

Interpretation of the Emerging Accounting Issues (E) Working Group

INT 08-08: Balance Sheet Presentation of Funding Agreements Issued to a Federal Home Loan Bank

ISSUE NULLIFIED BY SSAP NO. 15, SSAP NO. 50 AND SSAP NO. 52

INT 08-08 Dates Discussed

September 23, 2008; December 5, 2008; March 15, 2009

INT 08-08 References

SSAP No. 15—Debt and Holding Company Obligations (SSAP No. 15)

SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force (SSAP No. 50)

SSAP No. 52—Deposit-Type Contracts (SSAP No. 52)

INT 08-08 Issue

1. The Gramm-Leach Bliley Act of 1999, also known as the Financial Modernization Act (FMA) expanded insurance companies' ability to access and utilize funds available from Federal Home Loan Banks (FHLB). In recent years, insurance companies, primarily in the life insurance industry, have increased the utilization of this opportunity to obtain low cost funds through membership in FHLBs. Although these funds are used in both financial leverage and operating leverage capacities, it appears that operating leverage is the predominant use through investment spread type strategies.
2. Funding agreements have become the preferred method used by insurance companies to acquire FHLB funds. While the funding agreements generally issued to an FHLB are structured similar to ordinary funding agreements, there are characteristics unique to the FHLB arrangements that have led to inconsistent interpretations regarding their appropriate accounting treatment.
3. One of these characteristics is the requirement that an insurance company purchase stock in an FHLB in order to become a member and gain access to these funds. This requirement applies regardless of whether the company accesses the funds through a funding agreement or some type of borrowing arrangement. This feature is consistent with normal FHLB operations, as membership, attained through the purchase of FHLB stock, is required of any financial institution seeking to gain access to FHLB funds.
4. In addition to requirement to purchase FHLB stock, an insurance company is also required to pledge assets as collateral for the funds provided by the FHLB, again regardless of the nature of the arrangement.
5. As companies have moved toward the funding agreement approach of obtaining FHLB funds, it appears that in most instances, approval has been sought from respective state regulators through open communication of the reporting entity's intentions regarding these arrangements. Several states have approved the funding agreement approach, as long as the funds are used in an investment spread capacity, similar to the manner in which ordinary funding agreements are utilized. This classification results in the related liabilities being reported as deposit-type policyholder obligations, consistent with the guidance in SSAP No. 50 and SSAP No. 52. If the funds are used for any other purpose, these states have typically required the liabilities to be

reported as borrowed money in accordance with SSAP No. 15. Additional disclosures regarding these arrangements have often been required, as well. However, disclosure of the related information currently appears to be inconsistent.

6. Other states have allowed FHLB membership, but have required that any funds obtained from an FHLB be reported as debt, regardless of how the funds are used. Many states have yet to officially determine the appropriate treatment for these arrangements, and initial interpretations vary on which guidance is more applicable.

7. The accounting issue is:

Should funding agreements issued to an FHLB be accounted for as deposit-type contracts, in accordance with SSAP No. 50 and SSAP No. 52; or as debt, in accordance with SSAP No. 15?

INT 08-08 Discussion

8. The Working Group reached a consensus on Issue 1 that funding agreements issued to an FHLB shall be evaluated on an individual basis, and shall be accounted for according to the substance of the individual arrangement. If the arrangement is in substance a funding agreement, it shall be accounted for consistent with other funding agreements in accordance with SSAP No. 52. If the arrangement is in substance a borrowing agreement, it shall be accounted for in accordance with SSAP No. 15, consistent with other borrowed money.

INT 08-08 Status

9. No further discussion planned.