



November 28, 2016

Susan M. Cospers
Technical Director
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. 2016-340, Proposed Accounting Standards Update –
Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): *Premium
Amortization on Purchased Callable Debt Securities***

Dear Ms. Cospers:

Freddie Mac appreciates the opportunity to comment on the Exposure Draft for the proposed Accounting Standards Update of Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs (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. As of December 31, 2015, we held approximately \$114.2 billion of investments in debt securities, most of which were mortgage-related, and had approximately \$1.6 trillion of mortgage-related debt that was issued by our consolidated variable interest entities (“VIEs”). Also, we are a regular issuer of callable debt securities, with approximately \$110.2 billion of callable debt obligations outstanding as of December 31, 2015.

While we support the Board’s objective to better align an investor’s interest income recognition with the economics of the underlying instruments, we believe the proposed update fails to achieve this objective, while creating greater costs and operational complexity for investors, and resulting in asymmetrical financial reporting for investors and issuers. Furthermore, we believe the Board should clarify whether the scope of the proposed update is intended to include mortgage-related securities where the underlying collateral is pre-payable, or whether the scope is intended to be limited to callable debt securities that may be called solely by an issuer.

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

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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.

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 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. Nicholas 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 – Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.

Question 1: Do you agree that premiums on purchased callable debt securities should be amortized to the earliest call date? Please explain why or why not.

Response: No. While we support the Board’s objective to better align an investor’s interest income recognition with the economics of the underlying instruments, we believe the proposed update fails to achieve this objective, while creating greater costs and operational complexity for investors, and resulting in asymmetrical financial reporting by investors and issuers. Furthermore, we believe the Board should clarify whether the scope of the proposed update is intended to include mortgage-related securities where the underlying collateral is pre-payable or whether the scope is intended to be limited to callable debt securities that may be called solely by an issuer.

Objective of the Proposed Update

In the Basis for Conclusions, the Board states that the proposed update will result in an accounting model that more closely aligns the premium amortization period with the expectations that are incorporated by market participants in pricing the underlying instruments. Specifically, market participants will price the debt security to its earliest call date when the coupon of that debt security exceeds the current market rate (that is, the security is trading at a premium), as it is expected that the issuer will act in its economic best interest and will therefore exercise its call option. As a result, the Board believes that the proposed update to amortize the purchase premium to the earliest call date, will result in interest income recognition that is more aligned with the economics of the underlying instruments.

While this statement is true at acquisition, the proposed update ignores subsequent changes in the economics of the underlying instruments that are attributed to changes in market interest rates. For example, if after acquisition, but prior to the earliest call date, market interest rates were to increase above the security’s coupon rate, the proposed update would not require an investor to reassess the premium amortization period, nor would it require the investor to reset the debt security’s effective interest rate. As a result, an investor’s interest income recognition may not align with the current economics of the underlying instruments, thereby failing to achieve the Board’s objective.

To achieve the Board’s objective, investors would need to reassess the probability that an issuer will exercise its call option when market interest rates exceed the security’s coupon rate. In making this determination, investors would need to consider current information, including the market’s expectation of future interest rates. If an investor determines that it is no longer probable that the issuer will exercise its call option, an investor would need to reset both the amortization period and the effective interest rate for the debt security, as of the date of reassessment. While an ongoing reassessment would achieve the Board’s objective, it would also be more complex and operationally burdensome to preparers of financial statements. As a result, we believe the current accounting model is preferable compared to the proposed update.

Asymmetrical Financial Reporting

It is not clear why the proposed update does not address the issuer's accounting for the same instrument, as we would expect the accounting treatment by an investor and issuer to be symmetrical.

Consistent with an investor's accounting for premiums on callable debt securities under current GAAP, an issuer of callable debt securities will amortize the associated premium to the debt's contractual maturity date, regardless of the likelihood, at issuance (or reissuance), of the call option being exercised. Consequently, if the debt security is subsequently called, the issuer would recognize a gain equal to the unamortized premium. We believe the same reasoning discussed in the proposed update to support the change to an investor's accounting for premiums on purchased callable debt securities, would apply to the issuer's accounting for premiums on the same instrument. For example, the same considerations used by market participants to price the security from an investor's perspective would be considered by market participants to determine the price that an issuer would need to pay to transfer the liability.

Furthermore, to the extent mortgage-related securities are within the scope of the proposed update, issuers of these securities may need to apply different amortization models to lots of the same security CUSIP, despite the underlying risk of prepayment associated with those lots being the same. For example, as an issuer of mortgage-related securities, we often issue or reissue lots of the same security CUSIP at different points in time based on prevailing market conditions. As a result, certain of these lots may be issued at a premium, while other lots may be issued at a discount. The lots issued at a premium could be within the scope of the proposed update and therefore amortized to earliest call date (i.e., immediately given the mortgagor's option to prepay the loan on demand), while lots issued at a discount would not be in scope and therefore amortized to contractual maturity.

Scope of the Proposed Update

We believe the Board should clarify whether the scope of the proposed update is intended to include mortgage-related securities where the underlying collateral is pre-payable, or whether the scope is intended to be limited to callable debt securities that may be called solely by the issuer.

While we believe the scope of the proposed update was intended to be (and should be) limited to callable debt securities where the call option is held solely by the issuer, the Master Glossary section of the Accounting Standards Codification does not include a formal definition of callable debt securities. If mortgage-related securities are intended to be within the scope of the proposed update, an investor would be required to immediately recognize into earnings the entire purchase premium, as the underlying loans that back the mortgage-related securities may be prepaid by the mortgagor on demand. To the extent that the Board agrees that an investor and an issuer's accounting should be symmetrical, an issuer would also need to immediately recognize into earnings, any premiums recognized on the issuance of the mortgage-related securities.

If the issuer's accounting for premiums on the mortgage-related securities of its consolidated VIEs changes as a result of the proposed update, we believe it would also be necessary for the Board to provide the issuer (i.e., the primary beneficiary of the consolidated VIE) with the ability to change its accounting election for amortizing premiums on the underlying assets of the consolidated VIEs. While ASC 310-20-35 permits a reporting entity to include estimated future principal prepayments when calculating the constant effective yield for a large number of loans for which it is probable that prepayment will occur, no such option is provided to issuers in the debt

guidance. As a result, issuers of mortgage-related securities will generally make an accounting policy election to exclude estimated future principal prepayments from their calculated constant effective yield and will therefore amortize the premiums to the underlying asset's contractual maturity. This accounting election is often made to reduce the potential earnings volatility that would otherwise exist, if the amortization periods for the loan premiums and debt premiums were different.

Greater Costs and Operational Complexity

Finally, it is our view that the cost of the proposed update will likely exceed the benefit for most investors. While the scope of the proposed update includes premiums on all types of callable debt securities, the largest benefit (i.e., interest income recognition that is more aligned with the economics of the underlying instruments) will be realized by investors of municipal debt securities, as these securities are issued at significant premiums, while most non-municipal callable debt securities are issued or trade at or near par. As a result, the operational cost to an investor with a nominal portfolio of municipal debt securities will likely exceed the benefit realized from the proposed update.

Specifically, as the scope of the proposed update is limited to premiums on callable debt securities, investors will incur additional costs to modify their accounting systems, while adding operational complexity to their existing control processes, as premiums on callable debt securities will be amortized differently than premiums on non-callable debt securities and discounts on all types of debt securities.

Question 2: How much time would be needed to implement the proposed amendments? Should entities other than public business entities be provided more time? Should early adoption be permitted?

Response: As the proposed update will require that investors make certain system and process modifications, we believe the Board should provide one full calendar year from finalization of the ASU to its implementation effective date. However, we believe early adoption should be permitted.

Question 3: Do you agree with the proposed transition method and disclosures in paragraph 310-20-65-1(c)? Please explain why or why not.

Response: Yes. We agree that the application of a modified retrospective approach would be preferable due to practicability concerns with respect to full retrospective application. Further, we agree that an entity should provide the relevant disclosures for a change in accounting principle, as required by ASC 250-10-50-1 through 50-3.