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LETTER OF COMMENT NO. \mathcal{A}

September 21, 2007

Mr. Russell G. Golden
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via e-mail to director a fash org

Reference: Proposed Statement 133 Implementation Issue, Hedging – General: Issues Involving the Application of the Shortcut Method under Paragraph 68 (File Reference: Proposed Issue E23)

Dear Mr. Golden:

Freddie Mac appreciates the opportunity to comment on the proposed Statement 133 Implementation Issue, *Hedging - General: Issues Involving the Application of the* Shortcut Method *under Paragraph 68* (the "proposed Issue E23").

Freddie Mac is a publicly held company charted by Congress in 1970 to increase the availability of funds for home ownership by developing and maintaining a secondary market for residential mortgages. We participate in the secondary mortgage market principally by providing our credit guarantee on the mortgage-related securities we issue, and investing in mortgages and mortgage-related securities. At June 30, 2007, Freddie Mac owned or guaranteed approximately \$1.6 trillion of mortgages and mortgage-related securities.

We fully support the efforts of the FASB to clarify the accounting requirements relative to the application of paragraph 68 of Statement 133 (i.e., the shortcut method). However, we have concerns about some of the proposed changes. Specifically we have comments on the scope of paragraph 68(a) and the interaction between paragraph 7 of proposed Issue E23 and the transition provisions.



Scope of Paragraph 68(a)

Paragraph 2 of proposed Issue E23 states (in part) that the criterion in paragraph 68(a) of Statement 133 is met if the notional amount of the swap and principal amount of the asset (or liability) match for each hedged period for a cash flow hedge, or over the entire term for a fair value hedge. The Basis For Conclusions expands on this notion and states that a swap with a notional amount that changes at each settlement to match the principal of the hedged item complies with paragraph 68(a) of Statement 133 regardless of whether the changes in notional amounts are triggered by unscheduled prepayments or contractually scheduled principal amortization.

When the swap and the hedged item both contain scheduled amortization that exactly matches, we agree that the criterion in paragraph 68(a) of Statement 133 has been met. However, our conclusion is that the criterion in paragraph 68(a) is not met when the amortization is triggered by unscheduled prepayments.

When the notional amount of a swap amortizes based on an external factor, such as the declining notional of a hedged item due to unscheduled prepayments, we do not believe that such a swap should be considered in compliance with paragraph 68(a) of Statement 133. This type of swap is commonly referred to as a balance guaranty swap. With balance guaranty swaps, amortization is not scheduled, nor is the amortization determined independently or by reference to an index. The amortization is explicitly linked to an amortizing asset or liability, which is often the hedged item. A balance guaranty swap is effectively a compound derivative comprised of an interest rate swap with an embedded knock-out option.

The Basis for Conclusions references an example that involves unscheduled prepayments. A typical example of this type of arrangement would involve a mortgage-backed security ("MBS") and a balance guaranty swap. The amortization of an MBS is based on the actual cash flows of the mortgage loans that underlie the pool, and these cash flows are passed through to the holder of the MBS. As a result, there is no defined amortization schedule for an MBS, and the borrowers for the loans underlying the pool effectively have an embedded prepayment option in their loan. The amortization of the notional amount of the balance guaranty swap is linked to the amortization of the MBS, so the swap notional amortization cannot be independently determined. Given this linkage, we do not understand how such an arrangement can meet the criterion in paragraph 68(a) of Statement 133.

Further, the embedded prepayment option in the MBS is not the same option as the knock-out option embedded in the swap, and these options will be valued differently.

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Given that the knock-out option is not a typical feature in an interest rate swap and a knock-out option would invalidate the assumption of no ineffectiveness, we do not believe this arrangement would meet the criterion in paragraph 68(e) of Statement 133 (as clarified in paragraph 4 of this proposed Issue E23). Consequently, we believe that discussion in the Basis For Conclusions in the proposed Issue E23 stating that a balance guaranty swap could meet the criterion in paragraph 68(a) of Statement 133 is inconsistent with the criteria in paragraph 68(e) of Statement 133.

Because a balance guaranty swap contains a knock-out option that does not exist in the MBS, and because a balance guaranty swap does not meet the criterion in paragraph 68(s) of Statement 133, we believe the Board should amend the discussion of balance guaranty swaps in the Basis For Conclusions to conclude they do not meet the criteria in paragraph 68 of Statement 133.

Interaction Between Paragraph 7 of Proposed Issue E23 and the Transition Provisions

The transition provisions of proposed Issue E23 permits an entity to assess its existing relationships to which it applied shortcut method to determine whether or not it must dedesignate prospectively based on this proposal. However, we are having a difficult time reconciling this transition provision to the guidance in paragraph 7. We agree with the conclusion reached in paragraph 7 about zero-coupon instruments not meeting 68(e). However, it is our understanding that the FASB staff has long held this view, and has historically addressed this issue consistent with the conclusion in paragraph 7. Additionally, the SEC staff cites zero-coupon bonds as an example of instruments that do not qualify for the shortcut method in their speeches and presentations. In fact, the SEC has required several companies to restate for inappropriate use of the shortcut method for hedges of zero-coupon debt instruments. Therefore, the transition provisions in the proposed Issue E23 appear to be inequitable in that it allows entities that have not yet identified the misapplication of the shortcut method to hedges of zero-coupon debt instruments to re-designate the hedge relationship and assess effectiveness using the long haul method.

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Freddie Mac appreciates the opportunity to provide our comments on proposed Issue E23. If you have any questions about our comments, please contact James Egan (703-903-3410), Denny Fox (703-714-3160) or Timothy Kviz (703-714-3800).

Sincerely,

James R. Egan

Senior Vice President - Corporate Controller

cc: Anthony Piszel

Executive Vice President and Chief Financial Officer