FHLB Chicago

Federal Home Loan Bank of Chicago

LETTER OF COMMENT NO. 95

March 27, 2009

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

File Reference: Proposed FSP FAS 115-a, 124-a, and EITF 99-20

Dear Mr. Golden:

The Federal Home Loan Bank of Chicago ("FHLBC") appreciates the opportunity to comment on the proposed FASB Staff Position No. FAS 115-a, FAS 124-a, and EITF 99-20-b, "*Recognition and Presentation of Other-Than-Temporary Impairments,*" (hereinafter referred to as the "proposed FSP"). Our general comments and our responses to the specific questions posed by the Board are presented below.

General Comments:

FHLBC supports the alignment of impairment accounting between investment securities and loans. We believe that recognizing only the credit component of an other-than-temporary impairment in earnings is an improvement in the accounting for investment securities. In particular, recognition of the credit component alone better informs users of the actual loss expected to be realized and eliminates the distortion resulting from the inclusion of potential future losses into the current reporting period. We believe further alignment between the accounting for investment securities held-to-maturity and loans held for investment should be incorporated into the final FSP. In this regard, we believe the use of a valuation allowance should be permitted and the non-credit component should not be included in accumulated other comprehensive income ("AOCI"). Please refer to our response to Question 2 for a more detailed discussion.

Additionally, we believe that the proposed FSP represents a change in accounting principle that is inseparable from the change in accounting estimate. Further, due to the large number of entities that have recently recorded significant other-than-temporary impairment charges (a significant portion of which were attributable to factors other than credit), it is imperative that the final FSP permit a limited retrospective application. Specifically, a cumulative adjustment to

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beginning retained earnings should be required for investment securities that have been impaired and that exist on the December 31, 2008 balance sheet of an entity.

Response to Questions in Proposed FSP:

Question 1
This proposed FSP would require entities to separate (and present separately on the statement of earnings or "performance indicator") an other-than-temporary impairment of a debt security into two components when there are credit losses associated with an impaired debt security for which management asserts that it does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis. The two components would be (a) the credit component and (b) the noncredit component (residual related to other factors). Does this separate presentation provide decision-useful information?

Response to Question 1
FHLBC suggests that the Board remove the requirement to include a presentation of "total" impairment offset by the non-credit component in the statement of income. This presentation would complicate the face of the statement of income with information that is already required when reporting the components of comprehensive income and we believe this information would be more appropriately included in the disclosures to the financial statements. Additionally, we believe that presentation of the credit component alone provides useful and meaningful information because it informs users of the actual loss expected to be realized. See our response to question 2 below for additional views regarding the non-credit component.

Question 2
This proposed FSP would require that the credit component of the other-than temporary impairment of a debt security be determined by the reporting entity using its best estimate of the amount of the impairment that relates to an increase in the credit risk associated with the specific instrument. One way of estimating that amount would be to consider the measurement methodology described in paragraphs 12–16 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*. For debt securities that are beneficial interests in securitized financial assets within the scope of Issue 99-20, the amount of the total impairment related to credit losses would be determined considering the guidance in paragraph 12(b) of Issue 99-20. Do you believe this guidance is clear and operational? Do you agree with the requirement to recognize the credit component of an other-than-temporary impairment in income and the remaining portion in other comprehensive income? Under what circumstances the remaining portion should be recognized in earnings?

Response to Question 2
FHLBC agrees with the requirement to recognize the credit component of other-than-temporary impairment in income. However, we do not believe that the non-credit component of held-to-maturity securities should be recognized in accumulated other comprehensive income. We believe this introduces additional and unnecessary complexity into the financial statements. Subsequent to the day impairment is recognized, a held-to-maturity security would be carried at

neither fair value (due to accretion of the non-credit component) nor amortized cost (which is defined as previous cost basis less the impairment recognized in earnings). Rather than recording a held-to-maturity security at fair value for only one day (because of the accretion under the proposed FSP), the accounting for held-to-maturity debt securities should be amended to be consistent with the accounting for loans held for investment purposes under Statement 114. Under the historical cost method of accounting, held-to-maturity securities and loans held for investment are both carried at amortized cost. However, impairment of a loan held for investment purposes does not include an adjustment for non-credit impairment losses. The primary reason given by the Board for this difference between Statement 114 and Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* is provided in paragraph 113 of Statement 115 which states:

> The Board recognizes that the impairment provisions of this Statement differ from those in FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan,* which indicates that a loan is impaired when it is probable that the creditor (investor) will be unable to collect all amounts due according to the contractual terms of the loan agreement. This Statement requires that the measure of impairment be based on the fair value of the security, whereas Statement 114 permits measurement of an unsecuritized loan's impairment based on either fair value (of the loan or the collateral) or the present value of the expected cash flows discounted at the loan's effective interest rate. **The Board recognizes that a principal difference between securities and unsecuritized loans is the relatively greater and easier availability of reliable market prices for securities, which makes it more practical and less costly to require use of a fair value approach**. In addition, some Board members believe that securities are distinct from receivables that are not securities and that securities warrant a different measure of impairment—one that reflects both current estimates of the expected cash flows from the security and current economic events and conditions. **[Emphasis added]**

In today's dislocated credit markets, the principal difference between securities and unsecuritized loans no longer exists. Reliable market prices are not readily available for many of the debt securities for which entities are recording significant impairments and, therefore, the use of a fair value approach is not more practical and less costly. Since this difference no longer exists, the impairment model for held-to-maturity debt securities should be amended to be consistent with the impairment model in Statement 114. Additionally, the recognition of non-credit impairment on held-to-maturity debt securities in other comprehensive income is effectively recognizing (albeit in other comprehensive income) losses that are currently not expected to occur in the future. This would not be allowed under Statement 114 as stated in the response to question 14 of the FASB Staff implementation guide to Statement 114, which states, in part, "[U]nder generally accepted accounting principles, losses should not be recognized before they have been incurred, even though it may be probable based on past experience that losses will be incurred in the future. It is inappropriate to recognize a loss today for possible or expected future trends that may lead to a loss in the future." In fact, historically, many entities have been required to restate as a result of including future losses in their allowance for loan losses. Such a practice was viewed as managing earnings. We believe under principles-based accounting, the historical cost

method of accounting should be applied in a consistent manner and that inclusion of future losses in income or accumulated other comprehensive income for financial assets carried at amortized cost is overly conservative and inappropriate.

We recognize that some Board members believed impairment for securities should be different and recognize current economic events and conditions; however, we believe such recognition is inconsistent with the historical cost method of accounting, and therefore, is not conceptually supportable. Further, the fair value of held-to-maturity securities will be readily available to financial statement users pursuant to the proposed FSP FAS 107-b and APB 28-a: "*Interim Disclosures about Fair Value of Financial Instruments.*" As a result, requiring amortization from accumulated other comprehensive income to the security value creates additional operational complexity that is conceptually inconsistent with the historical cost method of accounting and provides little additional information to financial statement users that was not already available from other disclosures.

We also believe that the Board should consider allowing the use of an allowance for credit loss on held-to-maturity securities. An OTTI charge-off would be made upon the occurrence of a confirming event similar to the charge-offs on loans. Also, the ability to utilize an allowance for credit losses for investment securities obviates the need to address the accounting for subsequent recoveries. Specifically, similar to the accounting for loans, the allowance for credit losses could be adjusted if recoveries were to occur. In the event that a charge-off was recorded based on confirming events, then subsequent recoveries would only be recognized as cash is received.

Furthermore, we believe that aligning the impairment model for held-to-maturity securities with the impairment model for loans held-for-investment would result in guidance that is more consistent with International Accounting Standards No. 39, specifically, paragraphs 63 – 65, which apply to financial assets carried at amortized cost. This would further the Board's goal of convergence with International Financial Reporting Standards.

Lastly, in response to question 2, both Statement No. 5, *Accounting for Contingencies* (paragraph 23), and Statement 114 (paragraph 8) indicate that insignificant delays and/or insignificant shortfalls should not be considered. Accordingly, we recommend that the final FSP clearly indicate that insignificant delays and/or insignificant shortfalls should not result in other-than-temporary impairment.

Question 3

This proposed FSP modifies the current indicator that, to avoid considering an impairment to be other than temporary, management must assert that it has both the intent and the ability to hold an impaired security for a period of time sufficient to allow for any anticipated recovery in fair value. Does this modification make this aspect of the other-than-temporary impairment assessment more operational (the remaining factors discussed in FSP FAS 115-1/FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, would remain unchanged)? Should this modification apply to both debt and equity securities?

Will this change result in a significant change to the assessment of whether an equity security is *other-than-temporarily impaired*?

Response to Question 3

We believe this modification will make this aspect of the other-than-temporary impairment assessment more operational for available-for-sale securities. We do not believe it is useful for held-to-maturity securities since, by definition, we must have the intent and ability to hold held-to-maturity securities until their maturity in order to continue to classify them as held-to-maturity. Because FHLBC does not invest in equity securities, we have no further comments regarding this question.

Question 4

This proposed FSP would require that the portion of an impairment recognized in other comprehensive income for held-to-maturity securities be amortized (through other comprehensive income) over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows by offsetting the recorded value of the asset (that is, an entity would not be permitted to adjust the fair value of a held-to-maturity security for subsequent recoveries in the fair value of the security similar to the accounting for available-for-sale securities). Do you agree with this requirement?

Response to Question 4

As stated in our response to question 2, we do not believe that the non-credit component should be recognized in accumulated other comprehensive income. However, if the final FSP retains this requirement, we agree that the non-credit portion should be amortized over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows by offsetting the recorded value of the asset.

Additionally, we suggest that the final FSP further amend Statement 115 and EITF 99-20 to provide detailed guidance for the accounting of investment securities subsequent to the recognition of other-than-temporary impairment. In this regard, please consider providing detailed examples that illustrate various methods of amortizing discounted credit losses to the realized amount (including classification in the statement of income) and the methods of amortizing the non-credit component in response to changes in forecasted and realized cash flows.

Also, the Board should consider revisions to the disclosure requirements of Statement 115 because the amortized cost of a held-to-maturity security subsequent to the recognition of an other-than-temporary impairment (as defined in the proposed FSP) will no longer equal the carrying value.

Question 5

Is the proposed effective date of interim and annual periods after March 15, 2009, operational?

Response to Question 5

We believe that the proposed effective date of interim and annual periods after March 15, 2009 is operational.

Additionally, we believe that the proposed FSP represents a change in accounting principle that is inseparable from the change in accounting estimate. In effect, the change is more analogous to the transition in SFAS 159, "*Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115.*" Specifically, entities are effectively changing from fair value (albeit nonrecurring) to amortized cost under the historical cost method of accounting. Further, due to the large number of entities that have recently recorded significant other-than-temporary impairment charges (a significant portion of which were attributable to factors other than credit), it is imperative that the final FSP permit a limited retrospective application. Specifically, a cumulative adjustment to beginning retained earnings should be required for investment securities that have been impaired and that exist on the December 31, 2008 balance sheet of an entity. The cumulative adjustment should be, measured as the difference between total OTTI charges recorded in the statement of income (net of any recognized accretion) and the credit component as defined in the proposed FSP, as a cumulative-effect adjustment to the opening balance of retained earnings for the fiscal year in which the FSP is adopted. This limited form of retrospective application would be consistent with the transition provisions provided in SFAS 157, *"Fair Value Measurements."*

We thank the Board for its consideration of the FHLBC's views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (312) 565-5714.

Sincerely,

Roger D. Lundstrom
Chief Financial Officer
Executive Vice President

cc: Robert H. Herz, Chairman, Financial Accounting Standards Board