

October 21, 2013

Ms. Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
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P.O. Box 5116  
Norwalk, CT 06856-5116

Via email: [director@fasb.org](mailto:director@fasb.org)  
File Reference: FASB No. 2013-290

Dear Ms. Cospers:

The Federal Home Loan Bank of Chicago (the Bank) appreciates the opportunity to comment on the exposure draft, Insurance Contracts (ED). The Bank is a federally chartered corporation and one of 12 Federal Home Loan Banks (the FHLBs) that, with the Office of Finance, comprise the Federal Home Loan Bank System (the System). The FHLBs are government-sponsored enterprises (GSE) of the United States of America and were organized under the Federal Home Loan Bank Act of 1932, as amended (FHLB Act), in order to improve the availability of funds to support home ownership. The Bank is supervised and regulated by the Federal Housing Finance Agency (FHFA), an independent federal agency in the executive branch of the United States government. The Bank provides credit to members principally in the form of secured loans called advances as well as standby letters of credit. The Bank also provides liquidity for home mortgage loans to members approved as Participating Financial Institutions (PFIs) through the Mortgage Partnership Finance<sup>®</sup> (MPF<sup>®</sup>) Program<sup>1</sup>.

At this time, the Bank's comment is limited to Question 1, which is as follows:

**Question 1:** Do you agree with the scope and scope exceptions of this proposed guidance, including its applicability to contracts written by noninsurance entities? If not, what types of contracts or transactions also should be included or excluded from the scope and why?

**Background:**

Outlined below is a brief description of the Bank's MPF and MPF Xtra<sup>1</sup> Programs. The Bank believes that the standard representations and warranties/indemnities related to these Programs should be scoped out of the ED. Additionally, a brief description of the Bank's transaction structure for its standby letters of credit (LOC) product is provided, which the Bank also believes should be scoped out of the ED.

<sup>1</sup> "Mortgage Partnership Finance", "MPF", and "MPF Xtra" are registered trademarks of the Federal Home Loan Bank of Chicago. "

### **MPF and MPF Xtra Programs:**

The Bank has entered into a Mortgage Selling and Servicing Contract with Fannie Mae pursuant to which it concurrently sells MPF Loans acquired from PFIs. In connection with each sale, the Bank makes certain customary warranties to Fannie Mae regarding the eligibility of the mortgage loans. The Bank is exposed to mortgage repurchase liability in connection with its sale of MPF Loans to Fannie Mae under the MPF Xtra product. If a loan eligibility requirement or other warranty is breached, Fannie Mae could require the Bank to repurchase an ineligible MPF Loan or provide an indemnity. If the PFI from which the Bank purchased an ineligible MPF Loan is viable, the Bank may require the PFI to repurchase that MPF Loan from it or indemnify it for related losses.

PFIs also are required to repurchase ineligible MPF Loans the Bank holds in its portfolio and its repurchase requirement is factored into the Bank's determination of its allowance for credit losses.

### **Transaction Structure of Standby Letters of Credit (LOC) Product:**

At the time the Bank issues an LOC and at all times thereafter, a borrower must have an amount of "qualifying collateral" sufficient to fully secure the amount of the LOC. If the Bank were required to make a payment for a beneficiary's draw, then the payment amount would be converted into a collateralized advance to the member.

### **Scope out of Standard Representations and Warranties/Certain Indemnities:**

Standard representations and warranties and certain indemnities are currently scoped out from being accounted for as a guarantee under GAAP. Specifically, standard representations and warranties that are defined in the excerpt below as well indemnities that are similar in nature to standard representations and warranties are currently not considered guarantees for accounting purposes under GAAP.

#### **"Standard Representations and Warranties**

Representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date."

Standard representations and warranties/indemnities for the MPF Xtra Program effectively represent that the Bank is reviewing the mortgage loans at origination and that it can assert they are what they purport to be when the Bank sell the mortgage loans to Fannie Mae. Such representations and warranties/indemnities are only a guarantee of the Bank's future performance – that is, these standard representations and warranties//indemnities only provide a guarantee if the Bank correctly asserted a mortgage loan is what it purported to be at the transfer date. The excerpt below from **FASB ASC 460-10-55-18** provides an example, which by analogy is similar to representations and warranties/indemnities made under the MPF and MPF Xtra Programs.

## “Guarantees of an Entity's Own Performance

The following are examples of contracts that are outside the scope of this Topic because these contracts are of the type described in paragraph 460-10-15-7(i):

- a. A lessee will often indemnify a lessor for any adverse tax consequences that may arise from **acts, omissions, and misrepresentations of the lessee** (for example, using the leased asset outside the United States or subleasing to a tax-exempt entity). The lessee is, in effect, guaranteeing that its own future performance and actions with respect to the lease and the leased property will not result in adverse tax consequences to the lessor. Thus, that lessee’s indemnification is not within the scope of this Topic. In contrast, as discussed in paragraph 460-10-55-13(b), a guarantee by a lessee regarding the effect of future changes in the tax law on the guaranteed party’s tax liability is within the scope of this Topic because the lessee cannot change the tax law (or prevent a change) and thus cannot control whether payments will be required under the guarantee.”

Additionally, scope out of these stand representations and warranties/indemnities from being viewed as an insurance contract is consistent with **FASB ASC Topic 860**. Specifically, such representations and warranties/indemnities are not considered to be recourse when determining whether or not a transfer of financial assets (e.g., mortgage loans) would be accounted for as a sale – that is, the existence of these standard representations and warranties/indemnities does not disqualify a transfer from being accounted for as a sale.

Given the above and pursuant to the excerpt below from **FASB ASC 460-10-15-7**, representations and warranties/indemnities of an entity’s own future performance are scoped out of guarantee accounting and also should be scoped out of insurance contracts. Additionally, it should be noted that indemnification agreements that are guarantees are based on an underlying that is related to an asset of the indemnified party pursuant to **FASB ASC 460-10-10-15-4** – this is not the case with the Bank’s representations and warranties/indemnities to Fannie Mae.

### **Excerpt from FASB ASC 460-10-15-7:**

“The guidance in this Topic **does not apply to the following types of guarantee contracts:**

- a. ...

A guarantee or an indemnification of an entity’s own future performance (for example, a guarantee that the guarantor will not take a certain future action)...”

### **Scope out of Standby Letters of Credit (LOC):**

**FASB ASC 834-10-55-9** states the following:

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“Insurance risk is considered significant if, and only if, an insured event exposes an entity to a significant loss. Existence of one scenario in which the present value of the cash flows expected to be paid by the entity can significantly exceed the present value of the premiums and other cash inflows will be considered to satisfy the existence of significant insurance risk. That condition can be met even if the insured event is extremely unlikely or even if the expected (that is, probability weighted) present value of the contingent cash flows is a small proportion of the expected present value of all of the remaining cash flows from the insurance contract.”

Since the creation of the FHLBs in 1932, and through a wide range of economic cycles, no FHLB has ever experienced a loss on an advance or an advance commitment. Based on the absence of historical loss experience and the stringent collateral requirements for each LOC and advance, the Bank does not expect to experience any level of loss on an LOC. Accordingly, the issuance of an LOC by the Bank does not expose the Bank to a significant loss. Furthermore, because the Bank would not be exposed to any loss on an individual LOC basis, the aggregation of the exposure to losses on all outstanding LOCs would also be nonexistent. Therefore, the Bank’s LOCs do not meet the definition of an insurance contract and should be excluded from the scope of the ED.

Once again, the Bank appreciates the opportunity to comment on the ED. Please contact either James Potter (Controller at 312-552-2767) or myself at 312-565-5284 if you have any questions.

Sincerely,

Claude Edelson  
Director of Accounting Policy  
FHLB of Chicago