

Southwest Corporate Federal Credit Union
FINANCIAL REPORT
February 2008

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Management's Discussion and Analysis

Results of Operations

Southwest Corporate's net income for the two months ended February 29, 2008 totaled \$11,830,000, an increase of \$6,290,000 over the same period in 2007. A summary of Southwest Corporate's results of operations, return on average assets (ROA), and return on equity (ROE) for the two months ended February 29, 2008 is included in the following table (in thousands).

Net interest income	\$14,060
Noninterest income	4,960
<u>Operating expense</u>	<u>7,190</u>
Net income	\$11,830
ROA	0.56%
ROE	21.36%

Credit Risk

Southwest Corporate's investment activities are conducted within limits set by internal policies and by Part 704 (Appendix B Parts II, IV and V) of the National Credit Union Administration (NCUA) Rules and Regulations.

Southwest Corporate's investment policy limits longer-term investments to treasury and agency securities, asset-backed securities rated A- or higher, privately issued mortgage-backed securities rated at least A-, and corporate bonds rated BBB+ or higher. Deposits in financial institutions are generally limited to institutions with debt rating of at least A-. Commercial paper investments are limited to issuers rated P-2 or higher. Interest rate swap agreements are limited to counterparties rated at least A-. Dollar exposure limits are also established in Southwest Corporate's investment policies relative to each investment's rating and term.

A summary of the long-term credit ratings of Southwest Corporate's investment securities at February 29, 2008 is included in the following table (in thousands).

	Federal Agency	AAA	AA	A	<A	Total
Mortgage-backed securities (1)	\$193,908	\$2,326,130	\$19,611	\$11,514	\$	\$2,551,163
Asset-backed securities (2)		2,516,742	74,026	327,187		2,917,955
Corporate bonds (3)		106,190	329,336	114,670	9,562	559,758
Total	\$193,908	\$4,949,062	\$422,973	\$453,371	\$9,562	\$6,028,876

(1) The weighted average lives of Southwest Corporate's AAA, AA and A rated mortgage-backed securities are 3.24, 4.57 and 1.72.

(2) The weighted average lives of Southwest Corporate's AAA, AA and A rated asset-backed securities are 2.22, 1.55 and 1.84. A rated asset-backed securities are comprised of 50% credit card collateral, 7% equipment collateral and 43% home-equity collateral.

(3) The weighted average lives of Southwest Corporate's AAA, AA, A and <A rated corporate bonds are 2.90, 2.15, 0.95, and 0.91.

Southwest Corporate's portfolio consists of high credit quality investments with approximately 85 percent of investment securities rated AAA and higher at February 29, 2008. In addition,

Southwest Corporate does not have any investments in structured investment vehicles (SIVs), collateralized debt obligations (CDOs), commercial mortgage-backed securities, or auction-rate securities.

Southwest Corporate's investment in residential mortgage-backed and home equity asset-backed securities at February 29, 2008 is \$4,039,118,000, with 95 percent of these securities rated AAA. The collateral underlying these investments is classified as prime (i.e., FICO score greater than 720), near-prime (i.e., FICO score between 650 and 720) and sub-prime (i.e., FICO score below 650).

Southwest Corporate's residential mortgage-backed and home equity asset-backed security selection procedures are based on conservative portfolio management strategies and credit underwriting practices, and are focused on top-tier servicers and issuers. Additionally, Southwest Corporate maintains conservative exposure limits to single issuers (i.e. trusts). Currently, the largest single trust exposure to a sub-prime collateral issuer in residential mortgage-backed and home equity asset-backed security sector is approximately \$29.2 million or 4 percent of Southwest Corporate's total capital.

Residential mortgage-backed and home equity asset-backed structures are comprised of many classes of securities, with various levels of subordinated classes being first to absorb any losses experienced on the underlying mortgage loan collateral and thus providing credit enhancement to the senior classes. Southwest Corporate's residential mortgage-backed and home equity asset-backed securities are highly-rated classes which are senior to the subordinate classes. In addition, a portion of Southwest Corporate's securities also have insurance coverage to further support the senior classes in the event of deteriorating collateral performance. This insurance coverage provided by the monoline insurers increases the existing credit enhancement provided to the senior class which are owned by Southwest Corporate.

Beginning in January 2008, several of the monoline insurers were placed on review for downgrade by the rating agencies. These companies sought additional capital to maintain their AAA ratings from the rating agencies. In February 2008, FGIC Corp and XL Capital were downgraded from AAA to A by the rating agencies at the entity level. As a result, the securities which they provided re-insurance were downgraded to A as well. The migration in the ratings of Southwest Corporate's investment securities from AAA to A since January 2008 resulted from these actions.

The following table details the exposure to each monoline insurer for residential mortgage-backed and home equity asset-backed securities at February 29, 2008 (in thousands).

	Par Value	Fair Value
Ambac Financial Group	\$309,909	\$270,767
MBIA, Inc	219,305	197,811
FGIC Corp	188,030	147,238
FSA	85,626	74,242
XL Capital	10,153	7,636
	\$813,023	\$697,694

The average credit enhancements (including the financial guarantee insurance wraps by the monoline insurers) on the near-prime collateral is 41 percent and the sub-prime collateral is 36 percent at February 29, 2008. Due to the substantial credit enhancements available to the senior classes, the credit quality of Southwest Corporate's residential mortgage-backed and home equity asset-backed securities are substantially greater than the credit quality of the underlying collateral.

The following table details Southwest Corporate's investments in residential mortgage-backed and home equity asset-backed securities at February 29, 2008 (in thousands).

	AAA	AA	A	Total	Average Credit Enhancement	
					excluding wrapped securities	including wrapped securities
Prime collateral	\$1,299,962	\$18,534	\$59,168	\$1,377,664	7%	19%
Near-prime collateral						
Fico 720-700	1,203,724		73,205	1,276,929	18%	39%
Fico 700-680	306,887	2,444	5,959	315,290	21%	46%
Fico 680-650	87,466		5,765	93,231	36%	58%
Sub-prime collateral						
Fico 650-640	85,747			85,747	45%	46%
Fico 640-620	643,897	18,629	4,518	667,044	33%	33%
Fico 620-575	209,489	7,159	6,565	223,213	36%	39%
	\$3,837,172	\$46,766	\$155,180	\$4,039,118		

As noted in the table above, the credit enhancement rises when the wrapped securities are included as the financial guarantee by the monoline insurers provides credit enhancement of 100% on the wrapped securities.

U.S. Central

Southwest Corporate has \$7,009,406,000 invested in U.S. Central at February 29, 2008 of which \$3,134,192,000 is invested overnight. The weighted average life of investments in U.S. Central is 0.57 years (excluding capital investments).

As of February 29, 2008, U.S. Central had long term ratings of AAA by Fitch, AA+ by Standard & Poor's and Aa1 by Moody's. Fitch downgraded U.S. Central's long term ratings to AA+ in March. U.S. Central has held a split rating for several years. Standard & Poor's action in February 2008 and Fitch's action in March 2008 brings U.S. Central's long-term debt rating in line with Moody's. The long-term debt ratings held by U.S. Central are very high investment grade.

As reported by U.S. Central, U.S. Central's portfolio consists of high credit quality investments with approximately 91.4 percent of its long-term investments rated AAA, and an additional 5.0 percent rated AA at February 29, 2008. U.S. Central's investment in residential mortgage-backed and home equity asset-backed securities at February 29, 2008 is approximately \$21,233,000,000, with 90 percent of these securities rated AAA. The average credit enhancement of their investment

in residential mortgage-backed and home equity asset-backed securities is 40.9 percent as reported by U.S. Central.

U.S. Central has significant liquidity on its balance sheet and through external sources. Southwest Corporate monitors U.S. Central financial condition and reviews their portfolio regularly.

Spread Risk

Spread risk pertains to the decline in the fair values of Southwest Corporate's investment securities caused by a widening of the spread between the securities' yields and comparable treasury yields. Spreads on securities with residential mortgage collateral have dramatically widened since June due to a significant lack of liquidity (i.e., active trading) in the mortgage securities market stemming from concerns about the credit quality of mortgage loan collateral.

The credit dislocation described above has continued to widen since December 2007. The decline in the market prices since December has resulted from investors, which funded their investment portfolio through borrowings, (e.g. hedge funds) having to sell securities to meet margin calls in the current distressed market. This has driven market prices further down as the only trading currently taking place is by those investors that are forced to sell securities. Additionally, prices on securities which have additional financial guarantees by bond re-insurers have declined due to actions taken by the rating agencies. As a result of the forced sales and negative news, credit spreads have widened on all investment classes including agency securities. There continues to be an unwillingness of broker dealers and financial institutions to purchase securities in the current distressed market.

As disclosed in Footnote 8- Accumulated Other Comprehensive Loss, the impact of the recent market dislocation is most visible in the balance of Southwest Corporate's unrealized losses on available-for-sale securities. The following table summarizes the change in Southwest Corporate's unrealized losses on available-for-sale securities since June 30, clearly illustrating the impact of spread widening on the fair values of residential mortgage-backed and home equity asset-backed securities (in thousands):

	Unrealized Gains/(Losses) on Available-For-Sale Securities		
	February 2008	December 2007	June 2007
Mortgage-backed securities	(\$252,148)	(\$81,809)	(\$10,963)
Asset-backed securities	(315,669)	(186,017)	60
Corporate bonds	(9,282)	(6,964)	56
Total	(\$577,099)	(\$274,790)	(\$10,959)

Southwest Corporate utilizes a conservative methodology to determine the fair value of the investment securities and validates the fair value by obtaining three prices for each security. Southwest Corporate utilizes three pricing services, Bloomberg and broker quotes to obtain external prices. There was a wide range in the three prices obtained for securities. If the highest price had been selected for each security, the unrealized loss would have been \$364,962,000.

Southwest Corporate has the intent and ability to hold the investment securities until the anticipated recovery and believes the decline in fair value is largely due to the unique market conditions. The current unrealized losses on available-for-sale securities are not expected to result in appreciable realized losses due to the high credit quality of the securities and Southwest Corporate's additional sources of liquidity.

Interest Rate Risk

Southwest Corporate's primary method of monitoring interest rate risk is through the net economic value (NEV) test. The NEV test measures the dollar and percentage change in the fair value of Southwest Corporate's capital (i.e., retained earnings, paid-in capital and membership capital shares) given a parallel, instantaneous, and permanent 300 basis point upward and downward change in the yield curve. The objective of the NEV test is to measure whether Southwest Corporate has sufficient capital to absorb potential changes to the fair value of its balance sheet given large, sustained instantaneous interest rate shocks.

A summary of Southwest Corporate's NEV test at February 29, 2008 is as follows (in thousands):

	Fair Value	Fair Value +300 Basis Pts.	Fair Value -300 Basis Pts.
Capital	\$ 158,906	\$ 22,709	\$ 248,111
% Change in Capital	-	(85.70%)	56.10%

Southwest Corporate's NEV under a 300 basis point increase in rates exceeds the regulatory limit of 28%. Southwest Corporate's NEV results are materially impacted by the current unrealized losses on the available-for-sale securities. As discussed above, the unrealized losses have increased due to the continuation of the market dislocation that began in July 2007. The change in NEV since December 31, 2007 has not been the result of any investment purchase and sale activity, but rather the erosion in market price valuations. If the security prices were closer to pre-dislocation levels, the reported decline in NEV under a 300 basis point increase in rates would have been in the low teens.

Liquidity Risk

Liquidity risk pertains to whether Southwest Corporate has sufficient short-term assets, marketable securities, and borrowing capacity to meet member credit unions' potential liquidity needs.

Southwest Corporate's borrowing capacity at February 29, 2008 is approximately \$11,248,000,000. Southwest Corporate has the ability to borrow against Fed Funds lines of credit, issue commercial paper and pledge investments as collateral for advances from the Federal Home Loan Bank of Dallas, borrowings from U.S. Central, and on repurchase agreements.

Although Southwest Corporate's on-balance sheet loan portfolio is small, it has additional uncommitted lines of credit to members of \$6,160,709,000 at February 29, 2008. Approximately

99 percent of outstanding line of credits are collateralized by specific or general pledges by members.

Regulatory Capital

Southwest Corporate is required under the terms of Part 704 of the NCUA's rules and regulations to maintain a minimum capital to average assets ratio of 5 percent. Capital is defined in Part 704 as retained earnings, paid-in capital and members' capital shares. The 5 percent requirement is based upon Southwest Corporate's election to operate under an NEV limit of 28 percent.

A summary of Southwest Corporate's regulatory capital position at February 29, 2008 is as follows (in thousands).

Members' capital shares	\$390,783
Paid-in capital shares	8,364
Retained earnings	336,773
<u>Total regulatory capital</u>	<u>\$735,920</u>
<u>12 month daily average net assets</u>	<u>\$13,060,124</u>
Capital ratio	5.64%
Core capital ratio	2.64%
Retained earnings ratio	2.58%

Agency Ratings

Southwest Corporate has obtained a Commercial Paper Rating from two rating agencies addressing its capacity to service \$900,000,000 in total commercial paper borrowings, and a Senior Obligation Rating from the same two agencies addressing its creditworthiness as a counterparty in interest rate swap and other senior obligations.

Southwest Corporate received ratings in the highest category for its ability to service commercial paper debt, and in the second highest category for its ability to meet senior obligations. A summary of the agency ratings is as follows:

	Commercial Paper Ratings	Senior Obligation Ratings
Standard & Poor's (1)	A-1+	AA
Fitch Ratings (2)	F-1+	AA-

Note 1: Standard & Poor's reaffirmed Southwest Corporate's ratings in September 2007.

Note 2: Fitch Ratings reaffirmed Southwest Corporate's ratings in November 2007.

Southwest Corporate also received an Individual Rating from Fitch assessing Southwest Corporate on a wide range of factors including: profitability, balance sheet integrity, franchise value, management, operating environment, future prospects, operating consistency, capital, and product and geographic diversification. Southwest Corporate's Individual Rating is A/B on a scale of A through E.

The ratings are based on criteria such as Southwest Corporate's asset quality, liquidity sources, capital strength, and risk management practices.

Consolidated Statement of Financial Condition
February 29, 2008

(in thousands)

	unaudited
Assets	
Cash and cash equivalents	\$ 789,464
Overnight shares in U.S. Central	3,134,192
Trading account assets	30,042
Interest rate derivative assets	61,364
Investments available-for-sale	6,028,876
Other investments	3,886,005
Loans to members	582,955
Premises and equipment, net	22,106
Goodwill	2,263
Accrued receivables and other assets	62,492
Total assets	\$ 14,599,759
Liabilities	
Members' share accounts	14,677,732
Borrowed funds	50,000
Interest rate derivative liabilities	819
Accrued expenses and other liabilities	89,700
Total liabilities	14,818,251
Members' Equity	
Paid-in capital	8,364
Retained earnings	336,773
Accumulated other comprehensive loss	(563,629)
Total members' equity	(218,492)
Total liabilities and members' equity	\$ 14,599,759

The accompanying notes are an integral part of the consolidated financial statements

Consolidated Statement of Income
For the Period Ended February 29, 2008

(in thousands)

unaudited

Interest income

Investments and trading account assets	\$ 85,976
Loans to members	4,448
<u>Total interest income</u>	<u>90,424</u>

Cost of funds

Dividends on members' share accounts	72,052
Interest on borrowed funds	4,312
<u>Total cost of funds</u>	<u>76,364</u>

<u>Net interest income</u>	<u>14,060</u>
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Noninterest income

Share draft and depository processing fees	3,473
Net loss on investments	(120)
Net gain on derivative transactions	480
<u>Other noninterest income</u>	<u>1,127</u>
<u>Total noninterest income</u>	<u>4,960</u>

Operating expense

Compensation and benefits	3,960
Information technology	1,008
Outside processing and service fees	963
Professional fees	376
Office occupancy	316
<u>Other operating expense</u>	<u>567</u>
<u>Total operating expense</u>	<u>7,190</u>

<u>Net income</u>	<u>\$ 11,830</u>
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The accompanying notes are an integral part of the consolidated financial statements

**Consolidated Statement of Members' Equity
For the Period Ended February 29, 2008**

(in thousands)	Paid-In Capital Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total Members' Equity	Comprehensive Loss
unaudited					
Balance at December 31, 2007	\$ 8,364	\$ 324,581	(\$267,935)	\$65,010	
Net income		11,830		11,830	\$11,830
Cumulative effect of adoption of the fair value option		425		425	425
Other comprehensive loss			(295,694)	(295,694)	<u>(295,694)</u>
Dividends paid on paid-in capital shares		(63)		(63)	
<u>Comprehensive loss</u>					<u>(\$283,439)</u>
Balance at February 29, 2008	\$ 8,364	\$ 336,773	(\$563,629)	(\$218,492)	

The accompanying notes are an integral part of the consolidated financial statements

Notes to Financial Statements

1. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include pass-through reserves deposited with the Federal Reserve Bank of \$5,360,000 at February 29, 2008. Member credit unions' reserve balances are included in the other liabilities caption in the consolidated statement of financial condition.

2. INTEREST RATE DERIVATIVES

Interest rate derivatives at January 31, 2008 are comprised of interest rate swap agreements. The impact of netting interest rate swap gains and losses, and interest receivable and payable, per counterparty at February 29, 2008, is summarized in the following table (in thousands):

<u>Interest rate swap gains</u>	<u>\$69,913</u>
<u>Interest rate swap losses</u>	<u>(35,420)</u>
<u>Net interest rate swap gains</u>	<u>34,493</u>
<u>Interest receivable</u>	<u>57,035</u>
<u>Interest payable</u>	<u>(30,164)</u>
<u>Net interest receivable</u>	<u>26,871</u>
<u>Interest rate derivative assets</u>	<u>\$61,364</u>
<u>Interest rate swap gains</u>	<u>\$ 9</u>
<u>Interest rate swap losses</u>	<u>(395)</u>
<u>Net interest rate swap losses</u>	<u>(386)</u>
<u>Interest receivable</u>	<u>155</u>
<u>Interest payable</u>	<u>(588)</u>
<u>Net interest payable</u>	<u>(433)</u>
<u>Interest rate derivative liabilities</u>	<u>\$ (819)</u>

A net unrealized gain on derivative transactions of \$480,000 is recognized in the consolidated statement of income for the period ended February 29, 2008. Net unrealized gains or losses recognized in the consolidated statement of income pertain to interest rate swaps that are not designated as hedges and the ineffective portion of designated hedges.

A summary of Southwest Corporate's hedging activity at February 29, 2008 is included in the following table (in thousands):

Fair value hedges	\$4,430,973
Cash flow hedges	638,397
No hedge designation	21,379
Total	\$5,090,749

Fair value and cash flow hedges are comprised of interest rate swap agreements in which Southwest Corporate pays a floating rate and receives a fixed rate in return, or pays fixed and receives floating. Southwest Corporate utilizes swap agreements to manage interest rate risk. The fair value hedges consist of swaps that hedge the exposure to changes in the fair values of Southwest Corporate share certificates, investment securities, certificates in U.S. Central or member term loans. The cash flow hedges consist of swaps that hedge the variability of expected future interest payments on floating rate investments.

In the event of counterparty default, credit risk on interest rate swap transactions is limited to the balance of interest rate derivative assets. Southwest Corporate manages credit risk arising from interest rate swap transactions through credit approval procedures that include specific limits for individual counterparties, and ongoing monitoring procedures to measure outstanding swap exposure against the established limits. Southwest Corporate's policies require swap transactions to be executed with counterparties that possess a credit rating of A- or better. Credit risk is further mitigated by contractual arrangements with each of Southwest Corporate's counterparties that provide for the netting of replacement cost gains and losses, and accrued interest receivable and payable, on multiple swap transactions with the same counterparty. As of February 29, 2008, swap counterparties have pledged securities with a fair value of \$8,587,000 as collateral.

3. INVESTMENTS AVAILABLE-FOR-SALE

The estimated fair value of investments available-for-sale at February 29, 2008 are as follows (in thousands):

	Estimated Fair Value	Unrealized Gains/(Loss)
Mortgage-backed securities	\$2,551,163	(\$252,148)
Asset-backed securities	2,917,955	(315,669)
Corporate bonds	559,758	(9,282)
Total	\$6,028,876	(\$577,099)

Certain investments available-for-sale are pledged as collateral to secure borrowings and clearing settlements. The carrying value of pledged securities was \$57,892,000 at February 29, 2008.

4. OTHER INVESTMENTS

Other investments are comprised of the following investments at February 29, 2008 (in thousands):

Share certificates in U.S. Central	\$3,583,603
Membership capital shares in U.S. Central	242,372
Member paid-in capital shares in U.S. Central	20,290
Other shares in U.S. Central	28,949
Capital stock in Federal Home Loan Bank of Dallas	8,950
Other investments	1,841
Total	\$3,886,005

5. LOANS TO MEMBERS

Loans to members are comprised of the following loan types at February 29, 2008 (in thousands):

Open-end credit lines	\$ 75,861
Term loans	507,094
Total	\$ 582,955

6. MEMBERS' SHARE ACCOUNTS

Members' share accounts are comprised of the following account types at February 29, 2008 (in thousands):

Cash management	\$ 2,017,777
Performance tiered	6,281,200
Standard tiered	361,194
Share certificates	5,560,302
Members' capital shares	390,783
Other shares	66,476
Total	\$14,677,732

7. BORROWED FUNDS

Borrowed funds consist of advances from the Federal Home Loan Bank of Dallas at February 29, 2008 (in thousands):

Fixed rate advances	\$ -
Floating rate advances	50,000
Total	\$ 50,000

The advances are collateralized by pledges of securities with a fair value of \$55,418,000 at February 29, 2008.

8. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss is comprised of the following components (in thousands):

	Unrealized Losses On AFS Securities	Unrealized Gains/(Losses) On Cash Flow Hedges	Accumulated Other Comprehensive Loss
Balance at December 31, 2007	(\$274,790)	\$6,855	(\$267,935)
<u>Net change</u>	<u>(302,309)</u>	<u>6,615</u>	<u>(295,694)</u>
Balance at February 29, 2008	<u>(\$577,099)</u>	<u>\$13,470</u>	<u>(\$563,629)</u>

The net change in unrealized losses on AFS securities is as follows for the period ended February 29, 2008 (in thousands):

Unrealized holding losses arising during the period	(\$302,309)
Less: reclassification adjustment for losses (gains) included in net income	-
<u>Net change</u>	<u>(\$302,309)</u>

9. CAPITAL RATIOS

Southwest Corporate is required by Part 704 of the NCUA Rules & Regulations to maintain a minimum capital ratio (i.e., retained earnings, paid-in capital shares and members' capital shares over net average assets) of 5.00 percent. Southwest Corporate's capital ratio at February 29, 2008 is 5.64 percent. Southwest Corporate's retained earnings ratio (i.e., retained earnings over net average assets) at February 29, 2008 is 2.58 percent.