interest loans, for individuals and communities in need. We fund these grants and loans through our Affordable Housing Program (AHP) and a number of community economic development programs.

The Seattle Bank is one of 12 Federal Home Loan Banks (FHLBanks) that, along with the Federal Housing Finance Board (Finance Board), comprise the Federal Home Loan Bank System (Bank System). The 12 FHLBanks are government-sponsored enterprises of the United States of America. The Bank System was created by Congress under the authority of the Federal Home Loan Bank Act of 1932, as amended (the Act), to ensure the availability of housing funds to expand homeownership throughout the nation. The 12 FHLBanks are located throughout the United States (U.S.), with each responsible for a particular district. The Twelfth District, for which we are responsible, includes the states of Alaska, Hawaii, Idaho, Montana, Oregon, Utah, Washington, and Wyoming, as well as the territories of American Samoa, Guam, and the Northern Mariana Islands.

The primary source of funding for all the FHLBanks is consolidated obligation bonds and discount notes (collectively referred to as consolidated obligations). The FHLBanks' authorized agent, the Office of Finance, facilitates and executes the issuance of consolidated obligations on behalf of the FHLBanks. Consolidated obligations are the joint and several obligations of the 12 FHLBanks. Refer to the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report for additional information on consolidated obligations.

Membership

The Seattle Bank is a cooperative that is owned by member financial institutions located within our district. Members purchase the bank's stock and receive dividends, when and if payable, on their stock investment. All federally insured depository institutions and insurance companies engaged in residential housing finance and community financial institutions located in the Seattle Bank's district are eligible to apply for membership. All members are required to purchase stock in the Seattle Bank as a condition of membership, and all of the Seattle Bank's outstanding stock is owned by our members.

As of December 31, 2003, 376 financial institutions were members of the Seattle Bank. As of that date, our membership comprised 251 commercial banks, 79 credit unions, 42 thrifts, and four insurance companies. Membership has grown from 336 in 1999; however, the percentage composition of the membership group has remained essentially the same, with commercial institutions comprising approximately 67% of our membership and credit unions comprising between 14% and 21% of our membership over the last five years. At December 31, 2003, the percentages of our membership by state were as follows: Washington 32.4%, Montana 18.1%, Oregon 13.8%, Utah 12.0%, and Wyoming 10.4%, with the remaining states or territories comprising less than 10% each of total membership.

Of the $19.7 billion in outstanding advances at year-end 2003, Washington members held 42.6%, Oregon members held 36.4%, and Hawaii members held 10.0% of these advances. Advances held by members in the other states and territories in our district represented less than 10% of outstanding advances as of December 31, 2003.

Business Segments

The Seattle Bank offers products and services through two operating segments: traditional member finance and MPP. The traditional member finance segment includes advances, investments, and the borrowing cost related to these assets, as well as financial advisory and other fee-based member services. The MPP segment includes mortgage loans that are purchased for the Seattle Bank's portfolio from participating member institutions and the related financing cost associated with these assets. Refer to the financial statements and Notes to Financial Statements in this report for additional financial information on these segments.

Traditional Member Finance

Through our traditional member finance segment, we provide funding to our members through our advances, accept deposits from members, and provide additional member services consistent with our mission. To support these products and services, we maintain a portfolio of investments to meet our liquidity needs and generate income. We also use interest-rate exchange agreements to manage risk and reduce costs within this segment.

Advances We offer our members and eligible housing associates credit products, referred to as advances, at competitive rates, with maturities ranging from overnight to 30 years. Members and eligible housing associates pledge to the Seattle Bank mortgages and other collateral as security for advances. Advances can be customized to meet an institution's special funding needs, using a variety of interest-rate indices, maturities, amortization schedules, and embedded options.

Advances to Members Advances generally support mortgages held in member portfolios and may also be used to provide funds to eligible member community financial institutions for loans to small businesses, small farms, and small agribusinesses. Advances may serve as a funding source for a variety of conforming and nonconforming mortgages, including loans that members may be unable or unwilling to sell in the secondary mortgage market. Thus, advances support important housing markets, including those focused on low- and moderate-income households. For members that choose to sell their mortgages in the secondary mortgage markets, advances can provide funding for temporary liquidity needs.

Advances provide liquidity and long-term financing to support our members' financial strategies. Our advances provide competitively priced wholesale funding to smaller community lenders that typically do not have access to many of the funding alternatives available to larger financial organizations, including repurchase agreements, commercial paper, and brokered deposits. Members that use our advances for liquidity purposes can reduce the amount of low-yielding liquid assets that they would otherwise need to hold.

Our advances and other credit products also help our members manage their assets and liabilities. Advances matched to the maturity and prepayment characteristics of mortgage loans can reduce a member's interest-rate risk associated with holding long-term, fixed-rate mortgages. Alternatively, members can enter into interest-rate exchange agreements directly with the Seattle Bank to reduce their exposure to interest-rate risk.

We are able to assist members in meeting their Community Reinvestment Act responsibilities through a variety of specialized funding programs. Through the AHP and the Community Investment Program, members have access to subsidized and other low-cost funding to create affordable rental and home ownership opportunities and for commercial and economic development activities that benefit low- and moderate-income neighborhoods, thus contributing to the revitalization of these communities.

Advances to Non-Members The Seattle Bank is permitted under the Act to make advances to non-members that are approved under Title II of the National Housing Act. These eligible "housing associates" are not subject to certain provisions of the Act that are applicable to members (e.g., non-members have no capital stock purchase requirement), but the same regulatory lending requirements generally apply to them as apply to members. Non-member borrowers are subject to more stringent collateral requirements than are required of member borrowers.

Security Interests The Seattle Bank is required to obtain and maintain a security interest in eligible collateral at the time we originate or renew an advance. Eligible collateral includes: whole first mortgages on improved residential property or securities representing a whole interest in such mortgages; securities issued, insured, or guaranteed by the U.S. government or any of its agencies, including without limitation, mortgage-backed securities issued or guaranteed by Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), or Government National Mortgage Association (Ginnie Mae); cash or deposits in the Seattle Bank; and other acceptable real estate-related collateral, provided that such collateral has a readily ascertainable value and that we can perfect a security interest in such property. Additionally, community financial institutions are subject to expanded statutory collateral provisions dealing with small business or agricultural loans. As additional security for a member's indebtedness, the Seattle Bank has a statutory lien on our members' stock in the Seattle Bank.

The Act affords priority to any security interest granted to the Seattle Bank by any of our members over the claims and rights of any party, including any receiver, conservator, trustee, or similar party having rights as a lien creditor. The only two exceptions are claims and rights that would be entitled to priority under otherwise applicable law or that are held by actual bona fide purchasers for value or by parties that are secured by actual perfected security interests.

The Seattle Bank generally will perfect its security interests by taking physical possession of the supporting collateral, if the financial condition of a particular member so warrants. Additionally, we will take any steps necessary, including taking physical possession of collateral, to determine whether the security interest in all collateral pledged by non-depository institutions (e.g., insurance companies and housing associates) for an advance is as secure as the security interest in collateral pledged by depository institutions.

Management of Credit Risk In order to manage our credit risk on advances, we monitor our members' financial condition using quarterly reports submitted by our members to their regulators. We perform quarterly analyses and reviews of members whose financial performance does not meet the parameters defined in our credit monitoring system. In addition, members holding advances must submit annual collateral verification certifications, and we perform periodic on-site collateral audits to validate the sufficiency of their collateral.

Concentration of Credit Risk The Seattle Bank's potential credit risk from advances is concentrated with commercial banks and savings institutions. At December 31, 2003, we had advances of $8.2 billion outstanding to two member institutions, representing 30.4% and 11.4%, respectively, or 41.8% of our total advances outstanding. No other member held advances in excess of 10% of total advances outstanding. At year-end 2003, the Seattle Bank had $13.2 million in advances outstanding to three housing associates. Six housing associates were eligible to borrow from the Seattle Bank as of the end of 2003.

Investments The Seattle Bank maintains a portfolio of investments for liquidity purposes and to generate income. Investment income increases our capacity to meet our commitment to affordable housing and community investment and to cover operating expenditures. We maintain a liquidity portfolio of short-term investments issued by highly rated institutions, including overnight and term federal funds, interest-bearing certificates of deposit, and commercial paper. We also maintain a longer-term investment portfolio, which includes securities issued by the U.S. government and its agencies, and mortgage-backed securities that are issued by government-sponsored mortgage agencies or that carry the highest ratings from Moody's Investors Service or Standard & Poor's. We believe that the long-term investment portfolio should yield higher returns than those available in the short-term money markets.

Prohibited Investments Under Finance Board regulations, we are prohibited from investing in certain types of securities, including:

- Instruments, such as common stock, that represent an ownership in an entity, other than stock in small business investment companies or certain investments targeted to low-income persons or communities;
- Instruments issued by non-U.S. entities, other than those issued by U.S. branches and agency offices of foreign commercial banks;
- Non-investment grade debt instruments, other than certain investments targeted to low-income persons or communities and instruments that were downgraded after purchase by the Seattle Bank;
- Whole mortgages or other whole loans, other than:
    - Those acquired under the MPP;
    - Certain investments targeted to low-income persons or communities;
    - Certain marketable direct obligations of state, local, or tribal government units or agencies, having at least the second-highest credit rating from a nationally recognized statistical rating organization;
    - Mortgage-based securities or asset-backed securities backed by manufactured housing loans or home equity loans; and
    - Certain foreign housing loans authorized under section 12(b) of the Act; and
- Non-U.S. dollar denominated securities.

Finance Board regulations further limit our investment in mortgage-backed securities and asset-backed securities by requiring that the total book value of mortgage-based securities owned by the Seattle Bank not exceed 300% of the Seattle Bank's previous month-end capital on the day it purchases the securities. In addition, we are prohibited from purchasing:

- Interest-only or principal-only stripped mortgage-based securities;
- Residual-interest or interest-accrual classes of collateralized mortgage obligations and real estate mortgage investment companies; and
- Fixed-rate or variable-rate mortgage-based securities that, on the trade date, are at rates equal to their contractual cap and that have average lives that vary by more than six years under an assumed instantaneous interest-rate change of 300 basis points.

Management of Credit Risk As of December 31, 2003, our investment portfolio totaled $20.0 billion. Of this total, 36.6% represents investments in mortgage-backed securities issued or guaranteed by Fannie Mae, Freddie Mac, Ginnie Mae, or the Small Business Administration, or rated AAA by at least two national statistical rating organizations. We monitor the credit ratings of these securities on a continuous basis as discussed below. Another 47.1% of investment securities are debentures guaranteed by the U.S. government or one of its agencies. The remaining 16.3% of investment securities are short-term, unsecured investments in federal funds or certificates of deposit to other financial institutions.

We receive daily information on rating actions, watch list status changes, etc., to ensure that changes in our counterparties' financial conditions are monitored in a timely manner. In addition, we periodically review the financial condition of unsecured investment counterparties to verify that our investments and asset classifications are appropriate from a risk management perspective. For domestic banks and thrifts, this process includes monitoring and analyses of earnings, asset quality, and tier one leverage ratios. Security brokers/dealers must be listed as a Federal Reserve Board of New York Primary Dealer or as a Federal Home Loan Bank Approved Underwriter or be an affiliate of a member with capital in excess of $100 million. The performance of other institutions (e.g., foreign banks or commercial paper counterparties) is monitored using the credit watch lists of Moody's, Standard & Poor's, and Fitch rating services.

Interest-Rate Exchange Agreements Finance Board regulations establish guidelines for interest-rate exchange agreements. These regulations enable the FHLBanks to enter into interest-rate exchange agreements only to reduce the market risk exposures inherent in otherwise unhedged assets and funding positions. Accordingly, we can use interest-rate swaps, options to enter into interest-rate swaps (swaptions), interest-rate cap and floor agreements, calls, puts, and futures and forward contracts (collectively, interest-rate exchange agreements) in our interest-rate risk management and funding strategies. Finance Board regulations prohibit trading of or the speculative use of these instruments and limit our ability to incur credit risk arising from these instruments.

In the traditional member finance segment, we use interest-rate exchange agreements in three ways:

- *Fair Value Hedge* We use interest-rate exchange agreements as fair value hedges of underlying financial instruments, including advances or consolidated obligations. For example, we use interest-rate exchange agreements to adjust the interest-rate sensitivity of consolidated obligation bonds to approximate more closely the interest-rate sensitivity of assets, including advances, and/or to adjust the interest-rate sensitivity of advances to approximate more closely the interest-rate sensitivity of consolidated obligation bonds.
- *Intermediation* We use interest-rate exchange agreements to enable intermediation between our members and the financial markets. For example, to meet the needs of our members, we act as an intermediary between members and other non-member counterparties. In a typical transaction, we enter into an interest-rate swap agreement with a member and an offsetting interest-rate swap agreement with a non-member counterparty. This intermediation allows smaller members access to the swap market.
- *Risk Management* We use interest-rate exchange agreements to manage risks in a group of assets or liabilities. For example, interest-rate caps are purchased as insurance for consolidated obligation discount note debt to protect against rising interest rates. As short-term rates rise, the cost of issuing short-term consolidated obligation discount notes increases. We begin to receive payments (income) from the counterparty when rates rise above a pre-defined rate, thereby "capping" the effective cost of issuing the consolidated obligation discount notes.

We do not use these instruments for speculative purposes. A detailed discussion on the instruments used by the Seattle Bank can be found in the Quantitative and Qualitative Disclosures about Market Risk section of this report.

Management of Credit Risk We receive daily information on rating actions, watch list status changes, etc., to monitor changes in the financial condition of our interest-rate exchange agreements' counterparties. On a quarterly basis, we monitor the credit watch lists of Moody's, Standard & Poor's, and Fitch rating services and believe this process is appropriate from a risk management view.

Deposits The Act allows us to accept deposits from our members, from any institution for which we provide correspondent services, from other FHLBanks, or from other government instrumentalities. Deposit programs provide some of our funding resources, while giving our members a low-risk earning asset that helps to satisfy their regulatory liquidity requirements. We offer demand and term deposit programs to our members and to qualifying non-members. Demand deposits comprise the largest percentage of deposits, with 85.5% as of December 31, 2003, and 88.0% as of December 31, 2002.

As of December 31, 2003 and 2002, we were in compliance with the Act, which requires us to have an amount equal to our current deposits invested in obligations of the U.S. government, deposits in eligible banks or trust companies, or advances with a maturity not exceeding five years.

Other Member Services We offer a number of fee-based services to our members, including financial advisory services, security safekeeping services, and other miscellaneous services. These services do not generate material amounts of income and are primarily performed as ancillary, value-added services to our members.

Sales and Marketing We market traditional member finance products to our members via a direct sales force of relationship managers, who build consultative partnerships with members to improve the profitability of both the members and the Seattle Bank. For example, when members wish to enter into a traditional member finance product (e.g., an advance), their relationship manager directs them to our customer funding staff, who assist the member in structuring the transaction.

Mortgage Purchase Program (MPP)

Many Seattle Bank members originate mortgages, but for many reasons, including leverage, mortgage servicing, and risk management, they often sell these mortgages into the secondary mortgage market, rather than holding the mortgages in their portfolios. The MPP was developed by the Seattle Bank, in conjunction with the FHLBanks of Indianapolis and Cincinnati, to provide program participants with a more profitable alternative for the sale of whole mortgage loans in the secondary mortgage market and the ability to provide more attractive financing to the homebuyers in their communities. The MPP features a unique risk-sharing arrangement, under which the Seattle Bank manages the liquidity, interest-rate, and prepayment risk of these conventional loans, while the member retains the majority of the credit risk.

The MPP was instituted in 2001. Its operational requirements are different from those of our traditional member finance segment, and we consider the program's operations and financial results to be distinct from traditional member finance activities for decision-making purposes.

Eligible Loans Through the MPP, we currently purchase government-insured and conventional, conforming, one- to four-family residential mortgage loans from participating member institutions. We do not service the loans we purchase from our members. Members can choose to retain the mortgage servicing rights or sell the servicing to an approved service provider at the time of sale of the mortgage loans to the Seattle Bank. The par value of mortgage loans held in our portfolio at December 31, 2003, comprised government-insured loans totaling $2.5 billion and conventional loans totaling $8.6 billion. As of December 31, 2003, the MPP portfolio consisted of 68,959 loans, which were originated in all 50 states, plus the District of Columbia. Refer to the Supplemental Financial Data section of this report for additional information on mortgage loan holdings by state and geographic concentration.

Additional Segment Products The Native American Housing Assistance and Self-Determination Act of 1996 (NAHASDA) is designed to provide federal assistance for Native American tribes in a manner that recognizes the right of tribal self-governance. NAHASDA reorganized the system of federal housing assistance to Native Americans by eliminating several separate programs of assistance and replacing them with a single block grant program. To help stimulate housing construction on tribal lands, we purchase loans made to tribally designated housing entities that are guaranteed by Title VI of NAHASDA. At December 31, 2003, we held $392,000 of NAHASDA-designated mortgage loans.

Risk Management *Management of Interest-Rate and Prepayment Risk* The prepayment options embedded in mortgage-based assets can result in extensions or contractions in the expected maturities of these assets, depending on changes in prepayment speeds. We manage the interest-rate and prepayment risk associated with mortgages through debt issuance. We achieve cash flow patterns and liability durations similar to those expected on the MPP portfolio through our use of both callable and non-callable consolidated obligations.

Management of Credit Risk At the time we purchase conventional loans, we establish a lender risk account for mortgages purchased. The lender risk account is used to cover potential loan losses attributed to the loans purchased from the member and can be funded either up front as a portion of the purchase proceeds or over time through a portion of the interest paid by the borrower. This account is established to conform to Finance Board regulations covering all conventional mortgage purchase programs, which stipulate that the member is responsible for all expected losses on the mortgages sold to an FHLBank and for the supplemental mortgage insurance policy described below. In order to comply with these regulations, we evaluate the proposed conventional mortgages to be purchased (either the specific portfolio or a representative sample) to determine the amount of expected losses. The expected losses or the required deductible for the supplemental mortgage insurance policy represent the amount to be deposited into the lender risk account, and these funds are used to offset any losses that may occur. No lender risk account balance is required after 11 years. The lender risk account is recorded by the Seattle Bank in other liabilities and totaled $6.6 million at December 31, 2003.

Each member selling conventional loans to the Seattle Bank is required to purchase supplemental mortgage insurance, which adds an additional layer of credit enhancement. As a result of this credit enhancement, the Seattle Bank and its member share the credit risk, with the member assuming a first loss obligation equivalent to the greater of expected losses or the required deductible for the supplemental mortgage insurance policy, and the Seattle Bank assuming credit losses in excess of primary mortgage insurance coverage, supplemental mortgage insurance coverage, and the member's lender risk account.

No lender risk account or other enhanced credit feature is required on government-insured mortgage loans that we purchase from our members.

Regulation

Overview

The Seattle Bank is supervised and regulated by the Finance Board, which is an independent agency in the executive branch of the U.S. government. The Seattle Bank is subject to the Act. On January 30, 2001, the Finance Board published a final rule implementing a new capital structure requirement for the FHLBanks, as required by the Gramm-Leach-Bliley Act (GLB Act).

Capital Rules

Pre-GLB Act Until June 2002, when we implemented the new capital structure described below, we were subject to the pre-GLB Act capital rules. In particular, the pre-GLB Act rules required members to purchase capital stock equal to the greater of 1% of their mortgage-related assets or 5% of outstanding advances from the Seattle Bank. It also required non-thrift members to purchase additional stock to permit borrowing from the Seattle Bank if the non-thrift member's mortgage-related assets were less than 65% of total assets. At our discretion, members could redeem, at par value, any capital stock greater than their statutory requirement or sell it to other Seattle Bank members at par value. Capital stock outstanding under the pre-GLB Act capital rules was redeemable at a member's option with six months' notice.

Post-GLB Act The Finance Board's final rule implementing a new capital structure requirement for the FHLBanks established risk-based and leverage capital requirements for the FHLBanks, addressed the classes of stock that the FHLBanks may issue and the rights and preferences that may be associated with each class of stock, and required each FHLBank to submit a capital plan to the Finance Board for approval by October 29, 2001. The GLB Act allows the FHLBanks to have two classes of stock, and each class may have sub-classes. Class A stock is conditionally redeemable with six months' written notice from the member, and Class B stock is conditionally redeemable with five years' written notice from the member. The GLB Act made membership in all FHLBanks voluntary. Members that withdraw from membership may not reapply for membership for five years.

<u>*New Capital Structure*</u> The Finance Board approved our capital plan on March 13, 2002, and we converted to our new capital structure on June 30, 2002. Our capital plan offers two classes of Class B stock, Class B(1) and Class B(2), each of which has a par value of $100, the same par value as the Seattle Bank's pre-conversion capital stock. Each class of stock can be issued, redeemed, and repurchased only at par value. Members can elect to redeem their stock with five years' notice. We can repurchase both classes of stock prior to the expiration of the five-year notice period, at our discretion. Members are required to hold Class B(1) stock to meet membership and activity-based stock purchase requirements. Members are not required to hold any Class B(2) stock. Our capital plan does not include any Class A stock.

<u>*Risk-Based Capital Requirements*</u> The GLB Act and the implementing Finance Board rule define total capital for regulatory capital adequacy purposes as the sum of an FHLBank's permanent capital, the amounts paid in by its members for Class A stock, any general loss allowance, if consistent with U.S. generally accepted accounting principles (GAAP) and not established for specific assets, and other amounts from sources determined by the Finance Board as available to absorb losses. Under this definition, our permanent capital is defined as the amount paid in for Class B stock, plus the amount of our retained earnings, as determined in accordance with GAAP.

We became subject to the Finance Board's new risk-based capital regulations upon completing our capital conversion. Under these rules, we must maintain at all times permanent capital in an amount at least equal to the sum of our credit-risk capital requirement, our market-risk capital requirement, and our operations-risk capital requirement, calculated in accordance with the rules and regulations of the Finance Board. The credit risk requirement is determined by adding together the credit risk capital charges for assets, off-balance sheet items, and derivative contracts based on, among other things, the credit percentages assigned to each item as required by the Finance Board. The market risk requirement is determined by adding together the market value of the portfolio at risk from movements in interest rates that could occur during times of market stress and the amount, if any, by which our current market value of total capital is less than 85% of our book value of total capital. We calculate the market value of our portfolio at risk and the current market value of our total capital using an internal model. Our modeling approach and underlying assumptions are subject to Finance Board review and approval on an ongoing basis. The operations-risk capital requirement is equal to 30% of the sum of our credit-risk and market-risk capital requirements. At December 31, 2003, we had a total risk-based capital requirement of $694.9 million, comprising $172.9 million of credit risk capital, $361.6 million of market risk capital, and $160.4 million of operations risk capital. As of December 31, 2003, our permanent capital totaled $2.5 billion.

The GLB Act specifies a 5% minimum leverage ratio based on total capital, which includes a 1.5 weighting factor applicable to permanent capital, and a 4% minimum capital ratio that does not include the 1.5 weighting factor applicable to the permanent capital. Leverage and capital ratios measure the degree to which we are utilizing our debt. Higher leverage generally equates to higher returns on capital, but also increases risk. A minimum leverage ratio, which is defined as total capital (with permanent capital multiplied by 1.5) divided by total assets, is intended to ensure that we maintain a sufficient amount of capital to service our debt. The minimum capital ratio, which is defined as total capital over total assets, does not weight permanent capital and provides another measure for us to monitor our business. At December 31, 2003, our leverage ratio was 7.2% and our capital ratio was 4.8%.

We may not redeem or repurchase any of our stock without Finance Board approval if the Finance Board or our Board of Directors determines that the Seattle Bank has incurred or is likely to incur losses that result in or are likely to result in charges against our capital, even if we are in compliance with our minimum capital requirements, or if redeeming or repurchasing stock would cause us to be out of compliance with our minimum capital requirements. Therefore, a member's right to redeem its stock is conditional on our maintaining these leverage requirements.

Oversight, Audits and Examinations

The Finance Board, the Seattle Bank's supervisor and regulator, is charged with ensuring that we carry out our housing and community development finance mission, remain adequately capitalized and able to raise funds in the financial markets, and operate in a safe and sound manner. In carrying out its responsibilities, the Finance Board establishes regulations governing the operations of the Seattle Bank.

The Finance Board is a five-member board. Four board members are appointed by the President of the United States, with the advice and consent of the U.S. Senate, to serve seven-year terms. The fifth member of the board is the Secretary of the Department of Housing and Urban Development, or the Secretary's designee. The Finance Board is supported by assessments from the 12 FHLBanks; no tax dollars or other appropriations support the operations of the Finance Board or the FHLBanks. To assess the safety and soundness of the Seattle Bank, the Finance Board conducts annual, on-site examinations, as well as periodic off-site reviews. Additionally, we are required to submit monthly information on our financial condition and results of operations to the Finance Board.

The Finance Board has issued a proposed regulation, which will, if adopted as proposed, require us to voluntarily register a class of equity securities with the Securities and Exchange Commission (SEC). FHLBank representatives have been discussing issues with the SEC arising from potential voluntary registration under section 12(g) of the Securities Exchange Act of 1934 to reach an understanding of how various accounting, disclosure, and reporting rules would be applied to the FHLBanks. It is uncertain whether the proposed Finance Board regulation will be adopted, and even if adopted, when the FHLBanks would be required to register with the SEC.

We have an internal audit department, an audit committee, and an independent public accounting firm that audits our annual financial statements. The independent accounting firm adheres to U.S. generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the U.S., when conducting these audits. The Seattle Bank's Board of Directors and senior management, the Finance Board, and Congress all receive these audit reports. In addition, we must submit annual management reports to Congress, the President of the United States, the Office of Management and Budget, and the Comptroller General. These reports contain a statement of financial condition, a statement of operations, a statement of cash flows, a statement of internal accounting and administrative control systems, and the report of the independent public accountants on the financial statements.

The Comptroller General has authority under the Act to audit or examine the Finance Board and any FHLBank and decide the extent to which they fairly and effectively fulfill the purposes of the Act. Furthermore, the Government Corporations Control Act provides that the Comptroller General may review any audit of the financial statements conducted by an independent public accounting firm. If the Comptroller General conducts such a review, then it must report the results and provide recommendations to Congress, the Office of Management and Budget, and the FHLBank in question. The Comptroller General may also conduct an audit of any financial statements of an FHLBank.

Competition

Traditional Member Finance

Demand for the Seattle Bank's advance and other traditional member finance products is affected by, among other things, the cost of other available sources of liquidity for our members, including deposits. We compete with other suppliers of wholesale funding, both secured and unsecured. Other suppliers of such funding may include investment banking companies, commercial banks, and in certain circumstances, other FHLBanks. Smaller members may have access to alternative funding sources through sales of securities under agreements to resell, while larger members may have access to all of the alternatives listed. Larger members may also have independent access to the national and global financial markets. The availability of alternative funding sources to members can significantly influence the demand for our advances and can vary as a result of a number of factors including, among others, market conditions, members' creditworthiness, and availability of collateral.

Mortgage Purchase Program

We compete for the purchase of mortgage loans held in our MPP portfolio, primarily with other secondary market participants, including Fannie Mae and Freddie Mac. We compete primarily on the basis of structures, price, products, and services offered. Because of the infrastructure and processes required by our members to participate in this or in our competitors' programs, the sales cycle is relatively long. In addition, these infrastructure and process requirements can be barriers to entry, as many of our smaller members lack the resources to implement more than one program. Through December 31, 2003, we have purchased over 90% of our existing portfolio from one large member institution and over 97% of our portfolio from three participating financial institutions. We are actively building relationships and assisting interested members through the MPP enrollment process in order to expand member participation and to decrease our reliance on future purchases from a small number of MPP participants.

Debt Issuance

The Seattle Bank also competes with Fannie Mae, Freddie Mac, and other government-sponsored enterprises, as well as corporate, sovereign, and supranational entities, including The World Bank, for funds raised through the issuance of unsecured debt in the national and global debt markets. Increases in the supply of competing debt products may, in the absence of increases in demand, result in higher debt costs or lower amounts of debt issued at the same cost than otherwise would be the case. In addition, the availability and cost of funds raised through issuance of certain types of unsecured debt may be adversely affected by regulatory initiatives that tend to reduce investments by certain depository institutions in unsecured debt with greater than normal volatility or interest-rate sensitivity. Although the available supply of funds from the Bank System's debt issuance has kept pace with the funding requirements of our members, there can be no assurance that this will continue to be the case.

In addition, the sale of callable debt and the simultaneous execution of callable interest-rate exchange agreements that mirror the debt has been an important source of competitive funding for the Seattle Bank. Consequently, the availability of markets for callable debt and interest-rate exchange agreements may be an important determinant of our relative cost of funds. Due to the higher relative risk of this type of financial instrument, there is a more limited investor market relative to the supply generated from the FHLBanks and other government-sponsored enterprises, including Fannie Mae or Freddie Mac. There is no assurance that the current breadth and depth of these markets will be sustained.

Employees

As of December 31, 2003, we had 148 full-time employee positions and three part-time employee positions, for a total of approximately 150 full-time equivalents, up from 127 in the previous year. We expect that the employee base will continue to increase over the next year. Our employees are not represented by a collective bargaining unit, and we believe that we have a good relationship with our employees.

PROPERTIES

We occupy 46,836 square feet of leased office space at 1501 Fourth Avenue, Seattle, Washington 98101. The current lease arrangement is for 10 years, expiring on April 30, 2013. Two 10-year renewal options remain on the current lease arrangement. We also leased 10,304 additional square feet of office space at this address for 10 years, expiring on April 30, 2013. Two five-year renewal options are included on the lease arrangement. In addition, we leased 17,302 square feet of office space at 520 Pike Street, Seattle, Washington 98101, for five years, expiring on January 31, 2009. The square footage noted above houses our entire operations. In addition, we currently lease 2,920 square feet of office space as a back-up facility site used for disaster recovery. The term of this lease is 10 years, expiring on February 28, 2013. We believe that these facilities are adequate to meet our current needs and that suitable additional or alternative space will be available, as needed, in the future on commercially reasonable terms.

LEGAL PROCEEDINGS

The 12 FHLBanks are defendants in an employment litigation filed by a former employee of the FHLBank of Topeka. All FHLBanks other than the Topeka Bank have been dismissed as defendants; however, that dismissal is under appeal. Although we cannot give assurance about the outcome of this matter, we believe this dismissal will be sustained on appeal.

From time to time, the Seattle Bank is subject to legal proceedings arising in the normal course of business. After consultations with legal counsel, we do not anticipate that the ultimate liability, if any, arising out of any current matters will have a material impact on our financial condition, results of operations, or cash flows.

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Under the Act, with the exception of the election of directors, no matters were submitted to members for vote during 2003. In the fourth quarter of 2003, we conducted an annual election of directors for the purpose of filling all elective director positions designated by the Finance Board as commencing on January 1, 2004. We have 18 director positions; the Finance Board appoints eight directors and our members elect 10 directors.

Each elected director represents the members located in a particular area. In 2003, the Finance Board designated three director positions to commence on January 1, 2004, for Alaska, Utah, and Hawaii/Guam/American Samoa/Northern Mariana Islands. Five individuals were nominated by members in those areas. All five accepted their nomination and met the eligibility requirements to serve as a director.

We did not hold an in-person meeting of shareholders in 2003. Instead, we conducted the election process by mail as permitted by law. Our Board of Directors does not solicit proxies, nor are member institutions permitted to solicit or use proxies to cast their votes in an election. None of our directors, officers, employees, attorneys, or agents may, directly or indirectly, support the nomination or election of a particular individual for an elective director position.

To be eligible to vote for Board of Directors nominees, a member's Board of Directors must maintain a principal place of business in the area to be represented by the director position. A member's vote may be cast by an officer designated by the member's board. For each director position that is to be filled in an election, each member institution that is located in the area to be represented by the director position is entitled to cast one vote for each share of stock that the member was required to hold as of December 31 of the calendar year immediately preceding the election year (Record Date). However, the number of votes that any member may cast for any one director position shall not exceed the average number of shares of Seattle Bank stock that were required to be held by all members located in the area to be represented on the Record Date. Members are not permitted to split their votes between candidates; instead, they must vote their entire amount of shares for one candidate for each director position.

Forty-four members participated in the election of directors during 2003, casting a total of 776,018 votes. The following individuals were elected to take office on January 1, 2004:

Name	Votes For	Votes Against/ Withheld	Total Votes
Alaska Nominee:			
Betsy Lawer, First National Bank Alaska	only candidate nominated; automatically elected		
Hawaii/Guam/American Samoa/Northern Mariana Islands Nominees:			
Allan R. Landon, Bank of Hawaii	458,019	23,144	481,163
Philip J. Flores, BankPacific	23,144	458,019	481,163
Utah Nominees:			
W. David Hemingway, Zions First National Bank	161,642	133,213	294,855
Steven J. Nielsen, Escrow Bank USA	133,213	161,642	294,855

MARKET FOR OUR COMMON STOCK AND RELATED SECURITY HOLDER MATTERS

Our members own all of the outstanding stock of the Seattle Bank, the majority of our directors are elected by and from the membership, and we conduct our business in mortgages and advances almost exclusively with members. There is no established public trading market for our stock. It may be redeemed at its $100 par value five years after we receive a written request from a member, subject to regulatory limits. As of December 31, 2003, the Seattle Bank had 376 members and 23,985,053 shares of stock outstanding. The Seattle Bank's stock is divided into two classes, B(1) and B(2). At December 31, 2003, 376 and 64 members owned Class B(1) and B(2) stock, respectively.

The following table presents information on the 10 largest holders of the Seattle Bank's outstanding Class B(1)/B(2) stock at December 31, 2003:

Member Name (in millions)	City	State	Class B(1)/B(2) Stock	% of Outstanding Stock
Washington Mutual Bank*	Seattle	Washington	$ 741	30.9
Bank of America, Oregon, N.A.	Portland	Oregon	323	13.5
Washington Federal Savings*	Seattle	Washington	146	6.1
Merrill Lynch Bank USA	Salt Lake City	Utah	118	4.9
American Savings Bank, F.S.B.	Honolulu	Hawaii	95	4.0
Bank of Hawaii*	Honolulu	Hawaii	59	2.5
Washington Mutual Bank, F.S.B.	Salt Lake City	Utah	57	2.4
Sterling Savings Bank*	Spokane	Washington	51	2.1
Wells Fargo Bank Northwest, N.A.	Salt Lake City	Utah	47	2.0
HomeStreet Bank*	Seattle	Washington	36	1.5
			$1,673	69.9

*An officer of the member had a representative on the Seattle Bank's Board of Directors in 2003.

Dividends

We may pay dividends from retained earnings and current income. Our Board of Directors may declare and pay dividends in either cash or capital stock. Dividends on Class B(1) stock will be in the amount and form as may be declared by the Board of Directors, except that dividends may not exceed the sum of (1) our earnings for that quarter, plus (2) net earnings previously retained, less (3) the amount of any dividends which the Board of Directors declares on Class B(2) stock. Dividends on Class B(2) stock may be declared only at a rate equal to the lower of (1) the Class B(1) stock dividend, or (2) 73.47% times the daily average of three-month LIBOR during the quarter minus 0.25%. During 2003, 2002, and 2001, our Board of Directors declared dividends in the form of stock only. We do not, however, issue fractional shares; should the dividend calculation result in fractional shares, a payment equivalent to the fractional amount will be paid in cash. The following table represents the stock dividends paid in 2003, 2002, and 2001. Beginning in the third quarter of 2002, the dividends shown in the table below are on Class B(1) stock, which is most directly comparable to the capital stock prior to the conversion.

	2003		2002		2001	
Quarter (in thousands)	Amount	Annualized Dividend Rate	Amount	Annualized Dividend Rate	Amount	Annualized Dividend Rate
First	$ 35,005	6.75%	$ 35,360	6.00%	$ 34,884	6.50%
Second	28,448	5.25	37,402	6.00	39,487	7.00
Third	29,659	5.25	37,993	6.00	40,955	7.00
Fourth	28,636	5.00	33,564	6.75	41,610	7.00
Total	$121,748	5.56	$144,319	6.19	$156,936	6.88

Beginning in the third quarter of 2002, Class B(2) stock dividends were as follows:

	2003		2002	
Quarter (in thousands)	Amount	Annualized Dividend Rate	Amount	Annualized Dividend Rate
First	$ 449	0.79%	$	%
Second	412	0.73		
Third	324	0.65	47	1.15
Fourth	200	0.67	803	0.96
Total	$1,385	0.71	$850	1.05

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

This discussion and analysis reviews the Seattle Bank's financial condition as of December 31, 2003 and 2002, and results of operations for the years ended December 31, 2003, 2002, and 2001, and where appropriate, factors that may affect future financial performance. This discussion should be read in conjunction with the financial statements and related notes included in this annual report.

The amounts used to calculate percentage variances are based on numbers in thousands. Accordingly, recalculations may not produce the same results when the relevant amounts are disclosed only in millions or billions.

Forward-Looking Statements

This annual report contains certain forward-looking statements. These statements describe our expectations regarding future events and developments, including future operating results, growth in assets, and continued success of our products. These statements include, without limitation, statements as to future expectations, beliefs, plans, strategies, objectives, events, conditions, and financial performance. The words "will," "believe," "expect," "intend," "may," "could," "should," "anticipate," and words of similar nature are intended in part to help identify forward-looking statements.

Future events are difficult to predict, and the expectations described below are subject to risk and uncertainty that may cause actual results to differ materially from those we currently anticipate. Consequently, there is no assurance that the expected results will be achieved. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following:

- Local and national general and economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and could adversely affect our ability to continue our internal growth at historical rates and maintain the quality of our earning assets.
- Changes in interest rates could reduce interest margins more than expected and could negatively affect funding sources or other aspects of our business.
- Projected business volumes could be different than expected.
- Costs or difficulties related to the introduction of new products could be greater than expected.
- Competitive pressure among financial institutions in the secondary mortgage market could increase significantly.
- Legislation, regulatory requirements, rating agency changes, or accounting rule changes could adversely affect the businesses in which we are engaged.
- Events of terrorism, natural disaster, or other catastrophic events could disrupt the financial markets in which we obtain funding, the ability of our borrowers to repay advances, or the value of collateral that we hold.
- Changes in the U.S. economy could result in declines in asset quality.
- We could be required to cover principal or interest payments on other FHLBanks' consolidated obligations for which we are jointly and severally liable.

The cautionary statements made above apply to all related forward-looking statements, wherever they appear in this annual report. We do not undertake to update any forward-looking statements that we make in this annual report or that we may make from time to time.

Overview

In 2003, the Bank System, as well as other government-sponsored enterprises, received heightened regulatory, political, and market scrutiny. Congress also began work on legislation aimed at changing the regulatory structure of several of the government-sponsored enterprises, possibly impacting the Finance Board, the Bank System's regulator. The Finance Board issued a proposed regulation, which will, if adopted as proposed, require the Seattle Bank and the other FHLBanks to voluntarily register a class of equity securities with the SEC. The stated purpose of the proposed regulation is to ensure transparency of financial information and enhanced disclosures. The Seattle Bank is committed to providing the highest level of public disclosure and transparency, and we are actively engaged in enhancing our disclosure practices.

In November 2003, Standard & Poor's rating service revised the individual counterparty rating outlooks of the FHLBanks of Seattle, Chicago, and Indianapolis from stable to negative, citing concerns about the impact of growing mortgage-based asset portfolios on the banks' risk profiles. Standard & Poor's did not change the counterparty ratings and reaffirmed both the Seattle Bank's and the Bank System's ratings, which are AAA/A-1+. A change in a rating outlook reflects Standard & Poor's assessment of the potential direction of a long-term credit rating over the immediate- or longer-term; however, individual FHLBank ratings do not impact the credit rating of the consolidated obligations issued on behalf of the FHLBanks. We have met with Standard & Poor's and have provided them with detailed information regarding the MPP, including its unique credit risk-sharing features, as well as our practices used to manage interest-rate risk. We expect to continue to enhance our infrastructure in 2004 to manage the growth of the MPP.

The historically low interest-rate environment motivated a record number of homeowners to refinance their mortgage loans. The large volume of refinancing activity in late 2002 and during the first nine months of 2003 resulted in significant prepayments on mortgage loans purchased through the MPP. Many homeowners refinanced their mortgages to take advantage of the historically low mortgage interest rates, which were impacted by the Federal Reserve's discount rate reductions of 550 basis points from 2001 to the early part of 2003. Increased refinancing activity also negatively affected our investments in mortgage-backed securities during these periods. Although the return of principal on our investments in mortgage loans purchased under the MPP and in mortgage-backed securities was reinvested, these new investments were made at the prevailing market rates, which were often lower than the rates of the assets replaced, resulting in a decline in investment yields.

Despite the year's uncertain economic environment, the challenge of low interest rates, and volatility in the financial markets, we continued to record positive financial results. In 2003, net income totaled $143.8 million, a slight decrease of 2.2% from the $147.1 million earned in 2002. Although the overall decline was minimal, the composition of net income between 2003 and 2002 was significantly different. Net interest income declined by 21.2%, primarily as a result of the high prepayment activity experienced during much of 2003 on our mortgage-based asset portfolios. These prepayments impacted net interest income in two ways. First, we paid a premium for the majority of the loans we purchased through the MPP, and this premium is deferred and recognized as an expense over the life of the loans. As loans prepaid, we recognized immediate expense for the premium associated with the prepaid loans, resulting in lower yields on our MPP portfolio. Second, when loans prepaid, we received cash, which because of prevailing interest rates, generally was reinvested at lower yields than we had been receiving on the prepaid loans.

This decline in net interest income was almost fully offset by year-over-year increases in other income. Under SFAS 133, the fair value of derivatives, as well as the assets and liabilities that are part of qualifying hedge transactions, must be recorded on the statement of condition, with changes in those fair values recorded through earnings. We recorded a loss of $6.2 million on our derivatives and hedging activities during 2003, an improvement of $52.8 million over the $59.0 million loss in 2002. A significant portion of this improvement related to the performance of interest-rate swaps that hedge our securities held at fair value, which accounted for 82% of the improvement. The securities held at fair value are long-term agency securities. The fluctuations of these gains and losses are the result of the volatility of agency spreads relative to interest-rate swap spreads, which do not exactly offset during the life of the investment. However, over time these gains and losses are expected to converge. We currently intend to hold these securities to maturity, and we expect to recover these losses in future periods.

Primarily as a result of the merger of two members and large advance prepayments by one member in mid-2003, we recorded $21.1 million in advance prepayment fees in 2003. Approximately 50% of the fees were related to the member merger, and approximately 40% of the fees were related to the large prepayments by one member.

Finally, we recorded gains of $22.3 million on qualifying sales of held-to-maturity investments during 2003. These sales were the result of our ongoing review of our investment portfolios to identify small dollar securities for which the cost to maintain exceeds their value to the Seattle Bank (i.e., paid down to less than 15% of their original balance). Sales of such securities are made in accordance with GAAP. Sales of similarly qualifying held-to-maturity investments have occurred in previous years; however, the volume in 2003 was a direct result of the high rate of prepayment activity seen across all mortgage-based portfolios.

Summary of Critical Accounting Estimates

Our financial statements and reported results are prepared in accordance with GAAP, which requires the use of estimates and assumptions that may affect the reported results and disclosures. The significant accounting policies are described in the notes to the financial statements. Several of the accounting policies involve the use of accounting estimates that we consider to be critical because: (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. We review our estimates and assumptions frequently. An understanding of these estimates and assumptions may enhance the reader's understanding of our financial statements. Estimates and assumptions that are significant to the results of operations and financial condition are called critical accounting estimates and are described below.

Assets and Liabilities Reported at Fair Value We use a variety of means to estimate the values of the assets and liabilities reported at fair value on our financial statements, in footnotes to the financial statements, and within this annual report. Where available, external pricing sources, including FT Interactive Data, Bloomberg, and investment broker-dealers, are used to estimate the fair value of certain financial instruments. These pricing sources may provide price quotes for the financial instrument itself or for a financial instrument with similar terms and/or structures. The fair values of certain other instruments are based on pricing models that require the use of assumptions regarding interest rates, prepayment behavior, market volatility, and other factors. Our estimates of interest rates are based on observed U.S. Treasury rates adjusted for credit spreads; prepayment behavior is modeled using observed mortgage interest rates; and volatility estimates are provided by the Office of Finance. Changes in the assumptions used can have a significant effect on the modeled valuation of these financial assets and liabilities and, consequently, affect income and expense.

Accounting for Derivatives Accounting for derivatives is addressed in Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of Effective Date of FASB Statement No. 133*, and as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (herein referred to as SFAS 133).

We comply with SFAS 133 and record our derivative instruments on the statement of condition at their fair values and recognize all unrealized gains and losses on derivative positions in current-period earnings, regardless of whether offsetting gains or losses on the underlying assets or liabilities being hedged are permitted to be recognized. The accounting framework imposed by SFAS 133 introduces the potential for mismatch between the timing of income and expense recognition from assets or liabilities and the income effects of hedge instruments used to mitigate market risk.

SFAS 133 allows for alternative treatments when accounting for fair value hedges. If the derivative and hedged items share certain characteristics and all applicable criteria are met, the short-cut method of hedge accounting is allowed. Under short-cut hedge accounting, applicable hedges are assumed to be 100% effective, thus resulting in no income statement impact. We structure the majority of our hedged consolidated obligation and hedged advance transactions to qualify for short-cut hedge accounting treatment. We monitor the activities of the Financial Accounting Standards Board (FASB) regarding its position on short-cut hedge accounting. Should FASB change its interpretation or limit the use of short-cut accounting such that we could no longer apply it, our financial results could be materially impacted. Although our short-cut hedges are highly effective, minor price differences do exist. Because of the size of the hedged portfolio, these minor pricing differences could result in significant income volatility.

Allowance for Credit Losses We regularly evaluate our requirement for an allowance for credit losses on advances and mortgage loans purchased under the MPP. An allowance would be established if an event were to occur that made it probable that all amounts due for a mortgage loan or advance would not be collected and the resulting losses were estimable.

We have never experienced a credit loss on an advance. We are required by Finance Board regulation to obtain sufficient collateral on advances to protect against losses, and to accept only certain collateral on our advances, including securities issued by the U.S. government and its agencies, residential mortgage loans, deposits in the Seattle Bank, or other real-estate related loans. We periodically review the collateral held as security on advances and assess our borrowers' credit conditions. To incur a credit loss on an advance, two credit events must jointly occur: the member would have to fail, and the available collateral would have to deteriorate in value prior to its liquidation. In our judgment, the likelihood of both events occurring with respect to any advance is not probable. At December 31, 2003 and 2002, we had, with respect to each member, security interests in investment-grade mortgage loans and other securities in excess of amounts advanced. Consequently, we believe that at year-end 2003 and 2002, an allowance for credit loss on advances is not warranted.

Since the inception of the MPP, we have not experienced a credit loss on our mortgage loan portfolio or taken possession of a loan due to default. Because the participating financial institutions are responsible for remitting principal and interest to us, even though there have been individual mortgage loans with delinquent payments to the participating financial institutions, we have had no payment delinquencies. In addition, should a loan become significantly delinquent, under the credit enhancement structure of the MPP, the value of a foreclosed property would have to fall below 50% of the outstanding loan amount to result in a loss to the bank. Given the level of credit enhancement available to us, we do not believe an allowance for losses on mortgage loans is required. Refer to the MPP discussion in the Results of Operations – Segment Results section of this report for additional information on the credit enhancement structure.

Amortization of Premiums/Accretion of Discounts Premiums and discounts on mortgage-based assets, including mortgage-backed securities, collateralized mortgage obligations, and mortgage loans purchased under the MPP, are required to be recognized in earnings using a level-yield methodology over the estimated life of the asset. Actual prepayment experience and changes in estimates of future principal prepayments affect the premium amortization and discount accretion, which impacts our yields on the underlying investments and creates volatility in interest income. For a given change in estimated average maturity for a mortgage loan portfolio or mortgage-backed security, the retrospective change in yield is dependent on the amount of original purchase premium or discount and the cumulative amortization or accretion at the time the estimate is changed. A change in estimated average maturity has the least effect on mortgage loans or mortgage-backed securities that have either little cumulative amortization or accretion or are nearly fully amortized or accreted. A change in estimated average maturity has its greatest effect on long-term mortgage loans and mortgage-backed securities with cumulative amortization and accretion equal to approximately half of the original purchase premium or discount.

For certain mortgage-based assets, we use our own internal prepayment model and external source data, including Intex, a service that provides data on cash flows, as the basis for estimated future principal prepayments. However, for loans purchased under the MPP and certain other mortgage-based assets, we model prepayment behavior. Different assumptions about prepayment behavior can result in different amounts of premium amortization and discount accretion. We review prepayment information generated from the model prior to calculating its amortization and accretion to ensure the reasonableness of the data in light of market conditions.

Joint and Several Liability on the Bank System's Consolidated Obligations Consolidated obligations, consisting of bonds and discount notes, are our principal funding source, as well as the principal funding source for the other FHLBanks. Finance Board regulations govern the issuance of debt on behalf of the FHLBanks and related activities, and authorize the FHLBanks to issue consolidated obligations, through the Office of Finance as their agent, under the authority of the Act. The Office of Finance is responsible for facilitating and executing the issuance of the consolidated obligations. We are primarily liable for our portion of the consolidated obligations, and we record a liability for our share of the proceeds from the issuance of those consolidated obligations. However, under the joint and several liability of the FHLBanks, should one or more of the FHLBanks be unable to repay their obligation of principal or interest on their portion of the consolidated obligations, the Seattle Bank (or each of the other FHLBanks) could be called upon to repay all or a portion of such obligations. To the extent that the Seattle Bank makes any payment on a consolidated obligation on behalf of another FHLBank, the Seattle Bank is entitled to reimbursement from the non-complying FHLBank. However, if the Finance Board determines that the non-complying bank is unable to meet its obligations, then the Finance Board may allocate the outstanding liability among the remaining FHLBanks on a pro rata basis, in proportion to each FHLBank's participation in all consolidated obligations outstanding, or on any other basis the Finance Board may determine.

We record our allocated portion of the combined consolidated obligations, but do not record our joint and several liability relative to the other FHLBanks' consolidated obligations on our statement of condition, on the basis that its occurrence is conditional on the default of another FHLBank. The probability of failure of each of the other FHLBanks would have to be determined and evaluated against the particular FHLBank's debt level. Eleven of the 12 FHLBanks have a credit rating of AAA/A-1+ from Standard & Poor's and a bank deposits rating of Aaa/P-1 from Moody's. Although these ratings are subject to change, under current Finance Board regulations, all FHLBanks are required to maintain a rating of AA or higher. The possibility that one of the FHLBanks would be unable to repay its participation is considered remote.

Resolution Funding Corporation Liability The Financial Institutions Reform, Recovery and Enforcement Act and the GLB Act require the Seattle Bank, and each of the other 11 FHLBanks, to contribute 20% of annual earnings (after operating expenses and AHP obligation) to support the payment of part of the interest on bonds previously issued by the Resolution Funding Corporation (REFCORP). The FHLBanks must make these payments until the total amount of payments made is equivalent to a $300 million annual (or $75 million per quarter) annuity that has a final maturity date of April 15, 2030. The Finance Board will shorten or lengthen the period during which the FHLBanks must make payments to REFCORP, depending on actual payments relative to the referenced annuity. In addition, the Finance Board, with the Secretary of the Treasury, selects the appropriate discounting factors used in this calculation.

As of January 15, 2004, the Bank System's combined quarterly payments to date defeased payments after October 2020. If total Bank System earnings are insufficient in a quarter to meet the $75 million quarterly benchmark payment, previous quarters' payments that were used to defease future payment requirements could be used to satisfy the current quarter's obligation.

Our financial statements do not include a liability for the future statutorily mandated payments to REFCORP. Future payments by the Seattle Bank are contingent on its earnings and the earnings of each bank in the Bank System, and since those future earnings are not estimable under SFAS No. 5, *Accounting for Contingencies*, REFCORP payments are disclosed as a long-term statutory payment requirement and are treated for accounting purposes as a current-period expense.

Results of Operations

The following table presents summary financial information for the years indicated:

For the Years Ended December 31, (in thousands)	2003	2003 vs 2002 % Increase (Decrease)	2002	2002 vs 2001 % Increase (Decrease)	2001
Interest Income					
Advances	$ 516,651	(20.7)	$ 651,219	(46.4)	$1,216,093
Investments	581,118	(27.7)	803,914	(16.1)	958,334
Mortgage loans held for portfolio	464,166	114.9	216,019	278.1	57,127
Other	43	(36.8)	68	(67.5)	209
Total interest income	1,561,978	(6.5)	1,671,220	(25.1)	2,231,763
Interest Expense					
Consolidated obligations	1,346,725	(3.2)	1,390,605	(27.8)	1,925,378
Deposits	18,303	(35.5)	28,383	(52.6)	59,882
Other borrowings	105	(95.7)	2,465	(32.7)	3,665
Total interest expense	1,365,133	(4.0)	1,421,453	(28.5)	1,988,925
Net Interest Income	196,845	(21.2)	249,767	2.9	242,838
Other Income					
Prepayment fees	21,096	627.4	2,900	(72.7)	10,617
Service fees	2,433	6.1	2,294	(5.9)	2,437
Net gain (loss) on sale of held-to-maturity securities	22,291	*	850	380.2	177
Net gain (loss) on securities held at fair value	(7,906)	(127.6)	28,666	*	370
Net gain (loss) on derivatives and hedging activities	(6,179)	(89.5)	(59,000)	(594.1)	11,940
Other, net	479	(7.4)	517	192.1	177
Total other income	32,214	(235.5)	(23,773)	(192.4)	25,718
Other Expense					
Operating	28,246	26.7	22,301	9.9	20,285
Finance Board and Office of Finance	2,984	9.6	2,722	12.3	2,423
Other	2,143	173.3	784	350.6	174
Total other expenses	33,373	29.3	25,807	12.8	22,882
Income Before Assessments	195,686	(2.2)	200,187	(18.5)	245,674
Affordable Housing Program	15,974	(2.3)	16,342	(17.4)	19,781
Resolution Funding Corporation	35,942	(2.3)	36,769	(17.4)	44,507
Total assessments	51,916	(2.3)	53,111	(17.4)	64,288
Income Before Cumulative Effect of Change In Accounting Principle	143,770	(2.2)	147,076	(18.9)	181,386
Cumulative effect of change in accounting principle				*	(3,359)
Net Income	$ 143,770	(2.2)	$ 147,076	(17.4)	$ 178,027

*Calculation is not meaningful.

Net Interest Income

The main source of our earnings is net interest income, which consists of interest earned on advances, mortgage loans, and investments, less interest paid on consolidated obligations, deposits, and other borrowings. Net interest income is an important measure used by management to monitor our ongoing operations. Net interest income was $196.8 million, $249.8 million, and $242.8 million for the years ended December 31, 2003, 2002, and 2001, a decrease of 21.2% from 2002 to 2003, and an increase of 2.9% from 2001 to 2002.

Net interest income comprises two elements: (1) earnings related to the interest-rate spread (calculated as the difference between the average interest-rate yield on our interest-earning assets and the average interest-bearing liabilities), and (2) earnings on our average capital (calculated as the average interest-earning assets less the average interest-bearing liabilities, multiplied by the average interest-rate yield on the interest-earning assets). In 2003, these two elements each contributed approximately 50% of our net interest income. The earnings on capital were $99.6 million in 2003 compared to $106.2 million in 2002, while the earnings related to the interest-rate spread were $97.2 million in 2003 compared to $143.6 million in 2002. The decline in our earnings on capital of $6.6 million was due primarily to lower interest-rate yields on our interest-earning assets. The decrease of $46.4 million related to the interest-rate spread was due primarily to the compression of the interest-rate yields on our interest-earning assets compared to our interest-bearing liabilities, which decreased from 35 basis points in 2002 to 22 basis points in 2003 (100 basis points equals 1.0%). Although both earnings on capital and interest-rate spread declined in 2003, the compression of the interest-rate spread was the main reason for the decrease in our net interest income.

The interest-rate spread was 22 basis points, 35 basis points, and 30 basis points in 2003, 2002, and 2001. The interest-rate spread is impacted by changes in the interest-rate environment, which increases and decreases the interest-rate yields on our interest-earning assets and interest-bearing liabilities. The interest-rate spread changes when the interest-earning assets and interest-bearing liabilities change in different proportions, resulting in a compression or expansion of the interest-rate spread. An increase in the interest-rate spread would have a favorable impact on net interest income, while a decrease in the interest-rate spread would have an unfavorable impact on net interest income. Because of the high volume of prepayment activity in 2003, the amortization of premiums paid for mortgage loans accelerated. This resulted in lower spreads on the MPP portfolio in 2003 than in previous years.

We also monitor net interest margin, a ratio that represents net interest income divided by average interest-earning assets. This ratio measures the return on interest-earning assets less the cost of borrowing. Changes in the ratio are caused by fluctuations in the interest-rate environment and our return on investments, less the cost of borrowing. A higher net interest margin indicates a higher return, while a lower net interest margin indicates a lower return on investments after the cost of funds.

The following table presents average balances, income, and yields of major earning asset categories and the sources funding those earning assets for the years ended December 31, 2003, 2002, and 2001. It also presents spreads between the average yields on total earning assets and the average cost of interest-bearing liabilities and the net interest margin for these periods.

	2003			2002			2001		
(in thousands)	Average Balance	Interest Income/ Expense	Average Yield %	Average Balance	Interest Income/ Expense	Average Yield %	Average Balance	Interest Income/ Expense	Average Yield %
Interest-Earning Assets									
Advances to members	$21,493,287	$ 516,651	2.40	$21,802,546	$ 651,219	2.99	$25,006,396	$1,216,093	4.86
Mortgage loans	9,202,505	464,166	5.04	3,690,781	216,019	5.85	840,849	57,127	6.79
Investments	15,841,000	581,118	3.67	18,176,523	803,914	4.42	16,941,526	958,334	5.66
Other earning assets	3,479	43	1.24	4,359	68	1.56	6,050	209	3.45
Total interest-earning assets	46,540,271	$1,561,978	3.35	43,674,209	$1,671,220	3.83	42,794,821	$2,231,763	5.22
Other assets	292,771			345,746			491,990		
Total Assets	$46,833,042			$44,019,955			$43,286,811		
Interest-Bearing Liabilities									
Consolidated obligations	$41,780,766	$1,346,725	3.22	$38,958,439	$1,390,605	3.57	$38,645,508	$1,925,378	4.98
Member deposits	1,784,969	18,303	1.03	1,801,363	28,383	1.58	1,655,132	59,882	3.62
Other borrowings	7,205	105	1.46	142,820	2,465	1.73	85,002	3,665	4.32
Total interest-bearing liabilities	43,572,940	$1,365,133	3.13	40,902,622	$1,421,453	3.48	40,385,642	$1,988,925	4.92
Other liabilities	806,804			638,009			579,179		
Capital	2,453,298			2,479,324			2,321,990		
Total Liabilities and Capital	$46,833,042			$44,019,955			$43,286,811		
Net interest income		$ 196,845			$ 249,767			$ 242,838	
Interest rate spread			0.22			0.35			0.30
Net interest margin			0.42			0.57			0.57
Average capital to average assets			5.24			5.63			5.36
Net income		$ 143,770			$ 147,076			$ 178,027	
Interest rate spread earnings		$ 97,256			$ 143,615			$ 116,759	
Earnings on capital		99,589			106,152			126,079	
Net interest income		$ 196,845			$ 249,767			$ 242,838	

Changes in the dollar volume of interest-earning assets and interest-bearing liabilities and changes in the yields on interest-earning assets and interest-bearing liabilities influence changes in net interest income and net interest margin. Changes in interest income and interest expense not identifiable as either volume-related or rate-related, but rather equally attributable to both volume and rate changes, are allocated to the volume and rate categories based upon the proportion of the absolute value of the volume and rate changes. The changes in the amounts in 2003 compared to 2002, and 2002 compared to 2001, represent the impact of changes in asset or liability balances (volume) and the interest rate (rate) on the changes in net interest income year over year. For example, the interest income on advances and other loans for 2003 compared to 2002 declined $134.6 million. This was due primarily to a decline in the volume of advances and other loans on the statement of condition during the year, which accounted for $9.1 million of the decrease, and a decline in interest rates, which accounted for $125.5 million of the decrease.

The following table summarizes changes in interest income and interest expense due to volume and rate:

	2003 vs. 2002 Increase (Decrease)			2002 vs. 2001 Increase (Decrease)		
(in millions)	Volume	Rate	Total	Volume	Rate	Total
Interest Income						
Advances and other loans	$ (9.1)	$(125.5)	$(134.6)	$(140.9)	$(424.1)	$(565.0)
Mortgage loans	281.8	(33.6)	248.2	167.9	(9.0)	158.9
Investments	(95.7)	(127.1)	(222.8)	66.0	(220.5)	(154.5)
Total interest income	177.0	(286.2)	(109.2)	93.0	(653.6)	(560.6)
Interest Expense						
Consolidated obligations	96.6	(140.4)	(43.8)	15.9	(550.7)	(534.8)
Deposits and other borrowings	(2.3)	(10.2)	(12.5)	6.7	(39.4)	(32.7)
Total interest expense	94.3	(150.6)	(56.3)	22.6	(590.1)	(567.5)
Change in net interest income	$ 82.7	$(135.6)	$ (52.9)	$ 70.4	$ (63.5)	$ 6.9

Interest Income Interest income from advances totaled $516.7 million, $651.2 million, and $1.2 billion in 2003, 2002, and 2001, a decrease of 20.7% from 2002 to 2003, and 46.4% from 2001 to 2002. The decline in interest income from advances over the past two years was due primarily to the Federal Reserve's reductions in its discount rate (550 basis points between 2001 and early 2003), which resulted in lower short-term interest rates. Our advances portfolio is heavily weighted to shorter-term advances, with 74.9% of the portfolio having a length to maturity of three years or less at December 31, 2003, and the low interest-rate environment significantly impacted this portfolio's yields. In addition, increased liquidity in the financial system and our reduction of certain advance mark-ups (between 2.5 and 10 basis points) in late 2002 contributed to the decline.

Interest income from the MPP has grown significantly since its launch in 2001, reflecting our focus on building this segment of our operations. The MPP is a residential mortgage purchase program under which the Seattle Bank can purchase, from participating financial institutions, government-insured and conventional residential mortgage loans. Interest income on mortgage loans purchased under the MPP totaled $464.2 million, $216.0 million, and $57.1 million in 2003, 2002, and 2001, an increase of 114.9% from 2002 to 2003, and 278.1% from 2001 to 2002, driven by higher mortgage loan balances outstanding. Although significantly higher in 2003, interest income from the loans purchased under the MPP was negatively impacted by the accelerated recognition of premium amortization, due to the high level of prepayments experienced for much of the year. Premium amortization on mortgage loans purchased under the MPP totaled $37.7 million in 2003, compared to $12.2 million and $1.9 million in 2002 and 2001.

Interest income from investments, which includes shorter-term investments (e.g., interest-bearing deposits, securities purchased under agreements to resell, and federal funds sold), and longer-term investments (e.g., held-to-maturity securities and securities held at fair value), declined by 27.7% from 2002 to 2003, and 16.1% from 2001 to 2002, due to declines in investment yields. In addition, because interest rates have declined, the principal returned from the prepayments of mortgage-backed securities was reinvested in lower-yielding investments compared to the securities replaced.

Interest Expense Interest expense on consolidated obligations was $1.3 billion, $1.4 billion, and $1.9 billion for the years ended December 31, 2003, 2002, and 2001, a decrease of $43.9 million from 2002 to 2003, and $534.8 million from 2001 to 2002. The average balance of consolidated obligations grew by $2.8 billion from 2002 to 2003, and $312.9 million from 2001 to 2002, primarily as a result of the increase in the mortgage loan portfolio. We actively manage our debt portfolio by calling and reissuing consolidated obligation bonds to take advantage of lower interest rates, as well as using a combination of callable consolidated obligation bonds and interest-rate swaps. Due to the repayment terms on some of our consolidated obligations, it is more challenging to manage the negative effect of mortgage-based asset prepayments with early redemptions of our consolidated obligations. As a result, the interest rates on interest-earning assets declined by 48 basis points in 2003, and overall interest rates on interest-bearing liabilities declined by only 35 basis points.

Interest expense on deposits continued to decrease due to overall declines in the interest rates we pay on deposits. Interest expense on deposits was $18.3 million, $28.4 million, and $59.9 million for the years ended December 31, 2003, 2002, and 2001. The average balances of deposits remained relatively stable during 2003, 2002, and 2001; however, the cost of deposits declined by more than 259 basis points between 2001 and 2003.

Other Income Other income primarily includes member service fees, advance prepayment fees, gains and losses on derivatives and hedging activities, and other miscellaneous income not included in our core operations. Because of the type of financial activity reported in this category, other income can be volatile on a year-to-year basis. For instance, advance prepayment activity and associated fees may vary based on individual member liquidity and balance sheet restructuring activity, mergers and acquisitions among member institutions, and other factors. Gains and losses on derivatives and hedging activities are highly dependent on interest rates and spreads between various interest-rate yield curves. The following table details our other income for each of the last three years:

For the Years Ended December 31, (in thousands)	2003	2002	2001
Prepayment fees	$21,096	$ 2,900	$10,617
Service fees	2,433	2,294	2,437
Net realized gain (loss) on sale of held-to-maturity securities	22,291	850	177
Net unrealized gain (loss) on securities held at fair value	(7,906)	28,666	370
Net realized and unrealized gain (loss) on derivatives and hedging activities	(6,179)	(59,000)	11,940
Other, net	479	517	177
Total	$32,214	$(23,773)	$25,718

During 2003, total other income increased by $56.0 million compared to 2002. The increase in 2003 was due primarily to an improvement in net realized and unrealized losses on derivatives and hedging activities, gains on the sale of qualifying held-to-maturity securities, and prepayment fees.

During 2002, total other income decreased by $49.5 million compared to 2001. The decrease in 2002 was due primarily to declines in net realized and unrealized losses on derivatives and hedging activities and prepayment fees.

Finance Board regulations generally require advances with a maturity or repricing period greater than six months to carry a prepayment fee sufficient to make the Seattle Bank financially indifferent to the borrower's decision to prepay the advances. The amount of prepayment fee depends upon the prepaid advance's time to maturity and interest rate. Primarily as a result of the merger of two members and large advance prepayments by one member in mid-2003, we recorded $21.1 million in advance prepayment fees in 2003. Fifty-two percent of the fees were related to the members' merger, and 37% of the fees were related to the large prepayments by one member.

We recorded gains of $22.3 million on qualifying sales of held-to-maturity investments during 2003. These sales were the result of our ongoing review of our investment portfolios to identify small dollar securities for which the cost to maintain exceeds their value to the Seattle Bank (i.e., paid down to less than 15% of their original balance). Sales of such securities are made in accordance with GAAP. Sales of similarly qualifying held-to-maturity investments have occurred in previous years; however, the volume in 2003 was a direct result of the high rate of prepayment activity seen across all mortgage-based portfolios. As a result, we realized gains of $22.3 million on these sales in 2003. This compares to $850,000 and $177,000 of realized gains on the sale of held-to-maturity investments for the years ended December 31, 2002 and 2001. Proceeds from the sale of held-to-maturity securities totaled $730.3 million, $44.1 million, and $10.2 million in 2003, 2002, and 2001.

Much of the change in our net realized and unrealized gains (losses) on derivatives and hedging activities is due to changes in the fair value of interest-rate swaps that economically hedge our securities held at fair value. In 2003, the loss on the interest rate swaps hedging the securities held at fair value contributed approximately 43% of the net $6.2 million loss on derivatives and hedging activities. Because of the volatility of U.S. agency obligation interest-rate spreads relative to the LIBOR curve, the changes in the fair value of the securities held at fair value have not been completely offset by the changes in the fair value of the hedging instruments. In 2003, this volatility resulted in losses in both the fair values of the securities held at fair value and the hedging instruments. Because 2003 interest rates were less volatile compared to 2002 and 2001, the fair value adjustments for the securities held at fair value and the hedging instruments were lower than in 2002. The partially offsetting gains and losses in 2002 reflected this volatility with a $28.7 million gain on the securities held at fair value and a $45.8 million loss on the corresponding interest-rate swaps. We currently intend to hold the held at fair value securities to maturity, and therefore, expect to recover these unrealized losses in the future.

During 2003, losses on mortgage loan commitments and related hedge items (as allowed by SFAS 133) totaled $3.9 million. Prior to July 1, 2003, mortgage loan commitments were not classified as derivatives; therefore, these commitments were eligible for fair value hedge accounting treatment under SFAS 133. As a result, only the ineffective portion between the commitment and the hedging instrument (usually a forward sold security to-be-announced) was recorded in current-period earnings. After July 1, 2003, mortgage loan commitments are classified as derivatives and the changes in their fair values are included in the $3.9 million loss.

The gains and losses on advances and consolidated obligations in 2003, 2002, and 2001 reflect the ineffective portion of fair value hedges that did not meet the criteria to qualify for short-cut accounting treatment.

Finally, the losses on intermediary positions reflect the bank's net fair value position on interest-rate exchange agreements where we act as an intermediary for our members.

The following table identifies the components of the net realized and unrealized gains and losses on derivatives and hedging activities as well as the unrealized gains and losses on the securities held at fair value for the years ended December 31, 2003, 2002, and 2001:

(in thousands)	Advances	Investments	MPP Loans	Consolidated Obligations	Balance Sheet	Intermediary Positions	Total
2003 Earnings Impact							
Net gains (losses) on derivatives and hedging activities	$ 1	$ (2,651)	$(3,850)	$ 200	$ 487	$ (366)	$ (6,179)
Net unrealized losses on securities held at fair value		(7,906)					(7,906)
Total	$ 1	$(10,557)	$(3,850)	$ 200	$ 487	$ (366)	$(14,085)
2002 Earnings Impact							
Net gains (losses) on derivatives and hedging activities	$(39)	$(45,783)	$ 856	$ 518	$(13,402)	$(1,150)	$(59,000)
Net unrealized gains on securities held at fair value		28,666					28,666
Total	$(39)	$(17,117)	$ 856	$ 518	$(13,402)	$(1,150)	$(30,334)
2001 Earnings Impact							
Net gains (losses) on derivatives and hedging activities	$ 20	$ (6,459)	$ 109	$19,034	$	$ (764)	$ 11,940
Net unrealized gains on securities held at fair value		370					370
Total	$ 20	$ (6,089)	$ 109	$19,034	$	$ (764)	$ 12,310

Other Expense

The following table presents our other expense for each of the last three years:

For the Years Ended December 31, (in thousands)	2003	2002	2001
Salaries and employee benefits	$17,075	$13,851	$12,562
Occupancy cost	2,512	2,086	1,641
Other operating	8,659	6,364	6,082
	28,246	22,301	20,285
Finance Board and Office of Finance	2,984	2,722	2,423
Other	2,143	784	174
Total	$33,373	$25,807	$22,882

Total other expense increased by 29.3% from 2002 to 2003, and 12.8% from 2001 to 2002. Operating expenses were $28.2 million, $22.3 million, and $20.3 million for the years ended December 31, 2003, 2002, and 2001, an increase of 26.7% from 2002 to 2003, and 9.9% from 2001 to 2002. The increases in salaries and benefits reflect general pay and benefit increases. The increase in 2003 also includes higher staffing levels to support the growth of MPP and to address the increasingly complex nature of the Seattle Bank's operations and regulatory environment. We incurred incremental staffing, consulting, and legal costs in 2003 related to enhancing our disclosure practices. We expect that SEC registration would further increase these expenses. Occupancy costs increased during this period because additional office space was added to accommodate the additional staff. We expect these expenses to increase in 2004, reflecting a full year of increased space requirements for the additional staff.

The Office of Finance acts as the agent for the issuance of the Bank System's consolidated obligations and publishes the combined Bank System financial information. A portion of the expenses of the Office of Finance is allocated monthly to the Seattle Bank, based on its percentage of capital stock, consolidated obligations issued, and consolidated obligations outstanding for the previous month for the Bank System as a whole. The Seattle Bank's allocations of Office of Finance expenses were $1.2 million, $1.0 million, and $918,000 for the years ended December 31, 2003, 2002, and 2001. The Finance Board is the Bank System regulator. The expenses for the Finance Board are allocated monthly pursuant to a once-per-year allocation based on our capital stock outstanding as a percentage of Bank System stock outstanding. The Seattle Bank's allocations of Finance Board expenses were $1.8 million, $1.7 million, and $1.5 million for the years ended December 31, 2003, 2002, and 2001. Office of Finance and Finance Board expenses increased by 9.6% from 2002 to 2003, and by 12.3% from 2001 to 2002.

Assessments

Affordable Housing Program The Act requires each FHLBank to establish and fund an AHP. We charge the required funding for this program to earnings and establish a liability. The assessments for this program are based on 10% of net income after the required payment to the REFCORP. Over the last 13 years, the AHP has provided significant resources to member institutions for housing development across the Seattle Bank's district to assist in the purchase, construction, and rehabilitation of housing for very low-, low-, and moderate-income households. We awarded AHP grants of $20.1 million in 2003 for projects designed to provide housing for 3,402 households. Since the inception of the program in 1990, we have awarded $144.1 million in AHP grants to facilitate development of projects to create 32,069 units of low-income housing. Refer to Note 8 of the Notes to Financial Statements for additional information about the AHP.

Resolution Funding Corporation Along with the other FHLBanks, the Seattle Bank must pay 20% of its net earnings (after AHP assessment) to REFCORP to support the payment of part of the interest on the bonds issued by REFCORP. The FHLBanks must make these payments until the total amount of payments actually made is equivalent to a $300 million annual annuity with a final maturity date of April 15, 2030. In 2003, the Seattle Bank's REFCORP assessment was $35.9 million. Along with the other FHLBanks' assessments, the 2003 payments have fully satisfied all payments due after October 15, 2020, and $21.5 million of the $75 million benchmark payment due on July 15, 2020.

Segment Results

We manage our operations by grouping our products into business segments. We have two reportable business segments: traditional member finance and MPP. The traditional member finance segment includes revenues from advances and other member services and their related funding costs. In addition, the traditional member finance segment includes income from investment securities. The MPP segment includes revenues from mortgage loans purchased from members and the related funding costs, as well as other assets, income, and expenses directly related to the MPP. The AHP and REFCORP assessments have been allocated to each segment, based on that segment's income as a percentage of total income before assessments. Refer to Note 15 of the Notes to Financial Statements for information on our segment results.

Traditional Member Finance

Net Interest Income Net interest income from the traditional member finance segment totaled $133.4 million, $196.8 million, and $235.5 million in 2003, 2002, and 2001, a decrease of 32.2% from 2002 to 2003, and 16.4% from 2001 to 2002. The decline in net interest income is primarily due to the decrease in interest rates from 2001 to 2003, which resulted in significant prepayments on our investments in mortgage-based securities. In addition, the decline reflects the reduction of certain advance mark-ups by 2.5 to 10 basis points in 2002. The average balances for advances remained approximately equal for 2003 and 2002, at $21.5 billion and $21.8 billion, compared to $25.0 billion in 2001. The average yields on advances were 2.4%, 3.0%, and 4.9% during 2003, 2002, and 2001. Average balances for investments were $15.8 billion, $18.2 billion, and $16.9 billion for 2003, 2002, and 2001, with average yields of 3.7%, 4.4%, and 5.7% during the same periods.

Other Income Total other income for this segment totaled $36.0 million, $(24.7) million, and $25.6 million in 2003, 2002, and 2001, which represented an increase of $60.7 million from 2002 to 2003, and a decrease of $50.3 million from 2001 to 2002.

During 2003, the increase of $60.7 million was due primarily to an $18.2 million increase in prepayment fees, a $21.4 million increase in net gains on the sale of qualifying held-to-maturity securities, and a $16.2 million improvement in net unrealized and realized loss on derivatives and hedging activities and securities held at fair value.

During 2002, the decrease of $50.3 million was due primarily to a $71.7 million increase in net losses on derivatives and hedging activities and a decrease of $7.7 million in prepayment fees, partially offset by an increase of $28.3 million in net unrealized gains of securities held at fair value.

The majority of the net realized and unrealized gains (losses) on derivatives and hedging activities in 2003, 2002, and 2001 were due to changes in the fair values of interest-rate swaps that hedge our securities held at fair value. Because of the volatility of U.S. agency obligation interest-rate spreads relative to the LIBOR curve, the changes in fair value on the securities held at fair value did not completely offset the changes in fair value on the hedging instruments. In 2002, other income included unrealized gains of $28.7 million on the securities held at fair value and an unrealized loss of $45.8 million on the corresponding interest-rate exchange agreements.

Other Expense Other expense totaled $29.6 million, $23.6 million, and $21.6 million, an increase of 25.3% and 9.5% in 2003 and 2002, compared to the prior year. Other expense primarily consists of operating expenses, which include personnel costs, occupancy costs, professional fees, and other operating costs. Increases in salaries and benefits reflect general increases in pay and benefits and higher staffing levels to address the increasingly complex nature of our operations and regulatory environment. In addition, the increased expenses related to enhanced disclosures are included in this segment.

Mortgage Purchase Program

Net Interest Income Net interest income from MPP loans totaled $63.5 million, $52.9 million, and $7.3 million in 2003, 2002, and 2001, an increase of 19.9% from 2002 to 2003, and 620.7% from 2001 to 2002. The year-over-year increases in net interest income are primarily attributable to the increased volume of mortgage loans purchased under the MPP in 2003 and 2002.

The mortgage loan balances increased 22.6% and 427.2% to $11.2 billion and $9.1 billion, as of December 31, 2003 and 2002, compared to the prior year. During 2003, 2002, and 2001, the asset yields were 5.0%, 5.9%, and 6.8%. Because of rapidly declining interest rates over the past two years, many of the MPP loans in our portfolio were purchased at a premium. Rapid prepayments on these loans resulted in accelerated recognition of premium amortization, which negatively impacted our yields. Premium amortization on the loans purchased under the MPP totaled $37.7 million in 2003, compared to $12.2 million in 2002 and $1.9 million in 2001.

Yields were not impacted by credit losses during 2003, 2002, or 2001. We have not experienced any credit losses on our MPP investments since the program's inception. Based on our analysis of the mortgage loan portfolio, we have determined that the credit enhancements provided by the sellers and mortgage insurance are sufficient to absorb potential credit losses and that an allowance for credit loss is unnecessary.

Other Income Other income was a loss of $3.8 million in 2003, compared to a gain of $883,000 and $120,000 in 2002 and 2001, a decrease of 526.3% from 2002 to 2003, and an increase of 635.8% from 2001 to 2002. Other income includes pair-off fees, which are based on a contractually agreed upon formula and charged to participating financial institutions when the amount of loans delivered differs from the committed amount. Other income also includes the fair value adjustments on mortgage delivery commitments.

Prior to July 1, 2003, we hedged the market value of purchase commitments on fixed-rate mortgage loans by using derivatives with similar market value characteristics. We typically hedged these commitments by selling mortgage-backed securities to-be-announced for forward settlement. When the mortgage loans settled, the current market value of the commitments was included with the basis of the mortgage loans and amortized accordingly. This transaction was treated as a fair value hedge. In accordance with SFAS No.149, mortgage loan purchase commitments entered into after June 30, 2003, are considered derivatives. Accordingly, both the commitment and the derivatives used in the firm commitment hedging strategy are recorded as a derivative asset or derivative liability at fair value, with changes in fair value recognized in current-period earnings. When the mortgage loan commitment settles, the current market value of the commitment is included with the basis of the mortgage loan and amortized accordingly. During 2003, we recorded a loss of $3.8 million related to SFAS No. 149.

Other Expense Other expense totaled $3.8 million, $2.2 million, and $1.3 million in 2003, 2002, and 2001, an increase of 73.1% from 2002 to 2003, and an increase of 66.7% from 2001 to 2002. Other expense includes operating expenses and other infrastructure costs associated with the ongoing operations of the MPP. The expense increases in each year reflect the infrastructure growth to support the MPP.

Financial Condition

Our asset composition has changed over the last three years since we launched the MPP. The following table presents the distribution of our total assets by major asset classes:

As of December 31,	2003	2002	2001
Advances	38.4%	42.9%	55.9%
Investments	39.2	36.8	39.3
Mortgage loans held for portfolio	21.8	19.5	4.0
Other assets	0.6	0.8	0.8
Total	100.0%	100.0%	100.0%

Our mix of product offerings has shifted from previous years, with the loans purchased under the MPP comprising approximately 21.8% and 19.5% of total assets at December 31, 2003 and 2002, compared with advances and investments comprising approximately 78.2% and 80.5% during the same period. Because of the prepayments on mortgage loans purchased under the MPP, our asset composition in 2003 did not shift as dramatically as had occurred in previous years, although mortgage loans acquired under the MPP continued to increase as a percentage of total assets.

Advances

The average advances balance remained essentially flat in 2003 at $21.5 billion compared to $21.8 billion in 2002, after declining significantly from the 2001 level of $25.0 billion. The advances balance was $19.7 billion and $20.0 billion as of December 31, 2003 and 2002, or 38.4% and 42.9% of total assets.

During economic periods when interest rates are low, consumers generally maintain a larger amount of cash in their bank accounts, which tends to increase the level of liquidity for our member institutions. Because member institution deposits represent a less expensive source of liquidity than advances, demand for advances tends to decline when interest rates are low. Although the balance of advances in 2003 declined slightly compared to 2002, member institutions with smaller asset sizes ($3.0 billion and below) continued to use and grow their advance balances during 2003, while use of advances by larger member institutions ($3.0 billion and above in assets) declined. Because 41.8% of our advances outstanding as of December 31, 2003, is concentrated with two large members, borrowing decisions by these two members can significantly impact our advances balance.

Approximately 36.7% and 40.1% of the par amounts of advances outstanding at December 31, 2003 and 2002 were variable-rate advances. Approximately $3.6 billion and $3.8 billion of the advances outstanding at December 31, 2003 and 2002 were convertible advances. With a convertible advance, we effectively purchase a put option from the member that allows us to terminate the fixed advance, which would normally occur when interest rates increase.

New advances totaled $38.7 billion, $40.5 billion, and $35.5 billion in 2003, 2002, and 2001. With the availability of liquidity in the financial markets, many of the new advances were shorter term in nature, as evidenced by the decline in advances with maturities of more than one year to 49.6% at December 31, 2003, from 78.5% at December 31, 2002. We believe that the demand for new advances will remain modest in our district. If maturing advances are not replaced with new advances, we would reinvest the cash into investment assets or reduce our consolidated obligations as they mature. Refer to Note 7 of the Notes to Financial Statements for additional information on advances.

Credit Risk Our potential credit risk from advances is concentrated in commercial banks and savings institutions. As noted above, as of December 31, 2003, we had advances of $8.2 billion outstanding to two member institutions, which represented 41.8% of our total advances outstanding. The income from advances to these two member institutions was $197.6 million in 2003. We held sufficient collateral to cover the advances to these two institutions, and we do not expect to incur any credit losses on these advances.

We classified as substandard $194.0 million of advances and $530,000 of letters of credit to two insurance companies under common ownership. The companies experienced financial distress in late 2003 and consented to supervisory orders with their respective state regulators to refrain from certain business actions without prior regulatory approval. In 2004, both companies were placed in receivership by their state regulators. Our credit exposure is fully collateralized with high-grade, marketable securities under our control. Because both borrowers continue to pay according to contractual requirements and because of our collateral position, interest continues to accrue on the advances. Interest income recognized during 2003 on the secured advances was $6.4 million. We expect full repayment and have concluded that, given current circumstances, no provision or allowance for credit losses is necessary.

Investments

Investments increased by $2.9 billion to $20.0 billion as of December 31, 2003, an increase of approximately 16.8%. Our principal investments are as noted in the table below:

As of December 31, (in thousands)	2003	2002
U.S. agency obligations	$ 5,884,050	$ 5,877,956
State or local housing agency obligations	41,273	87,000
Mortgage-backed securities	7,245,569	6,481,668
Federal funds sold	2,506,500	3,649,500
Other	4,370,000	1,074,993
Total	$20,047,392	$17,171,117

We invest in U.S. agency obligations, including securities issued by other government-sponsored enterprises. U.S. agency obligations increased by $6.1 million to $5.9 billion as of December 31, 2003, compared to 2002, and represented 29.4% and 34.2% of total investments as of December 31, 2003 and 2002. These investments consisted of $2.3 billion and $2.2 billion of Fannie Mae debt securities as of December 31, 2003 and 2002, and $2.4 billion of Freddie Mac debt securities for both years. The Finance Board limits investments in any one government-sponsored enterprise debt to 100% of our capital, with the exception of FHLBank investments, which have no limits. Our investment in other FHLBanks' consolidated obligations totaled $3.5 billion and $160.0 million as of December 31, 2003 and 2002.

Finance Board regulations limit the mortgage-backed security investments of an FHLBank to 300% of the bank's capital. Total mortgage-backed security investments at December 31, 2003, was $7.2 billion, compared to $6.5 billion at December 31, 2002, which represented 295.1% of our total capital as of December 31, 2003, and 272.1% as of December 31, 2002. The mortgage-backed securities balance at December 31, 2003 and 2002 consisted of $1.7 billion and $0.8 billion of investments in Fannie Mae securities and $2.0 billion and $1.6 billion in Freddie Mac securities, respectively.

The following table presents Standard & Poor's ratings for the securities held in our investment portfolio:

As of December 31, 2003 (in thousands)	AAA	AA	A	BBB	Total
U.S. agency obligations	$ 9,069,228	$	$	$	$ 9,069,228
State or local housing agency obligations	16,053	19,830	5,390		41,273
Mortgage-backed securities	7,245,569				7,245,569
Federal funds sold	30,000	299,500	2,012,000	165,000	2,506,500
Other*	1,184,822				1,184,822
Total	$17,545,672	$319,330	$2,017,390	$165,000	$20,047,392

*Other includes Small Business Administration securities, interest-bearing deposits and securities purchased under agreements to resell.

We have reviewed all investments with a fair value below cost to determine if an other-than-temporary decline in value has occurred. The determination of whether a decline is other-than-temporary is made based on the relevant facts and circumstances related to the security. These considerations include: (1) the length of time and the extent to which the fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer, including any specific events that influence the operations of the issuer or that affect its future earnings potential; (3) our intent and ability to retain the investment for a period of time sufficient to allow for a recovery in value; (4) a review of any downgrades of the security by a rating agency; and (5) any reduction or non-payment of scheduled interest payments. Determining what constitutes an other-than-temporary decline involves judgment. Declines in fair value below cost not considered other-than-temporary in the current period could be considered other-than-temporary in a future period and reduce earnings to the extent of the impairment.

We currently hold $97.2 million in mortgage-backed securities with unrealized losses of $1.3 million that have been in a continuous unrealized loss position for over 12 months. Based on the creditworthiness of the issuers and underlying collateral, we believe that these unrealized losses represent temporary impairments. A table summarizing the held-to-maturity securities with unrealized losses as of December 31, 2003, is included in Note 5 of the Notes to Financial Statements.

Mortgage Loans

As of December 31, 2003, 25 members were participating in the MPP. The total par value of mortgage loans purchased through the MPP was $11.1 billion and $8.9 billion as of December 31, 2003 and 2002, which comprised $2.5 billion and $2.4 billion in government-insured mortgage loans and $8.6 billion and $6.5 billion in conventional mortgage loans, respectively. The balance of total mortgage loans held for portfolio increased to $11.2 billion as of December 31, 2003, from $9.1 billion as of December 31, 2002. During 2003 and 2002, MPP activity was primarily concentrated with one participating financial institution, whose sales totaled $6.2 billion and $7.2 billion in 2003 and 2002. Approximately 97% of the balance of mortgage loans purchased through the MPP as of December 31, 2003, were purchased from three participating financial institutions.

Since late 2002, the Seattle Bank and the other FHLBanks offering the MPP have been in discussions with the principal federal banking agencies regarding the appropriate risk-based capital treatment of MPP by participating financial institutions. We are working diligently to answer the questions that have been raised by the federal banking agencies with respect to the MPP's regulatory capital treatment and believe that this inquiry will be favorably resolved. However, depending on the resolution of this issue, we may modify the MPP to accommodate the needs of our members.

Derivative Assets and Liabilities

We adopted SFAS 133 on January 1, 2001, which resulted in the recognition of all derivative instruments on the statement of condition at their fair values. As of December 31, 2003 and 2002, we had derivative assets of $45.8 million and $77.5 million and derivative liabilities of $306.5 million and $322.4 million. Refer to the Quantitative and Qualitative Disclosures About Market Risk – Interest-Rate Exchange Agreements section in this report for additional information.

Funding

The primary funding source for the Seattle Bank's operations is the proceeds from the issuance of consolidated obligations in the financial markets. Member deposits, capital, and to a lesser extent, repurchase agreements are also funding sources. We make significant use of interest-rate exchange agreements to restructure interest rates on consolidated obligations to better match our funding needs and to reduce funding costs. Our ability to access the financial markets, particularly through the sale of consolidated obligations across the entire maturity spectrum and through a variety of debt structures, allows us to obtain favorable funding for our operations.

Consolidated Obligations <u>Issuance</u> Finance Board regulations govern the issuance of debt on behalf of the FHLBanks and related activities, and authorize the FHLBanks to issue consolidated obligations, through the Office of Finance as their agent, under the authority of section 11(a) of the Act. All of the FHLBanks are jointly and severally liable for the consolidated obligations issued under section 11(a). FHLBanks are not permitted to issue individual debt under section 11(a) without Finance Board approval. We have not issued any such debt.

The Office of Finance is responsible for facilitating and executing the issuance of the consolidated obligations. It also services all outstanding debt, provides the FHLBanks with credit information for counterparties for which they have unsecured credit exposure, serves as a source of information for the FHLBanks on financial market developments, administers REFCORP and the Financing Corporation, and manages the FHLBanks' relationship with the rating agencies in regard to the Bank System rating.

Finance Board regulations also state that we must maintain the following types of assets free from any lien or pledge in an amount at least equal to the amount of consolidated obligations outstanding:

- Cash;
- Obligations of, or fully guaranteed by, the U.S. government;
- Secured advances;
- Mortgages, which have any guaranty, insurance, or commitment from the U.S. government or its agencies;
- Investments described in Section 16(a) of the Act, which among other items, includes securities that a fiduciary or trust fund may purchase under the laws of the state in which the Seattle Bank is located; and
- Other securities that are rated Aaa by Moody's or AAA by Standard & Poor's.

<u>Joint and Several Liability</u> Consolidated obligations are the joint and several obligations of the FHLBanks, backed only by the financial resources of the 12 FHLBanks. Consolidated obligations are not obligations of the U.S government and are not guaranteed by the U.S. government. Although an FHLBank is primarily liable for its portion of consolidated obligations (i.e., those issued on its behalf), the FHLBank is also jointly and severally liable with the other 11 FHLBanks for the payment of principal and interest on consolidated obligations of all the FHLBanks. If the principal

or interest on any consolidated obligation issued on behalf of an FHLBank is not paid in full when due, the FHLBank may not pay dividends to, or redeem or repurchase shares of stock from, any member of the FHLBank. The Finance Board, at its discretion, may require any FHLBank to make principal or interest payments due on any consolidated obligation.

To the extent that an FHLBank makes any payment on a consolidated obligation on behalf of another FHLBank, the paying FHLBank is entitled to reimbursement from the non-complying FHLBank. However, if the Finance Board determines that the non-complying FHLBank is unable to satisfy its obligations, then the Finance Board may allocate the outstanding liability among the remaining FHLBanks on a pro rata basis in proportion to each FHLBank's participation in all consolidated obligations outstanding, or on any other basis the Finance Board may determine.

Consolidated Obligation Bonds Consolidated obligation bonds satisfy longer-term funding requirements and have maturities ranging from one year to 20 years. The maturity terms are not subject to any statutory or regulatory limit. Consolidated obligation bonds can be issued and distributed through negotiated or competitively bid transactions with approved underwriters or selling group members. We use a number of different structures and maturity terms to meet our funding needs. Refer to Note 12 of the Notes to Financial Statements for additional information on consolidated obligation bonds.

Consolidated obligation bonds increased by 28.2% to $39.9 billion as of December 31, 2003, compared to 2002. This was primarily due to funding requirements related to the growth of the MPP.

Consolidated Obligation Discount Notes Consolidated obligation discount notes have maturities of up to 360 days and are a significant funding source for advances with short-term maturities or short repricing intervals, for convertible advances, and for money-market investments. Discount notes are sold at a discount and mature at par.

Consolidated obligation discount notes outstanding decreased by 36.6% to $6.6 billion as of December 31, 2003, compared to 2002. This decrease was primarily due to their overall funding cost relative to the cost of issuing consolidated obligation bonds and interest-rate swaps that, together, have similar characteristics of the consolidated obligation discount notes.

Credit Ratings At December 31, 2003, Moody's rated the Bank System's consolidated obligations Aaa/P-1, and Standard & Poor's rated them AAA/A-1+. In addition to an overall rating on the Bank System's consolidated obligations, each FHLBank is also rated. In November 2003, Standard & Poor's revised the counterparty rating outlooks of the FHLBanks of Seattle, Chicago, and Indianapolis from stable to negative, citing concerns about the impact of growing mortgage-based asset portfolios on the banks' risk profiles. Standard & Poor's did not change the counterparty ratings and reaffirmed the Seattle Bank's and the Bank System's ratings, which are AAA/A-1+. The change in the rating outlook reflects Standard & Poor's assessment of the potential direction of a long-term credit rating over the immediate- or longer-term.

Deposits Deposit programs provide some of our funding resources, while giving members a low-risk earning asset that helps to satisfy their regulatory liquidity requirements. We offer demand and term deposit programs to our members and to qualifying non-members. Deposits totaled $1.3 billion as of December 31, 2003, a decrease from the previous year's balance of $1.8 billion. Demand deposits comprise the largest percentage of deposits at 85.5% as of December 31, 2003, compared to 88.0% as of December 31, 2002.

Other Liabilities Other liabilities decreased by $110.0 million to $134.9 million at December 31, 2003, compared to $244.9 million at December 31, 2002. The decrease primarily relates to investments purchased but not settled as of December 31, 2002, of $237.5 million, which settled in January 2003, offset by an investment purchased but not settled as of December 31, 2003, of $119.9 million. Excluding these unsettled investment purchases, the other liabilities increased $7.6 million as of December 31, 2003, compared to 2002.

Capital Our capital increased by $53.2 million or 2.3% to $2.4 billion as of December 31, 2003. Retained earnings increased by $20.6 million to $57.2 million as of December 31, 2003. This was the result of the Board of Directors' decision to increase retained earnings to 2.0% of total capital. Retained earnings increased by $20.6 million, resulting from net income of $143.8 million less dividends paid to member institutions of $123.1 million. Dividends on Class B(1) stock totaled $121.7 million, and dividends on Class B(2) stock totaled $1.4 million for the year ended December 31, 2003. The 2003 dividend rate for Class B(1) stock was 5.56% and for Class B(2) stock was 0.71%, compared to 6.38% and 1.05% in 2002. In 2002, the combined Class B(1)/capital stock annualized dividend was 6.19%.

Class B(1) stock increased by $193.9 million to $2.3 billion as member institutions increased their stock holdings to comply with activity-based stock requirements. Class B(2) stock declined as member institutions converted their Class B(2) stock to Class B(1) to satisfy their activity-based requirements.

Liquidity

Our mission is to serve the public by enhancing the availability of credit for residential mortgage loans and targeted community development by providing a readily available, low-cost source of funds to our member institutions. We are required to maintain liquidity in accordance with Finance Board regulations and with policies established by our Board of Directors. We actively manage our liquidity and capital resource position to preserve stable, reliable, and cost-effective sources of cash to meet all current and future normal operating financial commitments, meet regulatory capital requirements, and meet any unforeseen liquidity crisis. We define liquidity as the ongoing ability to accommodate the maturity of consolidated obligations, to provide advances to member institutions to satisfy their demand for short- and long-term funds, and to meet other obligations through generally unconstrained access to funding.

In their asset/liability management planning, member institutions may look to the Seattle Bank to provide standby liquidity. We seek to be in a position to meet our member institutions' credit and liquidity needs without maintaining excessive holdings of low-yielding liquid investments or being forced to incur unnecessarily high borrowing costs. Our primary sources of liquidity are short-term investments and new consolidated obligations. Other short-term borrowings, including federal funds purchased, securities sold under agreement to repurchase, and loans from other FHLBanks, provide additional liquidity. To ensure that adequate liquidity is available to meet our cash requirements, we monitor and forecast our future cash flows and our members' liquidity needs, and we adjust funding and investment strategies as needed.

The primary funding source for our operations is consolidated obligations. The financial markets traditionally have treated FHLBank consolidated obligations as "federal agency" debt. As a result, although the U.S. government does not guarantee FHLBank debt, we have ready access to funding at relatively favorable spreads to U.S. Treasury rates. Member deposits, capital, short-term investments, and to a lesser extent, repurchase agreements are also funding sources.

Finance Board regulations require the FHLBanks to maintain, in the aggregate, unpledged qualifying assets equal to the consolidated obligations outstanding. Qualifying assets are defined as: cash; secured advances; assets with an assessment or rating at least equivalent to the current assessment or rating of the consolidated obligations; mortgages or other securities of or issued by the U.S. government or its agencies; and securities that fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located. We were in compliance with this requirement at December 31, 2003 and 2002.

We maintain contingency liquidity plans designed to enable us to meet our obligations and the liquidity needs of our members in the event of operational disruptions at the Seattle Bank or the Office of Finance, or short-term financial market disruptions. These include back-up funding sources in the repurchase and federal funds markets. We continuously monitor our liquidity position and anticipated funding needs. In the event of a financial market disruption in which the Bank System was not able to issue consolidated obligations, we could borrow against our held-to-maturity investment portfolio to meet operational needs. Our investment portfolio includes high-quality investment securities that are readily marketable. Our investments include U.S. agency obligations and mortgage-backed securities, of which 87.5% are rated AAA by Standard & Poor's. Refer to the Financial Condition – Investments discussion in this section of the report for additional information on investment quality and types.

The table below presents our contractual obligations and commitments:

As of December 31, 2003 (in thousands)	Payments Due by Period Less Than 1 Year	1 to 3 years	3 to 5 years	Thereafter	Total
Contractual Obligations					
Consolidated obligations	$7,800,400	$13,496,695	$7,744,675	$10,868,800	$39,910,570
Operating leases	1,701	3,669	3,933	7,517	16,820
Commitments to issue consolidated obligation bonds	341,000				341,000
Total	$8,143,101	$13,500,364	$7,748,608	$10,876,317	$40,268,390
Other Commitments					
Commitments for additional advances	$ 19,453	$ 9,158	$	$	$ 28,611
Standby letters of credit	108,811	21,288	7,579	50,700	188,378
Standby bond purchase agreements		96,191			96,191
Commitments to fund mortgage loans	612,674				612,674
Unused line of credits and other commitments	200,000				200,000
Total	$ 940,938	$ 126,637	$ 7,579	$ 50,700	$ 1,125,854

Capital Resources

We are subject to three statutory capital requirements. First, we are required to hold risk-based capital equal to the sum of our credit-risk capital requirement, our market-risk capital requirement, and our operations-risk capital requirement, calculated in accordance with Finance Board regulations. Only permanent capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. The Finance Board may require the Seattle Bank to maintain a greater amount of permanent capital than is required by the risk-based capital requirements as defined. Second, the GLB Act imposes a 5% minimum leverage ratio based on total capital, which includes a 1.5 weighting factor applicable to permanent capital. Leverage and capital ratios measure the degree to which we use debt. Higher leverage generally equates to higher returns on capital, but also increases risk. A minimum leverage ratio, which is defined as total capital (with permanent capital multiplied by 1.5) divided by total assets, is intended to ensure that we maintain a sufficient amount of capital to enable us to service our debt. Third, the GLB Act imposes a 4% minimum capital ratio that does not include the 1.5 weighting factor applicable to the permanent capital. This ratio, which is defined as total capital over total assets, does not weight permanent capital and provides another measure for the Seattle Bank to monitor its business. At December 31, 2003, our leverage ratio was 7.2% and our capital ratio was 4.8%.

The Seattle Bank's capital plan authorizes two classes of Class B stock, each of which has a par value of $100, the same par value as our pre-conversion capital stock. Each class of stock can be issued, redeemed, and repurchased only at par value. Member institutions are required to hold a specific amount of Class B(1) stock. Both classes of B stock are redeemable five years after: (1) written notice from the member; (2) consolidation or merger of two member institutions; or (3) withdrawal or termination of membership. The Seattle Bank may elect to repurchase stock that is subject to redemption prior to the expiration of the five-year notice period, but is under no obligation to do so. Refer to Note 13 of the Notes to Financial Statement for additional information on capital requirements.

Our Board of Directors may declare and pay dividends only from retained earnings or current net earnings. Dividends may be paid in either cash or capital stock. Although we expect to continue paying dividends in the foreseeable future, payment of future dividends is subject to the discretion of the Board of Directors and satisfaction of regulatory requirements and will depend on many factors, including our financial condition, earnings, capital requirements, regulatory constraints, legal requirements, and other factors that the Board of Directors deems relevant.

In 2003, the Finance Board issued guidance to the FHLBanks calling for each FHLBank, at least annually, to assess the adequacy of its retained earnings in light of alternative possible future financial and economic scenarios, including parallel and non-parallel interest-rate shifts, changes in the basis relationship between different yield curves, and changes in the credit quality of the FHLBank's assets. Each FHLBank's board of directors is expected to adopt a retained earnings policy that includes a target level of retained earnings as well as a plan that will enable the FHLBank to reach the target level of retained earnings.

We are currently undertaking a study of the level of our retained earnings in accordance with the Finance Board's guidance. Future dividend rates may be lower, depending on the amount of additional retained earnings that are deemed to be required, and the period of time in which the desired level is to be achieved.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our business segments provide our member institutions and housing associates with advances and other credit products with a wide range of maturities and terms, and provide our members with an alternative funding source in the secondary mortgage markets that can help them meet liquidity and other finance needs. The principal sources of funds for these activities are consolidated obligations and, to a lesser extent, capital and deposits from member institutions. Lending and investing funds and engaging in interest-rate exchange agreements may expose us to a number of market risks, including credit and interest-rate, operational, and business risks. We have established policies and practices to evaluate and to control these risks. In addition, the Finance Board has established regulations governing our risk management practices, and we file periodic compliance reports with the Finance Board.

We do not currently have any special purpose entities or any other type of off-balance sheet conduits. All derivatives are recorded in the statement of condition at fair value. Finance Board regulations prohibit the speculative use of interest-rate exchange agreements, and we do not trade derivatives for short-term profit.

Interest-Rate Risk

General

Interest-rate risk is the risk that relative and absolute changes in interest rates may adversely affect an institution's financial condition and future earnings. The goal of an interest-rate risk management strategy is not necessarily to eliminate interest-rate risk, but to manage or control it by setting appropriate limits. Our general approach to managing interest-rate risk is to acquire and maintain a portfolio of assets and liabilities that, together with our associated interest-rate exchange agreements, limits our expected market value and income statement volatility. Finance Board regulations regarding interest-rate exchange agreements enable the FHLBanks to enter into these agreements only to reduce the market-risk exposures inherent in otherwise unhedged assets and funding positions. Accordingly, we can use interest-rate swaps, options to enter into interest-rate swaps (i.e., swaptions), interest-rate cap and floor agreements, calls, puts, and futures and forward contracts (collectively, interest-rate exchange agreements) in our interest-rate risk management and funding strategies. Each of these instruments is described more fully below.

Swaps A swap is an agreement between two counterparties to exchange cash flows in the future. The agreement defines the dates when the cash flows are to be paid and the way in which they will be calculated. In the simplest interest-rate swap agreements, one party pays cash flows equal to interest calculated based on a predetermined fixed rate times a notional (or face) amount for a specified number of years. In return, the party receives interest calculated using a variable rate on the same notional principal for the same period of time. The variable rate in most interest-rate swap agreements is LIBOR.

Swaptions A swaption is an option on a swap that gives its buyer the right to enter into a specified interest-rate swap at a certain time in the future. When used as a hedge, a swaption provides protection against interest rate changes for future lending or borrowing activity. A party can purchase payer swaptions, which is the option to pay a fixed rate at a later date, and receiver swaptions, which is the option to receive a fixed rate at a later date.

Put and Call Options An option is a contract in which the seller (or writer of the option) gives the buyer the right to demand, within a specified period of time, the purchase (call) or sale (put) by the option seller of a specified amount of an asset or liability, at a fixed price or rate, called the strike price or rate. In return, the seller receives a payment, called an option premium.

Caps and Floors A cap is a contract or financial instrument that generates a cash flow if the price or rate of an underlying variable (e.g., interest-rate index) rises above some threshold "cap" rate. A floor is a contract or financial instrument that generates a cash flow if the price or rate of an underlying variable falls below some threshold "floor" rate. Caps and floors are designed to provide insurance against a variable interest-rate asset or liability above a certain level. Caps are generally used in conjunction with liabilities and floors are generally used with assets.

Futures and Forwards A future is a financial contract that encompasses the sale or purchase of financial instruments or physical commodities for future delivery, usually on a commodity exchange. A forward is a similar contract; however, these contracts are generally not traded on commodity exchanges. Financial futures and forwards are used as protection against interest-rate fair value changes that negatively impact assets and liabilities.

As noted above, interest-rate exchange agreements can be used to manage interest-rate risk. To do so, a relationship is created which designates a derivative financial instrument (e.g., an interest-rate exchange agreement) as a hedge of an interest-rate exposure on an asset or liability. The accounting treatment for these hedges depends on the characteristics of the derivative instrument and hedged item and their correlation to one another and is specified in SFAS 133 and its amendments.

The following summarizes our accounting for our derivative instruments and hedging relationships:

Fair Value Hedges In a fair-value hedge, the derivative hedges the exposure to changes in the fair value of an asset or liability that is attributable to a particular risk. We use fair value hedges to mitigate the risk of the changes in the overall fair value of hedged items. Changes in the fair value of a derivative that is effective as, and that is designated and qualifies as, a fair value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk, are recorded in current-period earnings. The following discussion describes the applicable accounting treatments for fair value hedging relationships under SFAS 133.

Short-Cut Hedge Relationships A short-cut relationship implies that the hedge between the derivative and hedged item is considered to be perfectly correlated. Therefore, the changes in the fair value of the derivative and hedged item will perfectly offset, as a short-cut relationship assumes no ineffectiveness. To qualify for short-cut accounting treatment a number of applicable conditions must be met:

- The notional amount of the derivative must match the principal of the interest-bearing asset or liability.
- The fair value of the derivative at the inception of the hedging relationship is zero.
- The formula for computing net settlements for the derivative is the same for each net settlement.
- The underlying instrument is not prepayable except in the following circumstances:
  - An interest-bearing asset/liability is prepayable solely due to an embedded call option, provided that the hedging derivative contains an embedded mirror-image call option.
  - An interest-bearing asset/liability is prepayable solely due to an embedded put option, provided that the hedging derivative contains an embedded mirror-image put option, and the index on which the variable leg of the derivative is based matches the benchmark interest rate designated as the interest-rate risk being hedged for that hedging relationship.
- Any other terms in the interest-bearing financial instruments or derivative are typical of those instruments and do not invalidate the assumption of no ineffectiveness.
- The expiration date of the derivative matches the maturity date of the interest-bearing asset or liability.
- There is no floor or ceiling on the variable interest rate of the derivative.
- The time period of repricings of the variable interest rate are frequent enough to justify an assumption that the variable payment or receipt is at a market rate.

Highly-Effective Hedge Relationships A highly effective relationship indicates that, at hedge inception and on an ongoing basis, both the prospective and retrospective effectiveness results indicate that the derivative and hedged item will be highly effective in achieving offsetting changes in fair value attributable to the hedged risk. The changes in fair value for the derivative and hedged item may or may not perfectly offset, and the difference, if any, will be recognized as a net gain or loss in current-period earnings on the income statement. To maintain the highly effective relationship, we perform hedge effectiveness testing at the inception of the hedge and on an ongoing basis. Upon effectiveness review, if at any point the hedge fails to maintain effectiveness, the hedge relationship is deemed ineffective and the hedging relationship is terminated.

Not-Highly-Effective Hedge Relationships In a not-highly-effective relationship, there is no accounting relationship between the derivative and hedged item. This does not imply that there is not an economic relationship between the derivative and hedged item; however, the relationship does not qualify for hedge accounting treatment under SFAS 133 and, therefore, the hedged item's change in fair value is not evaluated. We classify these types of hedges as "freestanding" pursuant to SFAS 133. Changes in the fair value of the derivative in a non-SFAS 133 hedge of an asset or liability (economic hedge) for asset/liability management are recorded in current-period earnings.

We face interest-rate risk on advances, mortgage loans held for portfolio, mortgage loan purchase commitments, investments, consolidated obligations, and intermediary positions. The following discussion describes our accounting for our derivative instruments and hedges.

Advances

The optionality embedded in certain financial instruments we hold (e.g., the prepayment terms in a member advance) can create interest-rate risk. When a member prepays an advance, we would suffer lower future income if the prepaid principal portion were invested in lower-yielding assets that continued to be funded by higher-cost debt. To protect against this risk, we generally charge a prepayment fee designed to make us financially indifferent to a borrower's decision to prepay an advance. When we offer advances (other than short-term advances) that a member institution may prepay without a prepayment fee, we usually finance such advances with callable debt or hedge this option.

With the issuance of a convertible advance, we purchase from the member a put option that enables us to convert the advance from a fixed rate to a variable rate, if interest rates increase, or to terminate the advance and extend additional credit on new terms. We may hedge a convertible advance by entering into a cancelable interest-rate exchange agreement where we pay a fixed rate and receive a variable rate based on a market index, typically LIBOR. This type of hedge is treated as a fair value hedge under SFAS 133. The swap counterparty can cancel the interest-rate exchange agreement on the put dates, which would normally occur in a rising-rate environment, at which time we would generally either terminate the advance or convert it to a variable rate.

Mortgage Loans Held for Portfolio

The prepayment options embedded in our mortgage loan assets can result in extensions or contractions in the expected maturities of these investments, depending on estimated prepayment speeds. In addition, to the extent that we purchase mortgage loans at premiums or discounts, net income is affected by extensions or contractions in the expected maturities of these assets. We manage the interest-rate and prepayment risk associated with mortgages primarily through our debt issuance. We use both callable and non-callable debt to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans. In addition, net income would be reduced if we were to replace the mortgages with lower-yielding assets and if our higher funding costs were not reduced concomitantly.

We may also purchase interest-rate exchange agreements to manage the prepayment risk embedded in the mortgage loans. Although these derivatives are valid economic hedges against the prepayment risk of the mortgage loans, they are not specifically linked to individual mortgage loans, and we account for these derivatives as freestanding pursuant to SFAS 133.

We analyze the risk of our mortgage portfolio by performing analyses of the portfolio's duration on a regular basis.

Mortgage Loan Purchase Commitments

We hedge the market value of certain commitments to purchase fixed-rate mortgage loans by selling mortgage-backed securities to-be-announced for forward settlement. The mortgage purchase commitment and the mortgage-backed securities to-be-announced derivative used in the firm commitment hedging strategy are recorded as derivative assets or liabilities at fair value on the statement of condition, with changes in fair value recognized in current-period earnings. When the mortgage loans are settled, the current market value of the mortgage purchase commitment is included with the basis of the mortgage loan and amortized accordingly. Prior to July 1, 2003, this transaction would have been treated as a fair value hedge. After July 1, 2003, we consider these hedges to be freestanding pursuant to SFAS 133.

Investments

We primarily invest in U.S. agency obligations, mortgage-backed securities, and the taxable portion of state or local housing finance agency securities. The interest-rate and prepayment risk associated with these investment securities is managed through a combination of debt issuance and derivatives. We may manage against prepayment and interest-rate risk by funding investment securities with consolidated obligations that have call features. For investment securities carried at fair value, we may also manage the risk arising from changing market prices by matching the cash outflow on the interest-rate exchange agreements with investment securities carried at fair value. These economic hedges are considered freestanding pursuant to SFAS 133.

Consolidated Obligations

We manage the risk arising from changing market prices of a consolidated obligation by matching the cash outflow on the consolidated obligation with the cash inflow on an interest-rate exchange agreement.

In a typical transaction, the Office of Finance issues a fixed-rate consolidated obligation for the Seattle Bank, and we simultaneously enter into a matching interest-rate exchange agreement in which the counterparty pays fixed cash flows, designed to mirror in timing and amount the cash outflows we pay on the consolidated obligation. Such transactions are treated as fair value hedges under SFAS 133. The net result of this transaction is that we pay a variable cash flow that closely matches the interest payments we receive on short-term or variable-rate advances. This intermediation between the financial and swap markets permits us to raise funds at lower costs than would otherwise be available through the issuance of simple fixed- or variable-rate consolidated obligations in the financial markets.

Intermediation

To help meet the asset/liability management needs of our member institutions, we enter into offsetting interest-rate exchange agreements, acting as an intermediary between member institutions and other counterparties. This intermediation allows smaller member institutions indirect access to the swap market. The derivatives used in intermediary activities are considered to be freestanding pursuant to SFAS 133. Because the two positions offset, the net result of the accounting for these derivatives does not significantly affect our operating results.

Interest-Rate Risk Management

We measure interest-rate risk exposure by a variety of methods, including calculation of duration of equity. Duration measures the time required to recapture an investment and reinvest repaid principal. Duration of equity is the market value-weighted duration of assets minus the market value-weighted duration of liabilities divided by the market value of equity. In this calculation, we consider all components of capital as equity. Duration of equity shows the sensitivity of market value of equity to changes in interest rates. Higher duration numbers, whether positive or negative, indicate greater potential volatility of the market value of equity. The value of an instrument with a duration of five years will change by approximately 5% with a one percentage point change in interest rates. Under our current policy, duration of equity must stay within a range of +5 to -5 years when measured using current interest rates. It must stay within a range of +7 to -7 years when measured under an instantaneous parallel increase or decrease in interest rates of 200 basis points. We report the results of our duration of equity calculations to the Finance Board each quarter.

The following table summarizes the interest-rate risk associated with all financial instruments entered into by the Seattle Bank based on the duration of equity in years:

Duration of Equity (in years)	Up 200 Basis Points	Base	Down 200 Basis Points
December 31, 2003	6.4	4.1	(5.2)
December 31, 2002	2.7	(1.9)	(6.8)

In calculating and measuring duration of equity, we also calculate and measure our duration gap (i.e., the difference between the durations of assets and liabilities). Duration gap summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time and across interest-rate scenarios. A positive duration gap signals a greater exposure to rising interest rates because it indicates that the duration of our assets exceeds the duration of our liabilities. A negative duration gap signals a greater exposure to declining interest rates because the duration of our assets is less than the duration of our liabilities.

The following table summarizes the range of our duration gap in months between our assets and liabilities:

Duration Gap (in months)	From	To
December 31, 2003	(2.9)	1.3
December 31, 2002	(1.6)	1.1

Credit Risk

Credit risk is the risk of loss due to default. We face credit risk on advances, certain investments, mortgage loans, interest-rate exchange agreements, and counterparty exposures.

Advances

The Seattle Bank has never experienced a credit loss on advances. We protect against credit risk on advances by requiring collateral on all advances we fund. We can also call for additional or substitute collateral during the life of an advance to protect our security interest. The Act limits eligible collateral to certain investment securities, residential mortgage loans, deposits with the Seattle Bank, and other real estate-related assets. The GLB Act and Finance Board regulations allow the FHLBanks to expand eligible collateral for many of their member institutions. Member institutions that qualify as community financial institutions, defined in the GLB Act as FDIC-insured depository institutions with average assets for the past three calendar years totaling no more than $538 million, may pledge small-business, small-farm, and small-agribusiness loans as collateral for advances. Advances to community financial institutions secured with expanded collateral represent $210.3 million of the $19.7 billion of advances outstanding as of December 31, 2003. We believe that we have the policies and procedures in place to effectively manage this credit risk.

Investments

We are subject to credit risk on some investments. We limit our unsecured credit exposure to any counterparty, other than the U.S. government or its agencies, based on the credit quality and capital level of the counterparty and the capital level of the Seattle Bank. As of December 31, 2003, our unsecured credit exposure to counterparties other than the U.S. government or its agencies was $6.9 billion. This primarily included $2.5 billion of federal funds sold and $3.5 billion of other FHLBank consolidated obligations.

Mortgage Loans Held for Portfolio

Under the MPP, we purchase mortgage loans from member institutions, and the member institutions continue to bear a portion of the credit risk. Our total par value of mortgage loans purchased through the MPP was $11.1 billion and $8.9 billion as of December 31, 2003 and 2002, which comprised $2.5 billion and $2.4 billion in government-insured mortgage loans and $8.6 billion and $6.5 billion in conventional mortgage loans, respectively. The conventional mortgage loans are credit-enhanced by our member institutions to a level equivalent to at least an investment-grade rating. Additionally, the conventional loans are covered by supplemental mortgage loan insurance sufficient to raise the credit quality of the loan pools to the equivalent of an AA rating. We have determined that no loan loss allowance is necessary, and believe that we have the policies and procedures in place to appropriately manage this credit risk.

Interest-Rate Exchange Agreements

At December 31, 2003, we had $17.5 billion total notional amount of interest-rate agreements outstanding, compared to $18.7 billion at December 31, 2002. The notional amount of these agreements serves as a factor in determining periodic interest payments or cash flows received and paid, and does not represent actual amounts exchanged or our exposure to credit and market risk. The amount potentially subject to credit loss is much less. Notional values are not meaningful measures of the risks associated with interest-rate exchange agreements or other derivatives, which can only be meaningfully measured on a market-value basis, taking into consideration the cost of replacing interest-rate exchange agreements with similar agreements from a highly rated counterparty.

With the Seattle Bank's adoption of SFAS 133 on January 1, 2001, we now record all derivative instruments on the statement of condition at their fair values. We classify derivative assets and derivative liabilities according to the net fair value of derivatives with each counterparty. If the net fair value of derivatives with a counterparty is positive, it is classified as an asset; if the net fair value of derivatives with a counterparty is negative, it is classified as a liability. At December 31, 2003 and 2002, we held derivative assets of $45.8 million and $77.5 million. At December 31, 2003 and 2002, we held derivative liabilities of $306.5 million and $322.4 million.

The following table categorizes the estimated fair value of derivative financial instruments, excluding accrued interest, by product and type of accounting treatment. Under "Fair Value," we include hedges where hedge accounting is achieved. In a fair value hedge, both the changes in fair value of the hedged item and the derivative offset each other, resulting in little or no impact to earnings. Under "Economic," we include hedge strategies where SFAS 133 hedge accounting is not applied and, therefore, changes in the fair value of the derivatives are recorded in current-period earnings with no adjustments made to the economically hedged asset or liability. Refer to the discussion of hedge accounting treatments in the Interest-Rate Risk section of this report for additional information.

As of December 31, (in thousands)	2003 Notional	2003 Estimated Fair Value (excludes accrued interest)	2003 Hedged Item Fair Value (excludes accrued interest)	2002 Notional	2002 Estimated Fair Value (excludes accrued interest)	2002 Hedged Item Fair Value (excludes accrued interest)
Advances						
Fair Value	$ 3,372,309	$(254,844)	$254,844	$ 3,619,359	$(352,843)	$352,843
Investments						
Economic	200,000	(48,522)	44,187*	200,000	(57,352)	52,094*
Mortgage Loans Held for Portfolio						
Fair Value				2,990,000	(13,312)	14,434
Economic	746,000	2,061				
Consolidated Obligations						
Fair Value	10,728,495	4,038	(4,035)	8,964,340	131,621	(131,621)
Discount Notes						
Fair Value				258,327	697	(697)
Balance Sheet						
Economic	700,000	6,185		700,000	5,705	
Intermediary Positions						
Intermediaries	1,134,800	151		1,985,700	509	
Other						
Standalone delivery commitments	612,674	(2,736)				
Total Notional and Fair Value	$17,494,278	$(293,667)	$294,996	$18,717,726	$(284,975)	$287,053
Accrued Interest		32,920			40,095	
Net Derivative Balance		$(260,747)			$(244,880)	
Net Derivative Assets Balance		$ 45,766			$ 77,480	
Net Derivative Liabilities Balance		(306,513)			(322,360)	
Net Derivative Balance		$(260,747)			$(244,880)	

* Fair value adjustment on securities held at fair value.

A table that presents the earnings impact of our hedging activities for 2003, 2002, and 2001 is included in the Results of Operations – Other Income section of this report.

Derivative Credit-Risk Exposure and Counterparty Ratings

The Seattle Bank is subject to credit risk because of the potential nonperformance by a counterparty to an agreement. The degree of counterparty risk on interest-rate exchange agreements and other derivatives depends on the extent to which netting procedures and other credit enhancements are used to mitigate the risk. We manage counterparty credit risk through credit analysis, collateral management, and other credit enhancements. We require agreements to be in place for all counterparties. These agreements must include provisions for netting exposures across all transactions with that counterparty. The agreements also require the counterparties to collateralize exposures with the thresholds for priority collateral tied to the credit risk of the counterparty. For example, a counterparty must deliver collateral to the Seattle Bank if the total market value of our exposure to that counterparty rises above a specific threshold. As a result of these risk mitigation initiatives, we do not currently anticipate any credit losses on our interest-rate exchange agreements.

Our maximum credit risk equals the estimated cost of replacing favorable interest-rate swaps, forward agreements, and purchased caps and floors, if the counterparty defaults, net of the value of related collateral. Our maximum credit risk, before considering collateral, was approximately $45.2 million and $77.2 million as of December 31, 2003 and 2002. In determining maximum credit risk, we consider accrued interest receivable and payable, and the legal right to offset assets and liabilities by counterparty. Our net exposure after collateral was approximately $25.1 million and $44.7 million as of December 31, 2003 and 2002.

Our counterparty credit exposure, by credit rating, is as follows:

As of December 31, 2003 (in thousands)	Notional Amount	Total Net Exposure at Fair Value	Collateral Held	Net Exposure After Collateral
AAA	$ 149,350	$	$	$
AA	2,600,871			
AA–	6,234,983	448		448
A+	5,691,900	38,639	20,100	18,539
A	685,000	4,718		4,718
Not Rated	569,000			
Member Institutions[1]	950,500	1,390		1,390
Total	$16,881,604	$45,195	$20,100	$25,095

As of December 31, 2002 (in thousands)	Notional Amount	Total Net Exposure at Fair Value	Collateral Held	Net Exposure After Collateral
AAA	$ 147,550	$	$	$
AA+	235,000			
AA	956,050			
AA–	3,258,799	733		733
A+	10,104,427	64,197	29,703	34,494
A	2,165,400	13,278	2,822	10,456
Member Institutions[1]	1,850,500	(968)		(968)
Total	$18,717,726	$77,240	$32,525	$44,715

[1] Collateral held with respect to interest-rate exchange agreements with member institutions represents either collateral physically held by or on behalf of the Seattle Bank or collateral assigned to the Seattle Bank, as evidenced by a written security agreement, and held by the member institution for the benefit of the Seattle Bank. This notional amount excludes standalone delivery commitments.

As of December 31, 2003, excluding interest-rate exchange agreements in which we served as an intermediary for member institutions and which are fully collateralized, 96.4% of our outstanding interest-rate exchange agreements are with counterparties rated A or higher. At December 31, 2003, 17 counterparties represented the total notional amount of our outstanding interest-rate exchange agreements, excluding agreements in which we served as intermediaries; of these, approximately 56.4% is with 10 counterparties rated AA– or higher.

Risk-Based Capital Requirements

After implementation of our capital plan in 2002, we became subject to the Finance Board's risk-based capital regulations. This regulatory framework requires each FHLBank to maintain sufficient permanent capital to meet its combined credit risk, market risk, and operations risk, calculated in accordance with such rules. Only permanent capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement.

The credit risk requirement is determined by adding the credit-risk capital charges for assets, off-balance sheet items, and derivative contracts based on, among other things, the credit percentages assigned to each item as required by Finance Board regulation.

The market risk requirement is determined by adding the market value of the portfolio at risk from movements in interest rate fluctuations that could occur during times of market stress and the amount, if any, by which our current market value of total capital is less than 85% of our book value of total capital. We calculate the market value of our portfolio at risk and the current market value of our total capital by using an internal model. Our modeling approach and underlying assumptions are subject to Finance Board review and approval on an ongoing basis.

The operations risk requirement is equal to 30% of the sum of the Seattle Bank's credit-risk capital and market-risk capital requirements.

At December 31, 2003, we had a total risk-based capital requirement of $694.9 million, comprising $172.9 million of credit risk capital, $361.6 million of market risk capital, and $160.4 million of operations risk capital.

The GLB Act specifies a 5% minimum leverage ratio based on total capital, which includes a 1.5 weighting factor applicable to permanent capital, and a 4% minimum capital ratio that does not include the 1.5 weighting factor applicable to the permanent capital. Leverage and capital ratios measure the degree to which we use debt. Higher leverage generally equates to higher returns on capital, but also increases risk. A minimum leverage ratio, which is defined as total capital (with permanent capital multiplied by 1.5) divided by total assets is intended to ensure that we maintain a sufficient amount of capital to service our debt. The minimum capital ratio, which is defined as total capital over total assets, does not weight permanent capital, and provides another measure for the Seattle Bank to monitor its business. At December 31, 2003, our leverage ratio was 7.2% and our capital ratio was 4.8%.

Business Risk

Business risk is the risk of an adverse impact on our profitability resulting from external factors that may occur in both the short and long term. Business risk includes competition from other financial institutions, changes in membership base due to consolidation, changing business practices, and political, strategic, reputational, accounting, and/or regulatory events that are beyond our control. From time to time, proposals are made or legislative and regulatory changes are considered, which could affect our status and our cost of doing business. The Seattle Bank's Board of Directors and our management try to mitigate these risks through long-term strategic planning and through continually monitoring economic, market, and competitive indicators, and the external environment.

Operational Risk

Operational risk is the risk of potential loss due to human error, reliance on vendors, outsourced systems and software, systems malfunctions, man-made or natural disasters, fraud, or circumvention or failure of internal controls. We have established comprehensive systems for risk assessments, financial and operating policies and procedures, and appropriate insurance coverage to mitigate the likelihood of, and potential losses from, these occurrences. Our policies and procedures include controls intended to ensure that system-generated data are reconciled to source documentation on a regular basis. The Seattle Bank's internal audit department, which reports directly to the Board of Directors' audit committee, regularly monitors compliance with established policies and procedures. In addition, we have a disaster recovery plan that is designed to restore critical business processes and systems in the event of disasters. However, some operational risks are beyond our control, and the failure of other parties to adequately address their operational risk could adversely affect us.

SUPPLEMENTAL FINANCIAL DATA

Quarterly Financial Data

Supplemental financial data for each full quarter within the years ended December 31, 2003, 2002, and 2001 are included in the tables below:

	2003 Quarter Ended			
(in thousands, except per share data)	December	September	June	March
Interest income	$406,400	$367,107	$387,734	$400,737
Interest expense	360,801	326,886	341,792	335,654
Net interest income	45,599	40,221	45,942	65,083
Non-interest income	10,713	16,412	6,332	(1,243)
Non-interest expense	9,371	8,256	7,967	7,779
Assessments	12,453	12,835	11,755	14,873
Net income	$ 34,488	$ 35,542	$ 32,552	$ 41,188
Earnings per share	$ 1.44	$ 1.46	$ 1.36	$ 1.77
Dividends per share	1.21	1.23	1.20	1.52

	2002 Quarter Ended			
(in thousands, except per share data)	December	September	June	March
Interest income	$430,703	$429,811	$410,247	$400,459
Interest expense	359,868	364,147	349,497	347,941
Net interest income	70,835	65,664	60,750	52,518
Non-interest income	(2,972)	(9,504)	(4,487)	(6,810)
Non-interest expense	6,960	5,939	6,576	6,332
Assessments	16,158	13,324	13,183	10,446
Net income	$ 44,745	$ 36,897	$ 36,504	$ 28,930
Earnings per share	$ 1.94	$ 1.46	$ 1.46	$ 1.21
Dividends per share	1.49	1.50	1.50	1.48

	2001 Quarter Ended			
(in thousands, except per share data)	December	September	June	March
Interest income	$453,605	$527,319	$588,369	$662,470
Interest expense	384,803	467,005	525,653	611,464
Net interest income	68,802	60,314	62,716	51,006
Non-interest income	15,902	(3,451)	5,254	8,013
Non-interest expense	6,869	4,802	5,324	5,887
Assessments	20,651	13,812	16,620	13,205
Cumulative effect of change in accounting principle				(3,359)
Net income	$ 57,184	$ 38,249	$ 46,026	$ 36,568
Earnings per share	$ 2.42	$ 1.65	$ 2.03	$ 1.68
Dividends per share	1.76	1.76	1.74	1.60

Assets

Supplemental financial data on our investment securities are included in the tables below.

Held-to-Maturity Securities

The tables below present the composition of our held-to-maturity securities by major security type as of December 31, 2003, 2002, and 2001, and the maturities and yield as of December 31, 2003:

As of December 31, (in thousands)	2003	2002	2001
U.S. agency obligations	$ 5,639,863	$ 5,625,862	$ 3,481,267
State or local housing agency obligations	41,273	87,000	121,353
Other FHLBanks' bonds	3,500,000	159,993	1,608,756
Commercial paper			299,691
Other			408,986
	9,181,136	5,872,855	5,920,053
Mortgage-backed securities	7,245,569	6,481,668	6,785,389
Total	$16,426,705	$12,354,523	$12,705,442

As of December 31, 2003 (in thousands)	Book Value	% Yield
U.S. agency obligations		
Within one year	$1,000,017	4.02
After one but within five years	3,498,508	3.60
After five but within 10 years	1,041,594	5.44
After 10 years	99,744	1.79
Total	$5,639,863	3.98
State or local housing agency obligations		
After 10 years	$41,273	4.67
Total	$41,273	4.67
Other FHLBanks' bonds		
After one but within five years	$3,000,000	2.45
After five but within 10 years	500,000	2.04
Total	$3,500,000	2.39
Mortgage-backed securities		
After one but within five years	$ 16,974	5.93
After five but within 10 years	65,972	6.43
After 10 years	7,162,623	4.13
Total	$7,245,569	4.16

Held at Fair Value Securities

The tables below present the composition of our held at fair value securities by major security type as of December 31, 2003, 2002, and 2001, and the maturities and yield as of December 31, 2003:

As of December 31, (in thousands)	2003	2002	2001
U.S. agency obligations	$244,187	$252,094	$223,257
Mortgage-backed securities			16,999
Total	$244,187	$252,094	$240,256

As of December 31, 2003 (in thousands)	Book Value	% Yield
U.S. agency obligations		
After 10 years	$244,187	6.30
Total	$244,187	6.30

Loan Portfolio Analysis

The table below presents our outstanding advances, mortgage loans, and loans 90 days or more past due and accruing interest:

As of December 31, (in thousands)	2003	2002	2001
Advances	$19,652,566	$20,035,612	$24,251,997
Mortgage loans	11,171,517	9,111,889	1,728,466
Mortgage loans past due 90 days or more and still accruing interest*	43,955	16,459	3,749

*The Seattle Bank had no nonperforming mortgage loans as of December 31, 2003, 2002, and 2001.

The following table presents the top 10 holdings by state as of December 31, 2003, for mortgage loans purchased from members.

State (in thousands, except loan count data)	Outstanding Balance	Loan Count	% of Balance
California	$2,579,046	13,198	23.3
Illinois	803,647	4,597	7.3
Washington	701,854	4,751	6.3
New York	512,893	2,676	4.6
Massachusetts	506,140	2,491	4.6
Texas	482,303	4,204	4.4
New Jersey	425,338	2,424	3.8
Florida	413,409	3,129	3.7
Colorado	376,543	2,161	3.4
Georgia	343,379	2,467	3.1

Each of the remaining states represent less than 2.9% of the outstanding balance at year-end 2003.

The geographic concentration of the total mortgage loan portfolio is as follows:

As of December 31,	2003[1]	2002[1]
Midwest[2]	16.0%	14.6%
Northeast[3]	18.3	16.5
Southeast[4]	16.8	16.6
Southwest[5]	14.3	14.8
West[6]	34.6	37.5
Total	100.0%	100.0%

[1] Percentages calculated based on the unpaid principal balance at the end of each period.

[2] Midwest includes Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.

[3] Northeast includes Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Puerto Rico, and the Virgin Islands.

[4] Southeast includes Alabama, Florida, Georgia, Kentucky, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, Washington D.C., and West Virginia.

[5] Southwest includes Arizona, Arkansas, Colorado, Kansas, Louisiana, Missouri, New Mexico, Oklahoma, Texas, and Utah.

[6] West includes Alaska, California, Hawaii, Idaho, Montana, Nevada, Oregon, Washington, Wyoming, and Guam.

Liabilities

Short-Term Borrowings

Borrowings with original maturities of one year or less are considered short-term. The table below presents a summary of short-term borrowings:

As of December 31, (in thousands)	2003	2002	2001
Discount notes			
Outstanding balance at yearend	$ 6,609,074	$10,426,313	$11,776,957
Weighted average rate at yearend	1.06%	1.39%	2.35%
Daily average outstanding balance for the year	$ 7,855,953	$ 8,637,511	$16,106,920
Weighted average rate for the year	1.19%	1.87%	4.43%
Highest outstanding balance at any month end	$11,062,153	$10,426,313	$20,983,913
Other short-term borrowings			
Outstanding balance at yearend			$ 150,000
Weighted average rate at yearend			0.88%
Daily average outstanding balance for the year	$ 7,205	$ 142,820	$ 85,002
Weighted average rate for the year	1.46%	1.73%	4.33%

Member Term Deposits The table below presents our member term deposits over $100,000 categorized by time to maturity:

As of December 31, 2003 (in thousands)	Amount
Within three months	$163,195
After three months but within six months	6,605
After six months but within 12 months	1,525
Total	$171,325

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

There were no changes in or disagreements with the Seattle Bank's independent accountants on accounting and financial disclosures during the two most recent fiscal years.

DIRECTORS AND EXECUTIVE OFFICERS OF THE SEATTLE BANK

The Act provides that a board of at least 14 directors will govern each FHLBank. Directors elected by the members to three-year terms comprise a majority of the directors at each FHLBank; the Finance Board appoints at least six public interest directors to three-year terms to each FHLBank. At least two of the directors of each FHLBank appointed by the Finance Board must come from organizations with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing, or financial consumer protections. The Finance Board has determined that the Seattle Bank shall have 18 directors. The Finance Board appoints eight of the directors, and 10 are elected by our members.

The Board of Directors is responsible for establishing policies and programs that carry out our housing finance mission. The board adopts and reviews policies governing the Seattle Bank's credit, investment, and funding activities, and oversees the implementation of these policies. The board also must adopt policies to manage our exposure to credit, liquidity, and interest-rate risk. In addition, the board is responsible for monitoring our compliance with Finance Board regulations.

The GLB Act requires each FHLBank's board of directors to elect a chairman and vice chairman from among its members to two-year terms. The board elected Michael P. Radway as chairman and Richard S. Swanson as vice chairman for the calendar years 2002 and 2003. During June 2003, Mr. Swanson stepped down as director of the Seattle Bank, and Daniel L. Stevens was elected vice chairman. In late 2003, Mr. Radway and Mr. Stevens were re-elected to serve as chairman and vice chairman for the calendar years 2004 and 2005.

Directors – 2003

The following individuals served as directors of the Seattle Bank during 2003.

Michael P. Radway, 50, has served as a director of the Seattle Bank since 1999. He has served as chairman of the Seattle Bank since 1999 and is a past chairman of the Council of Federal Home Loan Banks, a trade association dedicated to enhancing public awareness and understanding of the Bank System. Mr. Radway has been affiliated with the Council since 1999 and served as its chairman in 2002 and 2001. He was legislative director from 1985 to 1999 for U.S. Representative Paul Kanjorski (D-PA) and served from 1995 through 1999 as the Democratic staff of the Subcommittee on Capital Markets, Securities and Government-Sponsored Enterprises for the House Banking Committee.

Richard Swanson, 53, served as a director of the Seattle Bank from 1998 to June 2003. He served as vice chairman of the Seattle Bank from January 2002 until June 2003. Mr. Swanson was also chairman of HomeStreet Bank, formerly Continental Savings Bank, of Seattle, Washington, where he held various positions, including president, executive vice president, and general counsel from 1984 until 2003. HomeStreet Bank is a member of the Seattle Bank. Mr. Swanson serves on the board of governors of the Mortgage Bankers Association of America, and he is a director of the Washington Financial League, a trustee of the Greater Seattle Chamber of Commerce, and a director of the Washington Roundtable.

Daniel L. Stevens, 60, has served as a director of the Seattle Bank since 1997. Mr. Stevens has served as vice chairman of the Seattle Bank since June 2003. Mr. Stevens is chairman, president, and chief executive officer of Home Federal Savings and Loan Association of Nampa, Idaho, where he has served for over nine years. Home Federal Savings and Loan Association is a member of the Seattle Bank. Mr. Stevens has been in the financial services industry for over 30 years and has served as a senior officer or chief executive officer for four other mutual and stock thrifts during his career. He serves on America's Community Bankers (ACB) Bank System Committee, as well as the ACB Credit Union Working Group, and he co-chairs the Idaho Banker's Association Credit Union Task Force. He is a member of the ACB Small Institutions Committee and is a former director and president of the Iowa Mortgage Bankers Association. He serves as chairman of the board of directors and executive committee of the Boise Area Chamber of Commerce and serves as a director for the Idaho Community Bankers Association, Idaho Community Reinvestment Corporation, and the Midwest Conference of Community Bankers.

Carmen Julia Aguiar, 37, has served as a director of the Seattle Bank since 2003. Ms. Aguiar is president and chief executive officer of The Aguiar Group, a certified public accounting and consulting group, since 1993. She is a certified public accountant and certified financial planner. Ms. Aguiar has served as a commissioner on the National Accreditation Commission of the American Institute of Certified Public Accountants, an executive board member of the Washington Society of Certified Public Accountants, and an elected governing council member of the American Institute of Certified Public Accountants.

Hector R. Ariceaga, 38, has served as director of the Seattle Bank since 2003. He has been a vice president of business and technology development at First American Title Insurance Company of Oregon since 2002. Prior to this, Mr. Ariceaga served as vice chairman of the Housing Authority of Portland from 1993 to 2002, developed the first Hispanic Escrow Services Unit of Oregon in 2001, and was a founding member of the Hispanic Housing Coalition.

Mike Daly, 52, has served as a director of the Seattle Bank since 2002. He has also served as chairman and chief executive officer of Wheatland Bankshares, Inc. and First State Bank in Wheatland, Wyoming, since 1985. First State Bank is a member of the Seattle Bank. He opened First State Bank in Wheatland in 1981, after beginning his banking career in 1974 with First Wyoming Bancorporation. Mr. Daly serves as vice chairman of the Wheatland Area Development Corporation and as a member of the board of the Western States Director Education Foundation. He is past president of the Wyoming Bankers Association and currently serves as co-chair of the Government Relations Committee.

Robert L. Fenstermacher, 53, has served as a director of the Seattle Bank since 2003. Mr. Fenstermacher has been chairman, president, and chief executive officer of LibertyBank since 1986 and has been affiliated with Liberty Financial Group, Inc. since 1973. LibertyBank is a member of the Seattle Bank. He currently serves as a director of the Oregon Bankers Association, the Sacred Heart Medical Center Foundation, and the United Way of Lane County.

Phillip J. Flores, 53, served as a director of the Seattle Bank from July 2003 through December 2003. Mr. Flores has been president, chief executive officer, and chairman of the board of BankPacific since 1980, Marianas Finance Corporation since 1981, PBIC Insurance Services since 1978, and Casa De Flores, Inc., a real estate development and management company, since 1977. BankPacific is a member of the Seattle Bank.

Harold B. Gilkey, 64, has served as a director of the Seattle Bank since 2003. He has served as chairman of the board, chief executive officer, and co-founder of Sterling Savings Bank since its inception in 1981. Additionally, he is chairman of the board of INTERVEST-Mortgage Investment Company, Action Mortgage Company, and Harbor Financial Services, Inc., all subsidiaries of Sterling Savings Bank. Sterling Savings Bank is a member of the Seattle Bank. Mr. Gilkey served as president of Bancshares Mortgage Company of Spokane, Washington, from 1974 to 1978, and as senior vice president of Old National Bank of Spokane, Washington, from 1979 to 1981. Mr. Gilkey is a past director of the Washington Savings League and a current member of the Savings Association Insurance Fund Industry Advisory Committee, an advisory committee of the FDIC.

W. David Hemingway, 56, has served as a director of the Seattle Bank since 2000. He has been executive vice president of Zions First National Bank in Salt Lake City since 1997, and has been with the Zions organization since 1973. Zions First National Bank is a member of the Seattle Bank. Mr. Hemingway has also served as chairman of the Utah Bankers Association, member of the Great Salt Lake Development Authority, chairman of the Utah State Money Management Council, and member of the Utah Electoral College.

James R. Irvine, 56, has served as a director of the Seattle Bank since 2003. He has been president of the Conifer Group, a home building, land development, and property management firm and licensed real estate brokerage in Oregon and Washington, from 1980 until 2000, when he became chairman of the organization. Prior to that, he served as vice chairman on the Governor's Task Force on Land Use in 1982 and president of the National Association of Home Builders in 1995. He is currently a board member of the National Institute of Building Science. Mr. Irvine is a former director of the Seattle Bank, serving from 1991 to 1998.

William A. Longbrake, 60, has served as a director of the Seattle Bank since 2002. He currently serves as the vice chair of enterprise risk management at Washington Mutual Inc., where he began his career as executive vice president and chief financial officer in 1982. Washington Mutual Inc. is a member of the Seattle Bank. He held this position until February 1995, when he was appointed to serve as chief financial officer and deputy to the chairman of finance at the FDIC. Mr. Longbrake returned to Washington Mutual in 1996 as vice chair and chief financial officer and has held his current position since November 2002. Mr. Longbrake serves on the board of directors of the Washington Financial League and America's Community Bankers and chairs the Housing Policy Council of the Financial Services Roundtable.

Jan K. Sieberts, 61, has served as a director of the Seattle Bank since 2001. He joined National Bank of Alaska, now Wells Fargo Bank Alaska in 1975, where he has served as senior vice president, retiring in 2003. During his time at Wells Fargo, Mr. Sieberts managed the commercial real estate and project lending functions and trust committee and established the statewide Master Charge cards system. Wells Fargo Bank Alaska was a member of the Seattle Bank through November 20, 2003.

James H. Strosahl, 61, has served as a director of the Seattle Bank since 2003. Mr. Strosahl has served as the executive vice president and chief financial officer of Glacier Bancorp, Inc. He has been with Glacier Bancorp, Inc. since 1993. Glacier Bancorp Inc. is a member of the Seattle Bank. Mr. Strosahl serves as a director of Glacier Bank of Whitefish and as a director of the Montana Bankers Association.

Sue Taoka, 53, has served as a director of the Seattle Bank since 2001. Since 1994, she has served as the executive director of the Seattle Chinatown International District Preservation and Development Authority, the major property management and community development organization in Seattle's International District. She previously served as deputy chief of staff to Mayor Norman B. Rice and founded the Distressed Communities Coalition and the National Coalition of Asian Pacific American Community Development. Ms. Taoka is a board member of the National Coalition of Asian Pacific American Community Development, Impact Capital, Community Capital Development, and the National Community Securities Initiative Advisory Board.

Harry Thomas, 62, has served as a director of the Seattle Bank since 1991. He previously served as chairman of the Seattle Bank from 1995 through 1998. Mr. Thomas has also been the executive director of the Seattle Housing Authority since 1995. Prior to that, Mr. Thomas served as staff director for the Office of the Governor, State of Washington and was deputy county executive of King County and executive director of Neighborhood House, Inc., a nonprofit social service agency.

Vicki Varela, 47, has served as a director of the Seattle Bank since 2002. She has also served as vice president for public policy at Kennecott Land since 2002. Prior to that, Ms. Varela served as deputy chief of staff and spokesperson for Utah Governor Mike Leavitt from 1992 to 2001 and as Utah assistant commissioner of higher education from 1986 to 1992.

Lily K. Yao, 60, served as a director of the Seattle Bank from 2001 to June 2003. She also served as vice chairperson of First Hawaiian Bank. First Hawaiian Bank is a member of the Seattle Bank. Ms. Yao began her banking career at Pioneer Federal Savings Bank in 1968, rising to president and chief executive officer in 1984 and chairperson of the board of directors in 1994. Pioneer merged with First Hawaiian in 1993. Until her retirement, she was responsible for government and community relations and community reinvestment activities, as well as assisting in business development and customer relations activities for the bank in Hong Kong, China, and Taiwan. She also served as chairperson of the board of the Chamber of Commerce of Hawaii.

Randal S. Yoshida, 46, has served as a director of the Seattle Bank since 2002. Since 1999, he has operated his own law firm, focusing in civil litigation, labor law, and administrative law, and he serves as legal counsel for multi-million dollar pension funds. Mr. Yoshida was a member of the State of Hawaii Board of Education from 1981 to 1992, serving as its chairperson from 1985 to 1987.

Roy M. Whitehead, 51, has served as a director of the Seattle Bank since 2003. He serves as vice chairman, president, and chief executive officer of Washington Federal Savings. Washington Federal Savings is a member of the Seattle Bank. He is a member of the Thrift Institutions Advisory Council to the Federal Reserve Board and a director of the Washington Financial League.

Directors – Newly Elected for 2004

The following individuals were elected in 2003 to serve on the 2004 Seattle Bank's Board of Directors.

Allan R. Landon, 55, was elected to serve as a director of the Seattle Bank beginning January 2004. Mr. Landon currently serves as president and chief financial officer of Bank of Hawaii and also serves on its board of directors. Mr. Landon joined the Bank of Hawaii in 2000. He has served as chief financial officer of First American Corporation and was a partner at Ernst & Young LLP, a public accounting firm.

Betsy Lawer was duly elected to serve as a Seattle Bank director, representing Alaska, beginning January 2004, but subsequently resigned.

There are no family relationships among the above directors.

Executive Officers – 2003

The following individuals served as executive officers of the Seattle Bank during 2003.

Norman B. Rice, 60, has served as president and chief executive officer of the Seattle Bank since February 1, 1999. He joined the Seattle Bank in March 1998 as its executive vice president. Prior to that, Mr. Rice served two terms as the mayor of Seattle from 1990 through 1997, and served three terms as a member of the City of Seattle Council from 1979 until 1990. He has served as a director of Safeco Corporation since 1999 and is also a director of the YMCA.

Karen L. Aliabadi, 44, has served as vice president and director of human resources of the Seattle Bank since 2000. She joined the Seattle Bank in 1999 as an assistant vice president and organizational development manager. Before joining the Seattle Bank, Ms. Aliabadi managed the human resources group and participated on the senior management team for Rainier Pacific Bank, where she was responsible for ensuring alignment of human resources activities with the strategic mission, vision, and goals from 1999 to 2000. Prior to her tenure at Rainier Pacific Bank, Ms. Aliabadi managed the human resources group at Hexcel, an aerospace composite manufacturer.

David A. Bley, 50, has served as executive vice president and director of products and services since 2003. Prior to this, he oversaw the community lending, community research and development, corporate communication, external affairs, general counsel and corporate secretary functions for the Seattle Bank from 1999 to 2003. He served as director of external affairs from 1990 through 1992 for the Seattle Bank. From 1992 through 1996, Mr. Bley worked in Seattle city government as a special assistant to the mayor and director of intergovernmental relations during Mayor Norman B. Rice's tenure. From 1996 through 1999, he served as director of Fannie Mae's Seattle Partnership Office. He is a member of the board of directors of the Seattle Housing Authority and a steering committee member of the Bill and Melinda Gates Foundation's Sound Families Initiative.

Kelli L. Bono, 44, has served as the Seattle Bank's executive vice president since 2001 and as its chief financial officer since 1998. After joining the Seattle Bank in 1984 as a financial analyst, Ms. Bono served as asset/liability manager from 1986 to 1988, credit officer from 1988 through 1990, and vice president and treasurer from 1990 to 1998.

Cynthia K. Chirot, 52, has served as the Seattle Bank's executive vice president since 1999, as director of enterprise risk management since 2003, and as chief operating officer from 1999 to 2003. She joined the Seattle Bank in 1984, serving as vice president and manager of information services and was appointed senior vice president in 1986. Prior to joining the Seattle Bank, Ms. Chirot was with Seafirst Bank in Seattle for seven years, most recently as vice president-product development and management. Ms. Chirot serves on the boards of the Pacific Coast Banking School, the Business and Economic Development Program of the University of Washington, and the Capitol Hill Housing Improvement Program.

There are no family relationships among the above officers.

All executive officers serve at the pleasure of the Board of Directors.

The Seattle Bank has adopted a code of ethics for its chief executive officer, chief financial officer, controller, and those individuals that perform similar functions.

DIRECTOR COMPENSATION

Compensation for directors was determined and limited in 2000 with the enactment of the GLB Act, subject to adjustments of the Finance Board based on the percentage annual increase in the Consumer Price Index. The compensation limits for 2003 were $26,921 for the chairman, $21,537 for the vice chairman, and $16,152 for all other directors.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The Seattle Bank is a cooperative, of which its financial institution members own all of the outstanding stock. Individuals cannot own shares of the Seattle Bank's capital stock and, accordingly, we do not offer any compensation plan under which equities of the Seattle Bank are authorized for issuance.

Ownership of the Seattle Bank's capital stock is stratified across various institution types as noted in the following table:

(in millions)	Commercial Banks	Thrifts	Credit Unions	Insurance Companies	Total
December 31, 2003	$ 958	$1,315	$115	$10	$2,398
December 31, 2002	990	1,239	99	9	2,337
December 31, 2001	1,035	1,261	87	4	2,387
December 31, 2000	894	1,182	68	4	2,148
December 31, 1999	693	1,326	62	3	2,084

The following table presents the member institutions that hold 5% or more of our outstanding capital stock as of December 31, 2003:

Member Name (in millions)	City	State	Capital Stock	% Total Capital Stock
Washington Mutual Bank	Seattle	Washington	$741	30.9
Bank of America Oregon, N.A	Portland	Oregon	323	13.5
Washington Federal Savings	Seattle	Washington	146	6.1

Additionally, due to the fact that a majority of the Seattle Bank's Board of Directors is elected from our membership, these elected directors are officers of member institutions that own our capital stock. The following table presents our capital stock outstanding to member institutions whose officers serve as a director of the Seattle Bank, as of December 31, 2003:

Member Name (in millions)	City	State	Capital Stock	% Total Capital Stock
Washington Mutual Bank	Seattle	Washington	$741	30.9
Washington Federal Savings	Seattle	Washington	146	6.1
Sterling Savings Bank	Spokane	Washington	51	2.1
Zions First National Bank	Salt Lake City	Utah	30	1.2
Glacier Bank	Kalispell	Montana	7	*
LibertyBank	Eugene	Oregon	7	*
Home Federal Savings and Loan Association of Nampa	Nampa	Idaho	7	*
Glacier Bank of Whitefish	Whitefish	Montana	4	*
First State Bank	Wheatland	Wyoming	**	*

* Represents ownership of less than 1%

** Represents ownership of less than $1 million

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Seattle Bank is a cooperative wherein its members own all the capital stock of the Seattle Bank. The majority of the Seattle Bank's Board of Directors are elected by the membership.

At December 31, 2003, we had $5.5 billion or 28.4% of advances outstanding to members whose officers were serving as directors of the Seattle Bank.

PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table presents the aggregate fees billed to the Seattle Bank for the years ended December 31, 2003 and 2002, by its independent accounting firm, PricewaterhouseCoopers LLP:

For the Years Ended December 31, (in thousands)	2003	2002
Audit fees	$272	$158
Audit-related fees	62	51
Total	$334	$209

Audit fees during the years ended December 31, 2003 and 2002, were for professional services rendered for the audits of the Seattle Bank's financial statements.

Audit-related fees for the years ended December 31, 2003 and 2002, were for assurance and other services primarily related to accounting consultations and our capital plan conversion.

The Seattle Bank is exempt from all federal, state, and local taxation on income. Therefore, no fees related to income taxes were paid during the years ended December 31, 2003 and 2002.

No fees were paid to the external accounting firm for financial information system design and implementation.

Statements of Condition

in thousands, except share and par value data

As of December 31,	2003	2002
Assets		
Cash and due from banks (Note 3)	$ 4,313	$ 17,813
Interest-bearing deposits	770,000	715,000
Securities purchased under agreements to resell (Note 4)	100,000	200,000
Federal funds sold	2,506,500	3,649,500
Investments:		
Held-to-maturity securities (Note 5)	16,426,705	12,354,523
Securities held at fair value (Note 6)	244,187	252,094
Advances (Note 7)	19,652,566	20,035,612
Mortgage loans held for portfolio (Note 9)	11,171,517	9,111,889
Accrued interest receivable	222,045	253,365
Premises and equipment, net	5,259	2,842
Derivative assets (Note 2)	45,766	77,480
Other assets	14,957	14,149
Total Assets	$51,163,815	$46,684,267
Liabilities and Capital		
Deposits (Note 10):		
Demand and overnight	$ 1,125,313	$ 1,544,874
Term	171,325	177,287
Other	20,100	32,525
Total deposits	1,316,738	1,754,686
Consolidated obligations, net (Note 12):		
Discount notes	6,609,074	10,426,313
Bonds	39,909,274	31,142,607
Total consolidated obligations	46,518,348	41,568,920
Accrued interest payable	374,298	346,771
Affordable Housing Program (Note 8)	48,368	53,338
Payable to Resolution Funding Corporation (Note 1)	9,065	11,186
Derivative liabilities (Note 2)	306,513	322,360
Other liabilities	134,878	244,862
Total liabilities	48,708,208	44,302,123
Commitments and contingencies (Notes 7, 8, 12, 13, 14, 16, and 18)		
Capital (Note 13)		
Capital stock-Class B(1) ($100 par value) issued and outstanding shares:		
22,850,322 and 20,911,386 shares in 2003 and 2002	2,285,032	2,091,138
Capital stock-Class B(2) ($100 par value) issued and outstanding shares:		
1,134,731 and 2,541,859 shares in 2003 and 2002	113,473	254,186
Retained earnings	57,177	36,540
Accumulated other comprehensive income:		
Net unrealized gain (loss) relating to hedging activities (Note 2)	(75)	280
Total capital	2,455,607	2,382,144
Total Liabilities and Capital	$51,163,815	$46,684,267

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

Statements of Income

in thousands

For the Years Ended December 31,	2003	2002	2001
Interest Income			
Advances (Note 7)	$ 516,651	$ 651,219	$1,216,093
Interest-bearing deposits	9,838	20,353	29,008
Securities purchased under agreements to resell (Note 4)	1,546	3,598	6,570
Federal funds sold	29,268	54,803	138,465
Investments:			
Held-to-maturity securities (Note 5)	525,966	710,430	779,369
Securities held at fair value (Note 6)	14,500	14,730	4,922
Mortgage loans held for portfolio (Note 9)	464,166	216,019	57,127
Other	43	68	209
Total interest income	1,561,978	1,671,220	2,231,763
Interest Expense			
Consolidated obligations (Note 12)	1,346,725	1,390,605	1,925,378
Deposits (Note 10)	18,303	28,383	59,882
Securities sold under agreements to repurchase (Note 11)		2,429	3,624
Other borrowings	105	36	41
Total interest expense	1,365,133	1,421,453	1,988,925
Net Interest Income	196,845	249,767	242,838
Other Income			
Prepayment fees	21,096	2,900	10,617
Service fees	2,433	2,294	2,437
Net realized gain (loss) on sale of held-to-maturity securities (Note 5)	22,291	850	177
Net gain (loss) on securities held at fair value (Note 6)	(7,906)	28,666	370
Net realized and unrealized gain (loss) on derivatives and hedging activities (Note 2)	(6,179)	(59,000)	11,940
Other, net	479	517	177
Total other income	32,214	(23,773)	25,718
Other Expense			
Operating	28,246	22,301	20,285
Finance Board	1,804	1,670	1,505
Office of Finance	1,180	1,052	918
Other	2,143	784	174
Total other expense	33,373	25,807	22,882
Income Before Assessments	195,686	200,187	245,674
Affordable Housing Program (Note 8)	15,974	16,342	19,781
Resolution Funding Corporation (Note 1)	35,942	36,769	44,507
Total assessments	51,916	53,111	64,288
Income Before Cumulative Effect of Change in Accounting Principle	143,770	147,076	181,386
Cumulative effect of change in accounting principle (Note 2)			(3,359)
Net Income	$ 143,770	$ 147,076	$ 178,027

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

Statements of Capital

in thousands

For the Years Ended December 31, 2003, 2002, and 2001	Capital Stock Shares	Capital Stock Par Value	Capital Stock–Class B(1) Shares	Capital Stock–Class B(1) Par Value
Balance, December 31, 2000	21,543	$ 2,154,229		
Proceeds from sale of capital stock	1,600	160,014		
Redemption of capital stock	(802)	(80,207)		
Comprehensive income:				
Net income				
Other comprehensive income:				
Reclassification adjustment for gain (loss) on hedging activities included in net income				
Comprehensive income				
Transfers				
Dividends on capital stock (6.88%):				
Cash				
Stock	1,569	156,860		
Balance, December 31, 2001	23,910	$ 2,390,896		$
Proceeds from sale of capital stock	883	88,322	183	18,346
Redemption of capital stock	(84)	(8,360)	(2,885)	(288,455)
Comprehensive income:				
Net income				
Other comprehensive income:				
Reclassification adjustment for gain (loss) on hedging activities included in net income				
Comprehensive income				
Transfers			(2,538)	(253,852)
Conversion to Class B shares	(25,436)	(2,543,582)	25,436	2,543,582
Dividends on capital stock (6.00%):				
Cash				
Stock	727	72,724		
Dividends on Class B(1) stock (6.38%):				
Cash				
Stock			715	71,517
Dividends on Class B(2) stock (1.05%):				
Cash				
Stock				
Balance, December 31, 2002		$	20,911	$2,091,138
Proceeds from sale of capital stock			893	89,336
Redemption of capital stock			(1,440)	(143,977)
Comprehensive income:				
Net income				
Other comprehensive income:				
Reclassification adjustment for gain (loss) on hedging activities included in net income				
Comprehensive income				
Transfers			1,269	126,862
Dividends on Class B(1) stock (5.56%):				
Cash				
Stock			1,217	121,673
Dividends on Class B(2) stock (0.71%):				
Cash				
Stock				
Balance, December 31, 2003			22,850	$2,285,032

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

Capital Stock–Class B(2) Shares	Capital Stock–Class B(2) Par Value	Retained Earnings Restricted	Retained Earnings Unrestricted	Retained Earnings Total	Accumulated Other Comprehensive Income	Total Capital
		$ 4,116	$ 9,426	$ 13,542	$	$2,167,771
						160,014
						(80,207)
			178,027	178,027		178,027
					465	465
			178,027	178,027	465	178,492
		5,369	(5,369)			
			(76)	(76)		(76)
			(156,860)	(156,860)		
	$	$ 9,485	$ 25,148	$ 34,633	$ 465	$2,425,994
						106,668
(5)	(512)					(297,327)
			147,076	147,076		147,076
					(185)	(185)
			147,076	147,076	(185)	146,891
2,538	253,852	(2,764)	2,764			
			(37)	(37)		(37)
			(72,724)	(72,724)		
			(41)	(41)		(41)
			(71,517)	(71,517)		
			(4)	(4)		(4)
8	846		(846)	(846)		
2,541	$254,186	$ 6,721	$ 29,819	$ 36,540	$ 280	$2,382,144
						89,336
(152)	(15,224)					(159,201)
			143,770	143,770		143,770
					(355)	(355)
			143,770	143,770	(355)	143,415
(1,269)	(126,862)	9,488	(9,488)			
			(75)	(75)		(75)
			(121,673)	(121,673)		
			(12)	(12)		(12)
14	1,373		(1,373)	(1,373)		
1,134	$113,473	$16,209	$ 40,968	$ 57,177	$ (75)	$2,455,607

Statements of Cash Flows

in thousands

For the Years Ended December 31,	2003	2002	2001
Operating Activities			
Net income	$143,770	$147,076	$ 178,027
Cumulative effect of change in accounting principle			3,359
Income before cumulative effect of change in accounting principle	143,770	147,076	181,386
Adjustments to reconcile income before cumulative effect of change in accounting principle to net cash provided by (used in) operating activities:			
Depreciation and amortization:			
Net premiums and discounts on consolidated obligations, investments, mortgage loans, and deferred costs and fees received on interest-rate exchange agreements	18,568	(37,669)	(184,279)
Concessions on consolidated obligation bonds	16,642	20,755	12,116
Premises and equipment	1,125	832	448
Other	(354)	(186)	177
Net realized (gains) losses on sale of held-to-maturity securities	(22,291)	(850)	(177)
Decrease (increase) in securities held at fair value, net of transfers and transition adjustments	7,906	(11,837)	(211,931)
Loss (gain) due to change in net fair value adjustment on derivatives and hedging activities	(21,788)	60,569	1,121
Decrease (increase) in accrued interest receivable	31,320	6,312	343,326
Decrease (increase) in derivative asset – net accrued interest	(420)	13,309	(24,145)
Increase (decrease) in derivative liability – net accrued interest	7,594	(10,604)	(18,655)
Decrease (increase) in other assets	(17,411)	(17,792)	254
Net increase (decrease) in Affordable Housing Program (AHP) liability and discount on AHP advances	(4,970)	1,785	9,719
Increase (decrease) in accrued interest payable	27,527	33,637	(201,597)
Increase (decrease) in payable to Resolution Funding Corporation	(2,121)	(3,110)	5,890
Increase (decrease) in other liabilities	7,615	(2,252)	(34,289)
Total adjustments	48,942	52,899	(302,022)
Net cash provided by (used in) operating activities	192,712	199,975	(120,636)

For the Years Ended December 31,	2003	2002	2001
Investing Activities			
Net decrease (increase) in interest-bearing deposits	$ (55,000)	$ 4,000	$ 79,860
Net decrease (increase) in securities purchased under agreements to resell	100,000		(175,000)
Net decrease (increase) in federal funds sold	1,208,000	(476,500)	813,000
Net decrease (increase) in short-term held-to-maturity securities		299,691	384,351
Proceeds from sales of long-term held-to-maturity securities	730,313	44,078	10,186
Proceeds from maturities of long-term held-to-maturity securities	8,541,322	7,267,380	9,263,079
Purchases of long-term held-to-maturity securities	(13,519,638)	(7,042,172)	(9,045,508)
Principal collected on advances	39,018,861	44,877,667	37,598,014
Advances made	(38,733,814)	(40,457,719)	(35,460,128)
Principal collected on mortgage loans held for portfolio	4,512,306	787,191	183,614
Purchases of mortgage loans held for portfolio	(6,609,822)	(8,174,437)	(1,495,483)
Net decrease (increase) in premises and equipment	(3,579)	(538)	(1,880)
Net cash provided by (used in) investing activities	(4,811,051)	(2,871,359)	2,154,105
Financing Activities			
Net increase (decrease) in deposits	(437,948)	(254,619)	1,062,243
Net increase (decrease) in other borrowings		(150,000)	150,000
Net proceeds from issuance of consolidated obligations:			
Discount notes	173,470,279	201,797,032	273,264,975
Bonds	28,081,334	29,765,572	21,024,860
Payments for maturing and retiring consolidated obligations:			
Discount notes	(177,261,472)	(203,114,310)	(280,069,586)
Bonds	(19,177,402)	(25,175,124)	(17,539,607)
Proceeds from issuance of capital stock		88,322	160,014
Payments for redemption of capital stock		(8,360)	(80,207)
Proceeds from issuance of Class B(1) stock	89,336	18,346	
Payments for redemption of Class B(1) stock	(143,977)	(288,455)	
Payments for redemption of Class B(2) stock	(15,224)	(512)	
Cash dividends paid	(87)	(81)	(76)
Net cash provided by (used in) financing activities	4,604,839	2,677,811	(2,027,384)
Net increase (decrease) in cash and cash equivalents	(13,500)	6,427	6,085
Cash and cash equivalents at beginning of the year	17,813	11,386	5,301
Cash and cash equivalents at end of the year	$ 4,313	$ 17,813	$ 11,386
Supplemental Disclosures:			
Interest paid	$ 1,337,607	$ 1,387,817	$ 2,142,987
Stock dividends issued	$ 123,046	$ 145,089	$ 156,860

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

Notes to Financial Statements

For the Years Ended December 31, 2003, 2002, and 2001

BACKGROUND INFORMATION

The Federal Home Loan Bank of Seattle (Seattle Bank), a federally chartered corporation, is one of 12 district Federal Home Loan Banks (FHLBanks). The FHLBanks serve the public by enhancing the availability of credit for residential mortgages and targeted community development. The Seattle Bank provides a readily available, low-cost source of funds to its member institutions. The Seattle Bank is a cooperative in which member institutions own the capital stock of the Seattle Bank and receive dividends on their investment. Regulated financial depositories and insurance companies engaged in residential housing finance can apply for membership. All members must purchase stock in the Seattle Bank.

The Federal Housing Finance Board (Finance Board), an independent agency in the executive branch of the United States government, supervises and regulates the FHLBanks and the Office of Finance. The Finance Board ensures that the FHLBanks operate in a safe and sound manner, carry out their housing finance mission, remain adequately capitalized, and can raise funds in the capital markets. Also, the Finance Board establishes policies and regulations covering the operations of the FHLBanks. Each FHLBank operates as a separate entity with its own management, employees, and board of directors. The Seattle Bank does not have any special purpose entities or any other type of off-balance sheet conduits.

The FHLBanks' debt instruments (i.e., consolidated obligations) are the joint and several obligations of all the FHLBanks and the primary source of funds for the FHLBanks. Deposits, other borrowings, and capital stock issued to members provide other funds. The Seattle Bank primarily uses these funds to provide advances to members and to purchase mortgage loans from members through its Mortgage Purchase Program (MPP).

The Seattle Bank is governed by the Board of Directors. The 18-member Board of Directors was compensated during 2003 based on a fee schedule that included retainers and fees for board and committee meetings. The board members also had a deferred compensation plan available to them. During 2003, the board earned $318,000, of which $98,000 was deferred. In addition, the Seattle Bank paid $306,000 for travel and other related expenses incurred in connection with the performance of board duties.

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates The preparation of financial statements requires management to make assumptions and estimates. These assumptions and estimates may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expenses. Actual results could differ from these estimates.

Investments The Seattle Bank carries, at cost, investments for which it has both the ability and intent to hold to maturity, adjusted for the amortization of premiums and accretion of discounts using a method that approximates the level-yield method.

The Seattle Bank classifies certain investments as securities held at fair value and carries them at fair value. The Seattle Bank records changes in the fair value of these investments through other income. Under Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115), the investments would be classified as "trading." Because Finance Board regulation prohibits the FHLBanks from trading investments, the Seattle Bank does not participate in trading investments activities. Therefore, the Seattle Bank classifies the investments as securities held at fair value because it believes the description is more appropriate.

The Seattle Bank computes gains and losses on sales of investment securities using the specific identification method and includes these gains and losses in other income. The Seattle Bank treats securities purchased under agreements to resell as collateralized financings.

The Seattle Bank regularly evaluates outstanding investments for impairment. If there is an other-than-temporary impairment in value of an investment, the decline in value is recognized as a loss in other expense.

Advances The Seattle Bank presents advances, net of unearned commitment fees and discounts on advances for the Affordable Housing Program (AHP), as discussed below. The Seattle Bank credits interest on advances to income as earned. Following the requirements of the Federal Home Loan Bank Act of 1932, as amended (the Act), the Seattle Bank obtains sufficient collateral on advances to protect it from losses. The Act limits eligible collateral to certain investment securities, residential mortgage loans, cash or deposits with the Seattle Bank, and other eligible real estate-related assets. As Note 7 more fully describes, community financial institutions (FDIC-insured institutions with assets of $538.0 million or less during 2003) are subject to more liberal statutory collateral rules for small business and agricultural loans.

The Seattle Bank has not incurred any credit losses on advances since its inception. The Seattle Bank evaluates the creditworthiness of its members and non-member borrowers on an ongoing basis and classifies as impaired any advance where management believes that it is probable that all principal and interest due will not be collected according to its contractual terms. Impaired advances are valued using the present value of expected future cash flows discounted at the advance's effective interest rate, the advance's observable market price, or if collateral dependent, the fair value of the advance's underlying collateral. When an advance is classified as impaired, the accrual of interest is discontinued and unpaid accrued interest is reversed. Advances do not return to accrual status until brought current with respect to both principal and interest and management believes future principal payments are no longer in doubt. Because of the collateral held as security on the advances and repayment history, Seattle Bank management believes that an allowance for credit losses on advances is unnecessary.

Mortgage Loans Held in Portfolio The Seattle Bank, in conjunction with the FHLBanks of Indianapolis, Cincinnati, and Atlanta, participates in the MPP, under which the Seattle Bank invests in government-insured and conventional residential mortgage loans purchased from its participating members. The Seattle Bank manages the liquidity, interest rate, and options risk of the loans, while the members either retain or release the servicing activities. If participating in the servicing released program, a member concurrently sells the servicing of the mortgage loans to a designated mortgage service provider. The Seattle Bank and the members share in the credit risk on conventional loans, with the member assuming a first-loss obligation equivalent to the greater of expected losses or the required deductible for the supplemental mortgage insurance (SMI) policy, and the Seattle Bank assuming credit losses in excess of mortgage insurance coverage, SMI coverage, and the member's obligation.

To ensure the retention of credit risk and to cover, at a minimum, the expected losses on conventional loans originated or acquired by a member, the Seattle Bank funds a lender risk account (LRA), either up front as a portion of the purchase proceeds or through a portion of the interest paid by the borrower. This account is established to conform to Finance Board regulation for all conventional mortgage purchase programs. The Finance Board regulation stipulates that the member is responsible for all expected losses on the mortgages sold to the Seattle Bank. In order to comply with this regulation, the Seattle Bank evaluates the proposed conventional mortgages to be sold (either the specific portfolio or a representative sample) to determine the amount of expected losses that will occur. The expected losses represent the amount to be deposited into the LRA, and these funds are used to offset any losses that may occur. After five years, excess funds over required balances are distributed to the member in accordance with a step-down schedule that is stipulated in each master commitment contract. No LRA balance is required after 11 years. The LRA is recorded in other liabilities and totaled $6.6 million and $1.3 million at December 31, 2003 and 2002.

In addition to the expected losses covered by the LRA, a member selling conventional loans is required to purchase SMI as a credit enhancement to cover losses over and above losses covered by the LRA. The Seattle Bank is listed as the insured, and this coverage serves to further limit the exposure to losses. The LRA and the SMI are expected to provide the equivalent of an investment grade rating. In the event the LRA and the standard SMI policy do not provide sufficient loss protection to support the investment grade rating, additional mortgage insurance coverage called SMI Plus must be purchased by the member. This policy covers the expected losses to achieve an investment grade rating over and above the LRA and SMI.

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

The Seattle Bank defers and amortizes premiums and discounts paid to and received by Seattle Bank members as interest income, using a method approximating the level-yield method, over the estimated life of the related mortgage loans. Actual prepayment experience and estimates of future principal prepayments are used in calculating the estimated lives of the mortgage loans. The Seattle Bank aggregates the mortgage loans by similar characteristics (e.g., type, maturity, note rate, and acquisition date) in determining prepayment estimates.

The Seattle Bank records non-origination fees, such as pair-off fees, in other income.

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

The Seattle Bank bases the allowance for credit losses on management's estimate of credit losses inherent in the Seattle Bank's mortgage loan portfolio as of the statement of condition date. Actual losses greater than defined levels are offset by the members' credit enhancement up to each member's respective limits. The Seattle Bank performs periodic reviews of its portfolio to identify the losses inherent within the portfolio and to determine the likelihood of collection of the portfolio. The overall allowance is determined by an analysis that includes consideration of various data observations, such as past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, and prevailing economic conditions. As a result of this analysis, the Seattle Bank has determined that the members' obligation for losses and the mortgage insurance coverage exceed the inherent loss in the portfolio. Accordingly, no allowance for loan losses is considered necessary.

Affordable Housing Program (AHP) The Act requires each FHLBank to establish and fund an AHP (see Note 8). The Seattle Bank charges the required funding for AHP to earnings and establishes a liability. The AHP funds provide subsidies to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. The Seattle Bank issues AHP advances at interest rates below the customary interest rate for non-subsidized advances. When the Seattle Bank makes an AHP advance, the present value of the variation in the cash flow caused by the difference in the interest rate between the AHP advance rate and the Federal Home Loan Bank System's related cost of funds for comparable maturity funding is charged against the AHP liability and recorded as a discount on the AHP advance. As an alternative, the Seattle Bank has the authority to make the AHP subsidy available to members as a grant.

Prepayment Fees The Seattle Bank charges its members a prepayment fee when members prepay certain advances before the original maturity. The Seattle Bank credits prepayment fees to other income. The Seattle Bank nets gains and losses on interest-rate exchange agreements associated with prepaid advances with prepayment fees in other income. The Seattle Bank evaluates whether new advances meet the criteria to qualify as a modification of an existing advance or as a new advance. If the advance qualifies as a modification, the net fee on the prepaid advance is deferred, recorded in the basis of the advance, and amortized over the life of the modified advance. This amortization is recorded in advance interest income. If the modified advance is hedged, it is marked to fair value after the amortization of the basis adjustment. This amortization results in offsetting amounts recorded in net interest income and "net realized and unrealized gain (loss) on derivatives and hedging activities" in other income. The offsetting amortization was $26,000 in 2003, and $0 in 2002 and 2001. The net fees are recorded in other income if it is determined the advance is not a modification and should be treated as a new advance.

Commitment Fees The Seattle Bank defers commitment fees for advances and amortizes them to interest income using the straight-line method. Refundable fees are deferred until the commitment expires or until the advance is made. The Seattle Bank records commitment fees for letters of credit as a deferred credit when it receives the fees and amortizes them over the term of the letter of credit.

Derivatives Accounting for derivatives is addressed in SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of Effective Date of FASB Statement No. 133*, and as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities,* and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (herein referred to as SFAS 133). Accordingly, all derivatives are recognized on the statement of condition at their fair value and those not used for intermediary purposes are designated as: (1) a hedge of the fair value of (a) a recognized asset or liability or (b) an unrecognized firm commitment (a "fair value" hedge); (2) a hedge of (a) a forecasted transaction or (b) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a "cash flow" hedge); or (3) a non-SFAS 133 hedge of an asset or liability (an "economic" hedge) for asset/liability management purposes. Changes in the fair value of a derivative that is effective as, and that is designated and qualifies as, a fair value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk (including changes that reflect gains or losses on firm commitments), are recorded in current-period earnings. Changes in the fair value of a derivative that is effective as, and that is designated and qualifies as, a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction (e.g., until periodic settlements of a variable-rate asset or liability are recorded in earnings). Any hedge ineffectiveness, which represents the amount by which the change in the fair value of the derivative exceeds the change in the fair value of the hedged item or the variability in the cash flows of the forecasted transaction, is recorded in current-period earnings. Through year-end 2003, the Seattle Bank has not entered into any transactions that qualify for cash flow hedge accounting treatment. Changes in the fair value of a stand-alone derivative designated as an economic hedge are recorded in current-period earnings with no fair value adjustment to an asset or liability. Both the net interest on the derivative and the fair value adjustments are recorded in other income. Hedge ineffectiveness and changes in the fair value of stand-alone derivatives are recorded in other income as "net realized and unrealized gain (loss) on derivatives and hedging activities."

The Seattle Bank may purchase financial instruments in which a derivative instrument is "embedded" and that are not remeasured at fair value, with changes in fair value reported in earnings as they occur. Upon purchasing the financial instrument, the Seattle Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument (i.e., the host contract) and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and designated as either: (1) a hedging instrument in a fair value or cash flow hedge or (2) a stand-alone derivative instrument pursuant to an economic hedge. However, if the entire contract were to be measured at fair value, with changes in fair value reported in current-period earnings (e.g., an investment security classified as "trading" under SFAS 115), or if the Seattle Bank could not reliably identify and measure the embedded derivative for purposes of separating that derivative from its host contract, the entire contract would be carried on the statement of condition at fair value, and no portion of the contract would be designated as a hedging instrument.

The Seattle Bank formally documents all relationships between derivative hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions and its method of assessing ineffectiveness. This process includes linking all derivatives that are designated as fair value or cash flow hedges to: (1) assets and liabilities on the statement of condition, (2) firm commitments, or (3) forecasted transactions. The Seattle Bank also formally assesses (both at the hedge's inception and at least quarterly on an ongoing basis) whether the derivatives that are used in hedging transactions have been effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain effective in future periods. The Seattle Bank typically uses regression analyses or other statistical analyses to assess the effectiveness of its hedges. When it determines that a derivative has not been or is not expected to be effective as a hedge, the Seattle Bank discontinues hedge accounting prospectively, as discussed below.

The Seattle Bank discontinues hedge accounting prospectively when: (1) it determines that the derivative is no longer effective in offsetting changes in the fair value of the hedged item; (2) the derivative and/or the hedged item expires or is sold, terminated, or exercised; (3) a hedged firm commitment no longer meets the definition of a firm commitment; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued due to the Seattle Bank's determination that the derivative no longer qualifies as an effective fair value hedge, the Seattle Bank will continue to carry the derivative on the statement of condition at its fair value, cease to adjust the hedged asset or liability for changes in fair value, and begin amortizing the cumulative basis adjustment on the hedged item into earnings, using a method that approximates the level-yield method over the remaining life of the hedged item. When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Seattle Bank will continue to carry the derivative on the statement of condition at its fair value, removing from the statement of condition any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current-period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Seattle Bank will carry the derivative at its fair value on the statement of condition, recognizing changes in the fair value of the derivative in current-period earnings.

Hedging Activities General The Seattle Bank may enter into interest-rate swaps, swaptions, interest-rate cap and floor agreements, calls, puts, and futures and forward contracts (collectively, interest-rate exchange agreements) to manage its exposure to changes in interest rates. The Seattle Bank may adjust the effective maturity, repricing frequency, or option characteristics of financial instruments to achieve risk management objectives. The Seattle Bank uses interest-rate exchange agreements in three ways: (1) by designating them as a fair value hedge of an underlying financial instrument; (2) by acting as an intermediary; or (3) in asset/liability management (i.e., a non-SFAS 133 economic hedge). For example, the Seattle Bank uses interest-rate exchange agreements in its overall interest-rate risk management to adjust the interest-rate sensitivity of consolidated obligations to approximate more closely the interest-rate sensitivity of assets (both advances and investments), and/or to adjust the interest-rate sensitivity of advances, investments, or mortgage loans to approximate more closely the interest-rate sensitivity of liabilities. In addition to using interest-rate exchange agreements to manage mismatches of interest rates between assets and liabilities, the Seattle Bank also uses interest-rate exchange agreements to: (1) manage embedded options in assets and liabilities; (2) hedge the market value of existing assets and liabilities; and (3) reduce funding costs.

An economic hedge is defined as an interest-rate exchange agreement, hedging specific or non-specific underlying assets, liabilities, or firm commitments, that does not qualify for hedge accounting under the rules of SFAS 133, but is an acceptable hedging strategy under the Seattle Bank's risk management program. These strategies also comply with Finance Board regulatory requirements. An economic hedge by definition introduces the potential for earnings variability due to the change in fair value recorded on an interest-rate exchange agreement that is not offset by the recognition of corresponding change in the value of the economically hedged assets, liabilities, or firm commitments.

The Seattle Bank, consistent with Finance Board regulation, enters into interest-rate exchange agreements only to reduce the market risk exposures inherent in otherwise unhedged assets and funding positions. The Seattle Bank's management utilizes interest-rate exchange agreements in the most cost-efficient manner and may enter into interest-rate exchange agreements that do not necessarily qualify for hedge accounting under SFAS 133 accounting rules. As a result, the Seattle Bank recognizes only the change in fair value of these interest-rate exchange agreements in other income as "net realized and unrealized gain (loss) on derivatives and hedging activities" with no offsetting fair value adjustments for the asset, liability, or firm commitment.

Consolidated Obligations The Seattle Bank manages the risk arising from changing market prices and volatility of a consolidated obligation by matching the cash inflow on the interest-rate exchange agreement with the cash outflow on the consolidated obligation. Although consolidated obligations are the joint and several obligations of the FHLBanks, one or more FHLBanks may individually serve as counterparties to interest-rate exchange agreements associated with specific debt issues.

For instance, in a typical transaction, fixed-rate consolidated obligations are issued for one or more FHLBanks, and each of those FHLBanks simultaneously enters into a matching interest-rate exchange agreement in which the counterparty pays fixed cash flows to the FHLBank, designed to mirror in timing and amount the cash outflows the FHLBank pays on the consolidated obligation. Such transactions are treated as fair value hedges under SFAS 133. In this typical transaction, the FHLBank pays a variable cash flow that closely matches the interest payments it receives on short-term or variable-rate advances. This intermediation between the capital and swap markets permits the FHLBank to raise funds at lower costs than would otherwise be available through the issuance of simple fixed- or floating-rate consolidated obligations in the capital markets.

Advances With issuances of convertible advances, the Seattle Bank may purchase from the member a put option that enables the Seattle Bank to convert an advance from fixed rate to floating rate if interest rates increase or to terminate the advance and extend additional credit on new terms. The Seattle Bank may hedge a convertible advance by entering into a cancelable interest-rate exchange agreement with a non-member counterparty where the Seattle Bank pays fixed and receives variable. This type of hedge is treated as a fair value hedge under SFAS 133. The swap counterparty can cancel the interest-rate exchange agreement on the put date, which would normally occur in a rising rate environment, and the Seattle Bank can convert the advance to a floating rate.

The optionality embedded in certain financial instruments held by the Seattle Bank can create interest-rate risk. When a member prepays an advance, the Seattle Bank could suffer lower future income if the principal portion of the prepaid advance were invested in lower-yielding assets that continue to be funded by higher-cost debt. To protect against this risk, the Seattle Bank generally charges a prepayment fee that makes it financially indifferent to a borrower's decision to prepay an advance. When the Seattle Bank offers advances, other than short-term advances, that a member may prepay without a prepayment fee, it usually finances such advances with callable debt or otherwise hedges this option.

Mortgage Loans The Seattle Bank invests in mortgage loans. The prepayment options embedded in mortgage loans can result in extensions or contractions in the expected maturities of these investments, depending on changes in estimated prepayment speeds. Net income could be reduced if the Seattle Bank replaces the mortgage loans with lower-yielding assets and if the Seattle Bank's higher funding costs are not reduced concomitantly.

The Seattle Bank manages the interest-rate and prepayment risk associated with mortgage loans through its debt issuance. The Seattle Bank issues both callable and non-callable debt to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans. The Seattle Bank may also purchase interest-rate caps and floors, swaptions, callable swaps, calls, and puts to minimize the prepayment risk embedded in the mortgage loans. Although these derivatives are valid economic hedges against the prepayment risk of the loans, they are not specifically linked to individual loans and, therefore, do not receive either fair value or cash flow hedge accounting. The derivatives are marked to market through earnings.

The Seattle Bank analyzes the duration, convexity, and earnings risk of the mortgage loan portfolio on a regular basis under various rate scenarios.

Firm Commitment Strategies Prior to July 1, 2003, the Seattle Bank hedged the market value of purchase commitments on fixed-rate mortgage loans by using derivatives with similar market value characteristics. The Seattle Bank typically hedged these commitments by selling mortgage-backed securities to-be-announced for forward settlement. When the mortgage loans settled, the current market value of the commitments was included with the basis of the mortgage loans and amortized accordingly. This transaction was treated as a fair value hedge.

In accordance with SFAS No. 149, mortgage loan purchase commitments entered into after June 30, 2003, are considered derivatives. Accordingly, both the commitment and the derivatives used in the firm commitment hedging strategy are recorded as a derivative asset or derivative liability at fair value, with changes in fair value recognized in current-period earnings. When the mortgage loan purchase commitment derivative settles, the current market value of the commitment is included with the basis of the mortgage loan and amortized accordingly.

The Seattle Bank may also hedge a firm commitment for a forward starting advance through the use of an interest-rate swap. In this case, the swap will function as the hedging instrument for both the firm commitment and the subsequent advance. The basis movement associated with the firm commitment will be rolled into the basis of the advance at the time the commitment is terminated and the advance is issued. The basis adjustment will then be amortized into interest income over the life of the advance.

Investments The Seattle Bank invests in U.S. agency securities, mortgage-backed securities, and the taxable portion of state or local housing finance agency securities. The interest-rate and prepayment risk associated with these investment securities is managed using a combination of debt issuance and derivatives. The Seattle Bank may manage against prepayment and duration risk by funding investment securities with consolidated obligations that have call features, by hedging the prepayment risk with caps or floors, or by adjusting the duration of the securities by using interest-rate exchange agreements to modify the cash flows of the securities. These securities may be classified as "held-to-maturity," "available-for-sale," or "securities held at fair value." Through year-end 2003, the Seattle Bank has not purchased any securities that qualified for "available-for-sale" classification.

The Seattle Bank may also manage the risk arising from changing market prices and volatility of investment securities classified as securities held at fair value by entering into interest-rate exchange agreements (i.e., economic hedges) that offset the changes in fair value of the securities. The market value changes of both the securities held at fair value and the associated interest-rate exchange agreements are included in other income in the statements of income.

Credit Risk The Seattle Bank is subject to credit risk due to the risk of nonperformance by counterparties to the derivative agreements. The Seattle Bank has master agreements that provide netting arrangements in place with all its derivative counterparties, as well as collateralization to mitigate the risk. The Seattle Bank manages counterparty credit risk through credit analysis and collateral requirements and by following the requirements set forth in Finance Board regulation. Based on credit analyses and collateral requirements, Seattle Bank management does not anticipate any credit losses on its derivative agreements.

Other The Seattle Bank is not a derivative dealer and, thus, does not trade derivatives for short-term profit.

The Seattle Bank has not issued consolidated obligations denominated in currencies other than U.S. dollars.

To meet the hedging needs of its members, the Seattle Bank acts as an intermediary between the members and other non-member counterparties by entering into offsetting interest-rate exchange agreements. This intermediation allows smaller members access to the swap market. The derivatives used in intermediary activities do not qualify for SFAS 133 hedge accounting treatment and are separately marked to market through earnings. The net result of the accounting for these derivatives does not significantly affect the operating results of the Seattle Bank.

Premises and Equipment The Seattle Bank records premises and equipment at cost less accumulated depreciation and amortization of approximately $3.4 million and $2.7 million at December 31, 2003 and 2002. The Seattle Bank computes depreciation on the straight-line method over the estimated useful lives of assets ranging from three to 10 years. It amortizes leasehold improvements on the straight-line basis over the shorter of the estimated useful life of the improvement or the remaining term of the lease. The Seattle Bank capitalizes improvements and major renewals but expenses ordinary maintenance and repairs when incurred. Depreciation and amortization expense was $1.1 million, $832,000, and $448,000 for the years ended December 31, 2003, 2002, and 2001. The Seattle Bank includes gains and losses on disposal of premises and equipment in other income. The net realized gain on disposal of premises and equipment was $4,000, $0, and $1,000 in 2003, 2002, and 2001.

Concessions on Consolidated Obligations The Seattle Bank defers and amortizes, using the straight-line method, the amounts paid to dealers in connection with the sale of consolidated obligation bonds over the term or estimated life of the bonds. The Office of Finance prorates the amount of the concession to the Seattle Bank, based upon the percentage of the debt issued that is assumed by the Seattle Bank. When the Seattle Bank calls consolidated obligations, the unamortized concession is expensed. Unamortized concessions were $12.1 million and $12.2 million at December 31, 2003 and 2002, and are included in other assets. The Seattle Bank expenses the concessions applicable to the sale of consolidated obligation discount notes, using the straight-line method, over the term of the related notes. Amortization of such concessions is included in consolidated obligation interest expense and totaled $17.3 million, $22.1 million, and $12.1 million in 2003, 2002, and 2001.

Discounts and Premiums on Consolidated Obligations The Seattle Bank expenses the discounts on consolidated obligation discount notes, using the straight-line method, over the term of the related notes. It amortizes the discounts and premiums on consolidated obligation bonds to expense, using the straight-line method, over the term to maturity of the consolidated obligation bonds.

Resolution Funding Corporation (REFCORP) Assessments Although the Seattle Bank is exempt from ordinary federal, state, and local taxation, it is required to make payments to REFCORP. Each FHLBank is required to pay 20% of net earnings after AHP to REFCORP. The FHLBanks will expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a $300.0 million annual annuity with a final maturity date of April 15, 2030, at which point the required payment of each FHLBank to REFCORP will be fully satisfied. The Finance Board, in consultation with the Secretary of the Treasury, will select the appropriate discounting factors to be used in this annuity calculation. The cumulative amount to be paid to REFCORP by the Seattle Bank is not determinable at this time due to the interrelationships of all future FHLBanks' earnings. The FHLBanks' payments through 2003 defease all future benchmark payments after the third quarter of 2020 and $21.5 million of the $75.0 million benchmark payment for the second quarter of 2020.

Finance Board and Office of Finance Expenses The Seattle Bank is assessed for its proportionate share of the costs of operating the Finance Board and the Office of Finance, which manages the sale of consolidated obligations.

Other Expenses The Seattle Bank classifies third-party volume-related mortgage loan costs as "other expenses" in the statement of income.

Estimated Fair Values Many of the Seattle Bank's financial instruments lack an available trading market characterized by transactions between a willing buyer and a willing seller engaging in an exchange transaction. Therefore, the Seattle Bank uses significant estimates and present value calculations when disclosing estimated fair values. The Seattle Bank assumes that book value approximates fair value for financial instruments with three months or less to repricing or maturity. Note 17 details the estimated fair values of the Seattle Bank's financial instruments.

Cash Flows In the statements of cash flows, the Seattle Bank considers cash on hand and due from banks as cash and cash equivalents. The Seattle Bank excludes from the cash flow statement significant non-cash transactions. For December 31, 2003 and 2002, these included $119.9 million and $237.5 million in securities traded but not settled.

Reclassifications Certain reclassifications have been made to the prior year amounts to conform to the current-year presentation.

NOTE 2
CHANGE IN ACCOUNTING PRINCIPLE AND RECENTLY ISSUED ACCOUNTING STANDARDS AND INTERPRETATIONS

Adoption of SFAS 145 The Seattle Bank adopted SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* (SFAS 145), on June 30, 2002. SFAS 145 rescinds both SFAS No. 4, *Reporting Gains and Losses from the Extinguishment of Debt*, and the amendment to SFAS No. 4, SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*, and eliminates the requirement that gains and losses from the extinguishment of debt (except for those considered unusual or infrequent in nature) be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. In accordance with the transition provisions of SFAS 145, previously reported gains and losses on early retirement of debt have been reclassified into other income under "other, net." The amounts reclassified were not material.

Adoption of SFAS 149 The Financial Accounting Standards Board (FASB) issued SFAS No. 149 (SFAS 149), which amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities under SFAS 133. In most cases, SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003, and in most cases, all provisions of SFAS 149 should be applied prospectively. The Seattle Bank adopted SFAS 149 as of the effective date, and the adoption did not have a material impact on the financial statements.

Adoption of SFAS 150 FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (SFAS 150), in May 2003. The Seattle Bank will adopt SFAS 150 as of the effective date and is currently assessing the impact of SFAS 150 on its financial statements.

Adoption of SFAS 132 (revised 2003) FASB issued SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits* [SFAS 132 (revised 2003)], in December 2003. The Seattle Bank will adopt SFAS 132 (revised 2003) as of the effective date and is currently assessing the impact, if any, of SFAS 132 (revised 2003) on its related disclosures.

Adoption of FIN 45 FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57 and 107 and Recission of FASB Interpretation No. 34* (FIN 45), on November 25, 2002. FIN 45 expands existing disclosure requirements for guarantees at December 31, 2002, and provides initial recognition and measurement provisions to be applied on a prospective basis for guarantees issued or modified after December 31, 2002. The initial recognition and measurement provisions apply to the Seattle Bank's letters of credit. The resulting amounts recognized in other liabilities in 2003 were not material.

Adoption of SFAS 133 The Seattle Bank adopted SFAS 133 on January 1, 2001. SFAS 133 requires that all derivative instruments be recorded on the statement of condition at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on derivative instruments that are reported in other comprehensive income are reclassified to earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recognized in current-period earnings. Changes in the fair value of an economic hedge for asset/liability management are recorded in current-period earnings.

For a derivative designated as a fair value hedge, the transition adjustment for the derivative was reported as a cumulative effect adjustment of net income. Concurrently, any fair value gain or loss on the hedged item was recognized as an adjustment of the hedged item's carrying amount, but only to the extent of the offsetting transition adjustment of the derivative, and was also reported as a cumulative effect adjustment of net income. The transition provisions of SFAS 133 also provide that at the date of initial implementation, an entity may transfer any security classified as "held-to-maturity" to "available-for-sale" or "trading" (securities held at fair value), and any security classified as "available-for-sale" to "trading" (securities held at fair value).

In accordance with the transition provisions of SFAS 133, the Seattle Bank recorded the following cumulative effect adjustments to earnings as of January 1, 2001 (in thousands):

Net adjustments related to: (1) fair value hedges, (2) derivative transactions not designated as hedges under SFAS 133, and (3) derivative transactions not meeting the requirements for fair value or cash flow hedges	$(3,529)
Unrealized net gains (losses) on investments transferred from held-to-maturity to securities held at fair value	170
Total cumulative effect of accounting change on earnings	$(3,359)

The Seattle Bank also recorded cumulative effect adjustments in other comprehensive income as of January 1, 2001, and recorded changes in other comprehensive income for the years ended December 31, 2003, 2002, and 2001, as follows (in thousands):

Previously deferred hedging gains and losses	$ 432
Net change reclassified to earnings for the year ended December 31, 2001	33
Total cumulative effect of change in accounting principle on other comprehensive income at January 1, 2001, and net change during the year ended December 31, 2001, related to hedging activities	465
Net change reclassified to earnings for the year ended December 31, 2002	(185)
Accumulated comprehensive income related to hedging activities at December 31, 2002	280
Net change reclassified to earnings for the year ended December 31, 2003	(355)
Accumulated comprehensive income related to hedging activities at December 31, 2003	$ (75)

On January 1, 2001, the Seattle Bank transferred held-to-maturity securities with an amortized cost of $28.2 million and an estimated fair value of $28.3 million into the securities held at fair value category. The unrealized gain related to the transfer of certain held-to-maturity securities into the securities held at fair value category was $170,000, and has been shown as an increase to the Seattle Bank's results of operations in 2001 as a cumulative effect of a change in accounting principle. The remaining cumulative effect of adjustments related to fair value hedges and derivative transactions either not designated as hedges under SFAS 133 or not meeting the requirements for fair value or cash flow hedges have been shown as a charge to the Seattle Bank's results of operations in 2001 as part of the cumulative effect of a change in accounting principle, decreasing net income by $3.5 million. These factors combined resulted in a net SFAS 133 transition loss on January 1, 2001, totaling $3.4 million. In addition, the Seattle Bank recognized in accumulated other comprehensive income, as part of the cumulative effect of a change in accounting principle at transition, a gain of $432,000, increasing capital.

As a result of SFAS 133, for the years ended December 31, 2003, 2002, and 2001, the Seattle Bank recorded net gains (losses) on derivatives and hedging activities of $(6.2) million, ($59.0) million, and $11.9 million in other income. Net gains (losses) on derivatives and hedging activities are as follows:

For the Years Ended December 31, (in thousands)	2003	2002	2001
Gains (losses) related to fair value hedge ineffectiveness	$ 8,273	$ 1,351	$ (584)
Gains (losses) on economic hedges	(14,452)	(60,351)	12,524
Total	$ (6,179)	$(59,000)	$11,940

During the year ended December 31, 2003, the Seattle Bank did not enter into any cash flow hedges. As of December 31, 2003, the deferred net gains (losses) on derivative instruments accumulated in other comprehensive income expected to be reclassified as earnings during the next 12 months is not material.

NOTE 3
CASH AND DUE FROM BANKS

Compensating Balances The Seattle Bank maintains collected cash balances with commercial banks in return for certain services. These agreements contain no legal restrictions about the withdrawal of funds. The average compensating balances for the years ended December 31, 2003 and 2002, were approximately $2.9 million and $9.9 million.

In addition, the Seattle Bank maintained average required clearing balances with various Federal Reserve Banks and branches of approximately $4.7 million and $3.6 million for the years ended December 31, 2003 and 2002. These are required clearing balances and may not be withdrawn; however, the Seattle Bank may use earnings credits on these balances to pay for services received from the Federal Reserve Banks.

NOTE 4
SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

The Seattle Bank has purchased securities under agreements to resell those securities. These amounts represent short-term loans and are assets in the statements of condition. One of the Federal Reserve Banks holds the securities purchased under agreements to resell in safekeeping in the name of the Seattle Bank. Should the market value of the underlying securities decrease below the market value required as collateral, the counterparty must place an equivalent amount of additional securities in safekeeping in the name of the Seattle Bank or the dollar value of the resale agreement will be decreased accordingly.

NOTE 5
HELD-TO-MATURITY SECURITIES

Major Security Types Held-to-maturity securities were as follows:

As of December 31, 2003 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. agency obligations	$ 5,639,863	$132,704	$(24,440)	$ 5,748,127
Other FHLBanks' bonds	3,500,000	3,354	(2,044)	3,501,310
State or local housing agency obligations	41,273	225	(256)	41,242
	9,181,136	136,283	(26,740)	9,290,679
Mortgage-backed securities	7,245,569	74,152	(48,061)	7,271,660
Total	$16,426,705	$210,435	$(74,801)	$16,562,339

As of December 31, 2002 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. agency obligations	$ 5,625,862	$225,280	$	$ 5,851,142
Other FHLBanks' bonds	159,993	62	(66)	159,989
State or local housing agency obligations	87,000	1,122	(684)	87,438
	5,872,855	226,464	(750)	6,098,569
Mortgage-backed securities	6,481,668	166,710	(2,226)	6,646,152
Total	$12,354,523	$393,174	$ (2,976)	$12,744,721

As of December 31, 2001 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$ 299,691	$ 13	$ (16)	$ 299,688
U.S. agency obligations	3,481,267	91,744	(7,520)	3,565,491
Other FHLBanks' bonds	1,608,756	8,638		1,617,394
State or local housing agency obligations	121,353	996	(1,416)	120,933
Other	408,986	8,555	(852)	416,689
	5,920,053	109,946	(9,804)	6,020,195
Mortgage-backed securities	6,785,389	173,955	(11,833)	6,947,511
Total	$12,705,442	$283,901	$(21,637)	$12,967,706

The following table summarizes the held-to-maturity securities with gross unrealized losses aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months		12 months or more		Total	
As of December 31, 2003 (in thousands)	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
U.S. agency obligations	$ 540,820	$(24,440)	$	$	$ 540,820	$(24,440)
Other FHLBanks' bonds	997,956	(2,044)			997,956	(2,044)
State or local housing agency obligations	23,029	(256)			23,029	(256)
Mortgage-backed securities	2,341,799	(46,789)	97,179	(1,272)	2,438,978	(48,061)
Total	$3,903,604	$(73,529)	$97,179	$(1,272)	$4,000,783	$(74,801)

The Seattle Bank judged, based on the creditworthiness of the issuers and any underlying collateral, that all securities in the above table represent temporary impairments.

Redemption Terms The amortized cost and estimated fair value of held-to-maturity securities, by contractual maturity, are shown below. Expected maturities of some securities and mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

	2003		2002	
Year of Maturity (in thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 1,000,017	$ 1,005,075	$ 2,477,459	$ 2,494,804
Due after one year through five years	6,498,508	6,555,339	2,354,724	2,471,196
Due after five years through 10 years	1,541,594	1,588,358	553,405	606,043
Due after 10 years	141,017	141,907	487,267	526,526
	9,181,136	9,290,679	5,872,855	6,098,569
Mortgage-backed securities	7,245,569	7,271,660	6,481,668	6,646,152
Total	$16,426,705	$16,562,339	$12,354,523	$12,744,721

The amortized cost of the Seattle Bank's mortgage-backed securities classified as held-to-maturity includes net discounts of $64.5 million and $18.2 million at December 31, 2003 and 2002.

Interest-Rate Payment Terms The following table details interest-rate payment terms for investment securities classified as held-to-maturity:

As of December 31, (in thousands)	2003	2002
Amortized cost of held-to-maturity securities other than mortgage-backed securities:		
Fixed-rate	$ 7,951,543	$ 5,433,653
Variable-rate	1,229,593	439,202
	9,181,136	5,872,855
Amortized cost of held-to-maturity mortgage-backed securities:		
Pass-through securities:		
Fixed-rate	386,623	1,132,336
Variable-rate	18,511	84,861
Collateralized mortgage obligations:		
Fixed-rate	6,222,379	4,920,054
Variable-rate	618,056	344,417
	7,245,569	6,481,668
Total	$16,426,705	$12,354,523

Gains on the Sale of Held-to-Maturity Securities The Seattle Bank realized gains of $22.3 million, $850,000, and $177,000 on sales of held-to-maturity securities during the years ended December 31, 2003, 2002, and 2001. The proceeds received of $730.3 million, $44.1 million, and $10.2 million on the sale of held-to-maturity securities in 2003, 2002, and 2001 were for securities that had returned at least 85% of the principal outstanding from the date of acquisition.

NOTE 6

SECURITIES HELD AT FAIR VALUE

Major Security Types Securities held at fair value were as follows:

As of December 31, (in thousands)	2003	2002	2001
U.S. agency obligations	$244,187	$252,094	$223,257
Mortgage-backed securities			16,999
Total	$244,187	$252,094	$240,256

Net gain (loss) on securities held at fair value during the years ended December 31, 2003, 2002, and 2001, included a change in net unrealized holding gain (loss) of $(7.9) million, $28.7 million, and $370,000 for securities held on December 31, 2003, 2002, and 2001.

NOTE 7

ADVANCES

Redemption Terms As of December 31, 2003 and 2002, the Seattle Bank had advances outstanding, including AHP advances (see Note 8), at interest rates ranging from 1.03% to 8.65% and 1.20% to 8.85%, as summarized below. As of December 31, 2003 and 2002, AHP subsidized advance interest rates range from 2.80% to 5.99%.

	2003		2002	
Year of Maturity (in thousands)	Amount	Weighted Average Interest Rate %	Amount	Weighted Average Interest Rate %
Overdrawn demand deposit accounts	$		$ 311	2.16
2003			4,229,762	2.67
2004	9,779,304	1.81	6,841,911	2.62
2005	3,087,950	2.81	3,058,359	3.38
2006	1,858,332	4.40	1,370,912	5.25
2007	913,428	3.71	995,796	3.50
2008	988,318	4.94	738,627	5.47
Thereafter	2,774,709	5.19	2,448,709	5.33
Total par value	19,402,041	2.95	19,684,387	3.42
Unamortized commitment fees	(1,027)		(704)	
Discount on AHP advances	(480)		(914)	
Deferred prepayment fees	(2,812)			
SFAS 133 hedging adjustments	254,844		352,843	
Total	$19,652,566		$20,035,612	

The Seattle Bank offers advances to members that may be prepaid on pertinent dates (call dates) without incurring prepayment or termination fees (callable advances). Other advances may only be prepaid by paying a fee to the Seattle Bank (prepayment fee) that makes the Seattle Bank financially indifferent to the prepayment of the advance. The Seattle Bank had no callable advances at December 31, 2003 or 2002.

The following table summarizes advances at December 31, 2003 and 2002, by year of maturity or next call date for callable advances:

Year of Maturity or Next Call Date (in thousands)	2003	2002
Overdrawn demand deposit accounts	$	$ 311
2003		4,229,762
2004	9,780,406	6,843,094
2005	3,088,083	3,058,498
2006	1,858,332	1,370,912
2007	913,428	995,796
2008	988,318	738,627
Thereafter	2,773,474	2,447,387
Total	$19,402,041	$19,684,387

The Seattle Bank also offers convertible advances. With a convertible advance, the Seattle Bank effectively purchases a put option from the member that allows the Seattle Bank to terminate the fixed advance, which is normally when interest rates increase, and offer a floating-rate advance. At December 31, 2003 and 2002, the Seattle Bank had convertible advances outstanding of $3.6 billion and $3.8 billion.

The following table summarizes advances at December 31, 2003 and 2002, by year of maturity or next put date:

Year of Maturity or Next Put Date (in thousands)	2003	2002
Overdrawn demand deposit accounts	$	$ 311
2003		6,723,007
2004	12,297,499	6,992,411
2005	3,140,242	3,133,651
2006	1,827,222	1,406,301
2007	716,215	644,184
2008	437,618	120,027
Thereafter	983,245	664,495
Total	$19,402,041	$19,684,387

Security Terms The Seattle Bank lends to financial institutions involved in housing finance within its district according to federal statutes, including the Act. The Act requires the Seattle Bank to obtain sufficient collateral on advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans, cash or deposits in the Seattle Bank, and other eligible real estate-related assets as collateral on such advances. However, community financial institutions (CFIs) are subject to expanded statutory collateral provisions dealing with small business or agricultural loans. Borrowing members pledge their Seattle Bank stock as additional collateral for advances. At December 31, 2003 and 2002, the Seattle Bank had rights to collateral with an estimated value greater than outstanding advances. Based upon the financial condition of the member, the Seattle Bank: (1) allows a member to retain possession of the collateral assigned to the Seattle Bank, if the member executes a written security agreement and agrees to hold such collateral for the benefit of the Seattle Bank; or (2) requires the member specifically to assign or place physical possession of such collateral with the Seattle Bank or its safekeeping agent.

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

Credit Risk The Seattle Bank classified as substandard $194.0 million of advances and $530,000 of letters of credit to two insurance companies under common ownership. The companies experienced financial distress in late 2003 and consented to supervisory orders with their respective state regulators to refrain from certain business actions without prior regulatory approval. This credit exposure is fully collateralized with high-grade, marketable securities under the Seattle Bank's control. Because both borrowers continue to pay according to contractual requirements and because of the Seattle Bank's collateral position, interest continues to be accrued on the advances. Interest income on the secured advances recognized during 2003 was $6.4 million. The Seattle bank expects full repayment and has concluded that, given current circumstances, no provision for credit losses is necessary.

In September 2001, the Seattle Bank classified $14.1 million of advances as impaired and placed the advances on nonaccrual status. Accordingly, the accrual of interest was discontinued, and unpaid accrued interest was reversed. The advances were restructured in September 2002, and as a result, accrual of interest was resumed and unpaid accrued interest recognized. The Seattle Bank's average investment in impaired advances during 2003 and 2002 were $0 and $10.0 million. The cash basis of accounting resulted in no interest income being recognized during the impairment period on the impaired advances.

While the Seattle Bank has never experienced a credit loss on an advance to a member, the expanded eligible collateral for CFIs and nonmember housing associates provides the potential for additional credit risk for the Seattle Bank. The management of the Seattle Bank has policies and procedures in place to appropriately manage this credit risk. Accordingly, the Seattle Bank has not provided any allowances for losses on advances.

The Seattle Bank's potential credit risk from advances is concentrated in commercial banks and savings institutions. As of December 31, 2003, the Seattle Bank had advances of $8.2 billion outstanding to two member institutions, which represented 41.8% of total advances outstanding. The income from advances to these member institutions amounted to $197.6 million during 2003. The Seattle Bank held sufficient collateral to cover the advances to these institutions and does not expect to incur any credit losses on these advances.

Interest-Rate Payment Terms The following table details additional interest-rate payment terms for advances:

As of December 31, (in thousands)	2003	2002
Par amount of advances:		
Fixed-rate	$12,287,277	$11,784,167
Variable-rate	7,114,764	7,900,220
Total	$19,402,041	$19,684,387

NOTE 8
AFFORDABLE HOUSING PROGRAM

Section 10(j) of the Act requires each FHLBank to establish an AHP. Each FHLBank provides subsidies in the form of direct grants and below-market interest-rate advances to members who use the funds to assist with the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Annually, the FHLBanks must set aside for the AHP the greater of $100 million or 10% of the current year's income before charges for AHP, but after the assessment for REFCORP (see Note 1). The Seattle Bank charges the amount set aside for AHP to income and recognizes it as a liability. The Seattle Bank relieves the AHP liability as members use subsidies. If the result of the aggregate 10% calculation described above is less than $100 million for all 12 FHLBanks, then the Act requires the shortfall to be allocated among the FHLBanks, based on the ratio of each FHLBank's income before AHP and REFCORP to the sum of the income before AHP and REFCORP of the 12 FHLBanks. There was no shortfall in either 2003 or 2002. The Seattle Bank had outstanding principal in AHP-related advances of $3.2 million and $4.4 million at December 31, 2003 and 2002.

NOTE 9
MORTGAGE LOANS HELD FOR PORTFOLIO

The MPP involves the investment by the Seattle Bank in mortgage loans which are purchased from its participating members. The mortgage loans represent held-for-portfolio investments whereby the Seattle Bank's participating members originate, service, and credit-enhance home mortgage loans which are owned by the Seattle Bank. Members participating in the servicing released program do not service the loans owned by the Seattle Bank. The servicing on these loans is sold concurrently to a designated mortgage service provider. The following table presents information on mortgage loans held for portfolio:

As of December 31, (in thousands)	2003	2002
Real estate:		
Fixed medium-term* single-family mortgages	$ 1,939,564	$2,742,035
Fixed long-term single-family mortgages	9,141,616	6,199,423
Unamortized net premiums (discounts)	90,337	170,431
Total	$11,171,517	$9,111,889

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

The par value of mortgage loans held for portfolio outstanding at December 31, 2003 and 2002, was comprised of government-insured loans totaling $2.5 billion and $2.4 billion and conventional loans totaling $8.6 billion and $6.6 billion.

Based on its analysis of the Seattle Bank's mortgage loan portfolio, Seattle Bank management has determined that the credit enhancement provided by the sellers and mortgage insurance is sufficient to absorb inherent credit losses and that an allowance for credit loss is unnecessary.

The Seattle Bank had no nonaccrual loans at December 31, 2003 and 2002.

The estimated fair value of the mortgage loans held for portfolio as of December 31, 2003 and 2002, are reported in Note 17.

Mortgage loans, other than those included in large groups of smaller-balance homogeneous loans, are considered impaired when, based on current information and events, it is probable that the Seattle Bank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreement. At December 31, 2003 and 2002, the Seattle Bank had no recorded investments in impaired mortgage loans.

NOTE 10
DEPOSITS

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

NOTE 11
BORROWINGS

Securities Sold Under Agreements to Repurchase The Seattle Bank has sold securities under repurchase agreements. The amounts received under these agreements represent short-term borrowings and are liabilities on the statements of condition. The Seattle Bank has delivered securities sold under agreements to repurchase to the primary dealer. Should the market value of the underlying securities fall below the market value required as collateral, the Seattle Bank must deliver additional securities to the dealer.

NOTE 12
CONSOLIDATED OBLIGATIONS

Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated obligation bonds and discount notes. The FHLBanks issue consolidated obligations through the Office of Finance as their agent. Consolidated obligation bonds are issued primarily to raise intermediate- and long-term funds for the FHLBanks and are not subject to any statutory or regulatory limits on maturity. Consolidated obligation discount notes are issued primarily to raise short-term funds. These notes sell at less than their face amount and are redeemed at par value when they mature.

The par amounts of the FHLBanks' outstanding consolidated obligations, including consolidated obligations held by other FHLBanks, were approximately $759.5 billion and $680.7 billion at December 31, 2003 and 2002. Regulations require the FHLBanks to maintain, in the aggregate, unpledged qualifying assets equal to the consolidated obligations outstanding. Qualifying assets are defined as: cash; secured advances; assets with an assessment or rating at least equivalent to the current assessment or rating of the consolidated obligations; obligations, participations, mortgages, or other securities of or issued by the United States or an agency of the United States; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located.

On June 2, 2000, the Finance Board adopted a final rule amending the FHLBanks' leverage limit requirements. Effective July 1, 2000, until the implementation of its new capital structure, each FHLBank's leverage limit is based on a ratio of assets to capital, rather than a ratio of liabilities to capital. The Finance Board's former regulations prohibited the issuance of consolidated obligations if such issuance would bring the FHLBanks' outstanding consolidated obligations and other unsecured senior liabilities above 20 times the FHLBanks' total capital. The Finance Board's *Financial Management Policy* also applied this limit on an FHLBank-by-FHLBank basis. The final rule deletes the FHLBanks' overall leverage limit from the regulations, but limits each FHLBank's assets generally to no more than 21 times its capital. Nevertheless, an FHLBank whose non-mortgage assets, after deducting deposits and capital, do not exceed 11% of its assets may have total assets in an amount not greater than 25 times its capital. As a result of the implementation of its new capital structure, after June 30, 2002, the Seattle Bank was no longer required to follow this regulation (see Note 13).

To provide the holders of consolidated obligations issued before January 29, 1993 (prior bondholders), the protection equivalent to that provided under the FHLBanks' previous leverage limit of 12 times the FHLBanks' capital stock, prior bondholders have a claim on a certain amount of the qualifying assets [Special Asset Account (SAA)] if capital stock is less than 8.33% of consolidated obligations. At December 31, 2003 and 2002, the FHLBanks' capital stock was 4.96% and 5.17% of the par value of consolidated obligations outstanding, and the minimum SAA balance was approximately $24.0 million for both years. Further, the regulations require each FHLBank to transfer qualifying assets in the amount of its allocated share of the FHLBanks' SAA to a trust for the benefit of the prior bondholders if its capital to assets ratio falls below 2.0%.

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

These consolidated obligations, beyond having fixed-rate or simple variable-rate coupon payment terms, may also have the following broad terms regarding either principal repayment or coupon payment terms:

- *Indexed Principal Redemption Bonds* (index amortizing notes) repay principal according to predetermined amortization schedules that are linked to the level of a certain index. As of December 31, 2003 and 2002, most of the index amortizing notes had fixed-rate coupon payment terms. Usually, as market interest rates rise (fall), the maturity of the index amortizing notes extends (contracts);
- *Optional Principal Redemption Bonds* (callable bonds) may be redeemed by the Seattle Bank, in whole or in part, at its discretion, on predetermined call dates, according to terms of bond offerings; and
- *Putable Bonds* may be redeemed, in whole or in part, by the bondholder, at its discretion, on predetermined put dates, according to the terms of the bond offering.

With respect to interest payments, consolidated obligation bonds may also have the following terms:

- *Step-up Bonds* generally pay interest at increasing fixed rates for specified intervals over the life of the bond. These bonds generally contain provisions enabling the Seattle Bank to call bonds at its option on the step-up dates;

- *Conversion Bonds* have coupons that the Seattle Bank may convert from fixed to floating, or floating to fixed, or from one U.S. or other currency index to another, at its discretion;
- *Range Bonds* pay interest at variable rates, provided a specified index is within a specified range. The computation of the variable interest rate differs for each bond issue, but the bond generally pays zero interest or a minimal rate of interest if the specified index is outside the specified range; and
- *Comparative Index Bonds* have coupon rates determined by the difference between two or more market indices, typically Prime, CMT, and LIBOR.

Redemption Terms The following is a summary of the Seattle Bank's participation in consolidated obligation bonds outstanding at December 31, 2003 and 2002, by year of maturity:

Year of Maturity (in thousands)	2003 Amount	2003 Weighted Average Interest Rate %	2002 Amount	2002 Weighted Average Interest Rate %
2003	$		$ 4,988,240	2.70
2004	7,800,400	3.36	5,568,400	4.35
2005	7,840,595	2.75	4,691,400	3.87
2006	5,656,100	3.67	3,331,100	4.85
2007	3,902,625	4.81	3,672,625	5.31
2008	3,842,050	3.85	1,029,000	5.19
Thereafter	10,868,800	5.31	7,703,500	5.84
Total par value	39,910,570	4.00	30,984,265	4.58
Bond premiums	64,067		65,117	
Bond discounts	(75,777)		(39,967)	
Deferred net losses on terminated interest-rate exchange agreements	(101)			
SFAS 133 hedging adjustments	10,515		133,192	
Total	$39,909,274		$31,142,607	

Consolidated obligation bonds outstanding at December 31, 2003 and 2002, include callable bonds totaling $18.2 billion and $13.2 billion. The Seattle Bank uses fixed-rate callable debt to finance callable advances (see Note 7), MPP loans, and mortgage-backed securities. Simultaneous with such a debt issue, the Seattle Bank may also enter an interest-rate swap (in which the Seattle Bank pays variable and receives fixed) with a call feature that mirrors the option embedded in the debt (e.g., a sold callable swap). The combined sold callable swap and callable debt allows the Seattle Bank to provide members with attractively priced, variable-rate funding.

The Seattle Bank's consolidated obligation bonds outstanding includes:

As of December 31, (in thousands)	2003	2002
Par amount of consolidated obligation bonds:		
Non-callable or non-putable	$21,145,720	$16,990,965
Callable	18,214,850	13,443,300
Putable	550,000	550,000
Total	$39,910,570	$30,984,265

The following table summarizes the par value of consolidated obligation bonds outstanding at December 31, 2003 and 2002, by year of maturity or next call date:

Year of Maturity or Next Call Date (in thousands)	2003	2002
2003	$	$14,113,240
2004	23,125,250	6,181,700
2005	5,880,295	3,176,100
2006	3,268,100	2,276,100
2007	2,527,625	2,383,625
2008	965,500	276,000
Thereafter	4,143,800	2,577,500
Total	$39,910,570	$30,984,265

Interest-Rate Payment Terms The following table details interest-rate payment terms for consolidated obligation bonds:

As of December 31, (in thousands)	2003	2002
Par amount of consolidated obligation bonds:		
Fixed-rate	$39,360,570	$30,284,265
Step-up	50,000	50,000
Simple variable-rate	500,000	650,000
Total	$39,910,570	$30,984,265

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

(in thousands)	Book Value	Par Value	Weighted Average Interest Rate
December 31, 2003	$ 6,609,074	$ 6,613,749	1.06%
December 31, 2002	$10,426,313	$10,451,684	1.39%

The Act authorizes the Secretary of the Treasury, at his or her discretion, to purchase consolidated obligations of the FHLBanks aggregating not more than $4.0 billion. The terms, conditions, and interest rates are determined by the Secretary of the Treasury. There were no such purchases by the U.S. Treasury during the two years ended December 31, 2003.

NOTE 13
CAPITAL

The Gramm-Leach-Bliley Act (GLB Act) will result in a number of changes in the capital structure of all FHLBanks. The Finance Board's final capital rule, published on January 30, 2001, required each FHLBank to submit a capital structure plan to the Finance Board by October 29, 2001, in accordance with the provisions of the GLB Act and final capital rule. The Finance Board approved the Seattle Bank's capital structure on March 13, 2002. The GLB Act provides a transition period to the new capital structure of up to three years from the effective date of each FHLBank's capital structure. The Seattle Bank converted to its new capital structure on June 30, 2002. The conversion was considered a capital transaction and was accounted for at par value.

The Seattle Bank is subject to three capital requirements under Finance Board regulation. First, the Seattle Bank shall maintain at all times permanent capital in an amount at least equal to the sum of its credit-risk capital requirement, its market-risk capital requirement, and its operations-risk capital requirement, calculated in accordance with the rules and regulations of the Finance Board. Only permanent capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. The Finance Board may require the Seattle Bank to maintain a greater amount of permanent capital than is required by the risk-based capital requirements as defined. In addition, the GLB Act requires the Seattle Bank to maintain at all times at least a 4.0% capital to asset ratio and at least a 5.0% leverage ratio, defined as the sum of permanent capital weighted 1.5 times and nonpermanent capital weighted 1.0 times divided by total assets. The Seattle Bank was in compliance with the risk-based capital rules at December 31, 2003, with a 7.2% leverage ratio, weighted leverage capital of $3.7 billion, a 4.8% capital ratio, and permanent capital of $2.5 billion.

The Seattle Bank's capital plan offers two classes of Class B stock, each of which has a par value of $100, the same par value as the Seattle Bank's pre-conversion capital stock. Each class of stock is issued, redeemed, and repurchased only at par value. Members are required to hold Class B(1) stock (required balance) equal to the sum of: (1) 3.5% of the member's outstanding principal balance of advances; (2) $500 or 0.75% of the member's home mortgage loans; and (3) 5.0% of the outstanding principal balance of loans that the member has sold the Seattle Bank under the MPP minus the amount in (2) above (cannot be less than 0). Members can also hold some amount of Class B(1) stock in excess of the required balance under certain circumstances. Members cannot purchase Class B(2) stock and are not required to hold any amount of Class B(2) stock. Any Class B(1) stock held by a member that exceeds the permitted amount of Class B(1) stock will automatically convert to Class B(2) stock five days after the Seattle Bank notifies the member of that conversion. A member may elect to convert some or all of its Class B(2) stock back into Class B(1) stock if there is an increase in the amount of excess stock that the member is permitted to hold. In addition, the Seattle Bank will automatically convert any Class B(2) stock held by a member into Class B(1) stock to cover any shortfall in a member's required balance after any recalculation, if the member's excess Class B(1) stock is insufficient to cover the shortfall.

Each member has the right to vote its stock for the number of directors allocated to the member's state, subject to certain limitations on the maximum number of shares that can be voted, as set forth in applicable law and regulations.

The Seattle Bank's Board of Directors may declare and pay, in either cash or capital stock, dividends only from retained earnings or current net earnings. Dividends on Class B(1) stock will be in the amount and form as may be declared by the Board of Directors, except that dividends may not exceed the sum of: (1) that quarter's net earnings by the Seattle Bank; plus (2) net earnings previously retained by the Seattle Bank; less (3) the amount of any dividends that the Board of Directors declares on Class B(2) stock that quarter. Dividends on Class B(2) stock may be declared only at a rate equal to the lower of: (1) the Class B(1) dividend; or (2) 73.47% times the daily average of three-month LIBOR during the quarter minus 0.25%.

Provided that the Seattle Bank is in compliance with its capital requirements, both classes of B stock are redeemable five years after: (1) written notice from the member; (2) consolidation or merger of two members; or (3) withdrawal or termination of membership. This is a change from the previous capital structure, under which capital stock could be redeemed upon six months' notice. The Seattle Bank may elect to repurchase stock that is subject to redemption prior to the expiration of the five-year notice period, but is under no obligation to do so. In addition, the Seattle Bank may elect, at any time and upon five days' written notice, to repurchase for par value, payable in cash, any: (1) stock that is subject to a notice of redemption (provided that the stock is not required stock); (2) excess stock; or (3) Class B(2) stock. At December 31, 2003, the Seattle Bank had no outstanding redemption requests.

The GLB Act made membership in the Seattle Bank voluntary. Members that withdraw from membership must wait five years before being readmitted to membership in any FHLBank.

Prior to the Seattle Bank's implementation of the new capital regulations, the prior capital rules were in effect. In particular, the Act required members to purchase capital stock equal to the greater of 1.0% of their mortgage-related assets or 5.0% of outstanding Seattle Bank advances. However, the GLB Act removed the provision that required a non-thrift member to purchase additional stock to borrow from the Seattle Bank if the non-thrift member's mortgage-related assets were less than 65% of total assets. Members could, at the Seattle Bank's discretion, redeem at par value any capital stock greater than their statutory requirement or sell it to other Seattle Bank members at par value.

NOTE 14
EMPLOYEE RETIREMENT PLANS

The Seattle Bank participates in the Financial Institutions Retirement Fund (FIRF), a defined-benefit plan. The plan covers substantially all officers and employees of the Seattle Bank. The Seattle Bank's contributions to FIRF through June 30, 1987, represented the normal cost of the plan. The plan reached the full-funding limitation, as defined by the Employee Retirement Income Security Act, for the plan year beginning July 1, 1987, because of favorable investment and other actuarial experience during previous years. As a result, FIRF suspended employer contributions for all plan years ending after June 30, 1987, through June 30, 2003. Contributions to the plan resumed on July 1, 2003. Funding and administrative costs of FIRF charged to operating expenses were $748,000 in 2003. The FIRF is a multi-employer plan and does not segregate its assets, liabilities, or costs by participating employer. As a result, disclosure of the accumulated benefit obligations, plan assets, and the components of annual pension expense attributable to the Seattle Bank cannot be made.

The Seattle Bank also participates in a defined contribution plan. The Seattle Bank's contributions are equal to a percentage of voluntary employee contributions, subject to certain limitations. The Seattle Bank contributed $403,000, $369,000, and $301,000 in the years ended December 31, 2003, 2002, and 2001.

In addition, the Seattle Bank maintains two non-qualified deferred compensation plans, available to certain highly compensated employees, which are funded supplemental retirement plans. The plans' liability consists of the actuarial present value of benefits for the participants, accumulated compensation deferrals, and accrued earnings on the deferrals. The Seattle Bank's minimum obligation from these plans at December 31, 2003 and 2002, was $2.6 million and $1.6 million. Operating expense includes deferred compensation and accrued earnings of $744,000, $317,000, and $258,000 in the years ended December 31, 2003, 2002, and 2001.

NOTE 15
SEGMENT INFORMATION

The Seattle Bank has identified two main operating segments, the MPP and traditional member finance, based on its method of internal reporting. The products and services provided reflect the manner in which financial information is evaluated by management. MPP income is derived primarily from the difference, or spread, between the yield on mortgage loans and the borrowing cost related to those loans. The traditional member finance segment includes advances, investments, and the borrowing costs related to those assets.

The following table presents the Seattle Bank's financial performance by operating segment:

For the Years Ended December 31, (in thousands)	MPP	Traditional Member Finance	Total
2003			
Net interest income	$ 63,458	$ 133,387	$ 196,845
Other income	(3,764)	35,978	32,214
Other expenses	(3,792)	(29,581)	(33,373)
Income before assessments	55,902	139,784	195,686
AHP	(4,563)	(11,411)	(15,974)
REFCORP	(10,268)	(25,674)	(35,942)
Total assessments	(14,831)	(37,085)	(51,916)
Net income before cumulative effect of change in accounting principle	$ 41,071	$ 102,699	$ 143,770
2002			
Net interest income	$ 52,939	$ 196,828	$ 249,767
Other income	883	(24,656)	(23,773)
Other expenses	(2,191)	(23,616)	(25,807)
Income before assessments	51,631	148,556	200,187
AHP	(4,215)	(12,127)	(16,342)
REFCORP	(9,483)	(27,286)	(36,769)
Total assessments	(13,698)	(39,413)	(53,111)
Net income before cumulative effect of change in accounting principle	$ 37,933	$ 109,143	$ 147,076
2001			
Net interest income	$ 7,345	$ 235,493	$ 242,838
Other income	120	25,598	25,718
Other expenses	(1,314)	(21,568)	(22,882)
Income before assessments	6,151	239,523	245,674
AHP	(495)	(19,286)	(19,781)
REFCORP	(1,114)	(43,393)	(44,507)
Total assessments	(1,609)	(62,679)	(64,288)
Net income before cumulative effect of change in accounting principle	$ 4,542	$ 176,844	$ 181,386
2003			
Total assets	$11,221,604	$39,942,211	$51,163,815
2002			
Total assets	$ 9,157,235	$37,527,032	$46,684,267
2001			
Total assets	$ 1,738,772	$41,617,715	$43,356,487

NOTE 16
INTEREST-RATE EXCHANGE AGREEMENTS

The contractual or notional amount of interest-rate exchange agreements reflects the involvement of the Seattle Bank in the various classes of financial instruments. The notional amount of interest-rate exchange agreements does not measure the credit risk exposure of the Seattle Bank, and the maximum credit exposure of the Seattle Bank is substantially less than the notional amount. The maximum credit risk is the estimated cost of replacing favorable interest-rate swaps, forward agreements, mandatory delivery contracts for mortgage loans executed after June 30, 2003, and purchased caps and floors if the counterparty defaults, and the related collateral, if any, is of no value to the Seattle Bank. This collateral has not been sold or repledged.

At December 31, 2003 and 2002, the Seattle Bank's maximum credit risk, as defined above, was approximately $45.2 million and $77.2 million. These totals include $9.1 million and $10.6 million of net accrued interest receivable. In determining maximum credit risk, the Seattle Bank considers accrued interest receivables and payables, and the legal right to offset assets and liabilities by counterparty. The Seattle Bank held securities and cash with a fair value of $20.1 million and $32.5 million as collateral as of December 31, 2003 and 2002. Additionally, collateral with respect to interest-rate exchange agreements with member institutions includes collateral assigned to the Seattle Bank, as evidenced by a written security agreement and held by the member institution for the benefit of the Seattle Bank.

The Seattle Bank transacts most of its interest-rate exchange agreements with large banks and major broker-dealers. Some of these banks and broker-dealers or their affiliates buy, sell, and distribute consolidated obligations. Note 18 discusses assets pledged by the Seattle Bank to these counterparties.

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

The notional principal of interest-rate exchange agreements in which the Seattle Bank was an intermediary is $1.1 billion and $2.0 billion at December 31, 2003 and 2002.

NOTE 17
ESTIMATED FAIR VALUE

The following estimated fair value amounts have been determined using available market information and Seattle Bank management's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to the Seattle Bank as of December 31, 2003 and 2002. Although the Seattle Bank uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique or valuation methodology. For example, because an active secondary market does not exist for a portion of the Seattle Bank's financial instruments, in certain cases, fair values are not subject to precise quantification or verification and may change as economic and market factors and evaluation of those factors change. Therefore, these estimated fair values are not necessarily indicative of the amounts that would be realized in current market transactions. The fair value summary tables do not represent an estimate of the overall market value of the Seattle Bank as a going concern, which would take into account future business opportunities.

Cash and Due From Banks The estimated fair value approximates the recorded book balance.

Interest-Bearing Deposits and Investment Securities The estimated fair value is determined based on quoted prices, excluding accrued interest, as of the last business day of the year.

Securities Purchased Under Agreements to Resell The estimated fair value approximates the recorded book balance.

Federal Funds Sold The estimated fair value is determined by calculating the present value of the expected future cash flows for instruments with more than three months to maturity. The discount rates used in these calculations are the rates for federal funds with similar terms. The estimated fair value approximates the recorded book balance of federal funds with three months or less to maturity.

Advances and Other Loans The Seattle Bank determines the estimated fair value of advances with fixed rates and more than three months to maturity and advances with complex floating rates by calculating the present value of expected future cash flows from the advances and excluding the amount for accrued interest receivable. The discount rates used in these calculations are the replacement advance rates for advances with similar terms. Finance Board regulations stipulate that advances with a maturity and repricing period greater than six months require a prepayment fee sufficient to make the Seattle Bank financially indifferent to the borrower's decision to prepay the advances. Therefore, the estimated fair value of advances does not assume prepayment risk. The estimated fair value approximates the recorded book balance of advances with floating rates and fixed rates with three months or less to maturity or repricing.

Mortgage Loans Held for Portfolio The estimated fair values for mortgage loans are determined based on quoted market prices of similar mortgage loans. These prices, however, can change rapidly based upon market conditions and are highly dependent upon the underlying prepayment assumptions.

Accrued Interest Receivable and Payable The estimated fair value approximates the recorded book value.

Derivative Assets/Liabilities The Seattle Bank bases the estimated fair values of interest-rate exchange agreements on instruments with similar terms or available market prices, including accrued interest receivable and payable. However, active markets do not exist for many types of financial instruments. Consequently, fair values for these instruments must be estimated using techniques such as discounted cash flow analysis and comparisons to similar instruments. Estimates developed using these methods are highly subjective and require judgments regarding significant matters, such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes. The fair values are netted by counterparty where such legal right exists. If these netted amounts are positive, they are classified as an asset and if negative, a liability.

Deposits The Seattle Bank determines estimated fair values of member institutions' deposits with fixed rates and more than three months to maturity by calculating the present value of expected future cash flows from the deposits and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of deposits with similar terms. The estimated fair value approximates the recorded book balance for deposits with floating rates and fixed rates with three months or less to maturity or repricing.

Consolidated Obligations The Seattle Bank estimates fair values based on the cost of issuing comparable term debt. The estimated cost of issuing debt includes non-interest selling costs.

Borrowings The Seattle Bank determines the estimated fair value of borrowings with fixed rates and more than three months to maturity by calculating the present value of expected future cash flows from the borrowings and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of borrowings with similar terms. For borrowings with floating rates and fixed rates with three months or less to maturity or repricing, the estimated fair value approximates the recorded book balance.

Commitments The estimated fair value of the Seattle Bank's commitments to extend credit is determined using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates as of December 31, 2003, and the committed rates. In accordance with SFAS 149, such mortgage loan purchase commitments entered into after June 30, 2003, are recorded as derivatives at their fair value. The estimated fair value of standby letters of credit is based on the present value of fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties as of December 31, 2003. With the adoption of the initial recognition provisions of FIN 45 on January 1, 2003, the value of these guarantees are recognized and recorded in other liabilities. The estimated fair value of standby bond purchase agreements is based on the present value of the estimated fees, taking into account the remaining terms of the agreement.

2003 Fair Value Summary Table The carrying value and estimated fair values of the Seattle Bank's financial instruments were as follows:

As of December 31, 2003 (in thousands)	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 4,313	$	$ 4,313
Interest-bearing deposits	770,000	22	770,022
Securities purchased under agreements to resell	100,000		100,000
Federal funds sold	2,506,500	15	2,506,515
Held-to-maturity securities	16,426,705	135,634	16,562,339
Securities held at fair value	244,187		244,187
Advances	19,652,566	219,282	19,871,848
Mortgage loans held for portfolio	11,171,517	(15,470)	11,156,047
Accrued interest receivable	222,045		222,045
Derivative assets	45,766		45, 766
Liabilities			
Deposits	(1,316,738)	(4)	(1,316,742)
Consolidated obligations:			
Discount notes	(6,609,074)	151	(6,608,923)
Bonds	(39,909,274)	(668,090)	(40,577,364)
Accrued interest payable	(374,298)		(374,298)
Derivative liabilities	(306,513)		(306,513)
Other			
Commitments to extend credit for advances	1,027		1,027
Commitments to extend credit for mortgage loans held for portfolio	(2,736)		(2,736)
Commitments to issue consolidated obligation bonds		2,644	2,644
Commitments to enter into interest-rate swap agreements		(232)	(232)

2002 Fair Value Summary Table The carrying value and estimated fair values of the Seattle Bank's financial instruments were as follows:

As of December 31, 2002 (in thousands)	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 17,813	$	$ 17,813
Interest-bearing deposits	715,000	369	715,369
Securities purchased under agreements to resell	200,000		200,000
Federal funds sold	3,649,500	220	3,649,720
Held-to-maturity securities	12,354,523	390,198	12,744,721
Securities held at fair value	252,094		252,094
Advances	20,035,612	422,839	20,458,451
Mortgage loans held for portfolio	9,111,889	156,072	9,267,961
Accrued interest receivable	253,365		253,365
Derivative assets	77,480		77,480
Liabilities			
Deposits	(1,754,686)	(40)	(1,754,726)
Consolidated obligations:			
Discount notes	(10,426,313)	(837)	(10,427,150)
Bonds	(31,142,607)	(1,083,792)	(32,226,399)
Accrued interest payable	(346,771)		(346,771)
Derivative liabilities	(322,360)		(322,360)
Other			
Commitments to extend credit for advances	704		704
Commitments to extend credit for mortgage loans held for portfolio		317	317
Commitments to issue consolidated obligation bonds		78	78
Commitments to enter into interest-rate swap agreements		(78)	(78)

NOTE 18
COMMITMENTS AND CONTINGENCIES

As described in Note 12, the 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 Finance Board. The Seattle Bank does not recognize a liability for its joint and several obligation related to other FHLBanks' consolidated obligations.

Commitments that legally bind and unconditionally obligate the Seattle Bank for additional advances totaled approximately $28.6 million and $31.5 million at December 31, 2003 and 2002. Commitments generally are for periods up to 12 months.

Standby letters of credit are executed for members for a fee. A standby letter of credit is a short-term financing arrangement between the Seattle Bank and its member. If the Seattle Bank is required to make payment for a beneficiary's draw, these amounts are converted into a collateralized advance to the member. Outstanding standby letters of credit were approximately $188.4 million and $201.3 million at December 31, 2003 and 2002, and had original terms of one month to 20 years with a final expiration in 2020. Outstanding letter-of-credit commitments totaled $200.0 million for both years ended December 31, 2003 and 2002. Unearned fees for transactions, as well as the value of the guarantees related to standby letters of credit entered into after 2002, are recorded in other liabilities and amounted to $99,000 at December 31, 2003. Based on management's credit analyses and collateral requirements, the Seattle Bank does not deem it necessary to have any provision for credit losses on these commitments and letters of credit. Commitments and letters of credit are fully collateralized at the time of issuance (see Note 7). The estimated fair value of commitments and letters of credit as of December 31, 2003 and 2002 is reported in Note 17.

The Seattle Bank has entered into a standby bond purchase agreement with the State of Utah housing authority, whereby the Seattle Bank, for a fee, agrees to purchase and hold the authority's bonds until the designated marketing agent can find a suitable investor or the housing authority repurchases the bond according to a schedule established by the standby agreement. The standby agreement dictates the specific terms that would require the Seattle Bank to purchase the bond. The bond purchase agreement entered into by the Seattle Bank expires after 1.4 years, no later than May 2005. Total commitments for bond purchases were $96.2 million and $0 at December 31, 2003 and 2002. During 2003, the Seattle Bank was not required to purchase any bonds under this agreement. The estimated fair value of standby bond purchase agreements as of December 31, 2003, is reported in Note 17.

Commitments which unconditionally obligate the Seattle Bank to purchase mortgage loans totaled $612.6 million and $16.0 million at December 31, 2003 and 2002. Commitments are generally for periods not to exceed 90 days. In accordance with SFAS 149, such commitments entered into after June 30, 2003, were recorded as derivatives at their fair value.

The Seattle Bank generally executes interest-rate exchange agreements with major banks and broker-dealers and generally enters into bilateral collateral agreements. As of December 31, 2003, the Seattle Bank had pledged, as collateral, securities with a book value of $69.6 million to broker-dealers who have a market risk exposure from the Seattle Bank related to interest-rate exchange agreements.

The Seattle Bank charged to operating expenses net rental costs of approximately $1.4 million, $1.3 million, and $1.2 million for the years ending December 31, 2003, 2002, and 2001. Future minimum lease commitments at December 31, 2003, were as follows:

Year (in thousands)	Minimum Lease Commitment
2004	$ 1,701
2005	1,809
2006	1,860
2007	1,941
2008	1,992
Thereafter	7,517
Total	$16,820

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

The Seattle Bank recorded $65.0 million and $54.9 million in traded, but not settled, federal funds sold and held-to-maturity securities, respectively, as of December 31, 2003, and $237.5 million in traded, but not settled, held-to-maturity securities as of December 31, 2002.

The Seattle Bank entered into $341.0 million and $65.0 million par value of consolidated obligations as of December 31, 2003 and 2002, and $180.0 million and $65.0 million of notional amount of interest-rate exchange agreements that had traded, but not settled, as of December 31, 2003 and 2002, respectively.

Other Developments The Seattle Bank is subject to legal proceedings arising in the normal course of business. After consultation with legal counsel, management does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Seattle Bank's financial condition or results of operations.

Notes 7, 8, 12, 13, 14, and 16 discuss other commitments and contingencies.

Report of Independent Auditors

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF THE FEDERAL HOME LOAN BANK OF SEATTLE

In our opinion, the accompanying statements of condition and the related statements of income, capital and of cash flows present fairly, in all material respects, the financial position of the Federal Home Loan Bank of Seattle (the "FHLBank") at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the FHLBank's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Also, in accordance with those standards and as part of our audit of the FHLBank's financial statements, we issued a separate report on compliance and on internal control over financial reporting. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the FHLBank adopted Statement of Financial Accounting Standards No.133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by Statement of Financial Accounting Standards No. 138, on January 1, 2001.

PricewaterhouseCoopers LLP

San Francisco, California
February 9, 2004

Management Report of Financial Statements

Management is responsible for the preparation and presentation of the financial statements, related notes, and all other financial information contained in this Annual Report. The statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances, and include amounts that are based on management's best judgments. Financial information elsewhere in the Annual Report is consistent with that in the financial statements.

In meeting its responsibility for the accuracy of the financial statements, management relies on the internal control structure. This structure is designed to provide reasonable assurances that assets are safeguarded and transactions are properly authorized and recorded to permit the preparation of appropriate financial information. The internal control structure is supplemented by a program of internal audits to independently evaluate the adequacy and application of financial and operating controls in compliance with policies and procedures.

The Audit Committee of the Board of Directors meets periodically with management, the independent accountants, and the internal auditors to ensure that each is properly discharging its responsibilities with regard to the financial statements and internal accounting controls. The independent accountants have full and free access to the Audit Committee and meet with it, with and without management being present, to discuss auditing and financial reporting matters.

The financial statements in this Annual Report have been audited by PricewaterhouseCoopers LLP, independent accountants. Their audits were conducted in accordance with generally accepted auditing standards and include a consideration of the internal control structure, tests of accounting records, and other audit procedures necessary to allow the auditors to express their opinions on the fairness of the financial statements.

Norman B. Rice
President and Chief Executive Officer

Kelli L. Bono
Executive Vice President and
Chief Financial Officer

Audit Committee Report

The Audit Committee of the Board of Directors of the Federal Home Loan Bank of Seattle (Seattle Bank) for 2003 comprised seven directors for the period January through June, two representing the public sector and five representing industry members. From July through December, the committee comprised eight directors, three representing the public sector and five representing industry members. The members of the Audit Committee at year-end 2003 were: Daniel L. Stevens, Chairman, Carmen J. Aguiar, Robert L. Fenstermacher, Harold B. Gilkey, James R. Irvine, James H. Strosahl, Sue Taoka, and Roy M. Whitehead.

The 2004 Audit Committee comprises seven directors, three representing the public sector and four representing industry members. Both the 2003 and 2004 Audit Committee members are independent, as defined by the Federal Housing Finance Board.

The Audit Committee oversees the Seattle Bank's financial reporting process; reviews compliance with laws, regulations, policies and procedures; and evaluates the adequacy of administrative, operating, and internal accounting controls. The Audit Committee has adopted and is governed by a written charter, and satisfied its significant responsibilities during 2003 in compliance with the charter.

In fulfilling its responsibilities, the Audit Committee has reviewed and discussed with the independent auditor, the matters required to be discussed for Statement on Auditing Standards (SAS) No. 61, *Communication With Audit Committees*, and SAS No. 90, *Audit Committee Communications*. The Committee has also received the written disclosures and the letter from the independent auditor required by Independence Standards Board (ISB) Standard No. 1, *Independence Discussions with Audit Committees*, and has discussed with the auditor the auditor's independence.

Based on the review and discussions referred to above, the 2004 Audit Committee recommends to the Board of Directors that the financial statements be included in the Annual Report.

Daniel L. Stevens, Chairman
Carmen J. Aguiar
James R. Irvine
Allan Landon
Jack Riggs, M.D.
James H. Strosahl
Roy M. Whitehead

Audit Committee Charter

PURPOSE

The purpose of the Audit Committee ("Committee") is to assist the Board of Directors in fulfilling its oversight responsibilities for (1) the integrity of the bank's financial reporting, (2) the establishment of an adequate administrative, operating, and internal accounting control system, (3) the bank's compliance with legal and regulatory requirements, (4) the independent auditor's qualifications and independence, (5) the performance of the bank's internal audit function and independent auditors, and (6) the bank's compliance with internal policies and procedures.

Principles

The Committee is guided by the following principles:

- There are adequate internal controls, policies, and procedures in place to achieve established objectives.
- There are adequate policies to achieve disclosure and clarity regarding financial performance and governance practices.

Membership and Organization

The Committee shall consist of five or more board members who are appointed by the Chairman of the Board, subject to approval by the Board of Directors and who meet the criteria of independence as defined by the Federal Housing Finance Board. No member can be a current or former member of senior management. All members must be or become financially literate. At least one member of the Committee must have extensive accounting or related financial management experience. Membership requirements for the Committee are determined by regulation. The Committee routinely meets in accordance with a published schedule, generally in conjunction with meetings of the board, and at least four times a year. All Committee members are expected to attend each meeting, in person or via tele- or video-conference. All matters of significance to come before the Committee are regularly reported to the Board of Directors with recommendation for action, as required. The Committee shall meet in executive session with both the Director of Auditing and the external auditors at least twice annually. Written minutes shall be prepared for each meeting and a copy of such minutes forwarded to the Federal Housing Finance Board.

Authority

The Committee has authority to conduct or authorize investigations into any matters within its scope of responsibility. It is empowered to:

- Appoint, compensate, and oversee the work of the public accounting firm employed by the organization to conduct the annual audit. This firm will report directly to the Committee.
- Resolve any disagreements between management and the auditor regarding financial reporting.
- Pre-approve all auditing and permitted non-audit services performed by the bank's external audit firm.
- Retain independent counsel, accountants, or others to advise the Committee or assist in the conduct of an investigation.
- Seek any information it requires from employees—all of whom are directed to cooperate with the Committee's requests—or external parties.
- Meet with bank officers, external auditors, or outside counsel, as necessary.
- The Committee may delegate authority to subcommittees, including the authority to pre-approve all auditing and permitted non-audit services, providing that such decisions are presented to the full Committee at its next scheduled meeting.
- Hire, compensate, evaluate, and where appropriate, dismiss the Director of Auditing.[3]

Responsibilities

Financial Statements

1. Review significant accounting and reporting issues and understand their impact on the financial statements. These issues include: complex or unusual transactions and highly judgmental areas, major issues regarding accounting principles and financial statement presentations, including any significant changes in the bank's selection or application of accounting principles and the effect of regulatory and accounting initiatives, as well as off-balance sheet structures on the financial statements of the bank.

2. Review analysis prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analysis of the effects of alternative generally accepted accounting principles (GAAP) methods on the financial statements.[1]

3. Review with management and the external auditors the results of the audit, including any difficulties encountered. This review will include any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management.[1]

4. Discuss the annual audited financial statements and quarterly financial statements with management and the external auditors, including the bank's disclosures under Management's Discussion and Analysis of Financial Condition and Results of Operations.[1]

5. Review disclosures made by CEO and CFO during the certification process about significant deficiencies in the design or operation of internal controls, or any fraud that involves management or other employees who have a significant role in the bank's internal controls.

Internal Control

1. Consider the effectiveness of the bank's internal control system, including information technology security and control.

2. Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.[1]

3. Review policies and procedures established by senior management to assess and monitor implementation of the Strategic Business Plan.

Internal Audit

1. Review with management and the Director of Auditing the charter, plans, activities, staffing, and organizational structure of the internal audit function.[1, 3]

2. Ensure there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, or dismissal of the Director of Auditing.[3]

3. Review the effectiveness of the internal audit function, including compliance with The Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing.

4. On a regular basis, meet separately with the Director of Auditing to discuss any matters that the Committee or internal audit believes should be discussed privately.[1]

External Audit

1. Review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit.

2. Review the performance of the external auditors, and exercise final approval on the appointment or discharge of the auditors. In performing this review, the Committee will: At least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the bank.[1] Take into account the opinions of management and internal audit. Review and evaluate the lead partner of the independent auditor. Present its conclusions with respect to the external auditor to the board.

3. Ensure the rotation of the lead audit partner every five years and other audit partners every seven years, and consider whether there should be regular rotation of the audit firm itself.[1]

4. Present its conclusions with respect to the independent auditor to the full board.[1]

5. Set clear hiring policies for employees or former employees of the independent auditors.[1]

6. On a regular basis, meet separately with the external auditors to discuss any matters that the Committee or auditors believe should be discussed privately.[1]

7. Approve the external audit engagement letter.[3]

Compliance

1. Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) or any instances of noncompliance.

2. Establish procedures for: (i) the receipt, retention, and treatment of complaints received regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.[2]

3. Review the findings of any examinations by regulatory agencies, and any auditor observations.

4. Review the process for communicating the code of ethics to bank personnel, and for monitoring compliance therewith.[2]

5. Obtain regular updates from management and bank legal counsel.

Reporting Responsibilities

1. Regularly report to the Board of Directors about Committee activities and issues that arise with respect to the quality or integrity of the bank's financial statements, the bank's compliance with legal or regulatory requirements, the performance and independence of the bank's independent auditors, and the performance of the internal audit function.[1, 3]

2. Provide an independent, direct communication channel between internal audit, the external auditors, the Board of Directors, and the Federal Housing Finance Board examiners.[3]

3. Report annually to the full Board of Directors, describing the Committee's composition, responsibilities and how they were discharged, and any other information required by rule, including approval of non-audit services.

4. Review any other reports the bank issues that relate to Committee responsibilities.

Other Responsibilities

1. Reviewing the annual risk assessment performed by bank senior management.[3]

2. Perform other activities related to this charter as requested by the Board of Directors.

3. Institute and oversee special investigations as needed.

4. Review and assess the adequacy of the Committee charter annually, requesting board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.[3]

5. Confirm annually that all responsibilities outlined in this charter have been carried out.

The above responsibilities of the Committee will be discharged through review of audit reports and discussions with the internal and external auditors and bank management. The internal and external auditors shall have unrestricted access to the Audit Committee without the need for any prior management knowledge or approval. The Director of Auditing shall report directly to the Committee on substantive matters.[3]

[1] Requirement from New York Stock Exchange
[2] Requirement from Sarbanes-Oxley Act
[3] Federal Housing Finance Board "Governance" regulation section 917.7
[4] Recommended by the Institute of Internal Auditors

2003 Board of Directors


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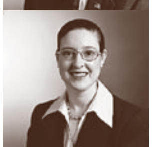
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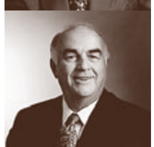
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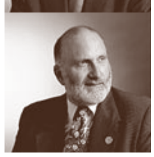
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a Michael P. Radway, Chairman
Consultant
Portland, OR
Committees: Council of Federal Home Loan Banks; Executive (Chair)

b Daniel L. Stevens, Vice Chairman
Chairman, President and Chief Executive Officer
Home Federal Savings and Loan of Nampa
Nampa, ID
Committees: Audit (Chair); Executive; Financial Operations

c Carmen Julia Aguiar
President and Chief Executive Officer
The Aguiar Group
Bellevue, WA
Committees: Audit; Governance & Budget

d Hector R. Ariceaga
Vice President, Business and Technology Development
First American Title Insurance Co. of Oregon
Portland, OR
Committees: Financial Operations; Products, Services & Housing

e Mike Daly
Chairman and Chief Executive Officer
First State Bank
Wheatland, WY
Committees: Executive; Organizational Development; Products, Services & Housing (Chair)

f Robert L. Fenstermacher
Chairman, President and Chief Executive Officer
LibertyBank
Eugene, OR
Committees: Audit; Governance & Budget; Organizational Development

g Philip J. Flores
Chairman, President and Chief Executive Officer
BankPacific
Hagatna, GU
Committees: Financial Operations; Governance & Budget

h Harold B. Gilkey
Chairman and Chief Executive Officer
Sterling Savings Bank
Spokane, WA
Committees: Audit; Governance & Budget

i W. David Hemingway
Executive Vice President
Zions First National Bank
Salt Lake City, UT
Committees: Executive; Financial Operations (Chair); Products, Services & Housing

j James R. Irvine
Chairman and Chief Executive Officer
The Conifer Group
Portland, OR
Committees: Audit; Products, Services & Housing

k William A. Longbrake
Vice Chair, Enterprise Risk Management
Washington Mutual Bank
Seattle, WA
Committees: Council of Federal Home Loan Banks; Executive; Financial Operations; Governance & Budget (Chair)

* Jan K. Sieberts
Senior Vice President
Wells Fargo Bank Alaska, N.A.
Anchorage, AK
Committees: Financial Operations; Organizational Development; Products, Services & Housing

l James H. Strosahl
Executive Vice President and Chief Financial Officer
Glacier Bank
Kalispell, MT
Committees: Audit; Financial Operations

m Sue Taoka
Executive Director
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The Federal Home Loan Bank of Seattle builds financial partnerships that enhance the success of our members and make our communities better places to work and live.

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