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August 15, 2008



LETTER OF COMMENT NO. 86

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

Via email to director@fasb.org

Reference: File Reference No. 1590-100, Statement of Financial Accounting Standards, Accounting for Hedging Activities, an amendment of FASB Statement No. 133

Dear Mr. Golden:

Freddie Mac appreciates the opportunity to comment on the proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities, an amendment of FASB Statement No. 133 (the "Proposed Standard").

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 are a significant user of derivative instruments in managing our risk profile. At June 30, 2008, our derivative portfolio had a notional balance in excess of \$1 trillion.

Freddie Mac fully supports the efforts of the FASB to address the differences between the accounting for derivative instruments and the accounting for the hedged item by simplifying hedge accounting and resolving some of the major practice issues related to hedge accounting that have arisen under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, as Amended ("Statement 133"). However, we urge the FASB Board to reconsider the provisions of the Proposed Standard that would eliminate individual risk hedging, except in certain circumstances and prohibit de-designation of hedge relationships. Further, we believe that the Proposed Standard should be converged with the proposed changes to hedge accounting in International Financial Reporting Standards ("IFRS").

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The remainder of this letter includes our responses to the questions included in the Exposure Draft's Notice for Recipients, as well as other comments on the Exposure Draft.

Issue 1 - Elimination of the Ability to Designate Individual Risks as the Hedged Risk

Paragraph A16 of the Proposed Standard details the FASB Board's views on eliminating the ability of entities to designate individual risks as the hedged risk when pursuing hedge accounting. Specifically, the Board states its belief in the importance of reflecting unhedged risks in the financial statements to provide users with a more complete picture of an entity's financial position.

We believe that the elimination of benchmark interest rate hedging is inconsistent with the risk management process typically utilized by entities in executing hedging strategies, including those strategies classified as both fair value and cash flow hedges. Companies, including Freddie Mac, frequently hedge changes in value attributable to individual risks. For example, interest rate swaps are used to hedge changes in fair value or cash flows of financial instruments related to movements in interest rates. There are other components of fair value changes that may not be hedged, either intentionally because the company does not wish to hedge the component (i.e., mortgage-to-debt spreads), or because there are not derivatives available to hedge those components (i.e., credit spreads). As a result, it would appear inappropriate for the income statement to reflect changes in fair value related to a risk that was not hedged or may be impossible to hedge, and we do not believe that this will improve the ability for investors to understand all risks by requiring the entire change in fair value to be the hedged item.

The primary hedge accounting strategy that Freddie Mac employs is hedging the rollover of short-term discount notes (i.e., 90-day and 180-day zero coupon debt instruments). Under the Proposed Standard, we would be precluded from designating the hedged risk as the benchmark interest rate, but rather, would be required to hedge the full change in fair value. Because the rollover of our short-term discount notes is probable of occurring, there is no substantive economic difference between these debt instruments and a long-term variable rate debt instrument; however, the hedge accounting options available to such instruments would be different under the Proposed Standard. A long-term variable rate debt instrument could qualify for hedging of the interest rate risk component, whereas a hedge of the forecasted issuance or rollover of a short-term debt instrument would not qualify for individual risk hedging. We do not believe there should be a difference in the accounting for economically similar transactions, and do not believe that this difference in accounting results for economically similar transactions is an improvement to financial reporting.

We believe that the elimination of individual risk hedging in most circumstances will significantly increase the operational burdens of employing hedging accounting. To measure ineffectiveness in a cash flow hedge relationship, companies may need to use a hypothetical derivative method, similar to the one described in DIG Issue No. G7: "Cash

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Flow Hedges: Measuring the Ineffectiveness of a Cash Flow Hedge under Paragraph 30(b) When the Shortcut Method is Not Applied" ("DIG G7"); however, the guidance in DIG G7, as well as the guidance in paragraphs 65 and 68, which are oftentimes used as guidance to help develop a hypothetical derivative, have been removed from the Proposed Standard. The lack of guidance on how to determine ineffectiveness will make execution of hedge accounting far more challenging. Additionally, due to the elimination of individual risk hedging for most hedge relationships, it may be impossible to develop a hypothetical derivative to measure ineffectiveness. As noted above, there are risks that are oftentimes not hedged, and derivatives do not exist to hedge most of the unhedged risks in the majority of hedged items (i.e., credit spreads, liquidity premiums, etc.). As a result, the measurement of ineffectiveness will involve derivation of hypothetical instruments that would trade only in hypothetical markets. This introduces significant complexity in the construction of these instruments, the measurement of the changes in fair value of these instruments following the fair value guidance in FASB Statement No. 157, Fair Value Measurements, and disclosing these items in a manner that would provide useful information to investors.

While we understand the Board's view that all risks of the hedged item should be reflected in the financial statements, we do not believe the treatment under the Proposed Standard will result in an improvement in financial reporting. Requiring the full change in fair value to be the hedge risk in most all circumstances will introduce volatility into earnings and capital for risks that are neither hedged, nor represent actual cash flows for the company. Therefore, we believe that eliminating the ability to hedge individual risks will impair the transparency of hedge strategies frequently employed (i.e., benchmark interest rate hedging).

We believe the Proposed Standard is likely to result in fewer companies taking advantage of hedge accounting if they are required to include the full change in fair value of the hedged item in earnings, given the potential for increased income statement volatility and impacts on capital. We believe this is the same reason why few companies have taken advantage of the fair value option permitted by FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("Statement 159"). As a result, we believe the Proposed Standard will reduce the usefulness of financial statements and reduce comparability.

Issue 2 - Continued Ability to Designate Benchmark Rates in Select Circumstances

Consistent with our discussion above, we believe that the Board should continue to permit the hedging of individual risks for all types of hedges, which is consistent with risk management strategies employed by companies in their hedging activities.

Additionally, we disagree with the discussion in paragraph A19 regarding hedging interest rate risk of debt prior to its issuance and the requirement to designate all risks as the hedged risk. In this paragraph, a discussion regarding hedging of a forecasted issuance of debt concludes that the hedge would not result in synthetically creating

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variable-rate debt or fixed-rate debt, but would instead lock in a fixed rate prior to issuance for asset/liability management purposes or risk management purposes. Because the entity is not synthetically creating variable or fixed rate debt, the Board has concluded that it is not appropriate to designate a specific risk as a hedged risk.

We do not believe that this form of hedging should be excluded from individual risk hedging. We view locking in an interest rate prior to the issuance of debt as an interest rate management strategy similar to the creation of synthetic debt and not a general hedge accounting approach that should be excluded from applying a specific risk hedging approach. Due to Statement 133's requirement that the forecasted transaction must be probable of occurring, we do not believe that individual risk hedging should be precluded for forecasted issuances of debt. Further we are not aware of situations where this has been abused in practice, thereby necessitating this change.

We agree with the views expressed in paragraph A58 regarding the ramifications of excluding forecasted issuances of debt and the potential for companies discontinuing this type of hedging to avoid income statement volatility. As a result, we believe that the exception to full fair value hedging should, at a minimum, be expanded to include an entity's hedging of a forecasted issuance of its own debt.

Issue 3 - Elimination of shortcut method and critical term matching

We concur with the Board regarding the elimination of the shortcut method and critical term matching regarding the assumption of no ineffectiveness. We believe that, although the concepts prescribed in these methods are appropriate qualitative assessments for assessments of effectiveness, ineffectiveness amounts should be recognized in the income statement.

Issue 4 - Modification of effectiveness thresholds

We believe the proposed modification of the effectiveness threshold from highly effective to reasonably effective would facilitate the hedge accounting process and simplify the currently complicated process that many companies are required to utilize currently when considering effectiveness. Additionally, we believe that providing entities the ability to assess effectiveness through qualitative measures is a rational approach and will provide benefits from an operational perspective.

The revision of the thresholds would be necessary in light of the proposal to require consideration of the entire change in fair value of certain financial instruments, which would likely cause hedging relationships to be less effective than when effectiveness is assessed by taking into account only the change in fair value attributable to the hedged risk.

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Issue 5 - Inception effectiveness testing

We believe that the proposed amendment to require effectiveness assessments subsequent to inception only when circumstances suggest the relationship may no longer be effective would be a rational approach. Developing a monitoring process to assess current circumstances on an ongoing basis would likely be less burdensome than requiring complete formal assessments on a periodic basis and would seem more logical in its approach. For risk management purposes, entities typically monitor the effectiveness of their hedge relationships.

This proposed amendment alone would likely not reduce the frequency of discontinued hedging relationships; however, when combined with the reduction in the threshold for applying hedge accounting from highly effective to reasonably effective, we believe the number of discontinued hedging relationships resulting from failed effectiveness assessments will decrease. As a result, we support this change.

Issue 6 - Effectiveness testing required when hedging relationship may no longer be reasonably effective

We believe that it is appropriate to continue to require hedge accounting to be discontinued subsequent to a hedge no longer being considered reasonably effective. Allowing hedge accounting in timeframes subsequent to the relationship being determined to no longer be reasonably effective appears to be inconsistent with the objective of hedge accounting. Continual assessment also appears logical given that facts and circumstances change over time and reassessment would be appropriate.

Additionally, maintaining some reassessment requirements is consistent, at least in part, with the elimination of the shortcut and critical terms match provisions.

Issue 7 - Presentation of gains and losses associated with hedging instruments

We believe it would be helpful to amend Statement 133 to allow for the presentation of realized gains and losses on derivatives not in designated hedging relationships in net interest income separate from unrealized gains or losses on the derivatives.

The only guidance that exists for income statement presentation for derivatives not in hedging relationships is from a December 2003 speech by a Professional Accounting Fellow from the Office of the Chief Accountant at the Securities and Exchange Commission. That speech stated that both unrealized and realized gains and losses should be presented together in the same income statement line item. As such, interest income and expense amounts that relate to derivatives that are not formally designated in hedging relationships are required to be presented outside of net interest income and included with all other gains and losses related to the derivatives. It is our understanding that the rationale for the position described in this speech is that separation of realized

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gains and losses from unrealized gains and losses on derivatives in the income statement results in synthetic cash flow hedge accounting, even though the derivative was never designated in a cash flow hedging relationship. We do not agree with this rationale, and we believe it is inconsistent with recording both realized and unrealized gains and losses on the same line of the income statement, which could result in synthetic fair value hedge accounting results on the income statement for derivatives not designated in a fair value hedge accounting relationship.

Statement 133 does not provide any guidance on income statement presentation for derivatives, other than to disclose where the activity is recorded. As a result, we believe that guidance on this issue would be useful, particularly for entities where net interest margin is an important measure.

We believe the more appropriate treatment would be to permit realized gains and losses related to derivatives (i.e., the interest income or interest expense realized from a derivative, such as the current period accrual of an interest rate swap) to be included as a component of net interest margin, regardless of the formal hedging designation of the derivative. Unrealized gains and losses from these derivatives (i.e., the changes in fair value resulting from expected future cash flows from the derivative) should be recorded on a single line outside of net interest margin.

Economically, this treatment would be consistent with the accounting for several other instruments, where interest income or interest expense is realized for accretion of discounts and premiums and yield, including the following:

- Beneficial interests accounted for in accordance with EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that continue to be Held by a Transferor in Securitized financial Assets";
- Amortization of basis adjustments resulting from other-than-temporary impairments recognized in accordance with FASB Staff Position FAS 115-1 and FAS 124-1, The Meaning of other-Than-Temporary Impairment and Its Application to Certain investments;
- Interest recognition separate from the remaining change in fair value for instruments accounted for at fair value under the fair value option election permitted by Statement 159;
- Interest income recognition for investment securities classified as trading securities separate from the remaining change in fair value as prescribed by Rule 9-04.3 of Regulation S-X; and
- Purchased loans within the scope of AICPA Statement of Position 03-3,
 Accounting for Certain Loans or Debt Securities Acquired in a Transfer.

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Additionally, we believe that the ability to record realized gains and losses on derivatives in net interest margin, separate from the unrealized gains and losses on the derivatives, is consistent with the guidance in International Accounting Standard 39, *Financial Instruments: Recognition and Measurement* ("IAS 39").

We believe that permitting interest amounts for all derivatives to be included in net interest margin would better present the true economic net interest margin of a company and would enhance the clarity of the financial statements. To provide our investors with more useful information, we reclassify realized gains and losses on derivatives not designated in hedging relationships to net interest margin in our segment disclosures. This segment presentation reflects how we manage and evaluate the business, and we believe that providing investors with this information enhances the transparency of our financial results. We believe transparency would be further enhanced if realized gains and losses on our derivatives not designated in hedging relationships were also included in net interest margin on our GAAP financial statements.

Issue 8 - Effective Date

We believe that the proposed effective date for financial statements issued for fiscal years beginning after June 15, 2009 provides sufficient time for entities to adjust to the amended hedging requirements.

We believe that early adoption of the provisions of the Proposed Standard, with appropriate disclosure, should be permitted. The Proposed Standard should permit the improvements related to hedge accounting to be realized by firms that are in a position to adopt them prior to the mandatory effective date. We do not believe that comparability of financial statements would be significantly impaired, given that the Proposed Statement relaxes some of the more stringent requirements of hedge accounting, and results in an improved representation of the underlying economics of hedging relationships.

Issue 9 - Transition Disclosures

We agree with the Board's position that there should be no specific transition disclosure requirements. Companies should be free to provide the level of disclosure they believe is appropriate in connection with their transition to the revised accounting standard.

Issue 10 - Fair Value Option Election

We believe that the ability to elect the fair value option for certain financial instruments should be expanded beyond those that were previously designated as a hedged item prior to initial application of this Proposed Standard to include all amounts currently within the scope of Statement 159. Some entities may have decided to not elect hedge accounting due to the complexities involved in its application. We do not believe that entities that

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chose not to elect hedge accounting should be prohibited from electing the fair value option, while those that did chose to elect hedge accounting should be permitted to make a fair value option election. Further, we believe that electing hedge accounting prior to the effective date could circumvent this transition provision, so that companies would be able to take advantage of the fair value option. To avoid such a situation, we believe it would be preferable to simply permit a one-time election of the fair value option for all instruments within the scope of Statement 159 at the transition date of this Proposed Standard.

Issue 11 - Cost/Benefit Considerations

We do not agree with the Board's conclusions regarding the benefits associated with this standard related to reduced complexity and broader application of hedge accounting outweighing the costs associated with implementation.

While it may seem as though costs will be reduced because hedge effectiveness can be measured qualitatively, and the effectiveness threshold has been reduced from highly effective to reasonably effective, we believe the elimination of individual risk hedging and the inability to de-designate hedge relationships will actually increase the cost of hedge accounting. As discussed above, we believe that it will be more difficult to measure ineffectiveness if individual risk hedging cannot be used, and it will be more operationally burdensome and costly to de-designate hedge relationships, particularly in hedges of pools or portfolios of assets or liabilities. Further, we believe that companies will actually change the way they hedge in order to meet the accounting requirements, or will no longer attempt to apply hedge accounting.

The requirements of the Proposed Standard will introduce volatility to both income and capital for companies that attempt to apply hedge accounting, when the very risk management activities these companies are using are designed to reduce volatility in earnings and protect capital. We believe the results of hedge accounting from the application of this Proposed Standard will result in accounting that is not representative of the economics of the risk management activities being employed, and will obscure presentation of the hedging strategies used.

De-designation of Hedge Accounting Relationships

Paragraph 14(b) of the Proposed Standard states that in order for an entity to discontinue prospectively hedge accounting, the hedging instrument must expire, be sold, terminated, or exercised. We believe that entities seeking to de-designate hedging relationships will likely sell an existing derivative and enter into a new derivative with similar terms to maintain the same risk profile. In these instances, entities will incur additional fees associated with these activities in order to achieve an accounting result. We believe that this requirement will introduce unnecessary costs without yielding tangible benefits.

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The ability to de-designate is of particular importance to entities that hedge portfolios of assets or liabilities or engage in dynamic hedging strategies. When hedging portfolios as opposed to individual transactions, frequent re-balancing of the hedge position is often times necessary. By not permitting de-designation, except when derivatives are terminated or paired-off, the cost of hedging and the operational burdens of hedging portfolios will be significantly increased. That rationale for prohibiting de-designation is not clearly explained in either the Proposed Standard or the Basis for Conclusions. Therefore, we would recommend that the Staff consider permitting de-designation consistent with the provisions in Statement 133.

Convergence with International Financial Reporting Standards

The Proposed Standard diverges from the hedge accounting requirements currently contained in IAS 39. We understand that the IASB is currently considering amending the hedge accounting provisions in IAS 39. Although the Proposed Standard strives to contain many of the same concepts that are contemplated in the changes to IAS 39 that are being deliberated, we believe that it is in the best interests of the FASB to work with the IASB to develop a single set of converged hedge accounting principles. We believe this would prove beneficial from a financial statement comparability standpoint, as well as from an operational system perspective, given the impending move of U.S. GAAP to IFRS. We do not believe that a change to the Proposed Standard, followed by a potential change to either a converged hedge accounting standard, or IFRS itself, is useful for investors.

Freddie Mac appreciates the opportunity to provide our comments on the Proposed Standard. If you have any questions about our comments, please contact David Kellermann (703-903-3200), Denny Fox (703-714-3160) or Timothy Kviz (703-714-3800).

Sincerely.

Senior Vice President, Corporate Controller and Principal Accounting Officer

cc: Anthony Piszel

Executive Vice President and Chief Financial Officer