



We make home possible™



LETTER OF COMMENT NO.

337

April 1, 2009

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@fasb.org

Reference: Proposed FSP FAS 157-e, Determining Whether a Market Is Not Active and a Transaction Is Not Distressed

Dear Mr. Golden:

Freddie Mac appreciates the opportunity to comment on the proposed FASB Staff Position FAS 157-e, *Determining Whether a Market is Not Active and a Transaction Is Not Distressed* (the "proposed FSP").

Freddie Mac was chartered by Congress in 1970 to stabilize the nation's residential mortgage markets and expand opportunities for homeownership and affordable rental housing. We hold a significant amount of financial assets and liabilities that would be impacted by the proposed FSP.

We understand that the Board has received many requests to provide clarity and additional guidance regarding the application of FASB Statement No. 157, *Fair Value Measurements* ("Statement 157"), as a result of valuation issues in the marketplace. We believe that the guidance provided in FASB Staff Position FAS 157-3: *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* ("FSP 157-3") was helpful in providing clarification in guidance for pricing in inactive markets that include distressed sales. We are concerned that the guidance in the proposed FSP presents a similar approach that is more rule-based which will result in more confusion rather than provide clarity related to the guidance in Statement 157 and FSP FAS 157-3. We believe that Statement 157 and FSP FAS 157-3 adequately address valuation issues in inactive markets using Statement 157's exit price concept.

The valuation issue that currently exists in the marketplace and that has caused financial institutions to face capital adequacy issues is that the exit prices using observable market inputs and assumptions significantly deviate from the intrinsic values that incorporate expected credit losses. For example, there are numerous securities in the marketplace that have significant subordination and are credit insured by entities with sufficient capital to perform under their guarantees that are trading at considerable discounts to their par amounts. We believe that this valuation issue is appropriately addressed in the proposed FASB Staff Position FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments* (“proposed FSP 115”). Proposed FSP 115 permits an entity to present changes in value attributable to credit in current period earnings with changes in value attributable to all other factors in value reflected in other comprehensive income assuming the entity does not have the intent to sell the security or it is more likely than not that it will not have to sell the security before recovery of its cost basis. By segregating the valuation components and presenting them separately, financial statement users can gain insights into the attribution of pricing.

We do not believe the proposed FSP would address the valuation issue noted above with the same level of effectiveness. In our view, the proposed FSP does not provide any additional guidance beyond that already provided in Statement 157 and FSP FAS 157-3. In fact, the proposed FSP creates additional steps that entities must now address by *analyzing specific criteria, concluding on that criteria, and addressing how the results were handled*. However, despite these additional steps, we believe a price produced in compliance with the proposed FSP would be the same as the price produced by applying Statement 157 and FSP FAS 157-3.

FSP FAS 157-3 provides useful guidance for applying the concepts of Statement 157 by stating that the use of a cash flow approach, utilizing an appropriately risk-adjusted discount rate, is acceptable when relevant observable inputs are not available. This guidance permits entities to exercise judgment in determining whether a market is active and whether a quoted price is the result of a distressed sale and, if so, the appropriate approaches to take in pricing in illiquid markets. However, the guidance contained in the proposed FSP, including the proposed two-step approach it requires, appears to eliminate much of the judgment previously permitted under FSP FAS 157-3 and contains more onerous criteria that effectively requires an entity to prove that it is not using a distressed price.

Specifically, the proposed FSP details a two-step process whereby (i) a market is identified as inactive and (ii) a quoted price is determined to be the result of a distressed sale. If both criteria are met, an entity cannot use the quoted price because it is deemed to be the result of a distressed sale in an inactive market. In these instances, an entity must use an alternative valuation technique that does not include the quoted distressed price. The alternative valuation technique must include inputs that reflect an orderly transaction between market participants at the measurement date. As discussed below, we believe the basic fundamentals of this analysis were provided by Statement 157 and reinforced in FSP 157-3 without laying out specific criteria but rather by permitting entities to exercise judgment.

Paragraph 5 of Statement 157 defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. Paragraph 7 of Statement 157 further defines an orderly transaction as one “that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale)”. Our pricing services and those utilized by our pricing providers have historically been designed to identify distressed sales that occur in the marketplace and to exclude those amounts as inputs when determining prices. We believe that this methodology is being repeated in the proposed FSP when the concept has existed since the initial adoption of Statement 157.

We are also concerned that the proposed FSP will be interpreted as recommending a deviation from the exit price concept as originally prescribed in Statement 157 as detailed above. We do not believe that this was the intention of the Board. However, we wanted to bring to the Board’s attention the vagueness of the language in the proposed FSP as it now stands. We believe the confusion is the result of several different statements in the proposed FSP. Specifically, paragraph 15 of the proposed FSP states that if the two criteria in paragraph 13 are met, an entity must use an alternative valuation technique other than the one that uses the quoted price deemed to be a distressed sale. The guidance goes on to suggest an income approach utilizing a present value technique. In those instances, the inputs should reflect an orderly transaction between market participants at the measurement date.

Additionally, the examples detailed in paragraphs A32A – A32G provide some guidance into the determination of a discount rate that would be used in an alternative valuation methodology using a cash flow approach. The issue is that the discount rates inferred from (2) and (3) of paragraph A32E related to credit spreads, liquidity and nonperformance risks are completely subjective when trying to determine what willing buyers and willing sellers would consider based on an orderly transaction based on market conditions. A discount rate other than one based on the current market, regardless of the activity or liquidity of that current market, would imply that a price derived would not be considered a market price. However, the use of current market discount rates will result in a value that is similar to a price that was determined to be the result of a distressed trade in an inactive market as defined in paragraph 13.

The confusion is also compounded by the alternative views expressed by certain Board members in regards to the proposed FSP 115 who stated that they believed that the application of the guidance in the proposed FSP would result in “a market participant’s view as to the ultimate cash flows to be collected from a fixed income debt security and, thus, provide a reasonable estimate of the current value of the impaired item”. This implies that at least some Board members believe the proposed FSP is potentially recommending something other than an exit price approach.

In conclusion, we do not see a need for the Board to issue the proposed FSP. If the Board were to proceed with the issuance of the proposed FSP, we would recommend that there is a clarification regarding the exit price concept detailed in Statement 157 and the language in the proposed FSP as highlighted above. Additionally, if the Board were to issue the proposed FSP, we recommend the effective date be extended to interim periods or fiscal years ending after June 15, 2009 with early adoption permitted. Although we believe the guidance would not result in any meaningful changes to existing processes, entities would need time to reach those conclusions based on the final guidance that would not be available until after most have executed their pricing and related financial statement close processes shortly after March 31, 2009.

The views expressed in this comment letter are solely those of Freddie Mac, and do not purport to represent the views of the Federal Housing Finance Agency.

Freddie Mac appreciates the opportunity to provide comments on the proposed FSP. If you have any questions about our comments, please contact Denny Fox, Freddie Mac Acting Principal Accounting Officer & Vice President - Accounting Policy & External Reporting.

Sincerely,

A handwritten signature in black ink, appearing to read "Denny R. Fox". The signature is stylized and cursive.

Denny R. Fox
Freddie Mac
Vice President Accounting Policy and
External Reporting and Acting Principal
Accounting Officer

cc: Mr. David B. Kellermann, Senior Vice President and Acting Chief Financial
Officer
Ms. Wanda DeLeo, Federal Housing Finance Agency