Federal Housing Finance Board
Office of Supervision

Date: October 29, 2004

To: Federal Home Loan Bank Chairs, Presidents, Chief Financial Officers and Directors of Internal Audit
Managing Director, Office of Finance

From: Stephen M. Cross, Director
Office of Supervision

Subject: SEC Registration

Background

On June 29, 2004, the Federal Housing Finance Board (Finance Board) adopted a final rule that requires each Federal Home Loan Bank (Bank) to register a class of its equity securities with the Securities and Exchange Commission (SEC) under the Securities and Exchange Act of 1934 (1934 Act). The rule requires each Bank to file a registration statement with the SEC by June 30, 2005, and to have the registration statement declared effective no later than August 29, 2005. On August 6, 2004, Finance Board staff issued Advisory Bulletin 2004-AB-03, which requested each Bank to provide its examiner-in-charge with periodic written updates on its progress toward registering a class of its stock with the SEC. The Finance Board has reviewed the information provided in the initial submissions from the Banks and will continue to monitor the progress of the individual Banks through subsequent updates.

In discussing their progress with Finance Board staff, the Banks have raised questions about a number of specific issues that they may encounter as they go through the registration process. In response to those inquiries, the Office of Supervision has prepared a series of questions and answers that provide guidance to the Banks as they complete the registration process.

Guidance

After 1934 Act registration, will any Bank directors have to be "independent"?

At the board level, the Finance Board regulations do not impose any general independence requirement on Bank directors and, because Bank securities are not publicly traded, the independence requirements otherwise applicable to public companies under section 301 of the *Sarbanes-Oxley Act* or the listing standards of the New York Stock Exchange, the American Stock Exchange, or the NASDAQ do not apply to the Banks.

With respect to the audit committee, Finance Board regulations currently require each Bank to have an audit committee that consists of five or more directors, with each member of the committee satisfying the criteria for "independence" set forth in the regulations. 12 CFR § 917.7(b)(1). Registration under the 1934 Act will not affect this regulation or the Banks' obligation to comply with it.

After the Banks register, however, Item 401 of Regulation S-K also will require each Bank to disclose whether its audit committee includes an "audit committee financial expert" and, if so, whether that individual is "independent." Solely for purposes of evaluating whether an audit committee financial expert is independent, as required for disclosure purposes by Regulation S-K Item 401, a Bank would have to choose from among and apply one of the definitions of "independence" set forth in the listing standards of the New York Stock Exchange, the American Stock Exchange, or the NASDAQ.

Do other provisions of the Sarbanes-Oxley Act apply to the Banks?

The *Sarbanes-Oxley Act* modified U.S. civil and criminal law in response to the corporate scandals of recent years. Among the more significant provisions of the *Sarbanes-Oxley Act* is the requirement in section 302 that each registrant's CEO and CFO certify that the registrant has established effective internal controls over financial reporting. Section 404 of the *Sarbanes-Oxley Act* further requires management to include in the annual report an assessment of the effectiveness of the registrant's internal controls, and requires the outside public accountant to attest to, and report on, management's assessment of those internal controls.

Some *Sarbanes-Oxley Act* provisions, such as the first five sections of Title VIII and of Title IX, respectively, are of general application and apply to the Banks regardless of whether they register with the SEC. Other *Sarbanes-Oxley Act* provisions will apply to the Banks only after they register with the SEC under the 1934 Act. Those latter provisions include expanded disclosures required by 1934 Act Forms 10-K, 10-Q, and 8-K, and by Regulations S-K and S-X.

After the Banks register with the SEC, they will be subject to the above-described provisions relating to a registrant's internal controls over financial reporting, *i.e.*, management's certification and assessment of the effectiveness of the internal controls and the outside public accountant's attestation on management's assessment of the effectiveness of the internal controls. To varying degrees, a Bank may have to invest in new systems and personnel to be able to obtain the necessary certifications and attestations. Such an investment, however, would be warranted by the safety and soundness benefits that flow from strengthened internal controls.

Do all Banks have to implement their new capital plans before SEC registration?

As required by the *Gramm-Leach-Bliley Act*, the Finance Board has approved new capital plans for each of the Banks. To date, nine Banks have implemented their capital plans.

A Bank's implementation of its capital plan is not a precondition to SEC registration. If a Bank has not yet implemented its capital plan by June 30, 2005, it may register its existing capital stock under the 1934 Act. After registering that stock with the SEC, the Bank may subsequently

implement its capital plan. When it does so, the Bank would file a Form 8-A (a short form registration statement) with the SEC to register the new Class A or Class B stock, which would replace the currently outstanding Bank stock as the registered security. The Bank would not be required to file a new Form 10 with respect to the newly issued stock. The Bank would simultaneously provide appropriate disclosures with respect to the implementation of its approved capital plan by filing a Form 8-K with the SEC.

The SEC staff has acknowledged to Finance Board staff that it will review a converting Bank's Forms 10, 8-A and 8-K only for the purpose of assessing whether the Bank has complied with applicable securities laws. The Finance Board will retain exclusive jurisdiction over matters of safety and soundness, as well as over matters of compliance with the Bank Act and its implementing regulations, such as the approval of a Bank's capital plan and oversight of the conversion process.

Will the SEC review the Combined Financial Reports?

The SEC staff will be given the opportunity to review the financial reports and disclosure documents prepared by the Office of Finance and provide comments to the Finance Board. The Finance Board will consider the SEC's comments, if any, and will discuss disclosure issues with SEC staff. All final determinations with respect to disclosure documents prepared by the Office of Finance rest exclusively with the Finance Board.

Will 1934 Act registration require one Bank to conduct due diligence on the other Banks?

Each Bank will be responsible only for its own 1934 Act disclosure documents, not the disclosure documents of the other Banks. Each Bank's disclosures, however, necessarily involve a discussion of the Bank System's joint-and-several debt. Thus, each Bank has an affirmative duty, as part of its assessment of its contingent liability for Bank System debt, to review the financial condition of the other Banks to evaluate the likelihood that its contingent joint-and-several guarantee might be called upon. Under United States generally accepted accounting principles (GAAP), however, each Bank already has the obligation to assess the possibility that its contingent joint-and-several liability might become an actual liability and to make appropriate financial statement disclosures. The act of registering a class of securities under the 1934 Act will not add any additional due diligence obligations beyond those that currently exist under GAAP.

Will the SEC issue one no-action letter for all of the Banks or will each Bank receive a separate no-action letter?

The SEC staff issued separate but identical no-action letters to Fannie Mae and Freddie Mac. While the SEC could issue no-action letters individually or collectively, SEC staff has indicated to the Finance Board that it is willing to accede to the Banks' request that a separate no-action letter be issued to each Bank. SEC staff also has indicated that the substance of each no-action letter would be the same for each Bank. Any Bank that intends to request a no-action letter from the SEC staff but that has not yet done so is encouraged to submit the request as soon as possible.

Will registration by the Banks cause the Finance Board to change any Regulatory Accounting Policies (RAP)?

The Finance Board has not authorized the Banks to use RAP, nor has the Finance Board established any RAP. The Finance Board currently requires each Bank and the Office of Finance to prepare audited financial statements in accordance with GAAP. The Finance Board will continue to require the Banks and the Office of Finance to present their financial results in accordance with GAAP and does not intend to modify current Bank GAAP accounting practices by Finance Board-established RAP accounting.

The SEC staff has advised that GAAP requires each Bank to disclose on the face of its financial statements that its common stock is "puttable" and to disclose in the notes to its financial statements how members may redeem stock and how much of a Bank's stock is in excess of the amount required to be held by its members. In addition, GAAP requires each Bank to treat any Bank stock for which a redemption request is outstanding as a liability on its balance sheet.

Nevertheless, this accounting treatment of Bank stock for which a redemption request has been made does not change the designation of such stock for the purpose of meeting the Bank's regulatory capital requirements. The Bank Act makes no such distinction between stock for which a redemption request has been made and all other Bank stock. Accordingly, for regulatory compliance purposes, the Banks' capital will continue to include all outstanding capital stock, including that for which a redemption request is pending.

What actions must a Bank take in order to have "filed" a registration statement with the SEC?

Section 998.2(a) of the Finance Board rules requires each Bank to file its registration statement with the SEC by no later than June 30, 2005. Accordingly, a Bank must electronically file a registration statement on the SEC's EDGAR system on or before June 30, 2005. Thereafter, each Bank must ensure that its registration becomes effective no later than August 29, 2005. The Finance Board expects each Bank to undertake the steps necessary to prepare its registration statement to meet those deadlines.

In preparing its registration statement, the board of directors and management of each Bank should bear in mind that in addition to the time required for the Bank to prepare the initial draft of the registration statement, the process for SEC review is apt to extend over several additional months. The SEC may take up to 30 days to review and provide comments on the initial draft of the registration statement, and up to 10 days to review and comment on subsequent drafts. The Banks will likely need to budget additional time to revise the registration statement in response to each round of SEC comments.

Finance Board staff understands that some Banks have provided, or will soon provide, the SEC with a draft registration statement for informal review, which should allow sufficient time for those Banks to meet the June 30 and August 29, 2005 deadlines. The Finance Board strongly encourages each Bank to continue, or to commence, its discussions with the SEC about the registration process and to have prepared an initial draft of the registration statement for informal review by the SEC by December 31, 2004.

An Advisory Bulletin is a staff document through which the Office of Supervision provides guidance to the Federal Home Loan Banks regarding particular supervisory issues. Although an Advisory Bulletin does not have the force of a regulation or an order, it does reflect the position of the Office of Supervision on the particular issue and as such will be followed by examination staff. If non-compliance with an Advisory Bulletin is cited as the basis for a supervisory determination, any such determination will be subject to review by the Board of Directors pursuant to the procedures of 12 C.F.R. § 907.9.

Advisory Bulletins are effective upon issuance. The Office of Supervision may amend an Advisory Bulletin, either on its own initiative or in response to comments or suggestions from the Banks or other interested parties.