



May 30, 2008



Mr. Russell G. Golden
Director—Technical Application and
Implementation Activities and EITF Chair
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

LETTER OF COMMENT NO. 34

File Reference: 1550-100 Preliminary Views
Financial Instruments with Characteristics of Equity

Dear Mr. Golden:

The 12 Federal Home Loan Banks (the “FHLBanks”) appreciate the opportunity to comment on the Financial Accounting Standards Board’s (“FASB” or “Board”) Preliminary Views: *Financial Instruments with Characteristics of Equity* (hereinafter referred to as the “Preliminary Views”). The FHLBanks generally agree with the Board’s preliminary view that the basic ownership approach provides more decision-useful information to investors and significantly simplifies accounting requirements. However, the basic ownership approach, as currently drafted, will not faithfully represent the equity of certain entities. As a result, we suggest revising the Preliminary Views such that certain puttable financial instruments that are largely equivalent to basic ownership interests would be classified as equity consistent with the requirements of International Accounting Standard No. 32 *Financial Instruments: Presentation*, as amended (“IAS 32”).

Overview of the FHLBanks

The FHLBanks were created by the Federal Home Loan Bank Act of 1932 (the “FHLB Act”) to enhance the availability of credit for residential mortgages, community lending, and targeted community development. The FHLBanks are supervised and regulated by the Federal Housing Finance Board (“Finance Board”), which is an independent agency in the executive branch of the United States Government. The Finance Board has a statutory responsibility and corresponding authority to ensure that the FHLBanks operate in a safe and sound manner. Consistent with that duty, the Finance Board has an additional responsibility to ensure the FHLBanks are able to raise funds in the capital markets and carry out their housing and community development finance mission. In order to carry out those responsibilities, the Finance Board establishes regulations governing the operations of the FHLBanks, conducts ongoing off-site supervision and monitoring of the FHLBanks, and performs annual on-site examinations of each FHLBank.

Each FHLBank operates as a separate entity within a defined geographic region of the country, known as its “district.” The FHLBanks are cooperatives, which means that only members and (in certain circumstances) former members own the capital stock in each of the FHLBanks and receive dividends on their investment in capital stock from the earnings of their respective FHLBank. Any such dividends are paid at the discretion of the board of directors of the FHLBank. As independent, member-owned cooperatives, the FHLBanks seek to maintain a balance between their public purpose and their ability to provide adequate economic returns on the capital supplied by their

members. The FHLBanks' primary business is lending low cost funds (known as advances) to their member institutions.

As cooperatives, the FHLBanks' capital stock can only be held by members, non-member institutions that acquire stock by virtue of acquiring member institutions and former members that retain capital stock to support advances or other activity that remain outstanding or until any applicable stock redemption or withdrawal notice period expires. Members are required to purchase capital stock as a condition of membership and to support borrowing activity. The FHLBanks' capital stock has a par value of \$100 per share and by regulation is purchased, redeemed, repurchased and transferred (with the prior approval of the FHLBank) only at its par value. As required by statute and regulation, and subject to certain limitations and restrictions, a FHLBank's members may request the FHLBank to redeem excess capital stock, or withdraw from membership and request the FHLBank to redeem all outstanding capital stock. This put option is exercisable at the par value of \$100 per share. Similarly, a FHLBank has the ability, at its discretion, to repurchase (or call) excess stock (i.e., the amount of stock held by a member (or former member) in excess of that institution's minimum investment requirement) at its par amount of \$100 per share.

Under the Gramm-Leach-Bliley Act of 1999 ("GLB Act"), FHLBanks may issue one or both of Class A and Class B stock in accordance with capital plans that have been adopted by the FHLBanks' boards of directors and approved by the Finance Board. Among other things, these capital plans specify minimum investment requirements for members. Members may request redemption of capital stock by providing a written redemption notice to the FHLBank indicating the number of shares to be redeemed, or by submitting a membership withdrawal notice. In addition to a member-submitted withdrawal notice, an institution's membership may be terminated through acquisition by another member or non-member institution, or through involuntary termination by action of a FHLBank's board of directors.

The GLB Act added section 6(h) to the FHLB Act, which provides that the holders of Class B stock shall own the retained earnings, surplus, undivided profits, and equity reserves, if any, of the FHLBank. In the event of a liquidation, the Class B holders would share in the net assets of the FHLBank proportionate to their ownership. Further, the Code of Federal Regulations states that the respective rights of the Class A and Class B stockholders, in the event that a FHLBank is liquidated, or is merged or otherwise consolidated with another FHLBank, shall be determined in accordance with the capital plan of the FHLBank. Two FHLBanks currently issue both classes of stock. The capital plan of one of the FHLBanks requires that both classes of stock share equally in any cash and property remaining after satisfaction of all FHLBank obligations in the event of liquidation proportionate to their ownership. The capital plan of the other FHLBank provides that in the event of liquidation, the holders of Class A stock and Class B stock shall be entitled to receive the par value of their Class A stock and Class B stock plus any declared but unpaid dividends on a pari passu basis, provided that payment obligations to the FHLBank's creditors have been fully satisfied. Further, the holders of Class B stock shall thereafter be entitled to receive the retained earnings, surplus, undivided profits and equity reserves, if any. Hereinafter, FHLBank capital stock refers to the Class B stock of all the FHLBanks and the Class A stock which shares equally in the distribution of any cash and property remaining in the event of liquidation.

Redeemable Basic Ownership Interests

Paragraph 18 of the Preliminary Views defines a basic ownership interest as having both of the following conditions (footnote omitted):

- a. The holder has a claim to a share of the assets of the entity that would have no priority over any other claims if the issuer were to liquidate on the date the classification decision is being made; and
- b. The holder is entitled to a percentage of the assets of the entity that remain after all higher priority claims have been satisfied. The holder's share depends on its share of the total claims with the lowest priority and has no upper or lower limit except for the amount of assets available.

FHLBank capital stock meets these conditions; however, as the stock is redeemable it must also meet the more restrictive interpretive requirements in paragraphs 20 and 21 of the Preliminary Views which state (footnote omitted):

20. Many basic ownership instruments are perpetual, but an instrument that is redeemable (mandatorily or at the option of the holder) is a basic ownership instrument if it possesses the two characteristics in paragraph 18. It possesses those characteristics if both of the following criteria are met:
 - a. The redemption amount is the same as the share of the issuer's net assets to which the holder would be entitled if it were to liquidate on the classification date; and
 - b. The terms of the instrument prohibit redemption if redemption would impair the claims of any instruments with higher priority than other basic ownership instruments.
21. The fair value of an instrument would be used to approximate the share of the issuer's net assets for purposes of the criterion in paragraph 20(a) unless both of the following conditions exist. If both conditions exist, a redemption amount based on book value would be acceptable.
 - a. The redemption formula is designed to approximate fair value of the instrument or the share of assets to which the holder would be entitled; and
 - b. There is no active market for the instrument or the instrument can be exchanged only with the reporting entity.

As noted above, in the absence of a liquidation, the FHLBanks' capital stock is purchased, redeemed, repurchased and transferred only at its par value of \$100 per share. The stated redemption amount is not based on a formula that is designed to approximate the fair value of the instrument nor is it designed to approximate the share of assets to which the holder would be entitled in the event of a liquidation. Therefore, as currently written, the Preliminary Views may be interpreted to require that the FHLBanks classify all of their capital stock as a liability. If this were the case, the FHLBanks would have no ownership interests classified as equity. As a result, the FHLBanks believe the definition of a basic ownership interest should be revised to address the Board's previous concern that classifying all ownership interests as liabilities does not result in a representationally faithful presentation for such entities as stated in paragraph 64 of the Preliminary Views.

International Accounting Standards

In February 2008, the International Accounting Standards Board (“IASB”) amended IAS 32 to classify certain puttable instruments and instruments, or components of instruments, that impose on an entity an obligation to deliver to another party a pro rata share of the net assets of the entity only upon liquidation as equity instruments. As stated in paragraph BC70 of IAS 32, the IASB concluded that classifying these instruments as equity “would improve the comparability of information provided to the users of financial statements. That is because financial instruments that are largely equivalent to ordinary shares would be consistently classified across different entity structures (e.g., some partnerships, limited life entities and co-operatives). The specified instruments differ from ordinary shares in one respect; that difference is the obligation to deliver cash (or another financial asset). However, the Board [IASB] concluded that the other characteristics of the specified instruments are sufficiently similar to ordinary shares for the instruments to be classified as equity. Consequently, the Board [IASB] concluded that the amendments will result in financial reporting that is more understandable and relevant to the users of financial statements.”

In order for an instrument to be classified as equity, IAS 32 requires conditions consistent with the requirements of paragraph 18 of the Preliminary Views (i.e., the holder is entitled to the most residual claim based on a pro rata share). However, in order for a puttable (i.e., redeemable) instrument to be classified as equity, IAS 32 requires that the formula used to calculate the repurchase or redemption price is the same for all instruments in that class. As all FHLBank capital stock is repurchased or redeemed at its par value of \$100 per share, it would meet this condition. Accordingly, we request the Board consider conditions consistent with IAS 32 for classification as equity rather than require that the repurchase or redemption price approximate fair value. This would allow the FHLBanks, and other entities with similar capital structures, to continue to classify capital stock as equity.

Current U.S. Accounting Standards

Under the current application of Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (“SFAS 150”), the FHLBanks reclassify capital stock that becomes subject to a mandatory redemption or withdrawal notice as a liability. As required under paragraph 22 of SFAS 150, the FHLBanks’ mandatorily redeemable financial instruments are measured subsequently at the amount of cash that would be paid if settlement occurred at the reporting date (i.e., par value), recognizing the resulting change in that amount from the previous reporting date as interest cost (i.e., an amount equal to the payment or accrual of dividends). In essence, when a FHLBank’s capital stock becomes mandatorily redeemable, it is essentially the equivalent of a floating rate liability that resets every three months. We are currently unable to determine the impact of the Preliminary Views on the FHLBanks’ accounting for mandatorily redeemable capital stock, if any, and therefore request clarification regarding the extent to which SFAS 150 will be modified.

The FHLBanks are aware and appreciative of the considerable lengths the Board went to in considering the impact of Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (“SFAS 141(R)”) on mutual entities, including cooperatives. In addition to numerous meetings, the Board performed field visits and held roundtable discussions to ensure the concerns of mutual entities were fully vetted. In SFAS 141(R), “the term equity interests is used broadly to mean ownership interests of investor-owned entities and owner, member, or participant interests of mutual entities.” We believe the term equity interests should continue to encompass the owner, member, or participant interests of mutual entities. Accordingly, we request the Board perform the

necessary diligence to ensure the concerns of mutual entities, many of which have similar capital structures to the FHLBanks, are sufficiently considered in the context of its liabilities and equity project.

Summary

For the reasons cited above, the FHLBanks believe that equity is the appropriate classification of FHLBank stock. Accordingly, we request that the definition of a basic ownership instrument be revised such that it would include stock with features similar to FHLBank stock. We believe this change would result in financial reporting that is more understandable and relevant to the users of financial statements and would assist the Board in achieving global convergence in accounting standards.

We thank the Board for the consideration of our views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (404) 888-8000.

Sincerely,



J. Daniel Counce
First Vice President and Controller
Federal Home Loan Bank of Atlanta
(On behalf of the 12 Federal Home Loan Banks as Chair of the Controllers' Committee)