

U.S. CENTRAL

2008 Annual Report

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U.S. CENTRAL

Letter from CEO

2008 Annual Report

Letter from CEO

U.S. Central 2008 Annual Report

Aug. 31, 2009

My tenure at U.S. Central began amid the steepest downturn in the global financial sector since the Great Depression. This economic tidal wave – borne of an unprecedented collapse in housing prices, the concomitant detrimental effect on asset-backed securities and the virtual halt of traditional business in the world's credit markets – has damaged many financial institutions.

While losses to depositors have been rare, all too plentiful are the cases in which homeowners, employees and investors have suffered material losses. Some losses to investors have occurred in institutions that have failed or have been merged out of existence. Other firms, such as U.S. Central, are damaged and now are operating under government control.

Yet, we're still standing, persevering and adapting.

And as we endure this downturn and confront its challenges, we must remember one historical constant: Every crisis breeds opportunity. So it will be in this case, as well. Opportunities may take the form of modification of the structure within which products and services are delivered. Or it may be the structure of the products and services themselves. Or it may be in the efficiency by which the products and services are delivered. We are evaluating all of these, and more.

I accepted this challenge because I believe that U.S. Central serves many important functions – functions that should be preserved, supported and even promoted during this period. While we will almost certainly look different in the future from how we have looked in the past, we are dedicated to providing these functions, which are vital to many, with high levels of service quality and with competitive features and pricing. At the same time, we will be researching and developing initiatives as opportunities present themselves.

2008: A Retrospection

The nature and scope of the financial crisis we're enduring is so extraordinary and so pervasive that the credit union industry had virtually no chance of escaping it. U.S. home values lost \$2 trillion last year, and one in every 12 mortgages nationwide was delinquent by the end of the year. In a matter of months, Wall Street giants Lehman Brothers, Bear Stearns and Merrill Lynch all either closed their doors or were sold, and

risk-aversion became so pronounced in late 2008 that investors and counterparties who had conducted business with one another for decades virtually halted their normal activities.

U.S. Central's balance sheet did not perform well in that environment. As home prices plunged and foreclosures mounted, market values on our portfolio sank and credit losses deepened as the world's capital markets simply stopped working.

Our leveraged balance sheet contained substantial exposure to mortgage-backed securities. This asset/liability management strategy was, for many years, the source by which we paid attractive share and certificate rates, attracted greater market share, covered contributions to many credit union organizations and charities, and subsidized overhead costs of the corporate network. It also proved to be the source of our impairment. In an environment in which the only thing that mattered was liquidity – the ability to convert assets to cash without suffering material losses – we didn't have nearly enough.

Speaking for the staff of U.S. Central, we are sorry this happened. We are embarrassed that we allowed this to happen on our watch. We are haunted by self-doubt concerning our decisions. Those entrusted and vested with authority necessary to have avoided the problems are no longer affiliated with U.S. Central. Even while we understand that responsibility rests among them, we – as an organization and as individuals – are hurt and scarred by the resulting losses absorbed by our members and by their members.

Our failures, combined with those of the other elements of the risk-control environment designed to protect this organization, left us more vulnerable to these extraordinary market forces than, in hindsight, was appropriate.

These failures – at U.S. Central and at all too many other financial institutions – are the subject of discourse and debate today. Trust that we are learning from our mistakes.

Operating in Conservatorship

The events leading up to the National Credit Union Administration's decision to place U.S. Central into federal conservatorship March 20, 2009, have been well documented. Obtaining funding from our members was becoming more problematic. Borrowing from traditional, non-credit union sources was drying up rapidly, and the rising credit and market-value losses in our investment portfolio required large write-downs. These all threatened our viability and, in turn, the performance of services deemed to be mission-critical for many of those we serve.

Coincident with placing U.S. Central into conservatorship, the NCUA provided funding that was essential as external, historical sources of funding were no longer available to

finance our leveraged balance sheet. This funding backstop, along with the steps taken to guarantee deposits, enables us to concentrate on providing our products and services.

As market counterparties comprehend our status (including their credit exposure in the course of normal, commercial transactions), they are considering re-establishing business relationships. We have seen some early signs of progress and are working to build on these early, preliminary successes. If this trend continues, we may be in a position to repay the funding provided by the NCUA – our lender of last resort – with borrowings from these more traditional counterparties.

A bright spot for us has been the performance of our payment and settlement services area. Throughout this period of upheaval, we continued processing payments through our ACH, automated settlement and electronic bill pay systems, and we support foreign exchange wires to about 90 countries. Demand for these services is growing. This is a source of non-capital intensive fee income, and we are nurturing this growth and supporting development in this area.

Controlling the growth in operating expenses, including elements of general corporate overhead, was less of a priority in the past than maintaining/increasing market share and the competitiveness of share and certificate rates. Emphasis on controlling operating expenses has a higher priority today. Our budget for operating expenses for calendar year 2009 is \$48 million, a 25 percent decline from the level incurred in 2008. The areas cut include staff, employee benefits, training, travel and incidental expenses, data processing, outside professional services, dues and memberships, contributions and occupancy.

We also are in the early stages of developing business plans for our core strengths. These will be essential to the development of strategies we will deploy during the period immediately ahead.

Volatility

From the mid-1980s until recently, economic cycles have been fairly subdued – periods of expansion have been relatively long and generally temperate, and the contractions have been fairly short and moderate. Many firms that were directly or indirectly involved in the businesses of investing, financial services and money management grew to be quite comfortable operating within this paradigm.

Individuals observed the same environment and determined that it was reasonable to finance life's non-essentials and to assume the price of real property never goes down. New risk management tools were the rage, sophisticated risk modeling systems were used to support management's decisions, and complex financial engineering permitted

the construction of highly rated instruments from elements that were not consistent in quality. The idea that financial market volatility could be held in check, muted in some way, was accepted as conventional wisdom and ruled the day.

Until it didn't.

I close with this topic because one of the lessons we have relearned recently is that volatility in investment results, volatility in outcomes compared to expectations, is very expensive to hedge effectively. The premium paid to obtain the hedge often completely negates the instrument's attractive yield advantage. Electing, instead, to accept this volatility of outcomes – even those outcomes that seem unimaginably remote and unlikely – can threaten a financial institution's very viability.

The challenge we face is to be able to deliver products and services that are in demand while, at the same time, reducing our exposure to the volatility of financial instruments, monetary policy and the economic cycle. This will produce less volatile, more predictable financial results for U.S. Central. In light of recent events, that would be a good thing.

Sincerely,

A handwritten signature in cursive script, appearing to read "James L. Nance".

James L. Nance

U.S. CENTRAL

Management's
Discussion and Analysis

2008 Annual Report

Management's Discussion and Analysis

The overall market deterioration that began in 2007 intensified in the second half of 2008 and has continued into 2009. The slump in the U.S. housing market and its subsequent impact on mortgage loans caused capital markets to freeze late in 2008, resulting in wider credit spreads, lower business and consumer confidence, and concerns about the solvency of many financial institutions.

As these events unfolded, investors' fears worsened, virtually halting market activity. Federal funds and commercial paper trading nearly ceased, while term lending shut down entirely. In an attempt to renew confidence and restart lending among financial institutions, the Federal Reserve and the U.S. Treasury created more than \$3.0 trillion in government-supported or government-guaranteed programs.

U.S. Central was not immune to this global financial crisis. With a significant portion of its investments concentrated in consumer-based assets, particularly non-agency, residential mortgage-backed securities (RMBS), the fair value of U.S. Central's portfolio decreased. This coincided with a decline in member deposits – historically U.S. Central's primary funding source.

Unlike U.S. Central's seasonal member-balance trend, which typically peaks in March or April and falls to a low in August or September, balances declined throughout 2008. Additionally, concerns regarding the quality of assets within U.S. Central's portfolio spurred a series of credit ratings downgrades that curtailed U.S. Central's ability to borrow in the open market. U.S. Central did not have access to funding necessary to provide for its own needs and the needs of its members in a reliable fashion.

On March 20, 2009, the Board of the National Credit Union Administration (NCUA) placed U.S. Central in conservatorship. This action was taken in order to preserve U.S. Central's assets and the interests of its members and to protect the National Credit Union Share Insurance Fund by rebuilding member and public confidence in the credit union system, restoring the flow of liquidity throughout the credit union system and maintaining uninterrupted payment system operations.

Results of Operations

U.S. Central recorded a \$4.8 billion net loss for the year ended Dec. 31, 2008, compared with a net loss of \$50.7 million for the prior year. U.S. Central experienced significant deterioration in some of its consumer-based investment securities throughout 2008, particularly non-agency RMBS. U.S. Central records other-than-temporary impairment (OTTI) charges in cases when it does not expect to receive all contractual principal and interest cash flows. As a result of both internal and independent analyses of U.S. Central's portfolio, with specific emphasis on non-agency RMBS, U.S. Central recorded OTTI charges totaling \$4.9 billion as of Dec. 31, 2008.

Other net losses on all financial instruments in 2008 were the result of net unrealized losses of \$23.6 million on trading securities, net unrealized losses of \$21.1 million on jumbo mortgage loans held-for-sale, \$5.9 million of net unrealized losses in SFAS 133 hedge ineffectiveness, and \$2.5 million of combined net realized losses on 1) early redemptions of member certificates, 2) early repayments of member loans and 3) sales of investment securities. In addition, management established a jumbo mortgage loan loss reserve of \$0.9 million in the fourth quarter of 2008. Including OTTI charges, net losses on financial instruments totaled \$5.0 billion in 2008, compared with \$154.7 million in 2007.

Net interest income, after dividends on Membership Capital Shares (MCS), totaled \$193.8 million in 2008, an increase of \$49.2 million, or 34.0 percent, from 2007. Although average interest-earning assets fell by \$3.4 billion (7.1 percent) in 2008 from 2007, average spreads on fed funds compared with LIBOR widened, especially in the second half of 2008. This resulted in the increase in net interest income, as U.S. Central is paid LIBOR-based rates on the majority of its assets and pays fed funds-based rates on the majority of its variable-rate liabilities. Combined dividends on MCS and Paid-In Capital (PIC) totaled \$55.1 million for the year ended Dec. 31, 2008, compared with \$92.2 million for the prior year. In 2008, average annualized rates paid on MCS and PIC were 2.7 percent and 3.5 percent, respectively. These rates were 5.6 percent and 6.3 percent, respectively, in 2007.

Fee income totaled \$20.2 million for the year ended Dec. 31, 2008, an increase of \$0.8 million from 2007. The table below provides further detail regarding fee income by product category for both years:

Fee Income

(dollars in thousands)

	2008		2007	
	Income	% of Total	Income	% of Total
E-commerce services	\$ 6,546	32.5%	\$ 6,764	34.8%
Payment services	5,556	27.5%	5,570	28.7%
Investment brokerage and advisory	3,135	15.5%	1,700	8.8%
Technology services (including Core Network Processing)	2,535	12.6%	3,384	17.4%
Securities custody	1,835	9.1%	1,535	7.9%
Other	563	2.8%	461	2.4%
	<u>\$ 20,170</u>	<u>100.0%</u>	<u>\$ 19,414</u>	<u>100.0%</u>

E-commerce services offered by Corporate Network eCom, LLC (eCom), a U.S. Central majority-owned subsidiary, provided the largest source of consolidated fee income. eCom partners with U.S. Central's corporate credit union members to provide electronic payment services to credit unions. eCom recorded 16.5 million electronic payment transactions in 2008, up from 16.4 million transactions in 2007. However, comparing 2008 to 2007, eCom's fee income declined \$0.2 million (3.2 percent), reflecting a shift in the mix of eCom's transactions toward lower-priced products and services. Increased transaction volume for U.S. Central's wholly-owned broker-dealer, CU Investment Solutions, Inc., contributed \$1.4 million to the annual increase in consolidated fee income, which was partially offset by a \$0.9 million decrease in technology services income.

Operating expenses increased \$4.2 million to \$64.2 million in 2008, up 7.0 percent from 2007. The table below depicts the composition of 2008 and 2007 operating expenses:

Operating Expenses
(dollars in thousands)

	2008		2007	
	Expense	% of Total	Expense	% of Total
Salaries and benefits	\$ 27,549	42.9%	\$ 28,234	47.2%
Data processing	14,777	23.0%	14,417	24.0%
Professional and outside services	13,837	21.6%	9,571	16.0%
Office occupancy and administration	3,034	4.7%	3,317	5.5%
Travel and entertainment	1,854	2.9%	1,765	2.9%
Marketing and public relations	1,258	2.0%	1,108	1.8%
Other	1,889	2.9%	1,554	2.6%
	<u>\$ 64,198</u>	<u>100.0%</u>	<u>\$ 59,966</u>	<u>100.0%</u>

Professional and outside service costs increased \$4.3 million from 2007. These expenses included audit fees, pricing services and external valuation consultant fees, U.S. Central's use of which rose in response to deteriorating market conditions throughout 2008. In addition, data processing costs increased \$0.4 million compared with 2007 as capitalized Automated Clearing House (ACH) back-end replacement processing costs were expensed in late 2008. Net increases in other expense categories totaled \$0.2 million and were individually insignificant. Salaries and benefits decreased \$0.7 million, primarily reflecting a reduction of incentive compensation expenses.

Assets

U.S. Central's assets as of Dec. 31, 2008, totaled \$27.1 billion, a decrease of \$17.6 billion, or 39.4 percent, from \$44.7 billion recorded Dec. 31, 2007. The decline in total assets reflects, in part, the reduction in market prices for U.S. Central's investment securities, which appear on the balance sheet at fair value. The total fair value of U.S. Central's investment securities fell by \$11.4 billion in 2008.

The table at the top of page 4 presents U.S. Central's portfolio of investment securities by category or type of investment:

Category	December 31, 2008			December 31, 2007		
	Fair Value	Amortized Cost	% of Amortized Cost	Fair Value	Amortized Cost	% of Amortized Cost
Agency Debt	\$ 72,727	\$ 72,083	0.2%	\$ 25,890	\$ 25,378	0.1%
Govt & Agency RMBS	1,528,495	1,600,826	5.4%	2,084,638	2,100,797	5.5%
Non-Agency RMBS	8,721,634	14,444,022	49.1%	20,253,345	21,538,959	56.4%
ABS						
Credit Cards	5,190,458	6,147,613	20.9%	5,438,585	5,521,558	14.4%
Student Loans	2,252,810	2,678,525	9.1%	2,522,567	2,577,351	6.8%
Autos	1,862,777	2,173,499	7.4%	2,602,693	2,619,299	6.9%
CMBS	315,007	391,399	1.3%	1,341,574	1,341,551	3.5%
Other	409,358	484,112	1.6%	497,553	500,913	1.3%
Subtotal	10,030,410	11,875,148	40.3%	12,402,972	12,560,672	32.9%
Corporate Bonds, Notes & Commercial Paper	1,302,541	1,461,298	5.0%	1,904,802	1,932,452	5.1%
Total Investment Securities	\$ 21,655,807	\$ 29,453,377	100.0%	\$ 36,671,647	\$ 38,158,258	100.0%

A material risk currently facing U.S. Central's portfolio is credit risk. It is the risk that assets owned by U.S. Central – including investment securities, loans and short-term investments – may not pay all principal and interest cash flows according to their contractual terms. Credit ratings assigned by the national rating agencies represent an independent view of credit risk in a securities portfolio. As conditions in the credit markets deteriorated in 2008, particularly in the RMBS market, the rating agencies responded with downgrades of previously assigned credit ratings.

The following table presents an overview of U.S. Central's investment securities categorized by the lowest rating of Standard & Poor's (S&P) or Moody's Investor Service (Moody's). (If specific securities are not rated by S&P or Moody's, U.S. Central uses ratings of Fitch Ratings.)

Lowest Rating	December 31, 2008		December 31, 2007	
	Amortized Cost	% of Amortized Cost	Amortized Cost	% of Amortized Cost
AAA	\$ 19,691,729	66.9%	\$ 35,714,102	93.7%
AA	2,853,754	9.7%	1,887,211	4.9%
A	1,810,139	6.1%	536,931	1.4%
BBB	2,908,456	9.9%	4,389	0.0%
< BBB	2,189,299	7.4%	15,625	0.0%
	\$ 29,453,377	100.0%	\$ 38,158,258	100.0%

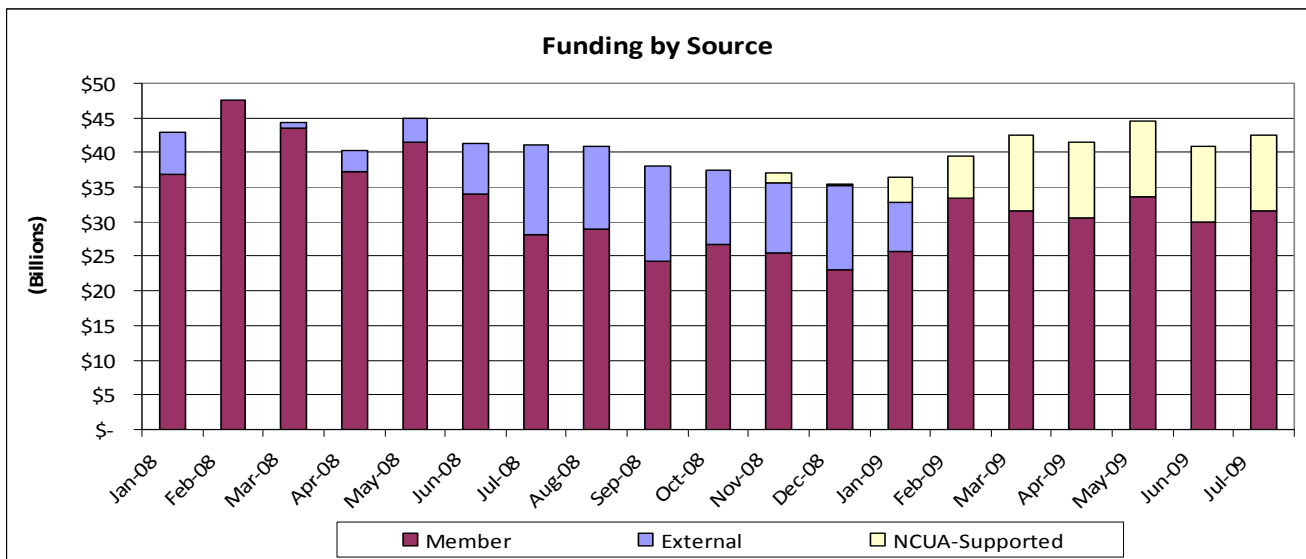
U.S. Central owns certain investment securities guaranteed by monoline insurers. In these cases, the insurance acts as a secondary form of protection, in addition to normal credit enhancements embedded in the security. Financial Guaranty Insurance Company (FGIC), a monoline insurer that has experienced severe declines in its credit ratings, has insured several of the investment securities in U.S. Central's portfolio. Based on analysis performed as of Dec. 31, 2008, management determined that FGIC did not have sufficient claims paying ability to cover expected losses. As a result, OTTI charges recorded in 2008 include charges for bonds insured by FGIC if, without the effects of insurance, losses of principal or interest cash flows were projected.

As of Dec. 31, 2008, all securities in U.S. Central’s portfolio – representing approximately 80.0 percent of total assets – were classified as available-for-sale (AFS) and appear on the balance sheet at fair value. Previous management of U.S. Central had elected to transfer certain securities to held-to-maturity status during 2008, which requires the positive intent and ability to hold those securities to their legal maturity. The current management and Advisory Board of U.S. Central (post-conservatorship) intends to hold these securities to recovery, not necessarily legal maturity. As a result, management considers the AFS classification most appropriate for all securities in U.S. Central’s portfolio.

Because all of U.S. Central’s marketable securities are classified as AFS, declines in the prices of these securities as of Dec. 31, 2008, negatively affected accumulated other comprehensive income (AOCI). As of Dec. 31, 2008, AOCI, which currently consists almost entirely of net unrealized losses on AFS securities, showed an unrealized loss of \$7.9 billion, compared with an unrealized loss of \$1.5 billion as of Dec. 31, 2007.

Borrowings and Members’ Accounts

Total funding (excluding capital accounts) decreased \$6.5 billion, or 15.0 percent, to \$36.9 billion at Dec. 31, 2008, corresponding with the decrease in par value of U.S. Central’s assets. Member balances declined throughout 2008. As a result, U.S. Central increasingly turned to sources outside the credit union system to fund itself. However, as market prices for the securities in U.S. Central’s portfolio declined, U.S. Central’s ability to borrow funds, using those securities as collateral, diminished. Concerns regarding U.S. Central’s portfolio of RMBS caused national credit rating agencies to downgrade U.S. Central’s debt ratings, further limiting available funding. By February 2009, NCUA-supported borrowings had replaced all external funding. Beginning in April 2009, U.S. Central re-established borrowing lines with certain market counterparties. The following chart depicts U.S. Central’s sources of funding since the beginning of 2008:



In January 2009, the NCUA established the Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP). This is a voluntary program that provides an NCUSIF guarantee for any share or certificate investment at a participating corporate credit union in excess of the existing share insurance of \$250,000. With the support of the TCCUSGP, beginning in February 2009, U.S. Central experienced increases in member accounts that are more consistent with seasonal inflows of previous years.

In addition, the NCUA has taken other actions to ensure adequate funding for U.S. Central, as discussed below:

- The NCUA Board approved the Temporary Corporate Credit Union Liquidity Guarantee Program (TCCULGP), which allows corporate credit unions, including U.S. Central, to issue NCUSIF-guaranteed debt, in exchange for certain fees payable to the NCUSIF. Corporate credit unions can issue debt under the TCCULGP until June 30, 2010, with a maximum maturity of June 30, 2017. The maximum amount of TCCULGP-guaranteed debt that U.S. Central is authorized to have outstanding at any one time is \$10.0 billion.
- The NCUA initiated the Credit Union System Investment Program (CU SIP) and the Credit Union Homeowners Affordability Relief Program (CU HARP). These programs allowed credit unions to borrow from the NCUA's Central Liquidity Facility (CLF) and reinvest the loan proceeds in notes issued by U.S. Central and other corporate credit unions (NCUSIF-guaranteed under the TCCULGP). As of Feb. 28, 2009, U.S. Central had obtained a total of \$5.9 billion in CU SIP and CU HARP funding. These borrowings mature in early 2010.
- On Jan. 28, 2009, the NCUSIF contributed a \$1.0 billion capital note to U.S. Central.
- At the time the NCUA Board placed U.S. Central in conservatorship, the NCUSIF extended to U.S. Central a committed borrowing facility of \$10.0 billion. U.S. Central currently has outstanding a borrowing of \$5.0 billion under this facility, which matures in December 2009.
- In connection with the conservatorship, the NCUA Board authorized up to \$3.0 billion of additional combined cash and non-cash assistance, including, but not limited to, a guaranteed prior undivided earnings deficit (*i.e.*, negative retained earnings) and one or more additional capital notes.

Overnight accounts represented 25.3 percent of U.S. Central's total shares and certificates in 2008, while 59.7 percent consisted of term products. Term products include both fixed- and floating-rate certificates with initial maturities from one week to three years. Structured products, primarily callable or amortizing fixed-rate certificates, equaled 9.6 percent of shares and certificates in 2008, down from 13.9 percent in 2007. CLF shares accounted for 5.1 percent of shares and certificates, with other shares accounting for 0.3 percent.

The table below provides additional detail on the composition of share and certificate account balances:

Composition of Share and Certificate Accounts
(in millions)

	2008		2007	
	Average Balances	% of Total	Average Balances	% of Total
Overnight products <i>(Note 1)</i>	\$ 8,392	25.3%	\$ 9,610	25.9%
Term products	19,805	59.7%	20,574	55.4%
Structured products	3,177	9.6%	5,148	13.9%
Other shares	106	0.3%	195	0.5%
CLF shares	1,693	5.1%	1,613	4.3%
	<u>\$ 33,173</u>	<u>100.0%</u>	<u>\$ 37,140</u>	<u>100.0%</u>

NOTE 1: Overnight products include member federal funds purchased of \$4.9 billion in 2008, which are reported in the liability section of U.S. Central's balance sheet.

Short-term borrowings totaled \$13.9 billion as of Dec. 31, 2008, compared with \$6.4 billion as of Dec. 31, 2007. Short-term borrowings consisted primarily of advances from the Federal Home Loan Bank of Topeka (\$5.4 billion), advances from the Federal Reserve Bank of Kansas City (\$4.5 billion) and fed funds purchased from non-members (\$2.4 billion).

Capital

U.S. Central's regulatory capital consists of retained earnings, MCS and PIC. Under the definitions of membership capital and PIC in Part 704.2 of Rules and Regulations of the NCUA (Part 704.2), capital is available to cover losses that exceed retained earnings. In May 2009, the NCUA published Letter to Credit Unions 09-CU-10, reinforcing the regulatory requirement in Part 704.2 that PIC and MCS are available to cover losses that exceed retained earnings and stating that when there is an accumulated deficit (retained earnings deficit) at a corporate credit union, PIC and MCS must be depleted to the extent necessary to eliminate the accumulated deficit. As of Dec. 31, 2008, U.S. Central had an accumulated deficit that was greater than the combined total of PIC I, PIC II and MCS. However, the NCUA did not require U.S. Central to fully deplete all PIC and MCS accounts as of Dec. 31, 2008, for the reason discussed below.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position 115-2 / 124-2 (FSP 115-2), which changed the requirements for OTTI recognition. The NCUA opined that the Dec. 31, 2008, depletion of PIC and MCS should be determined as if the Jan. 1, 2009, reversal of non-credit losses (\$3.7 billion) had occurred one day earlier. As a result, PIC II of \$450.0 million was fully depleted, and PIC I was depleted by \$104.4 million as of Dec. 31, 2008.

In the first two quarters of 2009, U.S. Central recorded additional OTTI charges of \$1.1 billion, which resulted in significant net losses and additional depletion of member capital accounts. Through the

first half of 2009, the remaining \$195.6 million balance of PIC I was fully depleted, and MCS balances were depleted by \$789.4 million.

In April 2009, the NCUA issued an order enabling corporate credit unions, including U.S. Central, to use capital levels as reported in their 5310 regulatory call reports from November 2008 for determining compliance with their regulatory capital ratio and retained earnings ratio requirements, which for U.S. Central are, respectively, 5.0 percent and 1.0 percent.

In accordance with this order, U.S. Central's regulatory capital and retained earnings ratios as of Dec. 31, 2008, equaled 6.6 percent and 1.7 percent, respectively. Using actual capital balances as of Dec. 31, 2008, U.S. Central's regulatory capital and retained earnings ratios were negative 5.5 percent and negative 10.4 percent, respectively. As of Dec. 31, 2007, U.S. Central's regulatory capital and retained earnings ratios were 5.1 percent and 1.3 percent, respectively.

U.S. CENTRAL

2008 Consolidated
Financial Statements

2008 Annual Report

INDEPENDENT AUDITORS' REPORT

To the National Credit Union Administration as Conservator of
U.S. Central Federal Credit Union
Lenexa, Kansas

We have audited the accompanying consolidated balance sheet of U.S. Central Federal Credit Union and subsidiaries (the "Company" or "U.S. Central") as of December 31, 2008, and the related consolidated statements of loss, other comprehensive loss, members' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. The consolidated financial statements of the Company for the years ended December 31, 2007 and 2006, were audited by other auditors whose report dated August 8, 2008, expressed a qualified opinion because of the presentation of members' share and certificate accounts and membership capital shares as members' equity.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

U.S. Central has reported members' share and certificate accounts and membership capital shares as members' equity in the accompanying consolidated balance sheets and consolidated statements of members' equity. Accounting principles generally accepted in the United States of America require that these accounts be reported as liabilities. If these accounts were reported as liabilities, liabilities would increase and total members' equity would decrease by \$20,965,090,000 as of December 31, 2008.

In our opinion, except for the effect of the classification of members' share and certificate accounts and membership capital shares as described above, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2008, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, effective March 20, 2009, U.S. Central is under the control of its conservator and regulator, the National Credit Union Administration (NCUA). Further, U.S. Central is dependent on the continued financial support and regulatory forbearance of the NCUA.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2008, U.S. Central adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, and SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*.

As discussed in Note 13 to the consolidated financial statements, the financial statements include investments valued at \$9,052,263,000 (33% of total assets) as of December 31, 2008, whose fair values have been estimated by management in the absence of readily determinable fair values.

Deloitte & Touche LLP

September 8, 2009

U.S. CENTRAL FEDERAL CREDIT UNION AND SUBSIDIARIES
(In conservatorship)

CONSOLIDATED BALANCE SHEETS (in thousands)
DECEMBER 31, 2008 AND 2007

Assets	2008	2007
Cash	\$ 74,965	\$ 29,420
Time deposits	-	85,518
Federal funds sold	134,470	500,000
Securities purchased under agreements to resell	-	2,046,937
Investment securities:		
Available-for-sale, at fair value	21,655,807	35,643,532
Trading, at fair value	-	1,028,115
Total investment securities	<u>21,655,807</u>	<u>36,671,647</u>
Loans (Note 5)	3,171,310	3,426,071
Stock of the Central Liquidity Facility	1,643,347	1,565,647
Other assets	<u>437,031</u>	<u>408,452</u>
Total assets	<u><u>\$ 27,116,930</u></u>	<u><u>\$ 44,733,692</u></u>
Liabilities and Members' Equity		
Liabilities:		
Member federal funds purchased	\$ 3,313,820	\$ -
Short-term borrowings	13,864,817	6,374,488
Notes payable	-	32,674
Other liabilities	<u>363,643</u>	<u>498,401</u>
Total liabilities	17,542,280	6,905,563
Commitments and contingencies (Note 11)		
Members' equity:		
Members' share and certificate accounts	19,721,998	36,994,406
Membership Capital Shares	1,243,092	1,434,061
Paid-in capital (Note 7)	195,638	300,000
(Accumulated deficit) retained earnings	<u>(3,688,865)</u>	<u>598,260</u>
Total (deficit) capital	(2,250,135)	2,332,321
Accumulated other comprehensive loss	<u>(7,897,213)</u>	<u>(1,498,598)</u>
Total members' equity	<u>9,574,650</u>	<u>37,828,129</u>
Total liabilities and members' equity	<u><u>\$ 27,116,930</u></u>	<u><u>\$ 44,733,692</u></u>

See notes to consolidated financial statements.

U.S. CENTRAL FEDERAL CREDIT UNION AND SUBSIDIARIES
(In conservatorship)

CONSOLIDATED STATEMENTS OF (LOSS) INCOME (in thousands)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest and dividend income:			
Time deposits	\$ 7,266	\$ 10,978	\$ 24,441
Federal funds sold	22,629	59,358	50,154
Securities purchased under agreements to resell	48,917	181,919	211,594
Investment securities	1,338,619	2,160,793	1,507,521
Loans	103,248	81,051	60,552
Stock of the Central Liquidity Facility	55,128	85,634	74,930
	<u>1,575,807</u>	<u>2,579,733</u>	<u>1,929,192</u>
Interest and dividend expense:			
Dividends on members' share and certificate accounts	1,044,290	1,957,131	1,455,552
Interest on short-term borrowings and notes payable	293,359	404,963	305,723
	<u>1,337,649</u>	<u>2,362,094</u>	<u>1,761,275</u>
Net interest income, excluding dividends on Membership Capital Shares	238,158	217,639	167,917
Fee income	20,170	19,414	18,886
Net (losses) gains on financial instruments:			
Other-than-temporary impairment charges	(4,926,639)	(124,612)	-
Other net (losses) gains on financial instruments	(54,765)	(30,046)	629
	<u>(4,981,404)</u>	<u>(154,658)</u>	<u>629</u>
Operating expenses:			
Salaries and benefits	27,549	28,234	30,072
Data processing	14,777	14,417	13,433
Professional and outside services	13,837	9,571	10,148
Office occupancy and administration	3,034	3,317	3,425
Travel and entertainment	1,854	1,765	1,731
Marketing and public relations	1,258	1,108	1,362
Other	1,889	1,554	2,678
	<u>64,198</u>	<u>59,966</u>	<u>62,849</u>
Net (loss) income before dividends on Membership Capital Shares and minority interest	(4,787,274)	22,429	124,583
Dividends on Membership Capital Shares	44,370	73,022	61,788
Net (loss) income before minority interest	(4,831,644)	(50,593)	62,795
Minority interest	241	(102)	64
Net (loss) income	<u>\$ (4,831,403)</u>	<u>\$ (50,695)</u>	<u>\$ 62,859</u>

See notes to consolidated financial statements.

U.S. CENTRAL FEDERAL CREDIT UNION AND SUBSIDIARIES
(In conservatorship)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (in thousands)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net (loss) income	\$ (4,831,403)	\$ (50,695)	\$ 62,859
Other comprehensive (loss) income:			
Net unrealized (losses) gains on available-for-sale investment securities	(11,409,091)	(1,597,511)	29,135
Net accretion of basis adjustments in held-to-maturity securities	174,915	-	-
Net unrealized losses on cash-flow hedges	(88,951)	(9,017)	(11,007)
Net unrealized gains on investment securities reclassified to earnings on fair-value hedging relationships	(575)	(8,226)	(6,122)
Reclassification of net losses on cash-flow hedges included in net income	262	10,558	49,607
Reclassification of net realized (gains) losses on investment securities included in net income	(1,814)	114,962	1,258
Reclassification for other-than-temporary impairment charges included in net income	4,926,639	-	-
Other comprehensive (loss) income	<u>(6,398,615)</u>	<u>(1,489,234)</u>	<u>62,871</u>
Total comprehensive (loss) income	<u>\$ (11,230,018)</u>	<u>\$ (1,539,929)</u>	<u>\$ 125,730</u>

See notes to consolidated financial statements.

U.S. CENTRAL FEDERAL CREDIT UNION AND SUBSIDIARIES
(In conservatorship)

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY (in thousands)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	<u>Members' Shares & Certificates</u>	<u>Membership Capital Shares</u>	<u>Paid-in Capital</u>	<u>Retained Earnings (Accumulated Deficit)</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>
Balance, January 1, 2006	\$ 29,150,067	\$ 1,210,012	\$ 300,000	\$ 623,631	\$ (72,235)
Net change in members' accounts	5,389,454	(42,571)	-	-	-
Net income	-	-	-	62,859	-
Dividends on paid-in capital	-	-	-	(18,396)	-
Other comprehensive income	-	-	-	-	62,871
Balance, December 31, 2006	34,539,521	1,167,441	300,000	668,094	(9,364)
Net change in members' accounts	2,454,885	266,620	-	-	-
Net loss	-	-	-	(50,695)	-
Dividends on paid-in capital	-	-	-	(19,139)	-
Other comprehensive loss	-	-	-	-	(1,489,234)
Balance, December 31, 2007	36,994,406	1,434,061	300,000	598,260	(1,498,598)
Net gain upon adoption of Statement of Financial Standards No. 159, The Fair Value Option for Financial Assets and Financials Liabilities	-	-	-	609	-
Conversion of membership capital shares to paid-in capital	-	(450,000)	450,000	-	-
Net change in members' accounts	(17,272,408)	259,031	-	-	-
Net loss	-	-	-	(4,831,403)	-
Dividends on paid-in capital	-	-	-	(10,693)	-
Depletion of member paid-in capital (Note 7)	-	-	(554,362)	554,362	-
Other comprehensive loss	-	-	-	-	(6,398,615)
Balance, December 31, 2008	<u>\$ 19,721,998</u>	<u>\$ 1,243,092</u>	<u>\$ 195,638</u>	<u>\$ (3,688,865)</u>	<u>\$ (7,897,213)</u>

See notes to consolidated financial statements.

U.S. CENTRAL FEDERAL CREDIT UNION AND SUBSIDIARIES
(In conservatorship)

CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss) income	\$ (4,831,403)	\$ (50,695)	\$ 62,859
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation and amortization	2,254	3,173	3,380
Net losses (gains) on financial instruments	4,981,404	154,658	(629)
Net accretion of investment and loan discounts	(31,152)	(65,608)	(36,214)
Minority interest	(241)	276	(64)
Purchases of loans held for sale	(6,732)	(51,772)	(75,179)
Proceeds from sales of loans held for sale	-	-	44,642
Principal payments of loans held for sale	9,998	10,254	7,244
Net proceeds (purchases) of trading securities	783,370	(797,863)	69,732
Changes in:			
Other assets	161,189	9,139	(44,616)
Other liabilities	(267,717)	68,601	98,381
Net cash provided by (used in) operating activities	<u>800,970</u>	<u>(719,837)</u>	<u>129,536</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Changes in:			
Time deposits	85,518	764,482	(350,000)
Federal funds sold	364,527	487,000	2,560,500
Securities purchased under agreements to resell	2,046,937	2,095,799	(965,410)
Loans held for investment	235,554	(2,370,983)	36,497
Net (purchases) proceeds of stock of the FHLB	(77,982)	110,922	(150,029)
Purchases of stock of the Central Liquidity Facility	(77,700)	(86,391)	(77,883)
Purchases of available-for-sale securities	(72,772,291)	(239,298,253)	(160,106,569)
Purchases of held-to-maturity securities	(1,761,371)	-	-
Proceeds from sales of available-for-sale securities	514,814	8,847,853	11,599,320
Principal payments and maturities of available-for-sale securities	76,021,363	227,395,878	140,757,592
Principal payments and maturities of held-to-maturity securities	929,758	-	-
Net cash provided by (used in) investing activities	<u>5,509,127</u>	<u>(2,053,693)</u>	<u>(6,695,982)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Changes in:			
Short-term borrowings	7,487,685	516,591	1,306,655
Swap fees	3,492	-	-
Member federal funds purchased	3,313,820	-	-
Members' accounts	(17,026,182)	2,674,250	5,313,105
Repayments of notes payable	(32,674)	(386,364)	(36,364)
Dividends on paid-in capital	(10,693)	(19,139)	(18,396)
Net cash (used in) provided by financing activities	<u>(6,264,552)</u>	<u>2,785,338</u>	<u>6,565,000</u>
Net increase (decrease) in cash	45,545	11,808	(1,446)
CASH, BEGINNING OF YEAR	<u>29,420</u>	<u>17,612</u>	<u>19,058</u>
CASH, END OF YEAR	<u>\$ 74,965</u>	<u>\$ 29,420</u>	<u>\$ 17,612</u>
CASH PAID DURING THE PERIOD FOR:			
Dividends on members' share and certificate accounts	\$ 1,219,550	\$ 1,923,207	\$ 1,351,435
Dividends on Membership Capital Shares	57,434	70,364	58,512
Interest on member federal funds purchased, short-term borrowings and notes payable	309,096	401,597	301,363
NON-CASH ACTIVITIES:			
Conversion of Membership Capital Shares to paid-in capital	\$ 450,000	\$ -	\$ -
Transfer of securities from available-for-sale to held-to-maturity (at par value)	10,477,153	-	-
Transfer of securities from held-to-maturity to available-for-sale (at par value)	11,308,106	-	-

See notes to consolidated financial statements.

U.S. CENTRAL FEDERAL CREDIT UNION AND SUBSIDIARIES

(In conservatorship)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

1. ORGANIZATION AND CONSERVATORSHIP

U.S. Central Federal Credit Union and subsidiaries (U.S. Central) was chartered in 1974 to act as a corporate credit union for the mutual benefit of its membership. Membership in U.S. Central includes corporate credit unions, state credit union leagues, national credit union organizations, and international cooperatives. The business of U.S. Central is generated almost exclusively from its 26 member corporate credit unions.

The principal activity of U.S. Central is to provide wholesale investment, liquidity, custody, technology and payment services to its members. U.S. Central is designed to serve its members as a ready source of liquidity and as an efficient conduit to the financial markets.

U.S. Central owns 100 percent of three credit union service organizations (CUSOs): CU Investment Solutions, Inc. (ISI), Charlie Mac, LLC (Charlie Mac), and Network Financial Services, LLC (NFS). ISI provides brokerage and advisory services. Charlie Mac provides liquidity, primarily by purchasing loans originated by the credit union community. NFS provides advisory services to a common trust fund.

U.S. Central also owns a 95.3 percent majority interest in Corporate Network eCom, LLC (eCom) and a 51.5 percent majority interest in Core Network Processing, LLC (CNP). eCom provides bill payment services to corporate credit unions that in turn can offer these services to natural person credit unions. CNP provides core account system processing to U.S. Central and certain of its member corporate credit unions. The 4.7 percent outside ownership interest in eCom and the 48.5 percent outside ownership interest in CNP are reflected as minority interests in U.S. Central's consolidated financial statements.

Effective March 20, 2009, in accordance with the Federal Credit Union Act, the National Credit Union Administration Board (the NCUA Board) placed U.S. Central into conservatorship and appointed itself as conservator (Conservator). Upon its appointment, the Conservator immediately succeeded to all rights, titles, powers and privileges of U.S. Central, and of any member, shareholder, officer or director of U.S. Central with respect to U.S. Central and its assets, and succeeded to the title to the books, records and assets of any other legal custodian of U.S. Central.

Under the Federal Credit Union Act, the Conservator has the power to take over U.S. Central's assets and operate U.S. Central's business with all the powers of U.S. Central's members, shareholders, directors and officers, and to conduct all business of U.S. Central. As Conservator, the NCUA Board has appointed a Principal Agent for the Conservator, and several Sub-Agents. In addition, the Principal Agent has appointed an

Advisory Board of Directors, comprised of five current senior NCUA employees (the Advisory Board), and has appointed a new President & CEO of U.S. Central.

The NCUA Board, in its role as Conservator, has overall management authority over U.S. Central's business. The Conservator has delegated management authority over U.S. Central's business to the Principal Agent, who has, in turn, delegated authority to the CEO and management to conduct day-to-day operations so that U.S. Central can continue to operate in the ordinary course of business. The Conservator and, in turn, the Principal Agent, each retains the authority to withdraw its respective delegations at any time.

In addition, the Conservator has directed the CEO and management to consult with the Advisory Board and to obtain the consent of the Principal Agent before taking action in, among others, the following areas: payment of bonus dividends; increases in risk limits; material changes in accounting policies; reasonably foreseeable material increases in operational risk; any substantial non-ordinary course transactions with any subsidiary or affiliate; matters that relate to conservatorship; and actions involving hiring, compensation and termination benefits of senior executive officers and other specified officers. The members of the Advisory Board serve on behalf of the Conservator and provide advice and counsel to the Principal Agent, who exercises his authority as directed by and with the approval, where required, of the Conservator.

Under the Federal Credit Union Act, the Conservator has the power (subject to certain limitations for qualified financial contracts) to disaffirm or repudiate contracts entered into by U.S. Central prior to the appointment of the NCUA as Conservator if the NCUA determines, in its sole discretion, that performance of the contract is burdensome and that disaffirmance or repudiation of the contract promotes the orderly administration of U.S. Central's affairs.

As of August 31, 2009, the Conservator has advised U.S. Central that it has disaffirmed or repudiated several contracts that U.S. Central entered into prior to the appointment of the Conservator. The Federal Credit Union Act requires the NCUA to exercise its right to disaffirm or repudiate most contracts within a reasonable period of time after its appointment as Conservator. As of August 31, 2009, the Conservator had not determined whether or not a reasonable period of time had passed for purposes of the applicable provisions of the Federal Credit Union Act and, therefore, the Conservator may still possess and exercise this right.

The Conservator also has the power to transfer or sell any asset or liability of U.S. Central (subject to limitations and post-transfer notice provisions for transfers of qualified financial contracts) without any approval, assignment of rights or consent of any party.

The conservatorship has no specified termination date. There can be no assurance as to when or how the conservatorship will be terminated, or what U.S. Central's business structure will be during or following the conservatorship.

U.S. Central receives, directly and indirectly, substantial support from the NCUA, as Conservator, insurer, guarantor, and regulator. U.S. Central is dependent on the NCUA

in order to avoid being placed into liquidation and continue to access the debt markets. Based on consideration of all the relevant conditions and events affecting U.S. Central's operations, including U.S. Central's dependence on and continued support from the NCUA, U.S. Central continues to operate as a going concern and in accordance with U.S. Central's charter and bylaws.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Following are significant accounting policies for U.S. Central and its subsidiaries:

- (a) **Principles of Consolidation** - The consolidated financial statements include the accounts of U.S. Central and its wholly or majority owned CUSOs: ISI, Charlie Mac, NFS, eCom and CNP. All significant intercompany accounts and transactions have been eliminated in consolidation.
- (b) **Estimates** - The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Specifically, management has made assumptions in estimating (1) the fair value of financial instruments, (2) the amortization/accretion of premiums/discounts on investments subject to prepayment, and (3) principal and interest cash flows when evaluating investment securities for other-than-temporary impairment (see 2(f) below). Actual results could differ materially from the recorded estimates.
- (c) **Cash** - Cash includes demand deposits at financial institutions.
- (d) **Time Deposits** - Time deposits include investments in money market accounts.
- (e) **Securities Purchased Under Agreements to Resell** – U.S. Central purchases certain securities under agreements to resell the same securities at a later date. The fair values of the securities purchased are monitored and additional collateral is obtained for these transactions if the fair values of the securities decline.
- (f) **Investment Securities** - Investment security transactions are recorded at cost on trade date and are classified as held-to-maturity (HTM), trading, or available-for-sale (AFS) at the time of purchase. Securities are classified as HTM when U.S. Central has the positive intent and ability to hold the securities to maturity. HTM securities are carried on the balance sheet at amortized cost. Securities classified as trading are carried at fair value, with unrealized gains or losses reported in earnings. Securities that are not classified as HTM or trading are classified as AFS. AFS securities are carried at fair value, with unrealized gains and losses reported as a component of other comprehensive (loss) income.

Interest income is recorded on the accrual basis. Interest income on investment securities includes the amortization and accretion of premiums and discounts using methods approximating level yield. Gains and losses on securities transactions are

recognized using the specific identification method for determining the cost of securities sold.

Fair values for investment securities are generally determined by discounting the estimated future cash flows using rates currently available for similar investments, or based on quoted market prices or dealer quotations, if available. However, given the current illiquid market for many of U.S. Central's investment securities, particularly non-agency residential mortgage-backed securities (RMBS), the assumptions used to determine fair value have become increasingly dependent upon management's judgment. The primary assumptions used to determine fair value are estimates of possible credit losses, the amount and timing of principal prepayments and credit spreads used to determine discount rates. As a result, there exists a much wider range of estimates of fair value among market participants than would exist under more normal market conditions.

When the fair value of an investment security classified as AFS or HTM declines below amortized cost, U.S. Central considers certain factors that may indicate the decline represents an other-than-temporary impairment. These factors include the severity of the decline in fair value, the length of time that the decline in fair value has existed, credit ratings and overall economic and market conditions. In addition, U.S. Central considers its intent and ability to hold the security for a period of time sufficient for a recovery of fair value up to amortized cost. If one or more of these factors indicate that a decline in fair value may represent an other-than-temporary impairment, U.S. Central performs additional analysis of the asset.

In order to determine if a decline in fair value is other-than-temporary, U.S. Central performs detailed analysis of expected future principal and interest cash flows based on relevant information available from market participants. If U.S. Central believes that it is not probable that all principal and interest cash flows will be received according to the contractual terms of the asset, the decline in fair value is considered to be other than temporary and a charge is recorded in earnings equal to the difference between fair value and amortized cost, with a corresponding adjustment to the cost basis of the security. If U.S. Central believes that it is probable that all principal and interest will be received, and has the intent and ability to hold the asset until recovery, other-than-temporary impairment charges are not recorded.

See Note 2(q), New Accounting Pronouncements and Note 4, Investment Securities, regarding changes to the identification and recording of other-than-temporary impairment charges that are effective January 1, 2009.

- (g) **Loans Held for Investment (HFI)** – Loans are classified as HFI when U.S. Central has the positive intent and ability to hold the loans to their contractual maturity. Loans HFI include loans made by U.S. Central to its member corporates and certain consumer loans purchased from originating credit unions through Charlie Mac. Loans HFI are secured by members' accounts at U.S. Central or by consumer assets, typically automobiles or residential homes. If secured by automobiles, cash reserve accounts and/or recourse from the originating credit unions are also received. Based on availability of collateral, analysis of the creditworthiness of borrowers, the

adequacy of cash reserves or recourse provisions, consideration of current economic conditions, past loan performance and risk inherent in the loan portfolio, a loan-loss allowance is deemed unnecessary for automobile and member loans HFI. A loan loss allowance is recorded for mortgage loans HFI when, as a result of individual loan reviews, U.S. Central does not expect to collect all contractual principal and interest. Loans HFI are carried on the balance sheet at amortized cost.

Interest income is recorded on the accrual basis. Interest income on loans HFI includes the amortization and accretion of premiums and discounts using methods approximating level yield. If loans were to become more than 90 days delinquent, U.S. Central would cease accruing interest income.

Loans Held for Sale (HFS) – Loans are classified as HFS when U.S. Central intends to sell the loans prior to contractual maturity. Loans HFS are comprised of residential loans purchased from originating credit unions through Charlie Mac. Effective January 1, 2008, U.S. Central adopted Statement of Financial Accounting Standards No. 159 – *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 allows entities to elect fair value accounting for financial assets or liabilities, with changes in fair value reported in earnings. U.S. Central has elected to carry mortgage loans classified as HFS at fair value under SFAS No. 159. Upon adoption of SFAS No. 159 on January 1, 2008, U.S. Central recorded an unrealized gain of \$609,000 as an adjustment of the opening balance of retained earnings. Fair values for mortgage loans HFS are determined by discounting the estimated future cash flows using rates currently available for instruments with similar characteristics, such as credit quality, average maturity and other factors.

Interest income is recorded on the accrual basis. Interest income on loans HFS includes the amortization and accretion of premiums and discounts using methods approximating level yield.

- (h) **Stock of the Central Liquidity Facility** - The Central Liquidity Facility (CLF) is a mixed-ownership government corporation that exists within the NCUA and is managed by the NCUA Board. The CLF provides a source of credit to credit unions when funds are not available from traditional sources. U.S. Central is the Agent Group Representative for corporate credit unions. As Agent Group Representative, U.S. Central is obligated to purchase shares of CLF stock as required by NCUA Rules and Regulations. CLF stock is recorded at cost, as there is no readily determinable fair value. Management has reviewed U.S. Central's investment in CLF stock for possible impairment as of December 31, 2008 and has concluded that it is not impaired. Dividend income is recorded on the accrual basis.
- (i) **Investment in Federal Home Loan Bank of Topeka (FHLB)** - As a member of the FHLB, U.S. Central must maintain a minimum amount of capital stock. Minimum capital stock requirements are based on U.S. Central's borrowing activity with the FHLB and can be changed at the discretion of the FHLB. U.S. Central's investment in the FHLB is included in other assets at cost. Management has reviewed FHLB stock for possible impairment as of December 31, 2008 and has concluded that it is not impaired. Of the \$270,760,000 par value of FHLB stock owned by U.S. Central as of

December 31, 2008, \$255,506,000 was subsequently redeemed at par. Dividend income on FHLB stock is recorded on the accrual basis.

- (j) **Derivative Instruments** - All derivative instruments are carried at fair value. Fair values for derivatives are determined by discounting estimated future cash flows using rates currently available for similar instruments. Assets are recorded for any unrealized gains and liabilities are recorded for any unrealized losses on such instruments. U.S. Central uses derivative instruments primarily to minimize the effects of interest rate volatility on net interest income and utilizes fair value hedging strategies, cash flow hedging strategies and undesignated derivatives to accomplish this goal.

Fair-value hedges – U.S. Central uses derivative instruments, primarily interest rate swaps, in order to offset changes in fair value of fixed-rate available-for-sale securities, member loans, liabilities and members' accounts that occur during periods of interest rate volatility. U.S. Central is able to demonstrate an effective hedging relationship between derivatives and matched items by proving that their changes in fair values substantially offset. Changes in the fair values of both derivatives and matched items are recorded in earnings and are included in Net (losses) gains on financial instruments on the consolidated statements of (loss) income. If changes in the fair values of derivatives do not completely offset changes in the fair values of matched items, the difference represents ineffectiveness and such ineffectiveness is recorded in current earnings. Upon termination, realized gains or losses on derivatives designated in fair value hedging relationships are recorded in earnings.

Cash-flow hedges – U.S. Central uses derivative instruments, primarily interest rate swaps, to convert variable-interest cash flows on available-for-sale securities and members' accounts to fixed cash flows. Derivative instruments are also used to manage basis risk that exists between variable rate assets and variable rate members' accounts. U.S. Central is able to demonstrate effective hedging relationships between derivatives and the matched items by proving that their variable-interest cash flows substantially offset. Changes in the fair values of derivatives are recorded as components of other comprehensive income (loss) and are reclassified into earnings in the period in which the hedged variable-interest cash flows affect earnings. If the variable cash flows from derivatives do not exactly offset the variable cash flows of the matched items, the difference represents ineffectiveness and is recorded in earnings. Upon termination, realized gains or losses on derivatives designated as cash flow hedges are deferred as components of accumulated other comprehensive income and amortized into earnings during the period of the originally documented hedging relationships.

Undesignated positions – In the event that derivative positions are not designated as fair-value or cash-flow hedges, changes in fair value are recorded in earnings.

Interest accrual - The accrual of interest income or expense on derivative instruments is reported as a component of interest income or expense of the matched item.

- (k) **Long-Lived Assets, Including Intangibles** – U.S. Central reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be fully recoverable. If the sum of the estimated undiscounted future cash flows is less than the carrying value of the asset, an impairment loss is recognized for the amount by which the carrying value of the asset exceeds its fair value.
- (l) **Members' Share and Certificate Accounts** – Members' share and certificate accounts are issued to members at par. These accounts are carried at par on the balance sheet, unless designated in a fair value hedging relationship. Dividend expense on members' share and certificate accounts is recorded on the accrual basis. U.S. Central reports members' share and certificate accounts as equity, consistent with Federal credit union law. However, these accounts are considered liabilities under accounting principles generally accepted in the United States of America.
- (m) **Securities Sold Under Agreements to Repurchase** - U.S. Central sells certain of its investment securities under agreements to repurchase the same securities and pledges assets as collateral under these borrowings. If the counterparty may further repledge or sell the assets, the assets are presented separately on U.S. Central's consolidated balance sheet. However, as of December 31, 2008 and 2007, no assets pledged as collateral were able to be repledged or sold by the counterparty.

In addition to repurchase agreements using securities in U.S. Central's portfolio, U.S. Central enters into similar transactions involving securities owned by its members. U.S. Central purchases securities from its members and sells the securities to market counterparties. U.S. Central also enters into agreements to repurchase the securities from the market counterparties and to resell the securities to its members. As collateral under these borrowings, members pledge assets to U.S. Central, which U.S. Central then pledges to the market counterparties. Under the terms of these agreements, the assets may be repledged by the market counterparties.

- (n) **Short-term Borrowings and Notes Payable** – Short-term borrowings and notes payable are carried on the balance sheet at amortized cost, unless designated in a fair value hedging relationship. Interest expense is recorded on the accrual basis. Interest expense on short-term borrowings and notes payable includes the amortization and accretion of premiums and discounts using methods approximating level yield.
- (o) **Income Taxes** - U.S. Central is exempt from federal income taxes under Section 501(c)(1) of the Internal Revenue Code of 1986.
- (p) **Risks and Uncertainties** - U.S. Central is subject to certain risks and uncertainties in its normal operations, including, but not limited to, credit risk, interest rate risk, market risk, prepayment risk, and regulatory risk.

Credit Risk – Credit risk is the risk that assets owned by U.S. Central, including investment securities, loans and short-term investments, may not pay all

principal and interest according to the contractual terms. Projected losses associated with non-agency RMBS are discussed in Note 4, Investment Securities. A loan loss allowance has been established for certain of U.S. Central's jumbo mortgage loans and is discussed in Note 5, Loans.

Liquidity Risk – Liquidity risk is the risk that U.S. Central's sources of funding, members' share and certificate accounts and borrowings, mature more quickly than its asset portfolio repays principal, and U.S. Central is not able to obtain necessary funding from its members, market participants or its Conservator. Such an event could cause U.S. Central to sell investment securities, which, under current market conditions, could have a material, negative impact on U.S. Central.

Interest-rate Risk - U.S. Central's primary source of revenue, net interest income, represents the difference between interest and dividends earned on interest-earning assets less interest and dividends paid on interest-bearing liabilities and member accounts. Net interest income can be significantly affected by the level of market interest rates and the interest and dividend rates associated with U.S. Central's assets, liabilities, member accounts and derivative instruments.

Market Risk - U.S. Central's assets, liabilities, member accounts and derivatives are, to varying degrees, interest-rate and credit sensitive. As such, changes in market interest rates and market credit spreads may affect their fair value. Significant increases in market credit spreads have caused significant declines in the fair value of U.S. Central's investment securities portfolio in 2007, 2008 and 2009. Further information regarding the fair value of U.S. Central's investment portfolio, liabilities and member accounts is provided in Note 13, Fair Value of Financial Instruments.

Prepayment Risk - During periods of falling interest rates, loans underlying some securities in U.S. Central's portfolio are more likely to prepay. U.S. Central may not be able to reinvest the principal payments received at similar yields.

Regulatory Risk - Effective March 20, 2009, U.S. Central is under the control of its conservator and regulator, the NCUA. As a result, U.S. Central is dependent on the continued financial support and regulatory forbearance of the NCUA in order to maintain day-to-day operations. Further discussion of the conservatorship is provided in Note 1, Organization and Conservatorship. Additional discussion of regulatory forbearance is provided in Note 4, Investment Securities and Note 8, Regulatory Capital and Net Economic Value Requirements.

- (q) **New Accounting Pronouncements** – Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157) clarifies the definition of fair value as well as the methods used to measure fair value and expands disclosures about fair value measurements. SFAS No. 157 became effective for U.S. Central on January 1, 2008. Additional discussion of SFAS No. 157 and its effect on U.S.

Central's consolidated financial statements is provided in Note 13, Fair Value of Financial Instruments.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159) provides entities the option to carry selected financial assets and financial liabilities at fair value, with changes in fair value recorded in earnings. SFAS No. 159 became effective for U.S. Central on January 1, 2008. Upon adoption of SFAS No. 159, U.S. Central elected to carry mortgage loans classified as held-for-sale at fair value. As a result, U.S. Central recorded an unrealized gain of \$609,000 as an adjustment of the opening balance of retained earnings on January 1, 2008.

SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160) clarifies the required presentation of noncontrolling interests in the balance sheet and income statement, enhances disclosure requirements about noncontrolling interests, and clarifies the accounting for transactions that change ownership interests. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS No. 160 is not expected to have a material effect on U.S. Central's consolidated financial statements.

SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (SFAS No. 161) requires enhanced disclosures about an entity's derivative and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS No. 161 is not expected to have a material effect on U.S. Central's consolidated financial statements.

In April 2009, the FASB issued Staff Position FAS 115-2 and 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2). FSP 115-2 is effective for annual and interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 115-2 modified previous requirements for determining when an other-than-temporary impairment (OTTI) exists, as well as how OTTI charges are recorded. FSP 115-2 requires an entity to determine for each security in an unrealized loss position if 1) the entity intends to sell the security, and 2) if it is more likely than not that the entity will be required to sell the security. If an entity determines that it intends to sell the security, or that it is more likely than not that it will be required to sell the security prior to recovery of fair value up to amortized cost, then the decline in fair value is deemed to represent an other-than-temporary impairment, and a charge equal to the difference between amortized cost and fair value must be recorded in earnings.

If an entity determines for a security in an unrealized loss position that it does not intend to sell the security, and that it is not more likely than not that it will be required to sell the security, FSP 115-2 requires an entity to compare the present

value of expected future cash flows for the security to its amortized cost basis. If the present value is less than the amortized cost basis, an OTTI charge must be recorded. When such an other-than-temporary impairment is determined to exist, FSP 115-2 requires that the projected credit loss on the asset must be recorded in earnings, while all other declines in fair value are recorded in other comprehensive income. The credit loss is determined by subtracting the amortized cost basis of the asset from the calculated present value of the asset, as described in the preceding paragraph. In addition, for previously recorded OTTI charges, FSP 115-2 requires a reclassification of non-credit losses from retained earnings to accumulated other comprehensive income (AOCI). As a result of adopting FSP 115-2 effective January 1, 2009, U.S. Central reclassified \$3,688,865,000 of non-credit losses included in previous OTTI charges from retained earnings to AOCI.

While FSP 115-2 does not mandate a specific method for determining the present value of a security, discounting projected future cash flows at the effective interest rate at the date the security was acquired is specifically allowed. See Note 14, Subsequent Events, for further discussion of OTTI charges subsequent to December 31, 2008.

In April 2009, the FASB issued Staff Position FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4), which provides additional guidance for estimating fair value in accordance with SFAS No. 157 for assets and liabilities when market trading volumes have significantly decreased. FSP 157-4 also provides guidance to help identify when transactions are not orderly. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009 and must be applied prospectively. Early adoption is permitted for interim and annual periods ending after March 15, 2009, and is required if an entity elected to early adopt FSP 115-2. As a result, U.S. Central adopted FSP 157-4 effective January 1, 2009. The adoption of FSP 157-4 did not have a material effect on U.S. Central's consolidated financial statements.

- (r) **Regulatory Pronouncements** – In January 2009, the NCUA issued an Advance Notice of Proposed Rulemaking (ANPR) which seeks to solicit comments and input from credit unions as to the future role of corporate credit unions in the credit union system. Specifically, the NCUA requested comments from credit unions in the areas of payments systems, liquidity and liquidity management, field of membership, expanded investment authority, two-tiered corporate credit union structure, capitalization, permissible investments, credit risk management, asset/liability management and corporate governance. The deadline for comments to be received by NCUA was April 6, 2009. It is not known what impact, if any, changes resulting from the ANPR might have on U.S. Central or the corporate credit union network.

3. SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

As of December 31, 2008, no amounts were outstanding under these agreements. As of December 31, 2007, the outstanding agreements had a weighted-average maturity of 3.2 days and a weighted-average interest rate of 4.60 percent.

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of December 31, 2008 and 2007, are presented below (dollars in thousands). Amortized cost amounts presented have been adjusted downward, where applicable, to reflect the effects of OTTI charges.

	December 31, 2008			
	Amortized	Unrealized		Fair Value
	Cost	Gains	Losses	
Available-for-sale securities				
Government-sponsored enterprises	\$ 72,083	\$ 644	\$ -	\$ 72,727
Bonds, notes and commercial paper	1,461,298	-	(158,757)	1,302,541
Residential mortgage-backed securities:				
Agency	1,600,826	2,653	(74,984)	1,528,495
Non-agency	14,444,022	1	(5,722,389)	8,721,634
Asset-backed securities	11,875,148	3	(1,844,741)	10,030,410
	<u>\$ 29,453,377</u>	<u>\$ 3,301</u>	<u>\$ (7,800,871)</u>	<u>\$ 21,655,807</u>
Number of securities		20	700	
December 31, 2007				
	Amortized	Unrealized		
	Cost	Gains	Losses	Fair Value
Available-for-sale securities				
Government-sponsored enterprises	\$ 25,378	\$ 512	\$ -	\$ 25,890
Bonds, notes and commercial paper	1,932,452	92	(27,742)	1,904,802
Residential mortgage-backed securities:				
Agency	2,089,620	2,494	(18,824)	2,073,290
Non-agency	21,504,384	16,870	(1,302,807)	20,218,447
Asset-backed securities	11,579,801	7,959	(166,657)	11,421,103
	<u>\$ 37,131,635</u>	<u>\$ 27,927</u>	<u>\$ (1,516,030)</u>	<u>\$ 35,643,532</u>
Trading securities				
Residential mortgage-backed securities:				
Agency	\$ 11,177	\$ 171	\$ -	\$ 11,348
Non-agency	34,575	323	-	34,898
Asset-backed securities	980,871	4,225	(3,227)	981,869
	<u>\$ 1,026,623</u>	<u>\$ 4,719</u>	<u>\$ (3,227)</u>	<u>\$ 1,028,115</u>
Number of securities		169	795	

Included in asset-backed securities in the above tables are commercial mortgage-backed securities (CMBS) with par values of \$419,753,000 and \$1,339,829,000 as of December 31, 2008 and 2007, respectively. Remaining asset-backed securities are supported by various other collateral types, primarily credit card receivables, consumer auto loans and student loans.

Certain unrealized gains and losses on available-for-sale securities are included in earnings as a result of fair-value hedging relationships designated under SFAS No. 133. Cumulative net unrealized gains of \$8,442,200 and \$7,866,500 were included in retained earnings as of December 31, 2008 and 2007, respectively.

The following tables present available-for-sale securities in unrealized loss positions as of December 31, 2008 and 2007 (in thousands). Unrealized losses are separated into two categories – those existing for more than twelve months and those existing for less than twelve months. Amortized cost amounts presented have been adjusted downward, where applicable, to reflect the effects of OTTI charges.

	December 31, 2008			
	Amortized	Unrealized Losses	Unrealized Losses	Fair
	Cost	< 12 months	> 12 months	Value
Available-for-sale securities				
Bonds, notes and commercial paper	\$ 1,462,764	\$ 11,862	\$ 146,895	\$ 1,304,007
Residential mortgage-backed securities:				
Agency	1,432,889	10,168	64,816	1,357,905
Non-agency	12,176,336	524,104	5,198,285	6,453,947
Asset-backed securities	11,874,859	102,686	1,742,055	10,030,118
	<u>\$ 26,946,848</u>	<u>\$ 648,820</u>	<u>\$ 7,152,051</u>	<u>\$ 19,145,977</u>

	December 31, 2007			
	Amortized	Unrealized Losses	Unrealized Losses	Fair
	Cost	< 12 months	> 12 months	Value
Available-for-sale securities				
Bonds, notes and commercial paper	\$ 1,413,196	\$ 27,350	\$ 392	\$ 1,385,454
Residential mortgage-backed securities:				
Agency	1,574,324	11,630	7,194	1,555,500
Non-agency	19,563,704	1,142,896	159,911	18,260,897
Asset-backed securities	10,329,417	160,671	5,986	10,162,760
	<u>\$ 32,880,641</u>	<u>\$ 1,342,547</u>	<u>\$ 173,483</u>	<u>\$ 31,364,611</u>

Many of U.S. Central's investment securities are in significant unrealized loss positions as of December 31, 2008, particularly non-agency RMBS. Management believes that the unrealized losses, and the severity thereof, are the result of 1) historically high defaults and delinquencies on mortgages underlying non-agency RMBS and 2) a severe imbalance in the current, illiquid market between supply and demand for these same securities.

In order to determine if the declines in fair value below amortized cost represented other-than-temporary impairment for these securities, management considered U.S. Central's intent and ability to hold the securities to recovery of fair value up to amortized cost, the severity of the decline in fair value below amortized cost, the length of time that fair value has been below amortized cost, current ratings by credit ratings agencies and overall economic and market conditions. Because of the severity of the decline in fair value for many of the securities, as well as credit downgrades for many of these securities, management performed detailed cash flow analyses to determine if it is probable that all principal and interest cash flows will be received. The analyses performed included several assumptions about the collateral underlying the securities, including default rates, loss severities on defaulted loans, voluntary prepayments and other borrower behaviors.

For the securities where receipt of all contractual principal and interest cash flows was not viewed as probable, other-than-temporary impairment charges were recorded. As of December 31, 2008, these securities had a combined par value of \$7,328,830,000,

which represents 21.2 percent of U.S. Central's total investment securities portfolio. Other-than-temporary impairment charges, equal to the difference between amortized cost of these securities and their fair value, totaled \$4,926,639,000 for 2008 and are included on the consolidated statement of (loss) income. As of December 31, 2008, management possessed both the intent and ability to hold all securities in unrealized loss positions to recovery, except in cases where it was not probable that all contractual principal and interest payments were expected to be received.

On January 1, 2009, U.S. Central early adopted FSP 115-2. A detailed discussion of the provisions of FSP 115-2 is provided in Note 2(q), New Accounting Pronouncements. Among other provisions, FSP 115-2 changed how other-than-temporary charges are recorded. Specifically, under FSP 115-2, if an entity does not intend to sell a security and it is not more likely than not that the entity will be required to sell the security, only the portion of the OTTI charge determined to represent a "credit loss" is recorded in earnings. All other components of the unrealized loss are recorded as a component of other comprehensive income. FSP 115-2 also requires that all non-credit losses from previous other-than-temporary impairment charges be directly reclassified from retained earnings to AOCI upon adoption, if the entity does not intend to sell the securities and it is not more likely than not that it will be required to sell the securities. Of the \$4,926,639,000 recorded as other-than-temporary impairment charges in 2008, \$1,237,774,000 represented credit losses. Because U.S. Central does not intend to sell the securities and it is not more likely than not that U.S. Central will be required to sell the securities, upon adoption of FSP 115-2 on January 1, 2009, U.S. Central reclassified \$3,688,865,000 of non-credit losses included in previous OTTI charges from retained earnings to AOCI. See Note 14, Subsequent Events, for further discussion of OTTI charges subsequent to December 31, 2008.

U.S. Central owns a number of investment securities guaranteed by monoline insurers. In these cases, the insurance acts as a secondary form of protection, after normal credit enhancements embedded in the security. One of the monoline insurers, Financial Guaranty Insurance Company (FGIC), has experienced particularly severe declines in its credit ratings. Based on internal analysis and the aforementioned downgrades, management has determined that FGIC's claims paying ability was not sufficient to cover its estimated losses. As a result, OTTI charges were recorded in 2008 for securities insured by FGIC if, without the support of insurance, losses of principal or interest were projected as of December 31, 2008. OTTI charges for these securities, which had a combined par value of \$929,684,000 as of December 31, 2008, totaled \$668,467,000.

Management has reviewed the financial condition of all other monoline insurers to which U.S. Central has exposure and has determined that they possess sufficient claims paying ability to cover projected losses as of December 31, 2008. Therefore, no OTTI charges have been recorded in the 2008 financial statements related to any securities insured by monoline insurers, other than FGIC, regardless of collateral performance.

By regulation, U.S. Central is allowed to purchase securities with long-term credit ratings of BBB or higher. The effect of downgrades below BBB on U.S. Central's authority to continue holding securities depends on the number of ratings U.S. Central relied upon in its decision to purchase a particular security. If one rating was used at acquisition, a downgrade by that rating agency below BBB would mean U.S. Central could not

continue holding the security without permission from the NCUA. If two or more ratings were used at acquisition, a security must be downgraded below BBB by two or more agencies before permission from the NCUA is required to continue holding the security. If U.S. Central wishes to continue holding securities that have been downgraded below regulatory limits, U.S. Central must request approval from the NCUA to do so.

As of December 31, 2008, 125 securities with a total par value of \$3,977,517,000 had been downgraded below U.S. Central's regulatory limit. U.S. Central requested and received permission from the NCUA to continue to hold all of these 125 securities. Subsequent to December 31, 2008, 165 additional securities with a total par value of \$6,682,361,000 experienced such downgrades. As of August 31, 2009, U.S. Central had requested permission from the NCUA to continue to hold all 165 of these securities, and received permission to hold 49 securities with a par value of \$1,813,752,000. Management expects to receive permission from NCUA to continue to hold the remaining 116 securities with a par value of \$4,868,609,000 for which permission has not yet been received.

The investment portfolio as of December 31, 2008, by contractual maturity, is shown below (in thousands). Because the actual lives of mortgage-related and asset-backed securities can differ from contractual maturities due to call or prepayment features, these items are presented separately. As of December 31, 2008, mortgage-related and asset-backed securities have weighted-average expected lives of approximately 5.6 years and 3.3 years, respectively.

	Amortized Cost	Fair Value
Due in one year or less	\$ 26,802	\$ 26,568
Due after one year through five years	981,684	866,751
Due after five years through 10 years	524,895	481,949
	<u>1,533,381</u>	<u>1,375,268</u>
Residential mortgage-backed securities:		
Agency	1,600,826	1,528,495
Non-agency	14,444,022	8,721,634
Asset-backed securities	<u>11,875,148</u>	<u>10,030,410</u>
	<u>\$ 29,453,377</u>	<u>\$ 21,655,807</u>

In February 2008, U.S. Central transferred investment securities with a total par value of \$5,080,724,000 from AFS to HTM. At the time of transfer, the aggregate unrealized loss related to these securities was \$496,504,000. In June 2008, U.S. Central transferred a second group of investment securities with a total par value of \$5,396,429,000 from AFS to HTM. These securities were in an aggregate unrealized loss position of \$602,175,000 at the time of transfer. For both groups of transferred securities, the unrealized losses at the time of transfer were recorded as reductions of the cost basis of the assets, with an offset to accumulated other comprehensive income. From the dates of transfer to December 31, 2008, \$174,915,000 of the combined basis adjustments of both groups of

securities was accreted into earnings, with an equal, offsetting amount amortized into earnings from accumulated other comprehensive income. As a result, there was no earnings effect at the times of the transfers or subsequent to the transfers. All HTM investment securities were transferred back to AFS as of December 31, 2008, because management possessed the intent to hold the securities to recovery of fair value up to amortized cost, and not necessarily to their legal maturity. Amortized cost amounts do not include the remaining unamortized basis adjustments recorded upon the transfer of investment securities from AFS to HTM, unless the remaining basis adjustments were included in OTTI charges recorded in 2008.

As of December 31, 2008, U.S. Central had pledged to market counterparties investment securities with a total par value of \$26,887,429,000. The market counterparties did not have the right to re-pledge, sell or otherwise transfer the securities.

5. LOANS

The composition of loans is as follows (dollars in thousands):

	December 31,			
	2008		2007	
	Amortized Cost	Carrying Value	Amortized Cost	Carrying Value
Loans Held for Investment				
Member loans				
Overnight	\$ 185,428	\$ 185,428	\$ 365,045	\$ 365,045
Term	1,286,916	1,292,360	2,800,546	2,801,712
CLF pass-through	1,510,478	1,510,478	-	-
Automobile	56,341	56,341	92,824	92,824
Mortgage	54,465	54,465	69,991	69,991
Total Loans Held for Investment	<u>3,093,628</u>	<u>3,099,072</u>	<u>3,328,406</u>	<u>3,329,572</u>
Loans Held for Sale				
Mortgage	<u>92,770</u>	<u>72,238</u>	<u>96,499</u>	<u>96,499</u>
	<u>\$ 3,186,398</u>	<u>\$ 3,171,310</u>	<u>\$ 3,424,905</u>	<u>\$ 3,426,071</u>

Term loans and CLF pass-through loans to members, as of December 31, 2008, had weighted-average remaining maturities of approximately 1.5 and 0.3 years, respectively. As of December 31, 2008, automobile loans and mortgage loans classified as held for investment had weighted-average expected lives of approximately 1.2 and 4.4 years, respectively. Mortgage loans classified as held for sale had weighted-average expected lives of 4.1 years as of December 31, 2008. Actual lives of automobile and mortgage loans may differ from contractual maturities due to prepayment features.

As of December 31, 2008, the principal balance of loans delinquent more than 90 days was \$1,452,000. Loan loss reserves totaling \$889,000 were calculated as of December 31,

2008 related to a specifically identified group of delinquent mortgage loans expected to incur losses. There were no loans for which charge-offs were taken in 2008. In June 2008, U.S. Central ceased purchasing mortgage loans.

6. MEMBER FEDERAL FUNDS PURCHASED, BORROWINGS AND LIQUIDITY

Member federal funds purchased, short-term borrowings and notes payable are as follows (dollars in thousands):

	December 31,			
	2008		2007	
	Average Days to Maturity	Carrying Value	Average Days to Maturity	Carrying Value
Member federal funds purchased	1	\$ 3,313,820	-	\$ -
Federal Home Loan Bank borrowings	2	\$ 5,370,000	17	\$ 3,750,000
Federal Reserve borrowings	2	4,500,000	-	-
Federal funds purchased	2	2,425,000	-	-
CLF pass-through borrowings	102	1,510,478	-	-
Borrowings under the U.S. Department of Treasury Tax and Loan Program	-	-	3	2,231,543
Notes payable due within 12 months	182	35,318	154	386,364
Other borrowings	121	24,021	1,164	6,581
		<u>\$ 13,864,817</u>		<u>\$ 6,374,488</u>
Total short-term borrowings				
Notes payable	-	\$ -	548	\$ 32,674

In 2008, U.S. Central converted certain of its short-term member accounts to member federal funds purchased. These new member federal funds transactions are senior to all member share and certificate accounts of U.S. Central in the event of liquidation, and are presented separately in the liabilities section of the balance sheet. As of December 31, 2008, member federal funds purchased totaled \$3,313,820,000 and have maturities ranging from overnight to six days.

As a member of the Federal Home Loan Bank of Topeka (FHLB), U.S. Central can borrow on an overnight or term basis based on a defined percentage of the fair value of collateral pledged at the FHLB. As of December 31, 2008, U.S. Central's borrowing capacity at the FHLB totaled \$5,503,000,000 with advances outstanding of \$5,370,000,000. The FHLB does not have the unrestricted right to acquire or re-pledge investment securities pledged by U.S. Central.

In May 2008, U.S. Central elected to waive its banker's bank exemption and begin holding reserves with the Federal Reserve Bank of Kansas City (Federal Reserve). As a

result of this election, U.S. Central was eligible to borrow from the Federal Reserve discount window on a secured basis. As of December 31, 2008, U.S. Central had advances outstanding from the Federal Reserve of \$4,500,000,000. As of March 2009, U.S. Central is no longer eligible to borrow from the Federal Reserve.

U.S. Central also periodically pledges certain investment securities under the Treasury Tax and Loan Program and its line-of-credit agreement. The counterparties do not have the unrestricted right to acquire or repledge the assets. As of December 31, 2008, securities with a par value of \$1,163,709,000 were pledged under these arrangements.

As of December 31, 2008, U.S. Central maintained a one-year, \$1,000,000,000 standby credit facility and an intraday line of credit in the amount of \$800,000,000, both supported by domestic banks. As of December 31, 2008 and 2007, no amounts were outstanding under these facilities.

U.S. Central has a regulatory borrowing limit equal to the greater of 1) 50 percent of members share and regulatory capital, or 2) 10 times regulatory capital. As of December 31, 2008, U.S. Central's regulatory borrowing limit was \$26,814,170,000, based on November 30, 2008 regulatory capital balances (see Note 8, Regulatory Capital and Net Economic Value Requirements). Total borrowings outstanding as of December 31, 2008 totaled \$13,864,817,000.

7. MEMBERS' ACCOUNTS AND PAID-IN CAPITAL

The balances of the various types of members' accounts and paid-in capital are as follows (dollars in thousands):

	December 31,	
	2008	2007
	Carrying Value	Carrying Value
Members' share and certificate accounts		
Overnight accounts	\$ 189,383	\$ 8,304,470
Term floating-rate certificates	5,567,457	6,101,837
Term fixed-rate certificates	9,542,383	17,275,343
Structured certificates	2,708,881	3,679,272
Other shares	1,453	1,200
CLF shares	1,712,441	1,632,284
	<u>19,721,998</u>	<u>36,994,406</u>
Total members' share and certificate accounts	\$ 19,721,998	\$ 36,994,406
Membership Capital Shares	\$ 1,243,092	\$ 1,434,061
Paid-in capital	\$ 195,638	\$ 300,000

Dividend expense on members' share and certificate accounts is presented as follows (in thousands):

	<u>For the Years Ended December 31,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Dividend expense			
Members' share accounts	\$ 158,930	\$ 556,680	\$ 417,947
Members' certificate accounts	<u>885,360</u>	<u>1,400,451</u>	<u>1,037,605</u>
	<u>\$ 1,044,290</u>	<u>\$ 1,957,131</u>	<u>\$ 1,455,552</u>

The following table presents members' certificate accounts by contractual maturity as of December 31, 2008 (in thousands):

	Carrying Value
One month or less	\$ 2,758,140
One month through one year	6,315,690
One year through two years	3,656,406
Two years through three years	2,429,423
Three years through four years	905,081
Four years through five years	1,328,904
After five years	425,077
	<u>\$ 17,818,721</u>

As of December 31, 2008, members were required to maintain Membership Capital Shares (MCS) at the greater of \$10,000 or 5 percent of their average investments in and borrowings from U.S. Central. These accounts have no maturity date, require a three-year notice of withdrawal and constitute regulatory capital. MCS are subordinate to members' share and certificate accounts in the event of liquidation of U.S. Central and are available to absorb losses in excess of the total of retained earnings and paid-in capital (see next paragraph). Effective March 20, 2009, the Conservatorship Board of Directors waived the section of U.S. Central's Membership Policy that requires members to maintain a minimum level of MCS. As a result, members are no longer required to maintain a minimum amount of MCS in order to remain eligible for membership in U.S. Central. Effective April 23, 2009, the Conservatorship Board voted to extend a moratorium on any and all redemptions of MCS by U.S. Central's members until further notice. Dividends on MCS are discretionary and declared quarterly by the board of directors.

U.S. Central's paid-in capital (PIC) is comprised of two classes, PIC I and PIC II. Both classes have no stated maturity and qualify as equity under generally accepted accounting principles. A total of \$300,000,000 of PIC I was issued in May 1999. PIC I is subordinate to all other shares, except PIC II, in the event of liquidation of U.S. Central.

In December 2008, member corporate credit unions converted \$450,000,000 of MCS to PIC II. PIC II is subordinate to all other shares of U.S. Central, and is first to absorb losses in excess of retained earnings. Dividends on PIC I and PIC II are discretionary and declared quarterly by the board of directors.

Under the definitions of membership capital and PIC in Part 704.2 of Rules and Regulations of the NCUA (Part 704.2), capital is available to cover losses that exceed retained earnings. In May 2009, the NCUA published Letter to Credit Unions 09-CU-10, reinforcing the regulatory requirement in Part 704.2 that PIC and MCS are available to cover losses that exceed retained earnings and stating that when there is an accumulated deficit (retained earnings deficit) at a corporate credit union, PIC and MCS must be depleted to the extent necessary to eliminate the accumulated deficit. As of December 31, 2008, U.S. Central had an accumulated deficit that was greater than the combined total of PIC II, PIC I, and MCS. However, the NCUA did not require U.S. Central to fully deplete all PIC and MCS accounts as of December 31, 2008 for the reasons discussed below.

In April 2009, the FASB issued FSP 115-2, which changed the requirements for OTTI recognition (see Note 2(q), New Accounting Pronouncements). As U.S. Central reclassified \$3,688,865,000 of non-credit losses included in previous OTTI charges from accumulated deficit to AOCI upon adoption of FSP 115-2 on January 1, 2009, the NCUA opined that the depletion of PIC and MCS, as of December 31, 2008, should be determined as if the reclassification of non-credit losses had occurred one day earlier, as of December 31, 2008. As a result, PIC II of \$450,000,000 was fully depleted, and PIC I was depleted by \$104,362,000 as of December 31, 2008.

Claims by creditors, both secured and unsecured, have priority in the event of liquidation over accounts of members. Eligible accounts of members are typically insured by the National Credit Union Share Insurance Fund (NCUSIF) up to \$250,000 per member. As of December 31, 2008, insured member accounts totaled \$16,461,536. See discussion of actions taken by the NCUA with regard to U.S. Central's member accounts in Note 14, Subsequent Events.

8. REGULATORY CAPITAL AND NET ECONOMIC VALUE REQUIREMENTS

Part 704 of NCUA Rules and Regulations requires U.S. Central to maintain a minimum capital ratio of 5.0 percent. The capital ratio is defined by the NCUA as capital, consisting of retained earnings, MCS and PIC, divided by 12-month moving daily average net assets (DANA). In April 2009, the NCUA issued an order, under its authority in Part 704.1(b), permitting an alternative capital level for purposes of regulatory compliance outlined in Part 704. The order will remain in effect until modified or rescinded by the NCUA Board or until the effective date of the final rulemaking for Part 704 that is currently in the pre-rule stage. As a result of the order, U.S. Central is allowed to use capital levels reported in its November 2008 call report, for purposes of determining regulatory compliance with its capital ratio requirement and earnings retention requirement (see next paragraph). At November 30, 2008, regulatory capital totaled \$2,681,417,000 which, when divided by 12-month DANA as of December 31, 2008, resulted in a capital ratio of 6.6 percent. Using actual capital balances as of December 31, 2008, U.S. Central's capital

ratio was negative 5.5 percent. At December 31, 2007, regulatory capital totaled \$2,332,321,000 and resulted in a capital ratio of 5.1 percent.

U.S. Central is also subject to an earnings retention requirement in the event that its retained earnings ratio, defined as retained earnings divided by 12-month moving DANA, is less than 1.0 percent. U.S. Central's retained earnings as of November 30, 2008 were \$697,261,000, which, when divided by 12-month DANA as of December 31, 2008, resulted in a retained earnings ratio of 1.7 percent. Using the actual accumulated deficit as of December 31, 2008, U.S. Central's retained earnings ratio was negative 10.4 percent. As of December 31, 2007, U.S. Central's retained earnings were \$598,260,000, resulting in a retained earnings ratio of 1.3 percent.

U.S. Central's net economic value (NEV) sensitivity is limited by NCUA regulation to a decrease of not more than 28 percent under +/- 300 basis point (b.p.) interest rate scenarios. U.S. Central is also required to maintain an NEV ratio of not less than 2 percent under the same scenarios. If U.S. Central fails to meet its regulatory capital or NEV requirements, U.S. Central must submit a plan to achieve compliance.

Due to the effects of the declines in securities valuations, U.S. Central's NEV became negative in early 2008 and remained negative as of December 31, 2008. As a result, U.S. Central did not comply with the NEV sensitivity requirement or the NEV ratio requirement during most of 2008 or as of December 31, 2008. U.S. Central submitted the required plan to NCUA and the plan was approved by NCUA in April 2008.

U.S. Central was placed into conservatorship by NCUA on March 20, 2009. For further discussion of the conservatorship, see Note 1, Organization and Conservatorship.

9. DERIVATIVE INSTRUMENTS

Upon entering into a derivative instrument, U.S. Central designates a fair-value hedging relationship or a cash-flow hedging relationship, pursuant to SFAS No. 133. In some instances, while management believes that derivatives represent economic hedges, the criteria to qualify for hedge accounting are not met. In those cases, hedging relationships are not designated and the derivatives are marked to market through earnings.

The following tables provide information on U.S. Central's derivative portfolio by type of hedge as of December 31, 2008 and 2007 (in thousands):

	December 31, 2008			
	Notional	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
Cash-flow hedges				
Interest-rate swaps				
Pay floating, receive fixed	\$ 1,425,000	\$ 16,570	\$ -	\$ 16,570
Receive floating, pay fixed	1,367,095	-	(131,037)	(131,037)
Basis swaps	1,870,389	660	(46)	614
Interest-rate caps/floor	2,046,509	17,688	-	17,688
	<u>6,708,993</u>	<u>34,918</u>	<u>(131,083)</u>	<u>(96,165)</u>
Fair-value hedges				
Interest-rate swaps				
Receive fixed, pay floating	1,184,826	12,042	(2,035)	10,007
Pay fixed, receive floating	367,000	-	(11,320)	(11,320)
	<u>1,551,826</u>	<u>12,042</u>	<u>(13,355)</u>	<u>(1,313)</u>
Undesignated positions				
Interest-rate swaps	125,000	1,154	(3,875)	(2,721)
Other	75,000	-	(948)	(948)
	<u>200,000</u>	<u>1,154</u>	<u>(4,823)</u>	<u>(3,669)</u>
	<u>\$ 8,460,819</u>	<u>\$ 48,114</u>	<u>\$ (149,261)</u>	<u>\$ (101,147)</u>

	December 31, 2007			
	Notional	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
Cash-flow hedges				
Interest-rate swaps				
Pay floating, receive fixed	\$ 4,300,000	\$ 8,866	\$ (377)	\$ 8,489
Receive floating, pay fixed	787,618	36	(19,554)	(19,518)
Basis swaps	198,660	430	(408)	22
Interest-rate caps/floor	2,696,509	4,642	-	4,642
	<u>7,982,787</u>	<u>13,974</u>	<u>(20,339)</u>	<u>(6,365)</u>
Fair-value hedges				
Interest-rate swaps				
Receive fixed, pay floating	3,153,752	8,880	(3,976)	4,904
Pay fixed, receive floating	675,500	209	(8,693)	(8,484)
	<u>3,829,252</u>	<u>9,089</u>	<u>(12,669)</u>	<u>(3,580)</u>
Undesignated positions				
Interest-rate swaps	2,822,377	382	(34,869)	(34,487)
Other	78,585	11	(534)	(523)
	<u>2,900,962</u>	<u>393</u>	<u>(35,403)</u>	<u>(35,010)</u>
	<u>\$ 14,713,001</u>	<u>\$ 23,456</u>	<u>\$ (68,411)</u>	<u>\$ (44,955)</u>

As of December 31, 2008 and 2007, gross unrealized gains on derivatives of \$48,114,000 and \$23,456,000, respectively, are included in other assets. Gross unrealized losses on derivatives of \$149,261,000 and \$68,411,000 are included in other liabilities as of December 31, 2008 and 2007, respectively. As of December 31, 2008, cumulative net losses of \$13,608,000 have been excluded from the assessment of hedge effectiveness for fair value hedges.

Net unrealized losses of \$97,538,000 and \$11,629,000 on cash-flow hedges were included in accumulated other comprehensive income (AOCI) as of December 31, 2008 and 2007, respectively. In addition, deferred gains on terminated cash-flow hedges of \$6,258,000 and \$9,038,000 were included in AOCI at December 31, 2008 and 2007, respectively. Management estimates that of the net unrealized losses on cash-flow hedges included in AOCI as of December 31, 2008, losses of \$5,396,000 will be reclassified into earnings during 2009.

Other derivative instruments included \$75,000,000 and \$78,000,000 of open short-sale agreements of to-be-announced mortgage securities as of December 31, 2008 and 2007, respectively. As of December 31, 2007, U.S. Central had commitments to purchase fixed-rate mortgage loans of \$585,000.

U.S. Central is exposed to credit risk on derivative instruments if the counterparty should fail to perform under the terms of the contract. U.S. Central manages credit risk through the use of comprehensive credit-approval processes, the selection of only creditworthy counterparties and effective collateral administration. In addition, U.S. Central requires legally enforceable master netting arrangements, which permit netting of transactions with the same counterparty. The amount of credit exposure is limited to the net interest receivable and the fair market value of the derivative contracts in gain positions reduced by the value of any collateral pledged by the counterparty. As of December 31, 2008, the net credit exposure associated with derivative instruments totaled \$11,723,000. As of December 31, 2007, the net credit exposure associated with derivative instruments totaled \$24,008,000.

10. NET GAINS/(LOSSES) ON FINANCIAL INSTRUMENTS

The following table provides a summary of the net gains/(losses) on financial instruments:

	For the Years Ended December 31,		
	2008	2007	2006
Net gains (losses) on available-for-sale securities and loans held-for-sale	\$ 1,814	\$ 1,832	\$ (2,625)
Other-than-temporary impairment charges	(4,926,639)	(124,612)	-
Fair-value hedge ineffectiveness	77	74	139
Realized gains on termination of derivatives	44,744	5,416	404
Realized (losses) gains on early certificate redemptions	(5,321)	(2,440)	2,176
Changes in fair value of:			
Trading securities	(99,556)	954	(193)
Undesignated derivative instruments	25,507	(36,198)	1,070
Loans held for sale	(22,030)	316	(342)
	<u>\$ (4,981,404)</u>	<u>\$ (154,658)</u>	<u>\$ 629</u>

For the years ended December 31, 2008, 2007 and 2006, U.S. Central recorded gross realized gains on sales of investment securities of \$4,355,000, \$12,145,000, and \$23,545,000, respectively. Gross realized losses on sales of investment securities for the years ended December 31, 2008, 2007 and 2006, totaled \$57,721,000, \$9,153,000, and

\$24,803,000, respectively. In 2008, all gross realized losses were related to sales of securities classified as trading.

During 2008 and 2007, U.S. Central determined that the unrealized losses associated with certain debt securities were other than temporary because management did not view the receipt of all principal cash flows on these securities as probable. As a result, other-than-temporary impairment charges of \$4,926,639,000 and \$124,612,000 were recorded in 2008 and 2007, respectively, to reduce the carrying values of the securities to their fair values. Additional discussion of other-than-temporary impairment charges is provided in U.S. Central's Summary of Significant Accounting Policies, Note 2(f), and in Note 4, Investment Securities.

In 2008, 2007 and 2006, certain member corporate credit unions requested to redeem certificates prior to their contractual maturity. U.S. Central redeemed these certificates at fair value, which resulted in net realized losses of \$5,321,000 and \$2,440,000 during 2008 and 2007, respectively, and net realized gains of \$2,176,000 during 2006. In some cases, U.S. Central elected to retain assets or derivatives associated with the certificates rather than recognize offsetting losses or gains. U.S. Central is not obligated to redeem certificates prior to their contractual maturity.

Ineffectiveness resulting from cash flow hedging relationships was not material for the three years ended December 31, 2008, 2007 and 2006.

11. COMMITMENTS

U.S. Central provides loans with fixed or variable rates and commitments under standby letters of credit. Essentially all loans, advances and standby letters of credit are collateralized by members' accounts at U.S. Central or other qualifying collateral. Therefore, exposure to credit losses is limited in the event of non-performance by a counterparty. As of December 31, 2008, U.S. Central had outstanding letters of credit of \$1,150,000.

As of December 31, 2008, U.S. Central had extended committed lines of credit to its members in the amount of \$314,600,000. At December 31, 2008, \$313,000,000 was outstanding under these lines.

12. RETIREMENT PLAN

Under the terms of the plan, participants may immediately contribute a percentage of their salary up to limitations as defined by the Internal Revenue Service. After the participant completes one year of service, U.S. Central matches 50 percent of the participant contribution, up to 6 percent of the salary of the participant. The employer matching contributions vest immediately. U.S. Central also contributes 5 percent of participants' salaries up to limitations as defined by the Internal Revenue Service. These amounts are fully vested after four years of service.

U.S. Central contributed \$1,445,000, \$1,387,000 and \$1,385,000, to the plan for the years ended December 31, 2008, 2007 and 2006, respectively.

Effective July 1, 2009, the employer fixed contribution of 5 percent will no longer be made for any participant with respect to compensation paid or payable on or after July 1, 2009.

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values are generally based on internally calculated values, quoted market prices, or dealer quotations, if available. These valuations are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The derived fair-value estimates, in many cases, would not be realized in immediate settlement of the instrument. All non-financial instruments are excluded from fair-value disclosure requirements. Accordingly, the aggregate fair-value amounts presented are not intended to reflect the underlying value of U.S. Central.

The assumptions used by U.S. Central in estimating fair-value disclosures for its financial instruments are described below. The use of different market assumptions and/or estimation methodologies could have a material effect on the estimated fair-value amounts.

Cash - The carrying amount of cash represents its estimated fair value.

Time Deposits, Federal Funds Sold and Securities Purchased Under Agreements to Resell - These assets are valued by discounting future cash flows using interest rates currently available on similar instruments.

Investment Securities and Derivative Instruments - Fair values are generally determined by discounting the future cash flows using rates currently available for similar investments, or based on quoted market prices or dealer quotations, if available.

Loans - The estimated fair value of loans is determined by discounting future cash flows using interest rates currently being offered to members for loans with similar terms.

Stock of the CLF - Stock of the CLF is carried at cost because there is no readily determinable fair value. Stock of the CLF, if redeemed, would be redeemed at cost.

Short-term Borrowings and Notes Payable - These liabilities are valued by discounting future cash flows using interest rates currently available on similar instruments.

Members' Share and Certificate Accounts - The fair value of share and certificate accounts is estimated by discounting the future cash flows using rates currently available for similar certificates.

Loan Commitments and Letters of Credit - Fair values of loan commitments and letters of credit are determined based on the fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the present creditworthiness of the counterparty. Neither the fees earned during the year on these instruments nor their fair values at year end are material to the consolidated financial statements.

The following table summarizes the estimated fair value of financial instruments, by type, as of December 31, 2008 and 2007 (in thousands):

	2008		2007	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets:				
Cash	\$ 74,965	\$ 74,965	\$ 29,420	\$ 29,420
Time deposits	-	-	85,518	85,518
Federal funds sold	134,470	134,469	500,000	500,004
Securities purchased under agreements to resell	-	-	2,046,937	2,047,146
Investment securities:				
Available-for-sale	21,655,807	21,655,807	35,643,532	35,643,532
Trading	-	-	1,028,115	1,028,115
Loans	3,171,310	3,184,845	3,426,071	3,438,690
Lines and letters of credit	-	-	-	-
Stock of the CLF	1,643,347	1,643,347	1,565,647	1,565,647
Liabilities:				
Member federal funds purchased	3,313,820	3,313,840	-	-
Short-term borrowings	13,864,817	13,861,629	5,988,124	5,988,738
Notes payable	-	-	419,038	418,392
Members' share and certificate accounts	19,721,998	19,832,238	36,994,406	37,133,696

The fair-value estimates presented above are based on market conditions and other information available to management as of December 31, 2008 and 2007. Subsequent changes in available information could cause fair-value estimates to vary significantly from those presented.

Fair Value Measurement

Effective January 1, 2008, U.S. Central adopted Statement of Financial Accounting Standards No. 157 – Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a hierarchy for determining the fair value of a financial instrument. The hierarchy consists of three levels of valuations based on the evidence used to determine the valuation. SFAS No. 157 requires that the highest level of valuation available be used. A “Level 1” valuation is a quoted market price for a particular (or identical) asset in a market that is actively trading. A valuation is considered to be “Level 2” when a quoted market price (in an active market) is not available, but all necessary inputs into the calculation of fair value represent data observable in an active market. A valuation is considered “Level 3” when any significant component of the fair value calculation is based on data that is not observable in an active market, but rather is based on estimates by management or outside parties. In calculating the fair value of securities classified as Level 3, management utilized internal and outside estimates for model inputs. These inputs include default rates, loss severities and voluntary prepayment estimates for the collateral underlying the securities. In addition, management used internal and external data to determine discount rates appropriate for the securities based on collateral type, vintage, credit rating and other relevant characteristics.

Assets, liabilities and derivatives measured at fair value on a recurring basis are summarized below as of December 31, 2008 (in thousands).

	Fair Value Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets				
Investment securities - available-for-sale	\$ -	\$ 12,603,544	\$ 9,052,263	\$ 21,655,807
Loans - mortgage loans held-for-sale	-	-	72,238	72,238
Other assets - derivative assets	-	48,114	-	48,114
Total assets	\$ -	\$ 12,651,658	\$ 9,124,501	\$ 21,776,159
Liabilities				
Other liabilities - derivative liabilities	\$ -	\$ 149,261	\$ -	\$ 149,261
Total liabilities	\$ -	\$ 149,261	\$ -	\$ 149,261

Below is a reconciliation of all assets measured at fair value on a recurring basis using Level 3 inputs during 2008 (in thousands).

	Total Fair Value			Total
	Available-For-Sale Securities	Trading Securities	Mortgage Loans Held-For-Sale	
Balance, January 1, 2008	\$ 21,892,786	\$ 1,015,446	\$ 97,108	\$ 23,005,340
Total gains or losses (realized/unrealized):				
Included in earnings (or changes in net assets)	(4,926,471)	(99,333)	(21,678)	(5,047,482)
Included in other comprehensive income	(5,799,101)	-	-	(5,799,101)
Purchases, sales, issuances, and settlements	(2,250,609)	(780,455)	(3,192)	(3,034,256)
Transfers between categories	135,658	(135,658)	-	-
Balance, December 31, 2008	\$ 9,052,263	\$ -	\$ 72,238	\$ 9,124,501

14. SUBSEQUENT EVENTS

On January 28, 2009, U.S. Central received a \$1,000,000,000 capital note from the NCUSIF to be treated as paid-in capital for all regulatory purposes. This capital note has no stated maturity, but can be repaid by U.S. Central at any time after two years. In addition, the note has a variable dividend rate to be paid quarterly and has priority over any other capital accounts at U.S. Central, including MCS and PIC.

On January 28, 2009, the NCUA Board approved the Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP), under which the NCUSIF guaranteed U.S. Central's member deposits in excess of the \$250,000 share insurance already provided. Pursuant to Congressional amendment of the Federal Credit Union Act that established the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) – a separate fund under the control of the NCUA – in June 2009, the NCUA legally transferred the obligation to pay claims under the TCCUSGP to the TCCUSF. In August 2009, the TCCUSGP was extended by the NCUA to December 31, 2011. The maximum maturity for shares subject to the guarantee is two years.

Effective March 20, 2009, in accordance with the Federal Credit Union Act, the NCUA Board placed U.S. Central into conservatorship and appointed itself as conservator. Additional discussion of the conservatorship action is provided in Note 1, Organization and Conservatorship.

During the first two quarters of 2009, U.S. Central recorded significant additional OTTI charges, which had a material, adverse effect on U.S. Central's financial condition, results of operations, and compliance with regulatory capital requirements in the periods in which they were recorded. These 2009 OTTI charges were the result of increases in the projected credit losses for securities in U.S. Central's investment securities portfolio, primarily non-agency RMBS.

As a result of net losses recorded by U.S. Central in the first two quarters of 2009, significant additional depletion of PIC and MCS balances was required (see Note 7, Members' Accounts and Paid-in Capital).

In March 2009, the NCUA provided U.S. Central a committed borrowing facility of \$10,000,000,000 from the NCUSIF. U.S. Central borrowed \$5,000,000,000 under this facility in March 2009 for a term of 90 days. Upon maturity in June 2009, U.S. Central again borrowed \$5,000,000,000 under the facility with a maturity date of December 21, 2009.

In March 2009, the NCUA Board authorized up to \$3,000,000,000 of cash or non-cash special assistance to U.S. Central from the NCUSIF, including, but not limited to, a guaranteed prior undivided earnings deficit (i.e. negative retained earnings) and/or a capital note(s) in addition to the \$1,000,000,000 capital note provided to U.S. Central in January 2009. If assistance greater than \$3,000,000,000 is needed, NCUA board approval is required.

In May 2009, the NCUA Board approved changes to the Temporary Corporate Credit Union Liquidity Guarantee Program (TCCULGP), which was originally approved by the NCUA Board in October 2008. The TCCULGP allowed certain corporate credit unions, including U.S. Central, to issue NCUSIF-guaranteed debt. In June 2009, the NCUA Board further revised the TCCULGP to legally obligate the TCCUSF to pay all claims under the TCCULGP. Following the revisions, the deadline for issuance of guaranteed debt is June 30, 2010, while the maximum maturity date is June 30, 2017. The TCCUSF receives fees in exchange for the guarantee, ranging from 10 basis points per annum for two-year debt to 35 basis points per annum for seven-year debt. Debt issuances under the TCCULGP are ultimately backed by the full faith and credit of the United States government. U.S. Central can have outstanding up to \$10,000,000,000 of debt under the TCCULGP at any one time.