April 14, 2000

Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
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Washington, DC 20552

Re. 12 CFR Part 1750; RIN 2550-AA02
Second Notice of Proposed Rulemaking
Risk Based Capital for Fannie Mae and Freddie Mac

Salomon Smith Barney (the "Firm"), a major global investment bank, is pleased to comment on two comments made on the referenced NPR. The Firm has substantial experience with the operations and activities of Fannie Mae and Freddie Mac (the “Enterprises”), including:
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- the mortgage and liquid investment portfolios
- issuance of debt and mortgage-backed securities
- their use of derivative instruments to manage interest rate risk
- optimization of capital accounts
- innovation and new product development

In addition, the Firm is one of the world’s largest distributors and traders of fixed income, equity and derivatives instruments, with many clients and customers that are investors in the fixed income and equity securities of the Enterprises. Salomon Smith Barney’s views and comments are made solely within the context of its substantial activities in the global fixed income and equity capital markets, not as legal or regulatory expert.

1. MAKING THE PROPOSED REGULATION WORKABLE OPERATIONALLY

As stated in the comment letter dated and submitted March 10, 2000, Salomon Smith Barney suggests that whatever the final regulation, it must be completely workable for both the current product line as well as future innovation. We are concerned that this is not the case for new products, and Fannie Mae and Freddie Mac commented that it was not workable for even their current books of business.

The approach that each Enterprise suggests seems logical and workable, that is:

- OFHEO defines the assumptions and standards of the stress tests.
- Each Enterprise utilizes the OFHEO-defined cash flow model to calculate required capital in accordance with those assumptions and standards, and reports the results to OFHEO.

- As part of ongoing on-site examination, OFHEO monitors and verifies compliance.

In this way OFHEO can assure the integrity and consistency of the stress tests across both Enterprises, and the results would be consistent with the actual risks taken by the Enterprises. As it should be, the onus of computing and maintaining the appropriate amount of capital would be on the Enterprise, with that appropriate amount defined by the regulation.

This would facilitate the regulation's implementation for the current business lines as well as future innovation and change.

2. INCLUSION OF CREDIT DERIVATIVES

It appears that OFHEO intended to include credit derivatives in NPR 2. "Increasingly, credit risk can also be hedged in financial markets. Freddie Mac's 1998 MODERNS transaction effectively transferred a portion of credit risk on its 1996 mortgage purchases to investors in new securities. Further development of the credit derivatives market may provide additional opportunities for transferring credit risk in the future." 64 Fed. Reg. at 18114. Following up on this comment, we believe it appropriate and beneficial to use credit derivatives to reduce and diversify credit risk generally. Indeed, federal bank regulators, among others, have recognized credit derivatives as effective tools to mitigate risk.

We disagree with the comments that credit derivatives should be excluded from consideration at this time by OFHEO. Insurance companies have utilized credit derivatives to manage catastrophe risk, selling a portion of this risk into the capital markets. They also have been used by other financial institutions to sell credit risk. It would be burdensome to eliminate a market which already has been utilized by Freddie Mac and others, and which is available to the GSEs to complement other risk management techniques. Simply put, this would reduce their flexibility to manage risk.

Yours truly,

[Signed: William C. Oliva]

William C. Oliva
Managing Director