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July 26, 2006

By Electronic Mail and Courier

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2550-AA35
Office of Federal Housing Enterprise Oversight
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: Risk-Based Capital Regulation Amendment

Dear Mr. Pollard:

Freddie Mac respectfully submits these comments concerning the technical amendments proposed by the Office of Federal Housing Enterprise Oversight ("OFHEO") that were published in the Federal Register on June 26, 2006.[1] The proposed technical amendments (the "Proposed Amendments") would modify Appendix A to Subpart B of 12 CFR Part 1750 (the "Risk-Based Capital Regulation").

The Proposed Amendments are meant to enhance the accuracy and transparency of the calculation of risk-based capital requirements and to update the Risk-Based Capital Regulation to incorporate approved new activity treatments.[2] Specifically, the Proposed Amendments would incorporate new interest rate indices, clarify various definitions included in the Risk-Based Capital Regulation, and codify new activity treatments for reverse mortgages and split-rate ARM loans, futures and options on futures, swaptions, consumer price index coupon linked instruments and pre-funded tax-exempt municipal bonds. In addition, the Proposed Amendments would codify procedures to update the treatment of applicable fair value standards ("AFVS") accounting in the risk-based capital stress test.

Freddie Mac supports OFHEO's efforts to clarify the Risk-Based Capital Regulation and to codify current practices. We have previously expressed our view that the Risk-Based Capital Regulation should (i) be consistent with the requirements of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992; (ii) appropriately tie capital to risk; (iii) be operationally workable; and (iv) accommodate innovation.[3] Periodic clarifications and codifications of practices further these fundamental principles.

With respect to proposed new indices, revised definitions, and codification of treatments for split-rate ARM loans, swaptions, consumer price index coupon linked instruments and pre-funded tax-exempt municipal bonds, Freddie Mac recommends that the Proposed Amendments be adopted as proposed. However, Freddie Mac believes that the proposed update to the treatment of AFVS accounting requires

[1] 71 Fed. Reg. 36231 (June 26, 2006).
[2] *Id.* pp. 36232-33.
[3] *See,* Comment of Freddie Mac on the April 13, 1999 Notice of Proposed Rulemaking on Risk-Based Capital of the Office of Federal Housing Enterprise Oversight pp. 2-3 (March 10, 2000).

additional clarification. In addition, Freddie Mac believes that the scope of the proposed codification of a treatment for futures and options on futures should be narrowed, and the proposed codification of a treatment for reverse mortgages should be deferred pending further study of this issue. Freddie Mac's specific comments relating to these items are set forth below.

Comments

1. Update of Fair Value Treatment

The Proposed Amendments would modify Section 3.10.3.6.2[a] of the Risk-Based Capital Regulation to codify the current practice of reversing the GAAP impact of non-cash accounting valuations based on AFVS in calculating the stress test starting balance sheet.[4] Freddie Mac agrees that valuation amounts under AFVS should be reversed in calculating the starting position because the stress test methodology is designed to generate risk-based capital balance sheets based on the contractual cashflows of instruments given the specific stress test conditions realized in the simulation. However, Freddie Mac believes it is necessary to modify the language of the Proposed Amendments to clarify that only incremental fair value amounts (often referred to as "marked-to-market" or "marked" amounts) are covered by the proposed treatment. It is not necessary to reverse GAAP impacts related to a given AFVS that are not marked amounts to apply the stress test. Using current GAAP whenever possible is already consistent with the stress test design.[5]

For example, under FAS 115 provisions applicable to available-for-sale and trading assets, incremental fair value amounts would be reversed by the treatment specified in the Proposed Amendments and amortized balances (*e.g.,* outstanding UPB and remaining unamortized balances of discounts and premiums) would be used as starting stress test balances.[6]

Similarly, the fair value amounts for the guarantee asset and guarantee obligation required by FAS 140 and FIN 45 would be reversed because the underlying instruments are incorporated through the modeling of mortgage related cash flows in the stress test simulation. With respect to these instruments, the treatment specified in the Proposed Amendments would be consistent with OFHEO's current practice.

In contrast, mortgage-related discounts and premiums, when subject to a FAS 140 event, flow directly to income at the time of the original transaction under GAAP. Accordingly, it would not be necessary or appropriate to reverse the FAS 140 impact on these amounts to apply the stress test.[7] Freddie Mac's revision to the language of the Proposed Amendments would clarify that this FAS 140 impact should not be reversed.

[4] The starting position balance sheet is the Enterprise's balance sheet at the beginning of the 10-year stress period.
[5] See 66 Federal Regulation 47730, 47737 (Sep. 13, 2001) ("To the extent possible, the stress test makes use of Generally Accepted Accounting Principles. However, the stress test does not reflect certain securities and derivatives at their fair value, as required by the Financial Accounting Standards Board's Statement of Financial Accounts Standard (FAS) Nos. 115 and 133.").
[6] These amortized balances are similar to "held-for-maturity assets" as defined in FAS 115 (paragraph 7).
[7] Another example is cash paid or received for buy-ups and buy-downs under FIN 45. The unmarked cash balances are booked and amortized. Therefore, they need not be reversed because they can be amortized in the stress test.

In order to further reduce any ambiguity concerning the scope of the updated AFVS treatment, Freddie Mac believes that it also would be desirable to remove the term "rebook" from the Proposed Amendments and to replace the term "historical cost basis" with "amortized cost basis." The use of "rebook" and "historical cost basis" without additional explanation could suggest that all effects of covered GAAP pronouncements be reversed. Thus, it would be possible to interpret the use of "rebook" and "historical cost basis" as necessarily requiring the Enterprises return to a pre-AFVS state, rather than simply requiring that they reverse the valuation impact and record amortized costs, while following current GAAP otherwise. We do not believe returning to a pre-AFVS state is the intention of the updated fair value treatment outlined in the Proposed Amendments.

Freddie Mac recommends that OFHEO clarify the updated treatment of AFVS by revising proposed Section 3.10.3.6.2[a] as follows (additions are designated with boldface type and deletions are designated with strike-through type):

1. Fair Values

a. The valuation impact of any Applicable Fair Value Standards (AFVS), cumulative from their time of implementation, will be reversed out of the starting position data, by debiting any accumulated credits, and crediting any accumulated debits.

(1) AFVS are defined as GAAP pronouncements that require **or allow fair value measurements** ~~recognition of periodic changes in fair value~~, e.g., EITF 99-20, FAS 65, FAS 87, FAS 115, FAS 133, FAS 140, FAS 149 and FIN 45. **Valuation impacts of AFVS pertain only to amounts that are measured at fair value and not to other amounts that are included in AFVS but are not measured at fair value**.

(2) The GAAP pronouncements covered by this treatment are subject to OFHEO review. The Enterprises will submit a list of standards and pronouncements which are being reversed in the RBC Reports.

b. After reversing the valuation impact of AFVS, any affected activities are ~~rebooked~~ **presented** as follows:

(1) If absent the adoption of the AFVS, the affected transactions **measured at fair value** would have been accounted for on an ~~historical~~ **amortized** cost basis, they are ~~rebooked and~~ presented as if they had always been accounted for on an ~~historical~~ **amortized** cost basis. ~~(The historical cost basis may include amortization form the time of the activity to the beginning of the stress test.)~~ **Amounts not measured at fair value are represented as specified by GAAP and are presented using current GAAP rules.**

(2) To the extent that transactions would not have been accounted for on an ~~historical~~ **amortized** cost basis, they are accounted for as if they were income and expense activities.

2. Futures and Options on Futures

The Proposed Amendments would modify Section 3.8.3.6.2(d) of the Risk-Based Capital Regulation to include a treatment applicable generally for futures and options on futures. While Freddie Mac agrees that the proposed treatment should be adopted for futures, we do not believe that it is appropriate for all options on futures. This is because the proposed treatment does not take into account strike prices, thereby potentially over-estimating cash settlement amounts at option maturity dates.

A better approach for modeling options on futures would be a cash settlement methodology that calculates the difference between the futures price at the option maturity and the strike price of the option. Such an approach would result in a more accurate calculation than the methodology specified in the Proposed Amendments. Referencing a strike price in the settlement calculation would permit more accurate representation of forecasted cash settlement amounts and better tie capital to risk.

Because the proposed treatment for options on futures may not be accurate or appropriate for all options on futures, Freddie Mac recommends that the proposed treatment be limited to futures. After a more accurate methodology is developed and tested, the proposed treatment could be enhanced and amended to address options on futures.

3. Reverse Mortgages

The Proposed Amendments would add Section 3.6.3.3.1[c] 7 to the Risk-Based Capital Regulation to provide a capital treatment for reverse mortgages. Freddie Mac does not currently purchase or guarantee this type of mortgage. However, we note that the proposed treatment appears operationally complex, involving reporting mortgage information in the non-mortgage instrument data and requiring the creation of "proxy securities" to model reverse mortgage cash flows. In addition, this proposed treatment may not accurately tie capital to risk in terms of projecting proper cash flows for different reverse mortgage programs.

Freddie Mac recommends that OFHEO not codify at this time the proposed treatment for reverse mortgages in consideration of the complexity of the treatment and potential inaccuracies. In the event that Freddie Mac commences purchasing or guaranteeing reverse mortgages, we may suggest an alternate new activities treatment, as is contemplated by section 3.11 of the Risk-Based Capital Regulation.

* * *

Thank you for providing us with the opportunity to comment on the Proposed Amendments. Please let us know if there is any additional information you might need as you consider our comments and determine the final form of changes to the Risk-Based Capital Regulation.

Sincerely,

Joseph E. Amato
Vice President – Capital Management