

Southwest Corporate Federal Credit Union FINANCIAL REPORT

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Management's Discussion and Analysis

This section of the Southwest Corporate Federal Credit Union's (Southwest Corporate) October Financial Report should be read in conjunction with the Management's Discussion and Analysis in the 2006 Annual Report.

Results of Operations

Southwest Corporate's net income for the ten months ended October 31, 2007 totaled \$23,706,000, an increase of \$6,881,000 over the same period in 2006.

A summary of Southwest Corporate's results of operations, return on average assets (ROA), and return on equity (ROE) for the ten months ended October 31, 2007 is included in the following table (in thousands).

Net interest income	\$35,250
Noninterest income	19,083
Operating expense	30,627
<u>Net income</u>	<u>\$23,706</u>
<u>ROA</u>	<u>.24%</u>
<u>ROE</u>	<u>10.15%</u>

Credit Risk

A summary of the long term credit ratings of Southwest Corporate's investment securities at October 31, 2007 is included in the following table (in thousands).

	Federal Agency	AAA	AA	A	BBB+	Total
U.S. Central	\$	\$ 4,309,073	\$	\$	\$	\$ 4,309,073
Federal Home Loan Bank-Dallas		58,905				58,905
Mortgage-backed securities (1)	170,473	2,553,920	90,142	1,646		2,816,181
Asset-backed securities (2)		3,146,964	48,166	252,699		3,447,829
Corporate bonds (3)		107,069	353,324	135,611	27,171	623,175
Total	\$170,473	\$10,175,931	\$491,632	\$389,956	\$27,171	\$11,255,163

(1) The weighted average lives of Southwest Corporate's AAA, AA and A rated mortgage-backed securities are 2.43, 2.84 and 3.26.

(2) The weighted average lives of Southwest Corporate's AAA, AA and A rated asset-backed securities are 1.70, 2.35 and 1.26. A rated asset-backed securities are comprised of 88% credit card collateral, 10% equipment collateral and 2% home-equity collateral.

(3) The weighted average lives of Southwest Corporate's AAA, AA, A and BBB+ rated corporate bonds are 3.24, 2.36, 1.13, and 0.60.

Southwest Corporate's portfolio consists of high credit quality investments with approximately 92 percent rated AAA at October 31, 2007. In addition, Southwest Corporate does not have any investments in structured investment vehicles (SIVs), collateralized debt obligations (CDOs) or commercial mortgage-backed securities.

Southwest Corporate's investment in residential mortgage-backed and home equity asset-backed securities at October 31, 2007 is \$4,648,774,000, with 97 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 \$32.3 million or 5 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 senior 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 increases the existing credit enhancement provided to the senior class which are owned by Southwest Corporate. As noted in the table below, the average credit enhancements on the near-prime collateral is 43 percent and the sub-prime collateral is 34 percent at October 31, 2007. 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 October 31, 2007 (in thousands).

	AAA	AA	A	Total	Average Credit Enhancement
Prime collateral	\$1,385,741	\$ 60,068	\$1,646	\$ 1,447,455	9%
Near-prime collateral	2,002,040	38,976		2,041,016	43%
Sub-prime collateral	1,127,540	28,007	4,756	1,160,303	34%
	\$4,515,321	\$127,051	\$6,402	\$ 4,648,774	

Southwest Corporate has \$4,309,073,000 invested in U.S. Central at October 31, 2007 with a weighted average life of 1.13 years (excluding non capital investments). U.S. Central's portfolio consists of high credit quality investments with approximately 94.8 percent of its long-term investments rated AAA, and an additional 4.7 percent rated AA at October 31, 2007. U.S. Central also has significant liquidity on its balance sheet and through external sources. U.S. Central has long-term debt ratings of AAA by Standard & Poor's and Fitch.

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 over the past few months 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. For example, the credit spreads on sub-prime collateral increased from approximately 20 to 25 basis points to approximately 150 to 200 basis points from June to October.

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.

	Unrealized gains (losses) on available-for-sale securities	
	June	October
Mortgage-backed securities	(\$10,988)	(\$ 47,497)
Asset-backed securities	85	(75,882)
Corporate bonds	(56)	(3,095)
Total	(\$10,959)	(\$126,474)

The current unrealized losses on available-for-sale securities are not expected to result in any 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 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 interest rate shocks.

A summary of Southwest Corporate's NEV test at October 31, 2007 is as follows (in thousands):

	Fair Value	Fair Value +300 Basis Pts.	Fair Value -300 Basis Pts.
Capital	\$ 486,856	\$ 372,110	\$ 541,036
% Change in Capital	-	(23.57%)	11.13%

Southwest Corporate's NEV calculation at October 31, 2007 illustrates that it had more than sufficient capital relative to its interest rate risk. A 300 basis point increase in rates results in total residual capital of \$372,110,000 at October 31, 2007. In addition, the percentage change to

Southwest Corporate's capital under the rate shock is under the 28 percent NCUA regulatory limit at October 31, 2007.

Liquidity Risk

Southwest Corporate's borrowing capacity at October 31, 2007 totaled \$7,725,778,000. Southwest Corporate has the ability to 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. The borrowing capacity includes Southwest Corporate's line of credit from U.S. Central of \$2,500,000,000 which is supported by Southwest Corporate's investments in U.S. Central.

Although Southwest Corporate's on-balance sheet loan portfolio is small, it has additional outstanding line of credit commitments to members of \$5,450,050,000 at October 31, 2007. Approximately 99 percent of outstanding line of credit commitments are collateralized by specific or general pledges by members.

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
October 31, 2007

(in thousands)

	unaudited
Assets	
Cash and cash equivalents	\$ 908,648
Overnight shares in U.S. Central	130,885
Interest rate derivative assets	53,017
Investments available-for-sale (includes investments pledged as collateral of \$1,317,101)	6,887,185
Other investments	4,237,689
Loans to members	903,613
Premises and equipment, net	21,450
Goodwill	2,263
Accrued receivables and other assets	65,263
Total assets	\$ 13,210,013
Liabilities	
Members' share accounts	\$ 11,256,469
Borrowed funds	1,200,000
Interest rate derivative liabilities	-
Accrued expenses and other liabilities	584,422
Total liabilities	13,040,891
Members' Equity	
Retained earnings	292,081
Accumulated other comprehensive loss	(122,959)
Total members' equity	169,122
Total liabilities and members' equity	\$ 13,210,013

The accompanying notes are an integral part of the financial statements

Consolidated Statement of Income
For the Period Ended October 31, 2007

(in thousands)

unaudited

Interest income

Investments and trading account assets	\$ 484,248
Loans to members	26,875
Total interest income	511,123

Cost of funds

Dividends on members' share accounts	457,618
Interest on borrowed funds	18,255
Total cost of funds	475,873

Net interest income	35,250
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Noninterest income

Share draft and depository processing fees	14,598
Net realized (loss) gain on investment securities	(2,308)
Net unrealized gain (loss) on derivative transactions	1,363
Other noninterest income	5,430
Total noninterest income	19,083

Operating expense

Compensation and benefits	16,927
Information technology	4,360
Outside processing and service fees	3,804
Professional fees	1,483
Office occupancy	1,341
Other operating expense	2,712
Total operating expense	30,627

Net income	\$ 23,706
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The accompanying notes are an integral part of the financial statements

**Consolidated Statement of Members' Equity
For the Period Ended October 31, 2007**

(in thousands)	Retained Earnings	Accumulated Comprehensive Other Loss	Total Members' Equity	Comprehensive Loss
unaudited				
Balance at December 31, 2006	\$ 268,375	(\$ 5,577)	\$262,798	
Net income	23,706		23,706	\$23,706
Other comprehensive loss		(117,382)	(117,382)	<u>(117,382)</u>
<u>Comprehensive loss</u>				<u>(\$93,676)</u>
Balance at October 31, 2007	\$ 292,081	(\$122,959)	\$ 169,122	

The accompanying notes are an integral part of the 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 \$6,514,000 at October 31, 2007. 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 October 31, 2007 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 October 31, 2007, is summarized in the following table (in thousands):

<u>Interest rate swap gains</u>	<u>\$23,313</u>
<u>Interest rate swap losses</u>	<u>(8,578)</u>
<u>Net interest rate swap gains</u>	<u>14,735</u>
<u>Interest receivable</u>	<u>73,907</u>
<u>Interest payable</u>	<u>(35,625)</u>
<u>Net interest receivable</u>	<u>38,282</u>
<u>Interest rate derivative asset</u>	<u>\$53,017</u>

A net unrealized gain on derivative transactions of \$1,363,000 is recognized in the consolidated statement of income for the period ended October 31, 2007. 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 October 31, 2007 is included in the following table (in thousands):

<u>Fair value hedges</u>	<u>\$5,440,942</u>
<u>Cash flow hedges</u>	<u>1,066,200</u>
<u>No hedge designation</u>	<u>138,708</u>
<u>Total</u>	<u>\$6,645,850</u>

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. Southwest Corporate assumed no hedge

ineffectiveness on interest rate swap transactions with notional amounts of \$3,987,286,000 at October 31, 2007.

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 October 31, 2007, swap counterparties have pledged securities with a fair value of \$7,962,000 as collateral.

3. INVESTMENTS AVAILABLE-FOR-SALE

The amortized cost and estimated market value of investments available-for-sale at October 31, 2007 are as follows (in thousands):

	Amortized Cost	Estimated Market Value	Unrealized Gains/Loss
Mortgage-backed securities	\$2,863,678	\$2,816,181	(\$47,497)
Asset-backed securities	3,523,711	3,447,829	(75,882)
Corporate bonds	626,270	623,175	(3,095)
Total	\$7,013,659	\$6,887,185	(\$126,474)

Certain investments available-for-sale are pledged as collateral to secure borrowings and clearing settlements. The carrying value of pledged securities was \$1,317,101,000 at October 31, 2007. An other-than-temporary impairment of \$1,809,000 was recorded in October related to an asset-backed security that Southwest Corporate has concluded will not recover to par prior to maturity.

4. OTHER INVESTMENTS

Other investments are comprised of the following investments at October 31, 2007 (in thousands):

Share certificates in U.S. Central	\$3,939,674
Membership capital shares in U.S. Central	210,014
Member paid-in capital shares in	
U.S. Central	5,800
Other shares in U.S. Central	22,700
Capital stock in Federal Home Loan Bank of Dallas	58,905
Other investments	596
Total	\$4,237,689

5. LOANS TO MEMBERS

Loans to members are comprised of the following loan types at October 31, 2007 (in thousands):

Open-end credit lines	\$ 124,068
Term loans	779,545
Total	\$ 903,613

6. MEMBERS' SHARE ACCOUNTS

Members' share accounts are comprised of the following account types at October 31, 2007 (in thousands):

Cash management	\$ 1,678,004
Performance tiered	2,635,140
Standard tiered	181,689
Share certificates	6,383,674
Membership capital	317,517
Other shares	60,445
Total	\$11,256,469

7. BORROWED FUNDS

Borrowed funds consist of advances from the Federal Home Loan Bank of Dallas at October 31, 2007 (in thousands):

Fixed rate advances	\$ 1,150,000
Floating rate advances	50,000
Total	\$ 1,200,000

The advances are collateralized by pledges of securities with a market value of \$1,312,464,000 at October 31, 2007.

8. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss 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, 2006	(\$3,787)	(\$1,790)	(\$ 5,577)
<u>Net change</u>	<u>(122,687)</u>	<u>5,305</u>	<u>(117,382)</u>
Balance at October 31, 2007	<u>(\$126,474)</u>	<u>\$3,515</u>	<u>(\$122,959)</u>

The net change in unrealized (losses) gains on AFS securities is as follows for the period ended October 31, 2007 (in thousands):

Unrealized holding losses arising during the period	(\$124,995)
Less: reclassification adjustment for losses (gains) included in net income	<u>2,308</u>
<u>Net Change</u>	<u>(\$122,687)</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 and members capital over net average assets) of 5.00 percent. Southwest Corporate's capital ratio at October 31, 2007 is 5.20 percent. Southwest Corporate's retained earnings ratio (i.e., retained earnings over net average assets) at October 31, 2007 is 2.49 percent. The merger with Northwest Corporate Federal Credit Union effective December 1, 2007 will have a positive impact on Southwest Corporate's capital ratio.