March 28, 2016

Susan M. Cosper  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Via email to director@fasb.org


Dear Ms. Cosper:

Freddie Mac appreciates the opportunity to comment on the Exposure Draft for the proposed Accounting Standards Updates of Topic 230, Classification of Certain Cash Receipts and Cash Payments (the “proposed Update”).

Freddie Mac was chartered by Congress in 1970 with a public mission to provide liquidity, stability, and affordability to the United States housing market. 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. Several of the issues discussed in the proposed ASU will affect Freddie Mac, as we are active issuers of callable debt and zero-coupon debt, we have corporate-owned life insurance, and we are active securitizers of mortgage loans and often retain beneficial interests from these securitizations.

We support the Board’s efforts to reduce diversity in practice on issues involving the statement of cash flows with the proposed amendments to Topic 230. Overall, we believe that the proposed Update will generally reduce diversity in practice and improve comparability of financial information. However, we believe two of the issues included in the proposed Update arrive at conclusions that are inconsistent with other issues addressed in the proposed Update, where the issue is similar or where the economic substance of the transactions is similar - specifically Issue No. 2 on the settlement of zero coupon bonds, and Issue No. 5 on proceeds from the settlement of corporate-owned life insurance policies. Additionally, we believe Issue No. 7 on beneficial interests in securitization transactions could be further clarified to help ensure consistent application.

Appendix A includes Freddie Mac’s detailed responses to the individual questions posed by the Board in the proposed Update.

* * * * *
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 as our Conservator.

Freddie Mac appreciates the opportunity to comment on the proposed Update. If you have any questions about our comments, please contact Timothy Kviz (703-714-3800).

Sincerely,

Timothy Kviz
Vice President – Accounting Policy and External Financial Reporting

cc: Mr. James G. Mackey, Executive Vice President - Chief Financial Officer
Mr. Robert D. Mailloux, Senior Vice President – Corporate Controller and Principal Accounting Officer
Mr. Nick Satriano, Chief Accountant, Federal Housing Finance Agency
Appendix A

This Appendix contains our responses and comments to the specific questions that were raised by the Board in the Proposed Accounting Standards Update – Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force).

Question 1: Should cash payments for debt prepayment or extinguishment costs be classified as cash outflow for financing activities? If not, what classification is more appropriate and why?

Response: Yes. We agree with the proposed Update that cash payments for debt prepayment or extinguishment costs be classified as a cash outflow for financing activities. Specifically, the prepayment or extinguishment of an outstanding debt obligation is a financing decision and is non-recurring in nature.

We believe that the costs paid to prepay or extinguish a debt instrument are economically similar to debt issue costs or original issuance premiums and discounts. When a debt instrument is prepaid, unamortized debt issue costs and premiums and discounts are classified as cash flows related to financing activities.

While one might view a cash payment to prepay or extinguish a debt instrument as having characteristics of both an operating activity and a financing activity, we believe the predominant characteristic is that of a financing activity.

As a result, we believe it is appropriate to treat cash payments to prepay or extinguish a debt instrument as a cash flow related to a financing activity. We believe this conclusion is consistent with the conclusions reached in Issue No. 8, that the classification in the statement of cash flows should be based on the predominant characteristics of the cash flow being analyzed.

Question 2: Should the cash payment made at the settlement of a zero-coupon bond be separated and classified as follows: the portion of the cash payment attributable to the accreted interest as cash outflows for operating activities, and the portion of the cash payment attributable to the principal as cash outflows for financing activities? If not, what classification is more appropriate and why?

Response: No. While we support the Board’s efforts to provide specific guidance on the classification of cash payments made by a bond issuer at the settlement of a zero-coupon bond, we disagree with the conclusions reached by the Board, specifically that cash payments should be separated between the portion attributable to accreted interest and the portion attributable to original principal and classified separately in the statement of cash flows as operating activities and financing activities, respectively. We believe the conclusions reached by the Board will
result in reduced comparability of economically similar cash flows and increased operational cost and complexity.

It is our view that the entire cash payment be classified as a cash outflow for financing activities. Our concern with respect to this proposed Update is as follows:

**Reduced comparability with the classification of cash payments to settle coupon-paying bonds issued at an original discount** – Similar to zero-coupon bonds, an original issue discount associated with a coupon-paying bond will be accreted to interest expense. The entire cash payment to settle a coupon-paying bond, including the portion of the cash payment attributable to accreted interest, is classified as a cash outflow from financing activities. As a result, the conclusion reached in the proposed Update is inconsistent with the guidance for economically similar activities, which will reduce comparability. We believe the classification of these cash flows should be aligned and reported as financing activities.

**Reduced comparability with the classification of cash payments for debt prepayment or extinguishment costs** – Similar to accreted interest on zero-coupon bonds, debt prepayment or extinguishment costs are generally considered to be interest-related and may be classified as interest expense (or separately as a loss on debt extinguishment) in the statement of performance. While both cash flows enter into the determination of net income, the resulting cash payments have aspects of both an operating activity and a financing activity. However, while the cash payments attributable to debt prepayment or extinguishment costs are classified as a cash outflow for financing activities, the cash payments attributable to accreted interest on zero-coupon bonds is classified as a cash outflow for operating activities. As these cash flows are economically similar, we believe the classification of these cash flows should be aligned. Further, as both cash flows stem from a financing decision that involves consideration of all costs that will be incurred to borrow or extinguish debt, we believe both cash flows should be presented as a financing activity.

**Cash payment at settlement of a zero-coupon bond is a legal payment of principal** – Although interest is accreted from an accounting standpoint, legally the settlement of a zero-coupon bond provides solely for the payment of principal (i.e., the par value of the debt). In substance, interest is refinanced and rolled into the principal of the debt instrument. Consistent with the guidance provided in Topic 230, such cash flows should be classified as a financing activity.

**Increased cost and operational complexity** – Entities that have historically presented the cash payments to settle zero-coupon bonds as a financing activity will need to make costly system enhancements to separate the cash payment for zero-coupon bonds between the portion attributable to accreted interest and the portion attributable to original principal. We do not believe that the cost of these required system enhancements is justified, particularly given the resulting financial reporting produces inconsistent results for economically similar transactions.
Question 5: Should the proceeds received from the settlement of insurance claims be classified on the basis of the insurance coverage (that is, the nature of the loss), including those proceeds received in a lump-sum settlement for which an entity would be required to determine the classification on the basis of the nature of each loss included in the settlement? If not, what classification is more appropriate and why?

Response: Yes. We agree with the proposed Update that proceeds received from the settlement of insurance claims be classified according to the nature of the loss. We believe that this Update is consistent with the existing guidance provided in ASC 230-10-45-16(c).

Question 6: Should cash proceeds received from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, be classified as cash inflows from investing activities? If not, what classification is more appropriate and why?

Response: Yes. We agree with the proposed Update that cash proceeds from COLI policies be classified as cash inflows from investing activities. We believe this presentation is appropriate and consistent with the primary business purpose for investing in the policies - as investment vehicles.

Question 7: Should cash payments made for premiums of corporate-owned life insurance policies, including bank-owned life insurance policies, be permitted to be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities? If not, what classification is more appropriate and why?

Response: No. Although we support the Board’s decision to provide clarifying guidance concerning the classification of premium payments for COLI policies and the Board’s proposed classification of cash proceeds received from the settlement of COLI policies, we do not agree with the proposed Update that would provide an entity with an option to classify the related premium payments as operating activities, investing activities, or a combination of operating and investing activities.

By providing this option, the Board may create diversity in practice as it relates to the classification of premium payments, which is inconsistent with the stated intent of the proposed Update – to reduce diversity in practice on cash flow related issues. As COLI policies are essentially investment vehicles, we believe the related premium payments should be classified as cash outflows for investing activities. This classification would result in a presentation that is more consistent with the nature of the cash payment, as the cash surrender value of the COLI policies will increase when the premiums are paid. Additionally, this conclusion is consistent with the conclusion reached in Issue No. 8 – that cash flows should be classified based on the predominant characteristic of the cash flows.
Question 8: Should distributions received from an equity method investee when an investor applies the equity method be presumed to be returns on investment and classified as cash inflows from operating activities unless the investor’s cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor? When such an excess occurs, should the current-period distribution up to this excess be considered a return of investment and classified as cash inflows from investing activities? If not, what approach is more appropriate and why?

Response: Yes. We agree with the proposed Update that unless information exists to the contrary, distributions received from an equity method investee should be presumed to be returns on investment and classified as a cash inflow from operating activities, unless the investor’s cumulative distributions received, less distributions received in prior periods that were determined to be returns of investment, exceed cumulative equity in earnings recognized by the investor. Further, consistent with the guidance provided in Topic 230, returns on investment should be considered a cash inflow from operating activities, while returns of investment should be classified as a cash inflow from investing activities.

Question 9: Should a transferor’s beneficial interest obtained in a securitization of financial assets be disclosed as a noncash activity? If not, what treatment is more appropriate and why?

Response: Yes. While we support the proposed Update that requires transferors to disclose retained beneficial interests that are received as consideration for the transfer of financial assets (excluding cash) in a securitization transaction as noncash, we request that the Board clarify whether this proposed Update is intended to apply to securitization transactions where a transferor uses a third party as an agent and the transferor and third party exchange cash flows on a gross basis. Specifically, transferors in securitization transactions often use third parties (e.g., a dealer) to deposit the transferred financial assets into a securitization trust and to market and/or sell the issued beneficial interests. For a variety of reasons, including operational motives, the transferor and third party may exchange gross cash flows as part of the transaction.

For example, as part of a securitization transaction, a transferor may sell $10 million of mortgage loans to a non-consolidated trust, while agreeing to retain $4 million of the issued beneficial interests. In certain securitization transactions, the transferor and third party may agree to exchange gross cash flows. That is, the transferor will receive $10 million in cash flows in exchange for the securitized mortgage loans, while paying $4 million for beneficial interests in those same securitized mortgage loans.

As third parties to a securitization transaction often act as agents on behalf of the transferor, we believe the resulting cash flow impacts should be classified based on the substance of the transaction. As a result, we believe retained beneficial interests should be classified by the transferor as noncash, regardless of whether cash is exchanged.
To address this concern and to mitigate potential diversity in practice, we request the Board to clarify that a transferor should disclose retained beneficial interests from a securitization transaction as noncash, regardless of whether cash is exchanged with agents.

Question 10: Should cash receipts from payments on a transferor’s beneficial interests in securitized trade receivables be classified as cash inflows from investing activities? If not, what classification is more appropriate and why?

Response: Yes. We agree with the proposed Update that cash receipts from payments on a transferor’s beneficial interest in securitized trade receivables be classified as cash inflows from investing activities. We believe this classification is consistent with the nature and accounting for the asset (i.e., an investment security) that was retained as part of the securitization. Further, this classification reflects the fact that the transferor does not retain legal ownership over the trade receivables.

Question 11: Is the additional guidance that clarifies when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows on the basis of predominance understandable and operable? If not, please explain why and what additional guidance would be more appropriate.

Response: Yes. We support the additional guidance that clarifies when the predominant cash flow principle should be applied. We believe this guidance is understandable and operable.

Question 12: Should the proposed amendments for all eight cash flow issues be applied using a retrospective transition method? If not, what transition approach is more appropriate and for which specific cash flow issues and why?

Response: Yes. We agree the proposed amendments for the eight cash flow issues should be applied using a retrospective transition method, as this method would enhance comparability of financial information for all periods presented in the statement of cash flows.

Question 13: Should the proposed amendments include a provision that if it is impracticable for some of the amendments to be applied using a retrospective transition method, then those amendments would be applied prospectively as of the earliest date practicable? Why or why not?
Response: No. Although we agree that it may be impractical for certain of the amendments to be applied using a retrospective transition method, we do not believe it is necessary to include a provision that provides for the amendments to be applied prospectively if retrospective transition is not practical. Topic 250, *Accounting Changes and Error Corrections*, already provides relief if retrospective adoption is not practical.

**Question 14:** Should an entity be required to provide the transition disclosures specified in the proposed Update? Should any other transition disclosures be required? If yes, please explain what transition disclosures should be required and why.

**Response:** Yes. Entities should be required to provide only the transition disclosures specified in the proposed Update as this information is valuable to users of the financial statements.

**Question 15:** How much time will be necessary to implement the proposed amendments? Do entities other than public business entities that are required to present a statement of cash flows under Topic 230 (that is, private companies and not-for-profit entities, but not employee benefit plans) need additional time to apply the proposed amendments? Why or why not?

**Response:** We believe that at least one year is needed between the issuance of a final standard and the effective date to implement the proposed guidance.

**Question 16:** Should early adoption be allowed?

**Response:** No. We believe early adoption may reduce the comparability of different entities’ statement of cash flows.