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Comment Letter No. 10
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November 3, 2010

Mr. Trevor Farber
Practice Fellow
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via email to director@fasb.org

Reference: International Accounting Standards Board Staff Draft “IFRS X Consolidated Financial Statements”

Dear Mr. Farber,

Freddie Mac appreciates the opportunity to comment to the Financial Accounting Standards Board (“Board”) on the International Accounting Standards Board (“IASB”) Staff Draft “IFRS X Consolidated Financial Statements” (the “Staff Draft”).

Freddie Mac was chartered 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. As a result of the adoption of FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* (“Statement 167”), we consolidated approximately 275,000 securitization entities with total assets of approximately \$1.8 trillion. As a result, accounting guidance that impacts consolidation, particularly consolidation of entities controlled through means other than voting interests, is of great interest to us. Our responses to the individual questions raised in the Roundtable Agenda are set forth in Appendix A to this letter.

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 Conservator.

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

Sincerely,

A handwritten signature in black ink that reads "Timothy Kviz". The signature is written in a cursive style with a large, stylized 'K'.

Timothy Kviz
Vice President – Accounting Policy

cc: Mr. Ross J. Kari, Executive Vice President - Chief Financial Officer
Mr. Robert D. Mailloux, Senior Vice President – Corporate Controller and Principle
Accounting Officer
Ms. Wanda I. DeLeo, Senior Associate Director and Chief Accountant, Federal Housing
Finance Agency

Appendix A

- 1. The Staff Draft provides a single concept of control that is used to evaluate control on a consistent basis for all types of entities (both voting interest entities and variable interest entities). Do you agree that a single-model approach to assess control will provide more consistent financial reporting for all types of entities rather than providing separate models for voting interest entities and variable interest entities? If not, why not?***

We believe that a single consolidation principle (that a reporting entity should consolidate all other entities it exerts control over) with a single concept of control is an improvement over the current consolidation framework in U.S. GAAP, as it reduces the ability of the scoping conclusion (i.e., what consolidation standard to apply) to influence whether an entity is required to be consolidated or not.

At a conceptual level, we do not believe the Staff Draft necessarily has a “single-model approach to assess control.” The application guidance provided in Appendix B to the Staff Draft appears to divide investees into two groups: one group where power over the investee is exercised through voting rights and a second group where power is exercised through means other than voting rights. Appendix B to the Staff Draft then provides different considerations for each group of investees in arriving at a determination as to whether the reporting entity has power over the investee. Having different sets of considerations for investees over which power is exerted using different mechanisms is entirely appropriate; however, the result could be viewed as the creation of a “voting-interest model” and a “non-voting-interest model” within the overall framework of the Staff Draft not that dissimilar to existing authoritative guidance, albeit contained within a single framework.

That being said, we believe the Staff Draft has derived a meaningful concept of control as a basis for consolidation and do not believe that the question of whether that concept is applied via single or multiple “models” should arrest the discussion of whether the Staff Draft is an improvement over the existing U.S. GAAP consolidation guidance.

- 2. The Staff Draft does not incorporate the U.S. GAAP concept of a variable interest entity or a structured entity. Rather, the Staff Draft provides that the way in which control is assessed will vary depending on how the activities that significantly affect the entities’ returns are directed. For example, how control is assessed will depend on whether the decisions that significantly affect the returns of an entity are made through voting rights. Without an explicit definition of a variable interest entity, do you believe that (ignoring the differences when analyzing decisions making relationships and the effect related party arrangements have on the analysis) the Staff Draft will produce the same consolidation conclusions as the recently issued U.S. GAAP guidance for consolidating variable interest entities (FASB Accounting Standards Codification Subtopic 810-10, Consolidation)? If not, what are the situations that produce a different conclusion and why? Do you think it is sufficiently clear how to assess power and control for all types of entities in the Staff Draft?***

Broadly speaking, we believe the consolidation framework set forth in the Staff Draft will return the same consolidation conclusions regarding investees meeting the definition of a variable interest entity under U.S. GAAP. Based upon our review of the Staff Draft, including the discussion provided in the Basis for Conclusions thereto, we believe the vast majority of our consolidation conclusions made during our adoption of Statement 167 would remain the same if analyzed under the guidance set forth in the Staff Draft. Our sole observation in this respect is to urge the Board, if the decision is made to issue an exposure document similar in form to the Staff Draft, to follow the precedent set in the issuance of Statement 167 of including robust and detailed implementation guidance and examples so as to ensure consistent application of the principles of control.

We believe there may be certain unique fact patterns in which the guidance contained in the Staff Draft might return different consolidation conclusions than those reached in the application Statement 167. These differences center on plain-vanilla re-securitization transactions.¹ However, the difference may not necessarily be due to a divergence in the concept of control, but rather to clearer and more specific wording in the Staff Draft than that contained in Statement 167.

We understand that some entities applying the guidance in Statement 167 struggle to embrace the notion that there could be structures that do not involve any elements of power and that no party would consolidate. Further, these entities believe there may be a level of economic exposure at which a reporting entity is presumed to have a controlling financial interest in a variable interest entity used in a re-securitization transaction. We note that the Staff Draft contains more explicit language regarding the application of the consolidation principles that could be applied to such re-securitization entities than does Statement 167. For example, paragraphs BC54 and BC55 explicitly state that selection of the assets transferred into a securitization trust, in and of itself, would not be an appropriate basis for consolidation. Additionally, paragraphs BC12 and BC14(a) provide more explicit language regarding whether a certain level of economic exposure presumes control of an investee. As the Staff Draft provides more discussion that addresses these specific matters, it may lead to a change in the application of the control principle for these entities as compared to Statement 167. This is one example of a fact pattern that has led to differing views under Statement 167 where the inclusion of implementation guidance and/or examples that augment the principles set forth in the Staff Draft would help resolve differing views amongst preparers, advisory firms, and regulators and ensure consistency in the application of these principles.

¹ The term “plain vanilla re-securitization transaction” is intended to describe a re-securitization transaction where beneficial interests from a prior securitization are used as the underlying collateral in a second re-securitization, and there are no on-going activities associated with the re-securitization beyond collecting the cash from the beneficial interests deposited to the re-securitization trust, passing through this cash to the beneficial interests of the re-securitization trust, and income tax reporting (i.e., no active management of the underlying collateral, no repurchase rights or management of assets in default, no abilities to actively manage the assets or liabilities, etc.).

3. ***The Staff Draft proposes that in order to control an entity, the reporting entity must have the power to direct the activities of that entity. Power is defined as having existing rights that give the reporting entity the current ability to direct the activities that significantly affect the entity's returns. Do you agree with the control principle as articulated in the Staff Draft? Do you agree that there are situations when a reporting entity can have control of an entity controlled through voting rights with less than a majority of the voting rights? Why or why not?***

We agree with the control principle articulated in paragraph 7 of the Staff Draft. We believe this principle provides meaningful consolidated financial statements (i.e., it results in consolidated financial statements that provide decision-useful information to users) and is broadly consistent with the groundwork laid by the Board in issuing Statement 167. Consistent with our response to the previous question, we would suggest that the principles outlined in the Staff Draft be augmented with more examples and/or application guidance specific to securitizations (and re-securitizations in particular), so as to ensure consistent application upon any transition from Statement 167 to the guidance set forth in the Staff Draft.

We would also agree that there could be situations when a reporting entity can control an investee without having an absolute majority of that investee's voting rights. However, as noted in our response to Question 4 below, we question whether an investor holding less than a majority of voting rights in an investee would have the means to obtain the information necessary to conclude whether or not they would control the investee².

4. ***The Staff Draft states that if the activities that significantly affect an entity's returns are directed through voting rights, a reporting entity holding less than a majority of the voting rights (assuming no potential voting rights or other contractual rights exists) has power when it can unilaterally direct the activities of the entity that significantly affect the entity's returns. This assessment requires judgment. The Staff Draft provides application guidance to determine when a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. Specifically, the Staff Draft provides that, in some cases, a determination can be made about whether a reporting entity has power by just considering the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements. Do you believe that there are circumstances when, considering only these factors, an assessment could be made about whether a reporting entity has power? Why or why not?***

Due to our business model, we have only minimal involvement with investees over which power is exercised via voting rights. The preponderance of entities we are involved with are securitization vehicles, which are not directed via the exercise of voting rights, but through contractual arrangements and relationships. Therefore, we are not best placed to respond to

² A similar concern is mentioned in paragraph BC79 in the Basis for Conclusions to the Staff Draft

this question and will defer to those respondents who will be directly impacted by the guidance in the Staff Draft.

Our only observation with respect to an entity having power over an investee with less than a majority of voting rights is whether or not the entity undertaking the analysis would be able to gather sufficient information to perform the assessment required by the Staff Draft in a controlled manner, especially if the investee being evaluated is a small, privately-held enterprise.

- 5. *In other circumstances the Staff Draft provides that additional evidence may be needed in order to conclude that a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. The Staff Draft includes indicators that may provide additional evidence in these circumstances to assist in determining whether the reporting entity has power. Do you believe that these indicators provide sufficient guidance to conclude that a reporting entity has power in situations where it is unclear as to whether a reporting entity has power solely based on the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements? If not, what additional indicators should be included or which of these indicators should be removed?***

For the reasons noted above in our answer to Question 4, we are not best placed to respond to this question and will defer to those respondents who will be directly impacted by the guidance in the Staff Draft .

- 6. *The Staff Draft requires a reporting entity to consider its rights to obtain additional voting rights of another entity, as well as such potential voting rights (options or convertibles, for example) held by other parties, to determine whether the reporting entity has power. Do you believe the guidance in the Staff Draft is appropriate and operational? Specifically, do you believe that the guidance for determining when potential voting rights are considered substantive is operational? If not, what additional guidance would you suggest?***

Similar to our responses to Questions 4 and 5 herein, due to our limited involvement with investees for which power is exercised via voting rights, we will defer to those respondents who will be directly impacted by the guidance in the Staff Draft. Our only concern (as stated previously) is whether the information necessary to make this determination in a controlled manner can be obtained in a cost-efficient manner.

As an example, if an entity owns 40% of an investee's voting rights and also owns \$50M of convertible notes from a privately-placed \$100M issuance, it is unclear whether the entity would have or be able to obtain sufficient information as to who the owners of the other convertible notes are (i.e., if they are also current holders of the investee's voting rights), and the price at which these convertible notes were acquired (which would influence the assessment of how in-the-money or out-of-the-money the conversion option would be to those holders).

7. *When determining whether a reporting entity acts as an agent, the reporting entity must consider the overall relationship between it and other parties involved with the entity, considering the following factors:*
- a. The scope of its decision-making authority over the entity*
 - b. The rights held by other parties*
 - c. The remuneration the reporting entity is entitled to in the arrangement*
 - d. The reporting entity's exposure to variability in returns as a result of other interests that it holds in the entity.*

Do you believe the guidance related to assessing decision-making arrangements in the Staff Draft is appropriate and operational? Do you believe the Staff Draft would lead to appropriate consolidation conclusions?

We do believe the guidance cited above is appropriate and operational for determining whether a reporting entity is acting in a principal capacity or that of an agent. We note that this guidance takes a more holistic view of a reporting entity's involvement with an investee in assessing whether a reporting entity would be deemed a principal or an agent than does Statement 167 and, as the guidance in the Staff Draft would apply to all entities, provides guidance that can be translated more easily across various types of investees.

We believe the determination of whether a reporting entity acts in a principal capacity or that of an agent is another area where the Board, through enhancements to the implementation guidance and examples contained in the Staff Draft, could ensure appropriate and consistent application across reporting enterprises.

We would suggest the Board consider amending criterion (c) above to specifically include the variability a decision-maker is exposed to via representations and warranties they have made to other parties involved with the investee as these representations and warranties carry potentially significant exposure to the variability of the investee.

In non-agency residential mortgage loan securitizations, the party that transfers the mortgage loans into the securitization vehicle is commonly the servicer of those mortgage loans as well. In conjunction with the transfer of the mortgage loans to the securitization vehicle, the transferor typically makes certain representations and warranties about the guidelines used in originating those mortgage loans and the manner in which they will be serviced while they are the legal property of the securitization vehicle. If the transferor is found to have breached one of these representations or warranties, it is generally required to either repurchase the offending mortgage loans at a price equal to the outstanding principal amount (plus any accrued but unpaid interest) or reimburse the securitization vehicle for any realized losses it has experienced. Under the guidance set forth in Statement 167 (specifically paragraph B22), an entity is not required to explicitly consider the variability they would be exposed to under such representations and warranties in determining whether or not they were a service provider to a variable interest entity. Consequently, there may have been instances where a party with economic exposure to an entity closer to that of a principal was determined to be

an agent (and therefore would not have consolidated that entity). Over the past few years, the variability associated with representations and warranties has reached into the tens of billions of dollars – an amount we clearly believe is significant and should, therefore, be an explicit consideration in any future framework for determining whether a party is acting as a principal or an agent.

8. ***When evaluating a decision-maker's role, rights held by other parties are considered when determining whether a decision-maker is an agent. Specifically, situations in which a single party holds substantive removal rights and can remove the decision-maker without cause, in isolation, would be sufficient to conclude that the decision-maker is an agent. However, if numerous parties hold such rights, those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent. In such a situation, those rights would be considered together with the other factors included in question 7 above, to determine whether the decision-maker is an agent. Do you believe that removal rights held by numerous parties should be a factor when evaluating whether a decision-maker is an agent? If so, do you agree that it should be one factor but not in and of itself determinative, when evaluating whether a decision-maker is an agent?***

We believe the consideration of removal rights held by other parties is an appropriate factor to consider as part of evaluating whether a decision-maker is an agent. We do not believe this factor should, in and of itself, be determinative when evaluating whether a decision-maker is an agent, but should be one factor out of many considered in a reporting entity's analysis.

As an additional matter, we suggest the Board consider, as part of its deliberations about removal rights, revisit the rationale (found in both the Staff Draft and Statement 167) that the unilateral ability of one party to remove another would solely determine that the second party is acting as an agent.

We are aware of many instances in mortgage securitizations or other arrangements where the ability to remove a decision-maker "without cause" was included in a legal document, not for the purpose of providing another party (or parties) the unilateral ability to remove the decision-maker³, but for purposes of legal expediency when the decision-maker had committed an act that would render it eligible to be removed "for cause." When a decision-maker is eligible to be removed for cause, it is typically in the best interests of other parties to the transaction to remove the decision-maker as soon as possible. Removing a decision-maker for cause would require the parties exercising the removal right to prove that a causal event had occurred and could expose these parties to potential legal challenges by the decision-maker. Even if sufficient proof is shown and any such legal challenges fail, this process requires time and energies that could have otherwise been spent remedying any

³ In the cases we are aware of, the unfettered use of a "without cause" removal right would have the effect of limiting the number of market participants who would be willing to be a party to mortgage securitization transactions; therefore, in actuality, the right is only used when there is cause, so as not to limit the pool of potential future decision-makers in subsequent transactions.

damage caused by the decision-maker. In contrast, if the decision-maker can be removed “without cause”, this allows the party or parties exercising this right to expedite the decision-maker’s removal, while simultaneously shielding these parties from legal challenges to this removal. Thus, we believe there are instances where provisions in a legal document that are intended to provide a protective right are being inappropriately construed as the ability to control an investee.

9. The Staff Draft requires a reporting entity to reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control. Do you believe this principle, and the related guidance in the Staff Draft, is sufficiently clear and operational?

We do believe the principle articulated in the Staff Draft about reassessing whether an entity controls an investee is sufficiently clear and operational. We believe that this principle is, in some ways, easier to comply with operationally than Statement 167’s “continuous reassessment” as much of the data we rely on to make our reassessments is only available periodically (i.e., on a monthly or quarterly basis) and not on a real-time or continuous basis.