Robert H. Herz, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Freddie Mac’s Comment Letter Related to the FASB’s Exposure Draft

Dear Mr. Herz:

Enclosed please find our letter of comment on the Financial Accounting Standards Board’s (the “Board”) exposure draft Accounting For Transfers of Financial Asset – an amendment of FASB Statement No. 140 (“the Exposure Draft”). Freddie Mac appreciates the opportunity to participate in the due process of the Board and supports its mission to improve standards of financial accounting and reporting for the guidance and education of the public.

As discussed in our comment letter, we have significant concerns with the Exposure Draft. Currently, Freddie Mac does not use separate state law trusts or other legal entities (collectively, special purpose entities (“SPEs”)) to issue any of its mortgage-backed securities (“MBS”). However, proposed requirements established in paragraph 8A of the Exposure Draft would require Freddie Mac to establish SPEs that are qualifying (or “QSPEs”) in order to continue applying sales accounting treatment to certain transfers of its MBS to third parties.

We would like to point out that establishing QSPEs would not, in any way, enhance the legal isolation of mortgage assets that Freddie Mac securitizes based upon Freddie Mac’s statutory regime. As a result, we believe that requiring the use of QSPEs to issue MBS would be inconsistent with the Board’s original intent for QSPEs as expressed in paragraphs 171 through 179 of Statement 140. Additionally, we believe that establishing QSPEs to facilitate transfers would not provide a clearer financial reporting presentation of the economics of our securitization transactions. Further, and more importantly, establishing QSPEs would require Freddie Mac to make significant changes to various aspects of its security issuance processes that correspond to an overall program for which, as of August 2005, approximately $1.2 trillion in mortgage-backed securities were issued (by Freddie Mac) and outstanding. Based upon the significance and operational
complexity of such changes, Freddie Mac believes that it would be difficult to implement the appropriate process changes in a controlled manner any earlier than January 1, 2007. In summary, we believe that the expected costs of the referenced aspects of the Exposure Draft outweigh the intended benefits.

Based upon the foregoing, we would ask the Board to reconsider its proposal. If the Board or the staff would like to discuss any of issues articulated in the attached comment letter, please feel free to contact me, at (703) 903 - 3940, or John Woods, Corporate Controller, at (703) 903 - 3500. We would also be happy to schedule a meeting at your convenience to further explore these issues. Thank you in advance for your consideration.

/s/ Martin F. Baumann
Martin F. Baumann
Executive Vice President—Finance &
Chief Financial Officer
Ladies and Gentleman:

Freddie Mac appreciates this opportunity to comment on the FASB’s exposure draft *Accounting For Transfers of Financial Asset – an amendment of FASB Statement No. 140* (“the Exposure Draft”). Our mission is to stabilize the nation’s mortgage markets and expand opportunities for homeownership and affordable rental housing. Within the constraints of its charter, Freddie Mac has been a significant participant in the market for mortgage-backed securities (“MBS”) since 1974. Freddie Mac believes that the application of FASB Statement No. 140, *Accounting For Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("Statement 140") to its various securitization transactions provides a clear and relevant picture of these activities.

Given its potentially significant impact to Freddie Mac’s business and operational processes, we have followed with interest the development of Statement 140 and have provided a number of comments and suggestions below relating to the content of the Exposure Draft.

I. Executive Summary

As is further discussed in Section II of this letter, we have conceptual concerns with provisions established in paragraph 8A of the Exposure Draft as such guidance:

- Introduces arbitrary restrictions into the definition of a “participating interest” in sub-paragraph (b), which requires that all cash flows received on underlying assets be distributed on a proportional basis, and in sub-paragraph (c), which precludes a transferor from providing recourse to a transferee, that are not relevant to, or do not in any way advance, a transferee’s ability to freely pledge or exchange its ownership interest in financial assets.
o Would require Freddie Mac to establish for those transfers for which it intends to apply sales accounting treatment separate state law trusts or other separate legal entities (collectively, special purpose entities ("SPEs")) to facilitate the transfer of a portion of a financial asset even though the use of an SPE is not, as a function of legal circumstances that are unique to Freddie Mac, required to legally isolate a transferred portion. We believe that this outcome is inconsistent with the Board's original intent for QSPEs as established in paragraphs 171, 175 and 176 of Statement 140 and does not provide a clearer representation of the economics of our securitization transactions.

As an alternative to the construct established in paragraph 8A of the Exposure Draft, Freddie Mac recommends that the Board introduce language into Statement 140 that clarifies that, in instances where an SPE is not required to legally isolate a transferred portion of a financial asset, the legal form of the transferee's interest must provide it with a direct ownership interest that enables it to, consistent with paragraph 162 of Statement 140, "...obtain all or most of the cash inflows that are the economic benefits of the..." financial assets that are defined by a transferred interest.

As is further discussed in Section III of this letter, although Freddie Mac is conceptually open to a transferor’s recording beneficial interests received at fair value, Freddie Mac believes that some of the underpinnings of arguments expressed by the Board in support of such treatment require further development to address certain, apparent conflicts with Statement 140. For example, it is not clear to Freddie Mac how, based upon the governing principles of Statement 140’s financial components approach, a transferor could conclude that it relinquished full control over a financial asset that it transferred to a QSPE to the extent that it also took back a beneficial interest in the QSPE as part of the same, overall securitization transaction.

As is further discussed in Section IV of this letter, to the extent that Freddie Mac would be required to establish SPEs that are qualifying for the purpose of issuing its mortgage-backed securities, Freddie Mac would be required to implement relatively significant changes to various aspects of its existing security issuance processes to ensure that utilized issuing entities would be qualifying in nature. Such security issuance processes correspond to an overall program for which, as of August 2005, approximately $1.2 trillion in mortgage-backed securities issued (by Freddie Mac) and outstanding. Freddie Mac believes that it would be difficult to implement all requisite process changes in a controlled manner any earlier than January 1, 2007 and, as such, would request that the Board revise the proposed effective date of the Exposure Draft’s derecognition provisions to appropriately consider such circumstances.

Our detailed comments related to points expressed in Section I above follow.
II. Paragraph 8A of the Exposure Draft

Freddie Mac currently does not require the use of SPEs to legally isolate mortgage-related assets that back the mortgage-backed securities that it issues and transfers to third parties (for the purpose of this letter, such mortgage-backed securities will henceforth be referred to as “Freddie Mac Securities”). Rather, Freddie Mac pools mortgage-related assets and issues what in legal form are beneficial ownership interests in such assets. In this regard, Freddie Mac believes that an investor in Freddie Mac Securities can, as a function of its ownership interest in underlying assets, “...obtain all or most of the cash inflows that are the primary economic benefits of...” of underlying assets (which paragraph 161 of Statement 140 indicates is what fundamentally defines the ability to pledge or exchange a transferred asset). Such a view is also conceptually reflective of principles established in paragraphs 104 and 105 of Statement 140 that pertain to loan participations.

Freddie Mac Securities, however, do not meet the proposed definition of a participating interest as defined by paragraph 8A of the Exposure Draft. That is, the guarantee that Freddie Mac provides on such securities is tantamount to recourse that would conflict with the provisions of paragraph 8A(c). Likewise, as a function of either management and guarantee fees that are retained by Freddie Mac or as a function of the generally-tranched nature of the multiple-class structures of issued Freddie Mac Securities, all cash flows received on underlying assets that back such securities would not be divided among investors in Freddie Mac Securities in proportion to the share of ownership represented by each such security (such that the requirements of paragraph 8A(b) would not be satisfied). Understanding, however, that the legal form of issued Freddie Mac Securities provides -- as described above -- an investor with the ability to obtain all or most of the economic benefits that define its transferred interest, it is not clear to Freddie Mac how the proposed requirements established in paragraph 8A(b) and 8A(c) are necessarily relevant to an application of paragraph 9(b). For example, recourse is explicitly acknowledged in paragraph 6 of Statement 140 as being analogous to a put option a transferor essentially writes, or sells, to a transferee. Unless, as acknowledged in paragraph 167 of Statement 140, a put option can be observed as being deep-in-the-money, it is not clear to Freddie Mac how a transferee’s option in this case could in any way constrain its ability to monetize the economic benefits of its transferred interest.

Because Freddie Mac Securities would not meet the proposed requirements of paragraph 8A of the Exposure Draft, Freddie Mac would be required to use QSPEs to satisfy the

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1 Paragraph 161 of Statement 140: “...the Board concluded that the ways of using assets that are important in determining whether a transferee holding a financial asset controls it are the ability to exchange it or pledge it and thus obtain all or most of the cash inflows that are the primary economic benefits of financial assets...”

2 In exchange for its guarantee, Freddie Mac generally receives a management and guarantee fee that is payable over the life of an issued Freddie Mac Security from cash flows on the underlying mortgage assets.
requirements of paragraph 9(b) for those transfers for which it intends to apply sales accounting treatment. However, because the use of SPEs would not in any way advance the legal isolation status of mortgage assets that Freddie Mac securitizes (i.e., since legal counsel to Freddie Mac has indicated that the use of SPEs is not required to facilitate legal isolation), it would seem that arbitrarily requiring Freddie Mac to establish SPEs that must be qualifying (i) is inconsistent with the Board’s original intent for a QSPE as articulated in paragraphs 171, 175 and 176 of Statement 140, (ii) perpetuates an apparent misperception of the Board as expressed in paragraph A24 of the Exposure Draft that the use of a QSPE by Freddie Mac would advance the isolation of securitized assets and (iii) does not provide for a clearer representation of the economics of our securitization transactions. Accordingly, and understanding that Freddie Mac would likely incur significant costs to implement the use of QSPEs, it is not clear to Freddie Mac how the outcome that it use QSPEs is compatible with the cost / benefit objective expressed in paragraph A6 of the Exposure Draft.

As an alternative to inserting paragraph 8A, Freddie Mac recommends that the Board introduce language into Statement 140 that simply clarifies that, in instances where an SPE is not required to legally isolate a transferred portion of a financial asset, the legal form of the transferee’s interest must provide it with a direct ownership interest that enables it to, consistent with paragraph 161 of Statement 140, “...obtain all or most of the cash inflows that are the economic benefits of the...” transferred portion. Freddie Mac believes that such a standard is entirely consistent with the fundamental underpinnings of Statement 140’s financial components approach (as specifically expressed in paragraphs 146(a) and 146(b) of such guidance).

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3 Paragraph 171 of Statement 140: "...One significant purpose of those limitations on activities often to make remote the possibility that a qualifying SPE could enter bankruptcy or other receivership, even if the transferor were to enter receivership.”

4 Paragraph 175 of Statement 140: "...the Board recognized that often the transferee in a securitization is a trust, corporation or other legal vehicle (an SPE) that can engage in only limited activities and, therefore, is typically constrained from pledging or exchanging the transferred asset. The Board decided that some transfers to SPEs should qualify for sale accounting and, therefore, developed in Statement 125 the idea of a qualifying SPE.”

5 Paragraph 176 of Statement 140: “...The Board observed that the “effect of establishing the qualifying special purpose entity is to merge the contractual rights in the transferred assets and to allocate undivided interests in them—the beneficial interests”...The Board reached that conclusion in part because a qualifying SPE “does not have the right to pledge or exchange the transferred assets”,...a right that would involve it acting as an operating entity. Therefore, the Board observed that if the transferee is a qualifying SPE, the assets are legally owned by the trustee on behalf of those parties having a beneficial interest in the assets, and the right of those BISs to pledge or exchange their beneficial interests is the counterpart of the right of an ordinary transferee (for example, an entity other than a qualifying SPE) to pledge or exchange transferred assets.”

6 Paragraph A24 of the Exposure Draft: “Board members...do not believe that an asset has been isolated from the transferor unless the entire asset has first been placed in a qualifying SPE or otherwise segregated.”
III. Initial Measurement of Beneficial Interests

Although Freddie Mac is conceptually open to a transferor’s recording beneficial interests received at fair value, Freddie Mac believes that some of the underpinnings of arguments expressed by the Board in support of such treatment require further development to address certain, apparent conflicts with Statement 140. For example, it is suggested in paragraph A39\(^7\) of the Exposure Draft that a transferor could conclude that it relinquished full control over a financial asset that it transferred to a QSPE to the extent that it also took back a beneficial interest in the QSPE as part of the same, overall securitization transaction. In light of principles that were cited by the Board as support for Statement 140’s financial-components approach (e.g., paragraph 146(a)\(^8\) of such guidance), it is not clear to Freddie Mac how control in such a scenario can be said to have been fully relinquished given that that the transferor would presumably continue to control (in the form of beneficial interests that it controls) a portion of the economic benefits of the financial asset (or assets) that it transferred to a QSPE.

IV. Effective Date of the Proposed Statement

Concerning the effective date of the proposed derecognition provisions, and to the extent that Freddie Mac would be required to establish SPEs that are qualifying for the purpose of issuing Freddie Mac Securities, Freddie Mac would be required to implement relatively significant changes to various aspects of its existing issuance processes to ensure that utilized issuing entities would be qualifying in nature. As a matter of scale, such issuance-related processes correspond to an overall program for which, as of August 2005, approximately $1.2 trillion of Freddie Mac Securities were issued and outstanding. In this case, changes would be required to be made that impact each issuance channel used by Freddie Mac and affect virtually all functional aspects of an issuance (e.g., development and maintenance of SPE documentation, monitoring the fair value of beneficial interests held by third parties, etc.).

Based upon the extensiveness of the referenced sets of changes, as well upon transaction processing dependencies that Freddie Mac has on various third parties, Freddie Mac believes that it would be difficult implement the appropriate process changes in a controlled manner any earlier than January 1, 2007. Accordingly, Freddie Mac would request that the Board revise the proposed effective date of the Exposure Draft’s derecognition provisions to appropriately consider such circumstances.

\(^7\) Paragraph A39 of the Exposure Draft: “… if an entire financial asset is transferred (to a QSPE) and the transferor has given up control of that asset, then any asset received in return is a new asset even if the cash flows come from the asset originally held by the transferor”

\(^8\) Paragraph 146(a) of Statement 140: “…the economic benefits provided by a financial asset (generally, the right to future cash flows) are derived from the contractual provisions that underlie that asset, and the entity that controls those benefits should recognize them as its asset”
We appreciate the opportunity to participate in the Board’s due process. If the Board or the staff would like to discuss any of the issues raised in this letter, please feel free to contact David Bjarnason, Vice President, Accounting Policy, at (571) 382 - 4022. We would also be happy to schedule a meeting at your convenience to further explore these issues.

/s/ John F. Woods  
John F. Woods  
Corporate Controller  

/s/ Kenneth J. Evola  
Kenneth J. Evola  
Vice President, Accounting Policy