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Freddie
Mac

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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Reference: Comment letter regarding SPE Consolidation

Dear Ms. Bielstein:

The Federal Home Loan Mortgage Corporation (Freddie Mac) appreciates the opportunity to comment to the Financial Accounting Standards Board on its Exposure Draft (ED) of the Proposed Interpretation of ARB No. 51, titled *Consolidation of Certain Special-Purpose Entities*. Freddie Mac supports the FASB's effort to improve the financial reporting of enterprises using special purpose entities (SPEs) by clarifying the situations where the consolidation of the assets, liabilities, and the results of operations of an SPE are appropriate. Moreover, Freddie Mac agrees with the FASB that SPEs which effectively disperse risks, such as those typically used in the securitization of financial assets, should not be consolidated unless a single party holds an interest or combination of interests that effectively recombines the risk. However, in order to achieve its stated goals, we request the FASB consider clarifying and revising certain portions of the ED to ensure that financial securitizations that effectively disperse risks do not result in consolidation by one of the parties to the securitization. In addition, we oppose requiring consolidation based on a significant variable interest that is more than the variable interests held by any other entity, and instead suggest holding a majority of the interest, with some qualitative considerations, serve as the presumption for consolidation. The remainder of our comment is organized as follows. Section 1 provides background on

our guaranteed mortgage securitization business. Section 2 discusses portions of the ED we request the FASB clarify. Section 3 concludes with general comments on the presumptive consolidation guidance.

1. Freddie Mac's Guaranteed Mortgage Securitization Business

Under Freddie Mac's Guarantor program, mortgage seller/servicers transfer mortgages to Freddie Mac in exchange for Freddie Mac Participation Certificates (PCs). Freddie Mac PCs represent beneficial ownership in the principal and interest of the underlying mortgages, payment of which is guaranteed by Freddie Mac. In exchange for providing a guarantee, Freddie Mac is paid a monthly guarantee fee from the cash flows of the underlying mortgages. In addition, a monthly fee for servicing is paid to service the mortgages, typically, though not necessarily, to the same party that transferred the mortgages. Under SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the mortgage seller/servicer is considered the transferor in the transaction. In SFAS 140 Freddie Mac and the servicer are referred to as outside beneficial interests or in the terminology of the ED, "variable interest holders". Since the PC meets the criteria for being a QSPE, the mortgage seller/servicer, as transferor, is not required to consolidate the securitization vehicle as SFAS 140 QSPEs are not consolidated. The guaranteed mortgage securitization is a prime example of the type of securitization that effectively disperses risks in the underlying assets to multiple parties and, thus, should not require consolidation, as long as the risks remain dispersed.

Mortgages	G-Fee
PC's	Guarantee

2. Sections For Clarification

Paragraph 22 of the ED specifies variable interests in two categories of SPEs that hold financial assets shall be evaluated according to the provisions of paragraph 23. Paragraph 23 requires a variable interest holder meeting two of the three following conditions to follow guidance in (b) and (c) of paragraph 13 to determine whether consolidation is appropriate:

- a. It has the authority to purchase and sell assets for the SPE and has sufficient discretion in exercising that authority to significantly affect the revenues, expenses, gains, and losses of the SPE.
- b. It provides a guarantee, a back-up lending arrangement, or other form of liquidity, credit, or asset support that is subordinate to the interests of other parties.

c. It receives a fee that is not market based. (Refer to paragraph 19.)

Two sections of paragraph 23 require further clarification.

Paragraph 23.a

First, we are unclear on how to apply 23.a to guaranteed mortgage securitizations. In guaranteed mortgage securitizations, the guarantor agrees to guarantee the principal and interest payments on mortgages satisfying the guarantor's underwriting policy. Furthermore, when mortgages in these securitizations default, the guarantor typically purchases them from the SPE. Does the "authority to purchase" apply to the guarantor's credit decision on which loans to guarantee at the inception of the securitization? If so, the subsequent purchase of defaulted mortgages from the SPE would cause guarantors to answer yes to 23.a's "purchase and sell" conjunction. Second, the terms "sufficient discretion" and "significantly affect" are not clearly defined. Again, are the credit decision and purchasing of defaulted mortgages the exercise of "sufficient discretion" that "significantly affects" the revenues, expenses, gains, and losses of the SPE? We strongly believe the guarantor's decision about which loans to guarantee does not constitute "purchase" discretion. More clarity on the meaning and intent of the terms used in this section would be useful.

Paragraph 23.c

Paragraph 23.c refers to paragraph 19 for a discussion of the concept of a fee that is not market based. The last sentence of paragraph 19 presents the notion that a fee is not considered market based unless it can be demonstrated to be comparable to fees in similar observable arm's lengths transactions. We disagree with this notion and would like a better understanding of why a fee negotiated by two parties in arm's lengths transaction requires evidence from other market transactions before it can be concluded to be "market based."

3. Presumptive Consolidation Guidance and Conclusion

We understand the ED's rational in presuming SPEs are "controlled" and hence consolidated by the largest variable interest. On the other hand, we believe the largest variable interest concept places SPEs on a different footing than non-SPEs and we feel the notion of "control" and the presumptions that apply to corporations should also be relevant in assessing control of an SPE. With that said, we believe control should, absent other qualitative factors, be presumed based on ownership of a majority of the variable interests and "majority" should be clearly defined.

We thank the FASB for the opportunity to comment on this Exposure Draft. Freddie Mac agrees that SPEs which effectively disperse risks should not be consolidated and the

clarification of certain issues in the ED would achieve FASB's objectives. These issues are of extreme importance to Freddie Mac and we would be happy to discuss them with the FASB or its staff at their convenience.

Sincerely,

Ed Sannini
Senior Vice President, Corporate Controller