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July 26, 2006

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

Re: RIN 2550-AA35 (Risk-Based Capital Regulation Amendment)

Dear Mr. Pollard:

Fannie Mae appreciates this opportunity to provide the Office of Federal Housing Enterprise Oversight ("OFHEO") with our comments on the agency's recently proposed amendments to Appendix A of Subpart B of 12 CFR Part 1750 concerning risk-based capital requirements. *See* 71 *Fed. Reg.* 36231 (June 26, 2006). According to the preamble to the proposal, the overall intent of the amendments is "to enhance the accuracy and transparency of the calculation of the risk-based capital requirement for the Enterprises and [to update] the Risk-Based Capital Regulation to incorporate approved new activities treatments." *Id.* More specifically, the amendments, which are technical in nature, would (a) incorporate additional interest rate indices for floating rate instruments; (b) clarify existing definitions; (c) incorporate into the risk-based capital ("RBC") regulation certain OFHEO-approved new activity treatments that are not included in the current rule; and (d) apply current treatment consistently to all mark-to-market accounting standards.

Fannie Mae supports the proposed amendments to the RBC standard, which for the most part represent a regulatory codification of current practices. Changes in business practices, accounting standards and capital markets will likely require continued periodic updates to the regulation to maintain its goal--which Fannie Mae shares--of closely tying capital to risk.

Fannie Mae has no specific comments to make regarding the revisions relating to indices and definitions covered under (a) and (b) above, respectively. In our view, however, the proposed proxy treatments covered under (c) and the mark-to-market amendments covered under (d) should be modified slightly to improve the overall transparency and accuracy of the RBC regulation.

As discussed below, we are of the general view that proxy treatments should be evaluated with respect to accuracy, completeness and operational complexity before they are hard-wired into regulation. We believe the current approved treatments for split-rate adjustable rate mortgage (“ARM”) loans and reverse mortgage loans are insufficiently robust with regard to accuracy, and those for CPI-linked floating rate instruments with respect to completeness, to merit incorporation into the formal rule. Additionally, with regard to the mark-to-market changes, we believe that some clarifying language concerning cost basis estimation should be added to the text of the provision detailing uniform treatment of Applicable Fair Value Standards (“AFVS”). Our detailed comments follow.

New Activity Proxy Treatments

Although Fannie Mae believes OFHEO has appropriately incorporated all of the proposed new activity proxy treatments into the current RBC calculation (and provided concurrent public disclosure), we do not believe that all of these treatments necessarily merit formal incorporation into the rule. In general, Fannie Mae proposes that OFHEO examine three evaluation criteria when deciding whether to move an approved new activity treatment into the rule – accuracy, completeness, and operational complexity.

1) Accuracy: Most new activity treatments represent OFHEO-approved methods for the approximation of instruments’ contractual terms. For example, the approved treatment for split-rate ARM loans has been made necessary because the RBC model does not now possess the functionality to generate cash flows per the contractual terms. Pursuant to the proxy, the fixed-amortization feature is ignored and the mortgage is depicted for RBC purposes as a standard ARM product instead. While appropriately conservative for stress test modeling purposes, the resulting amortized principal cash flows are not accurate.

Rather than formally codify this imprecision, we recommend that only new activity treatments providing highly accurate (as opposed to conservative) approximation of actual cash flows should be considered for technical amendment status. By this criterion, we believe that both the split-rate ARM loan and reverse mortgage amendments should not be adopted in the final regulation.

2) Completeness: The new activity criterion of completeness refers to the robustness of the proposed technical amendment regarding its ability to accommodate and anticipate transactions highly similar to the specific approved new activity proxy treatment. Fannie Mae believes the proposed technical amendment for CPI-linked floating-rate instruments does not meet this test. We recommend that the amendment should instead address the broader issue of floating-rate instruments which rely upon floating-rate indices not currently available in the RBC model where the exposure to the floating-rate index is offset via a swap transaction. In such cases, the proposed amendment should allow for stress test simulation of the net synthetic position as the economic equivalent. OFHEO could use the new activity approval process to identify which type of floating-rate instruments qualify for this rule-based modeling option. We believe this approach would not only promote transparency and accuracy, but also offer the best means of keeping the published rule current as well.

3) Operational complexity: Finally, though less applicable to the currently proposed amendments, operational complexity needs to be considered in the rulemaking decision. Some proxy treatments may be highly accurate but extremely difficult to assemble using current model and data functionality. Similar to the accuracy concerns stated above, formal incorporation of overly complex new activity treatments into the rule would likely inhibit efforts to develop less cumbersome solutions.

Mark-to-Market Treatment

Finally, to promote transparency for all interested parties, Fannie Mae recommends inclusion of the following clarifying language--denoted in italics--in proposed section 3.10.3.6.2[a].1.b.(1) of Appendix A to Subpart B of 12 CFR Part 1750 detailing uniform treatment for AVFS.

“(1) If absent the adoption of the AFVS, the affected transactions would have been accounted for on an historical cost basis, they are rebooked and presented as if they had always been accounted for on an historical cost basis. (The historical cost basis may include amortization from the time of the activity to the beginning of the stress test). *Recognizing that construction of exact hypothetical cost basis information is not possible for certain activities, the Enterprise is permitted to estimate the cost basis when rebooking the AFVS.*”

This clarification is made necessary by the fact that the implementation of the AFVS may have obviated the need to otherwise maintain historical cost basis information.

Thank you. We hope that you will give our comments your serious consideration.

Sincerely,



Peter Niculescu
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