

Southwest Corporate Federal Credit Union  
FINANCIAL REPORT  
October 2008

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## Management's Discussion and Analysis

This section of the Southwest Corporate Federal Credit Union (Southwest Corporate) October 2008 Financial Report should be read in conjunction with the Management's Discussion and Analysis in the 2007 Annual Report.

### Results of Operations

Southwest Corporate's net income for the ten months ended October 31, 2008 totaled \$26,695,000, an increase of \$1,892,000 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 ten months ended October 31, 2008 is included in the following table (in thousands).

Net interest income	<b>\$67,829</b>
Net loss on investments	<b>31,956</b>
Other noninterest income	<b>28,598</b>
Operating expense	<b>37,776</b>
<u>Net income</u>	<b><u>\$26,695</u></b>
<u>ROA</u>	<b><u>0.33%</u></b>
<u>ROE</u>	<b><u>10.76%</u></b>

Southwest Corporate has recognized \$27,939,000 higher net interest income for the first ten months of 2008 as compared to the first ten months of 2007. The higher net interest income is primarily attributable to the historically wide spread between LIBOR and Effective Fed Funds rates resulting from the current market dislocation. In a typical market environment, the spread between LIBOR and Effective Fed Funds is 8 – 10 basis points. During the market dislocation the spread has averaged 50 basis points and has increased as high as 380 basis points. LIBOR rates are based on the rates banks borrow. Rates have increased as there is uncertainty in the market and banks have become unwilling to lend to each other. The higher net interest income provides additional retained earnings in 2008. And, this boost in retained earnings is especially important during the turbulent market conditions that currently exist.

Southwest Corporate has recorded an other-than-temporary impairment charge of \$24,745,000 on Lehman Brothers' (Lehman) unsecured corporate debt in September and an other-than-temporary impairment charge of \$1,772,000 in October on an asset-backed security that Southwest Corporate has determined will not recover to par prior to maturity. The impact of the other-than-temporary impairment is offset by the higher net interest income discussed above.

### 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 A or higher.

Deposits in financial institutions are generally limited to institutions with a debt rating of at least A-. Commercial paper investments are limited to issuers rated P-1 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 October 31, 2008 is included in the following table (in thousands).

	Federal Agency	AAA	AA	A	BBB	<BBB	Total
Mortgage-backed securities (1)	\$ 154,169	\$ 1,332,607	\$ 113,141	\$ 104,885	\$ 114,208	\$ 71,580	\$ 1,890,590
Asset-backed securities (2)	-	1,180,948	465,572	172,508	106,468	84,955	2,010,451
Corporate bonds (3)	-	96,731	188,219	146,723	9,580	21,250	462,503
	\$ 154,169	\$ 2,610,286	\$ 766,932	\$ 424,116	\$ 230,256	\$ 177,785	\$ 4,363,544

(1) The weighted average lives of Southwest Corporate's AAA, AA, A, BBB, and <BBB rated mortgage-backed securities are 4.35, 3.06, 4.19, 4.27 and 4.54, respectively.

(2) The weighted average lives of Southwest Corporate's AAA, AA, A, BBB, and <BBB rated asset-backed securities are 1.72, 2.83, 1.86, 3.64 and 3.90, respectively.

(3) The weighted average lives of Southwest Corporate's AAA, AA, A, BBB, and <BBB rated corporate bonds are 2.21, 1.64, 1.28, 0.24 and 0.35, respectively.

Southwest Corporate's portfolio consists of high credit quality investments with approximately 81 percent of investment securities rated AAA or AA at October 31, 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 had \$49,500,000 in senior debt exposure to Lehman outstanding at September 30, 2008. Lehman filed for Chapter 11 bankruptcy protection on September 15, and indicated that it is trying to sell off key business units. Southwest Corporate recorded a 50 percent other-than-temporary impairment charge on these holdings in September based on recovery estimates from a third-party credit firm. Southwest Corporate will continue to monitor the bankruptcy proceedings to determine if an additional write-down is required.

Southwest Corporate's investment in residential mortgage-backed and home equity asset-backed securities at October 31, 2008 is \$2,956,666,000, with 82 percent of these securities rated AAA or AA. The collateral underlying these investments is classified as prime (i.e., FICO score equal to and greater than 720), near-prime (i.e., FICO score between 720 and 650) 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 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 the residential mortgage-backed and home equity asset-backed security sector is approximately \$28.6 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, thus providing credit enhancement to the senior classes. Southwest Corporate's residential mortgage-backed and home equity asset-backed securities are highly-rated classes that 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. The insurance coverage provided by the monoline insurers increases the existing credit enhancement provided to the senior class 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. The capital raised was ultimately not enough, and the rating agencies downgraded the companies during the first and second quarters of 2008. The majority of the securities which had insurance guarantees were downgraded as well.

The following table details the exposure to each monoline insurer for residential mortgage-backed and home equity asset-backed securities at October 31, 2008 (in thousands).

	Par Value	Fair Value	Moody's	Fitch Ratings (Fitch)	Standard & Poor's (S&P's)
Ambac Financial Group	\$ 273,571	\$ 180,378	Aa3	n/a	AA
MBIA, Inc.	173,028	110,225	A2	n/a	AA
FGIC Corp.	157,344	92,418	B1	CCC	BB
FSA	73,162	47,775	AAA	AAA	AAA
Syncora Guarantee Inc.	8,012	3,628	n/a	n/a	BBB-
	<b>\$ 685,117</b>	<b>\$ 434,424</b>			

Southwest Corporate has received \$156,002,000 in pay-downs since December 31, 2007 on securities that have exposure to the monoline insurers.

The following table details Southwest Corporate's investments in residential mortgage-backed and home equity asset-backed securities at October 31, 2008 (in thousands).

	AAA	AA	A	BBB	<BBB	Total	Average Credit Enhancement	
							excluding wrapped securities	including wrapped securities
Prime collateral	\$ 822,879	\$ 109,169	\$ 10,022	\$ 24,185	\$ 25,699	\$ 991,954	10%	24%
Near-prime collateral								
Fico 719-700	504,877	155,744	101,532	115,911	38,671	916,735	18%	35%
Fico 700-680	71,864	75,133	-	29,834	25,802	202,633	21%	43%
Fico 680-650	40,834	16,208	4,807	6,491	2,606	70,946	42%	60%
Sub-prime collateral								
Fico 649-640	54,536	5,415	-	8,144	14,609	82,704	42%	43%
Fico 640-620	454,433	25,434	39,993	31,133	27,306	578,299	38%	39%
Fico 620-575	73,621	9,409	3,544	4,978	21,843	113,395	42%	47%
	<b>\$ 2,023,044</b>	<b>\$ 396,512</b>	<b>\$ 159,898</b>	<b>\$ 220,676</b>	<b>\$ 156,536</b>	<b>\$ 2,956,666</b>		

The average credit enhancements (including the financial guarantee insurance wraps by the monoline insurers) on the near-prime collateral is 38 percent and the sub-prime collateral is 40 percent at October 31, 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. As noted in the previous table, the credit enhancement rises when the wrapped securities are included as the financial guarantee by the monoline insurers provides credit enhancement of 100 percent on the wrapped securities.

Southwest Corporate's asset-backed security portfolio at October 31, 2008 is summarized by security type in the following table (in thousands).

	AAA	AA	A	BBB	<BBB	Total
Home equity	\$ 690,437	\$ 283,372	\$ 55,002	\$ 106,468	\$ 84,955	\$ 1,220,234
Student loan	296,874	64,803	-	-	-	361,677
Credit card	110,753	25,015	95,974	-	-	231,742
Auto	15,105	92,382	-	-	-	107,487
Equipment	67,779	-	21,532	-	-	89,311
Total	\$ 1,180,948	\$ 465,572	\$ 172,508	\$ 106,468	\$ 84,955	\$ 2,010,451

## U.S. Central

Southwest Corporate has \$4,006,005,000 invested in U.S. Central at October 31, 2008 of which \$1,565,631,000 is invested in overnight funds. The weighted average life of investments in U.S. Central is 0.57 years (excluding capital investments).

U.S. Central has long term ratings of AA+ by Fitch and S&P's and Aa1 by 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. The book value of U.S. Central's investment in residential mortgage-backed and home equity asset-backed securities at October 31, 2008 is approximately \$19,726,458,000, with 76 percent of these securities rated AAA or AA. The average credit enhancement of its investment in residential mortgage-backed and home equity asset-backed securities is 41.1 percent as reported by U.S. Central.

## 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 2007 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 linger since December 2007. The decline in the market prices since December has resulted from the lack of active trading in the non-agency mortgage-backed sectors. Entities have been forced to liquidate their holdings at fire-sale prices. The lack of liquidity in the market has forced several high profile firms to either be restructured,

liquidated or sold. These firms include Bear Stearns, Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch, Washington Mutual, and AIG. In September 2008, credit markets essentially froze across all sectors in the market. As a result, historic actions are being taken globally to restore confidence and liquidity into the credit market. The impact of the fire-sale prices and credit crisis are reflected in the prices received on Southwest Corporate's investment holdings.

As disclosed in Footnote 11, - 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, 2007, clearly illustrating the impact of the 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		
	October 2008	December 2007	June 2007
Mortgage-backed securities	<b>(\$588,029)</b>	(\$81,809)	(\$10,963)
Asset-backed securities	<b>(555,715)</b>	(186,017)	60
Corporate bonds	<b>(33,605)</b>	(6,964)	(56)
<b>Total</b>	<b>(\$1,177,349)</b>	(\$274,790)	(\$10,959)

Southwest Corporate utilizes a conservative methodology to determine the fair value of the investment securities. Southwest Corporate has engaged an independent third-party expert to value the sub-prime and near-prime securities. In addition to providing pricing, this firm also provides validation of the internal credit monitoring process performed by Southwest Corporate. The third party utilizes current market inputs such as similar trades, prepayment speeds and collateral performance to determine market prices. This additional transparency of pricing assumptions allows Southwest Corporate to reconcile the validity of the prices. If the highest price had been selected for each security, the unrealized loss at October 31, 2008 would have been \$1,006,079,000. Southwest Corporate has consistently applied its pricing methodology during the market dislocation.

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. The fair value is expected to recover as the securities approach maturity date or as market volatility stabilizes and returns to more historic levels.

### **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 (retained earnings and members' capital accounts) 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 October 31, 2008 is as follows (in thousands):

	Fair Value	Fair Value +300 Basis Pts.	Fair Value -300 Basis Pts.
Capital	\$ (434,221)	\$ (626,737)	\$ (204,158)
% Change in Capital	-	(44.3%)	53.0%

Southwest Corporate's NEV under a 300 basis point increase in rates exceeds the regulatory limit of 28 percent. Southwest Corporate's NEV results are materially impacted by the current unrealized losses on the available-for-sale securities. As previously discussed, 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.

At October 31, 2008 Southwest Corporate has \$2,337,607,000 in cash, overnight shares, and Federal funds sold at U.S. Central. When available, Southwest Corporate has the ability to borrow against Fed Funds lines of credit, issuance of commercial paper, reverse repurchase transactions, and secured lines of credit from U.S. Central. Southwest Corporate's primary source of external liquidity is secured advances from the Federal Home Loan Bank (FHLB) of Dallas. Currently, Southwest Corporate's line of credit at FHLB of Dallas is \$2,100,000,000 of which \$1,000,000,000 was outstanding at October 31, 2008. This compares to \$1,226,100,000 which was outstanding at October 31, 2007. Southwest Corporate is also able to access additional liquidity for credit unions from the Central Liquidity Facility (CLF). Southwest Corporate had \$100,000,000 outstanding for credit unions from the CLF at October 31, 2008.

Additionally, Southwest Corporate's investment portfolio is expected to generate cash flows of over \$2,600,000,000 in the next twelve months from principal pay-downs and maturities of U.S. Central share certificates. Southwest Corporate's focus over the last several months has been to build liquidity to meet members' increasing loan demands and share flows.

Southwest Corporate had outstanding loans to members of \$923,525,000 at October 31, 2008. This compares to \$909,258,000 in outstanding loans to members at October 31, 2007. Southwest Corporate continues to meet member liquidity needs. Southwest Corporate has additional uncommitted lines of credit to members of \$7,114,000,000 at October 31, 2008. Approximately 99 percent of outstanding lines of credit 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 5.0 percent. Capital is defined in Part 704 as retained earnings and members' capital accounts. The 5.0 percent requirement is based upon Southwest Corporate's election to operate under an NEV limit of 28.0 percent.

A summary of Southwest Corporate's regulatory capital position at October 31, 2008 is as follows (in thousands).

Members' capital accounts	<b>\$392,729</b>
Retained earnings	<b>351,590</b>
<u>Total regulatory capital</u>	<u><b>\$744,319</b></u>

<u>12-month daily average net assets</u>	<u><b>\$11,697,224</b></u>
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Capital ratio	<b>6.36%</b>
Retained earnings ratio	<b>3.01%</b>

Southwest Corporate's capital and retained earnings ratios have increased from 5.57% and 2.50%, respectively, at December 31, 2007.

## 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	Last Update
S&P's (1)	<b>A-1+</b>	<b>AA</b>	<b>9/30/08</b>
Fitch (2)	<b>F-1</b>	<b>A+</b>	<b>10/16/08</b>

**Note 1: S&P's has placed a negative outlook on the Senior Obligation Ratings.**

**Note 2: Fitch has placed the ratings on watch negative.**

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 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.

**Southwest Corporate Federal Credit Union  
Consolidated Statement of Financial Condition  
October 31, 2008**

(in thousands)

	unaudited
<b>Assets</b>	
Cash and cash equivalents	\$ 772,236
Federal funds sold	1,565,371
Trading account assets	28,619
Interest rate derivative assets	24,582
Investments available-for-sale	4,363,544
Investments held-to-maturity	73,425
Other investments	2,524,082
Loans to members	923,525
Premises and equipment, net	21,682
Goodwill	2,568
Accrued receivables and other assets	45,495
<b>Total assets</b>	<b>\$ 10,345,129</b>
<b>Liabilities</b>	
Members' share accounts	9,615,510
Borrowed funds	1,100,000
Interest rate derivative liabilities	2,617
Accrued expenses and other liabilities	53,710
<b>Total liabilities</b>	<b>10,771,837</b>
<b>Members' Equity</b>	
Members' capital accounts	392,729
Retained earnings	351,590
Accumulated other comprehensive loss	(1,171,027)
<b>Total members' equity</b>	<b>(426,708)</b>
<b>Total liabilities and members' equity</b>	<b>\$ 10,345,129</b>

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

**Southwest Corporate Federal Credit Union  
Consolidated Statement of Income  
For the Ten Months Ended October 31, 2008**

(in thousands)

unaudited

**Interest income**

Investments and trading account assets	\$ 315,642
Loans to members	<u>18,990</u>
Total interest income	<u>334,632</u>

**Cost of funds**

Dividends on members' share accounts	255,795
Interest on borrowed funds	<u>11,008</u>
Total cost of funds	<u>266,803</u>

Net interest income	<u>67,829</u>
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**Noninterest income**

Share draft and depository processing fees	17,154
Net loss on investments	(31,956)
Net gain on derivative transactions	1,871
Other noninterest income	<u>9,573</u>
Total noninterest (expense) income	<u>(3,358)</u>

**Operating expense**

Compensation and benefits	20,164
Information technology	5,163
Outside processing and service fees	4,848
Professional fees	2,192
Office occupancy	1,730
Other operating expense	<u>3,679</u>
Total operating expense	<u>37,776</u>

Net income	<u>\$ 26,695</u>
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*The accompanying notes are an integral part of the consolidated financial statements.*

**Southwest Corporate Federal Credit Union  
Consolidated Statement of Members' Equity  
For the Ten Months Ended October 31, 2008**

(in thousands)	Paid-in Capital Shares	Retained Earnings unaudited	Accumulated Other Comprehensive Loss	Comprehensive Loss
Balance at December 31, 2007	\$ 8,364	\$ 324,581	\$ (267,935)	
Net income		<b>26,695</b>		<b>\$ 26,695</b>
Redemption of paid-in capital	<b>(8,364)</b>			
Cumulative effect of adoption of the fair value option		<b>425</b>		<b>425</b>
Other comprehensive loss			<b>(903,092)</b>	<b>(903,092)</b>
Dividends paid on paid-in capital shares		<b>(111)</b>		
Comprehensive loss				<b>\$ (875,972)</b>
Balance at October 31, 2008	<b>\$ -</b>	<b>\$ 351,590</b>	<b>\$ (1,171,027)</b>	

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

## Notes to Financial Statements

### 1. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued Statement No.159, “The Fair Value Option for Financial Assets and Financial Liabilities” (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The standard is effective for Southwest Corporate on January 1, 2008. Southwest Corporate de-designated certain hedges and elected the fair value option on the related hedged items as of January 1, 2008. The impact of adopting SFAS 159 increases retained earnings by \$425,000.

### 2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include pass-through reserves deposited with the Federal Reserve Bank of \$16,808,000 at October 31, 2008. Member credit unions’ reserve balances are included in the members’ share accounts in the consolidated statement of financial condition. Cash on deposit and cash items in the process of collection from correspondent banks and the Federal Reserve Bank are included in cash and cash equivalents in the consolidated statement of financial condition. Cash items in the process of collection at October 31, 2008 totaled \$732,714,000. Also included in cash and cash equivalents are U.S. Central certificates of deposit maturing the next business day.

### 3. INTEREST RATE DERIVATIVES

Interest rate derivatives at October 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 October 31, 2008, is summarized in the following table (in thousands):

Interest rate derivative assets	
Interest rate swap gains	\$25,995
Interest rate swap losses	(11,730)
Net interest rate swap gains	14,265
Interest receivable	26,830
Interest payable	(16,513)
Net interest receivable	10,317
Interest rate derivative assets	\$24,582

<u>Interest rate derivative liabilities</u>	
Interest rate swap gains	<b>\$ 3,882</b>
Interest rate swap losses	<b>(7,271)</b>
<u>Net interest rate swap losses</u>	<b><u>(3,389)</u></b>

Interest receivable	<b>3,621</b>
Interest payable	<b>(2,849)</b>
<u>Net interest receivable</u>	<b><u>772</u></b>

Interest rate derivative liabilities **\$ (2,617)**

A net unrealized gain on derivative transactions of \$1,871,000 is recognized in the consolidated statement of income for the ten months ended October 31, 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 October 31, 2008 is included in the following table (in thousands):

Fair value hedges	<b>\$3,068,493</b>
Cash flow hedges	<b>228,356</b>
<u>No hedge designation</u>	<b><u>607,513</u></b>
<u>Total</u>	<b><u>\$3,904,362</u></b>

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 October 31, 2008 Southwest Corporate has pledged cash of \$3,349,000 as collateral.

#### 4. TRADING ACCOUNT ASSETS

Trading account assets are primarily comprised of fixed income mutual funds that invest in Treasury, agency and investment-grade residential mortgage-backed securities.

#### 5. INVESTMENTS AVAILABLE-FOR-SALE

The amortized cost and estimated fair value of investments available-for-sale at October 31, 2008 are as follows (in thousands):

	Amortized Cost	Estimated Fair Value	Unrealized Gain/(Loss)
Mortgage-backed securities	\$2,478,619	\$1,890,590	(\$588,029)
Asset-backed securities	2,566,166	2,010,451	(555,715)
Corporate bonds	496,108	462,503	(33,605)
Total	\$5,540,893	\$4,363,544	(\$1,177,349)

Certain investments available-for-sale are pledged as collateral to secure borrowings and clearing settlements. The fair value of pledged securities is \$1,265,725,000 at October 31, 2008.

#### 6. INVESTMENTS HELD-TO-MATURITY

The amortized cost and estimated fair value of investments held-to-maturity at October 31, 2008 are as follows (in thousands):

	Amortized Cost	Estimated Fair Value	Unrealized Gain/(Loss)
Mortgage-backed securities	\$23,490	\$23,490	\$ -
Asset-backed securities	49,935	49,473	(462)
Total	\$73,425	\$72,963	(\$462)

Southwest Corporate has not reclassified any securities from available-for-sale to held-to-maturity.

#### 7. OTHER INVESTMENTS

Other investments are comprised of the following investments at October 31, 2008 (in thousands):

Share certificates in U.S. Central	\$2,153,032
Membership capital shares in U.S. Central	236,732
Member paid-in capital shares in U.S. Central	20,290
Other shares in U.S. Central	30,320
Capital stock in Federal Home Loan Bank of Dallas	81,470
Other investments	2,238
Total	\$2,524,082

## 8. LOANS TO MEMBERS

Loans to members are comprised of the following loan types at October 31, 2008 (in thousands):

Open-end credit lines	\$ 244,777
CLF loans	100,000
Term loans	578,748
Total	\$ 923,525

## 9. MEMBERS' SHARE ACCOUNTS

Members' share accounts are comprised of the following account types at October 31, 2008 (in thousands):

Cash management	\$ 1,777,951
Performance tiered	3,127,584
Standard tiered	157,783
Share certificates	4,444,557
Other shares	107,635
Total	\$ 9,615,510

## 10. BORROWED FUNDS

Borrowed funds are comprised of the following at October 31, 2008 (in thousands):

Advances from Federal Home Loan Bank of Dallas	\$1,000,000
CLF borrowings	100,000
Total	\$1,100,000

Southwest Corporate accessed the Central Liquidity Facility (CLF) for the borrowings on the behalf of a credit union in September. The advances from Federal Home Loan Bank of Dallas are collateralized by pledges of securities with a fair value of \$1,260,491,000 at October 31, 2008.

## 11. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss at October 31, 2008 is comprised of the following components (in thousands):

	Unrealized Losses On AFS Securities	Unrealized Gains On Cash Flow Hedges	Accumulated Other Comprehensive Loss
Balance at December 31, 2007	(\$274,790)	\$6,855	(\$267,935)
Net change	<b>(902,559)</b>	<b>(533)</b>	<b>(903,092)</b>
Balance at October 31, 2008	<b>(\$1,177,349)</b>	<b>\$6,322</b>	<b>(\$1,171,027)</b>

The net change in unrealized (losses) gains on AFS securities is as follows for the period ended October 31, 2008 (in thousands):

Unrealized holding losses arising during the period	<b>(\$929,076)</b>
Less: reclassification adjustment for losses (gains) included in net income	<b>26,517</b>
Net change	<b>(\$902,559)</b>

## 12. 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 accounts over net average assets) of 5.00 percent. Southwest Corporate's capital ratio at October 31, 2008 is 6.36 percent. Southwest Corporate's retained earnings ratio (i.e., retained earnings over net average assets) at October 31, 2008 is 3.01 percent.