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June 29, 2015

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

Via email to [director@fasb.org](mailto:director@fasb.org)

**Reference: File Reference No. EITF-15B, Proposed Accounting Standards Update – *Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Cards***

Dear Technical Director:

Freddie Mac appreciates the opportunity to comment on the Exposure Draft for the proposed Accounting Standards Update (“ASU”) of *Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored Value Cards* (the “proposed Update”).

We agree with the Task Force’s decision in the proposed Update to provide a scope exception to the guidance in Subtopic 405-20 pertaining to the extinguishment of liabilities. We believe that accounting for breakage for certain types of prepaid stored-value cards consistent with the breakage guidance in Topic 606 (*Revenue from Contracts with Customers*) results in financial reporting that is consistent with the economics of such transactions.

In response to Question 1 in the “Questions for Respondents” in the proposed Update, we believe that the Task Force may wish to consider broadening the scope of the proposed Update to address financial reporting issues related to the derecognition of certain other types of financial liabilities. For example, the Task Force may wish to consider amending the liability derecognition guidance for nonrecourse debt whose cash flows are based solely on the cash flows of specific financial assets (hereinafter referred to as “asset-linked nonrecourse debt”).<sup>1</sup>

We believe that the existing liability derecognition guidance in Subtopic 405-20 results in financial reporting that does not faithfully represent the net credit risk exposure or the expected obligation of the reporting entity in transactions involving asset-linked nonrecourse debt. For these types of transactions, the debt balance is reduced upon default of the associated financial assets and credit losses are allocated to the nonrecourse debt securities and absorbed by the investors in those securities. The existing liability derecognition guidance in Subtopic 405-20 does not allow derecognition of asset-linked nonrecourse debt until the reporting entity is legally released from being the primary obligor under the liability by the creditor, which typically does not occur in these transactions until completion of foreclosure on the

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<sup>1</sup> The types of transactions that result in Freddie Mac recognizing nonrecourse debt whose cash flows are based solely on the cash flows of specific financial assets are explained in further detail in Appendix A.

financial assets and sale of the underlying collateral. However, recognition of credit losses on the associated financial assets, either through recognition of probable incurred losses or other-than-temporary-impairment, is typically required prior to legal release from being the primary obligor on the asset-linked nonrecourse debt. Under this financial reporting model, the reporting entity is required to record credit losses to which it is not ultimately exposed in certain periods, while recording offsetting gains upon derecognition of the asset-linked nonrecourse debt that it does not have to repay in other periods, which obfuscates the financial results of the reporting entity.

We acknowledge that the financial reporting issue described above for asset-linked nonrecourse debt is not identical to the issue for prepaid stored value cards addressed in the proposed Update. However, we believe that the liability for asset-linked nonrecourse debt is similar to the liability for prepaid stored-value cards in two key respects that may justify a similar accounting treatment:

- **Neither liability is an unconditional obligation of the reporting entity.** Rather, the reporting entity's obligation under both liabilities is conditional on the action (or lack thereof) of a third party that the reporting entity does not control. In the case of a prepaid stored-value card, fulfillment of the liability is conditional on cardholder usage, while, in the case of asset-linked nonrecourse debt, fulfillment of the liability is conditional on payments from the associated financial assets.
- **Both liabilities entitle the reporting entity to benefits when a portion of the obligation does not have to be fulfilled.** The issuer receives a benefit from asset-linked nonrecourse debt by not having to repay the full amount of the debt when the associated financial assets default. Similarly, the issuer of a prepaid stored-value card benefits from breakage by not having to provide goods or services or pay cash if the cardholder does not use the card. We believe that the reduction in the balance of asset-linked nonrecourse debt that occurs upon default of the associated financial assets is conceptually similar to the breakage that occurs on a prepaid stored value card.

We believe that amending the liability derecognition guidance for asset-linked nonrecourse debt to be consistent with the guidance for prepaid stored value cards in the proposed Update would more faithfully represent the net credit risk exposure and the expected obligation of the reporting entity. We believe that aligning the derecognition threshold for asset-linked nonrecourse debt with the recognition threshold for credit losses on the associated financial assets would result in financial reporting that is consistent with the economics of such transactions. We also believe that such a derecognition threshold for asset-linked nonrecourse debt is consistent with the recognition of breakage on prepaid stored-value cards when the likelihood of the customer exercising its remaining rights becomes remote and with the industry-specific liability accounting guidance in Subtopic 924-405 (*Entertainment – Casinos – Liabilities*).

Lastly, we note that the Financial Accounting Standards Board (the "Board") acknowledged potential accounting mismatches in both timing and amount for certain types of nonrecourse financial liabilities and proposed guidance to address those mismatches as part of its 2013 Exposure Draft on the recognition and measurement of financial instruments.<sup>2</sup> However, we understand that, after redeliberations, the

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<sup>2</sup> See paragraphs 825-10-35-11, BC138, and BC139 from the Proposed Accounting Standards Update – *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, issued February 14, 2013.

recognition and measurement of financial instruments project is not expected to provide incremental guidance with respect to accounting for nonrecourse financial liabilities. We also understand that this issue may be further impacted by the Board's project on accounting for impairment of financial instruments.

\* \* \* \* \*

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 comment on the proposed Update. 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, slightly slanted style.

Timothy Kviz  
Vice President – Accounting Policy

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

## **Appendix A – Nonrecourse Debt Transactions**

### **Transaction 1 – Consolidation of Variable Interest Entity**

Freddie Mac purchases single-family residential mortgage loans from mortgage lenders. After an aggregation period, Freddie Mac sells a pool of mortgage loans to a trust that funds the purchase of the mortgage loans by issuing senior and subordinate debt securities. Freddie Mac guarantees the senior debt security but does not guarantee the subordinate debt securities, which receive payment based solely on the cash flows of the underlying mortgage loans and provide credit protection to Freddie Mac by absorbing losses on the underlying mortgage loans until their balances are reduced to zero. Freddie Mac is the primary beneficiary of the trust and therefore consolidates the trust, recognizing the assets and liabilities of the trust on its consolidated balance sheet. When the underlying mortgage loans default, the outstanding balance of the subordinate debt securities is reduced and is not required to be repaid by Freddie Mac. We believe that the reduction of the balance of the subordinated debt securities upon default of the underlying mortgage loans is conceptually similar to the breakage that occurs on prepaid stored value cards.

### **Transaction 2 – Issuance of Unsecured Debt**

Freddie Mac purchases single-family residential mortgage loans that it intends to hold until payoff or maturity. In order to transfer a portion of the credit risk of the purchased mortgage loans to third-parties, Freddie Mac issues unsecured nonrecourse corporate debt whose repayment is based solely on the payment performance of a reference pool of the purchased mortgage loans. When the mortgage loans in the reference pool default, the outstanding balance of the debt is reduced and is not required to be repaid by Freddie Mac. We believe that the reduction of the debt balance upon default of the mortgage loans in the reference pool is conceptually similar to the breakage that occurs on prepaid stored value cards.