



December 29, 2008

Mr. Robert H. Herz, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
P. O. Box 5116  
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LETTER OF COMMENT NO. 148

Dear Chairman Herz,

The twelve Federal Home Loan Banks appreciate the opportunity to comment on the recently issued FSP EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement guidance of EITF No. 99-20*. Further, we applaud the Financial Accounting Standards Board's (FASB) decision to address these issues in a timely manner. The proposal to align the EITF 99-20 impairment model with the *Statement of Financial Accounting Standards No. 115* (Statement 115) impairment model is a step in the right direction, and does provide some incremental benefit to preparers and users of financial statements. Specifically, basing an impairment determination on the expectations of the holder of the beneficial interests regarding the probability of collecting all amounts due according to the contractual terms, rather than being based on a market participant's assumptions of the expected future cash flows, improves the other-than-temporary impairment (OTTI) model for beneficial interests that are within the scope of EITF 99-20, but only to the extent that it aligns the two OTTI models.

However, we do not believe the proposed FSP EITF 99-20-a goes far enough to resolve the problems that exist in the current model for assessing OTTI, under both Statement 115 and EITF 99-20. In a letter addressed to you dated October 14, 2008, the Chief Accountant of the Securities and Exchange Commission (SEC), Conrad Hewitt, wrote that "the [Office of the Chief Accountant] has requested that the FASB expeditiously address issues that have arisen in the application of the OTTI model in Statement 115." We agree that the OTTI model needs to be adjusted and we urge the FASB to provide additional guidance expeditiously so that the guidance can be applied for December 31, 2008, financial reporting.

### **Background**

The Federal Home Loan Banks are major investors in mortgage-backed securities (MBS), holding over \$172 billion as of September 30, 2008 which are classified as either held-to-maturity or available-for-sale, of which \$77 billion are private-label MBS. All of these MBS were rated triple-A at the time of purchase based on structural credit enhancements designed to withstand a significant increase in defaults combined with a sharp downturn in housing prices. During the financial crisis that has persisted throughout 2008, prices on these securities have plummeted precipitously to levels that vastly overstate the credit risk of the securities. Market dislocation has been exaggerated by forced sales as levered entities have faced margin calls, leading to a downward spiral in prices and more forced sales. However, entities such as the Federal Home Loan Banks, that have demonstrated the capacity and intent to hold securities to recovery, have been threatened with significant capital erosion by the current requirement to recognize the estimated full fair value impairment for securities determined to be OTTI, rather than the estimated credit losses. Thus, we believe that the current impairment models under Statement 115 and EITF 99-20 create a high potential for significantly overstated losses, thereby inflicting unnecessary harm to the affected entities.

Accordingly, we believe that the current impairment model serves neither the interests of investors nor those of issuers of financial statements. Investors are misled by losses that are overstated and frequently inconsistent in terms of measurement in a dislocated market. Financial statement issuers suffer

unnecessary losses and capital erosion. For entities that have demonstrated the capacity and intent to hold securities until recovery, the determination of whether OTTI exists as well as the magnitude of loss recorded, given OTTI, should be based on a rigorous credit analysis appropriate to the characteristics of the securities, including credit enhancements. We also note that this treatment would resolve the current inconsistency with *Statement of Financial Accounting Standards No. 114 (As Amended)*, "Accounting by Creditors for Impairment of a Loan - an amendment of FASB Statements No. 5 and 15", which results in different earnings recognition depending on whether a loan is embedded in a security. Specifically, we believe that a new direct measurement of an investment security carried at historical cost should not be recognized on the date of impairment consistent with the accounting treatment for loans under SFAS 114. In particular, SFAS 114, paragraph 54, states the following:

"The Board concluded that impairment of a loan is not an event that should result in a new direct measurement of the loan at fair value at the date impairment is recognized. Under that approach, an impaired loan's expected future cash flows would be discounted at a market interest rate commensurate with the risks involved to arrive at a measure of the loan's fair value. Noting that unimpaired loans are not carried at fair value after origination, the Board concluded that loan impairment should be recognized based solely on deterioration of credit quality evidenced by a decrease in expected future cash flows rather than on changes in both expected future cash flows and other current economic events, such as changes in interest rates."

### **Recommendation**

To remedy this situation, we recommend that the FASB adopt an OTTI model that is similar to that of the International Accounting Standards Board which focuses on loss events that provide evidence of impairment. The recommended approach would be to evaluate and recognize in earnings losses associated with OTTI of held-to-maturity and available-for-sale as follows:

- The determination of OTTI would be based on a quantitative and qualitative analysis of credit impairment.
- The amount of loss recognized in earnings would be based on the difference between the carrying amount of the instrument and the present value of estimated future cash flows discounted at the instrument's original effective interest rate.
- If the impairment loss as measured above subsequently changes, the amount of the change would be recognized immediately through earnings. Any recovery should be recorded only to the extent that the carrying amount of the instrument does not exceed what the amortized cost would have been, had the impairment not been recognized. We understand that this approach is consistent with a FASB staff recommendation outlined at the meeting of December 15, 2008.

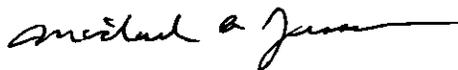
We recognize that this approach necessitates rigorous analysis based on sound judgment. However, we believe that disclosure based on such an approach is superior to disclosure that is based on prices that are, in many cases, reflective more of technical market dislocations rather than fundamental underlying value.

Recent market events have shown that the current U.S. GAAP model for OTTI has served neither investors nor issuers well. While we applaud the proposed FSP EITF 99-20-a as a step in the right direction, the job will not be complete until the impairment model is revised. We strongly encourage the FASB to adopt quickly an impairment model that would base loss recognition on credit risk rather than fair value, so that it is available for application as of December 31, 2008.

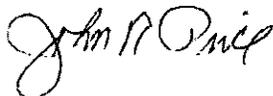
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Thank you for considering our views. We would be pleased to provide additional information as you move forward on this project of immediate urgency.

Sincerely yours,



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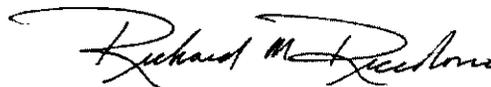
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cc: Russell G. Golden, Technical Director, Financial Accounting Standards Board  
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