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By Comments Online process at: <http://comments.cftc.gov> and [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

February 22, 2011

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Joint Proposed Rule; Proposed Interpretations: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"; RIN 3235-AK65; SEC File No. S7-39-10

Dear Secretaries Stawick and Murphy:

Freddie Mac is pleased to submit these comments in response to the Joint Proposed Rule regarding the further definition of certain terms, published by the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC"; and together with the CFTC, the "Commissions") on December 21, 2010 (the "Proposal")<sup>1</sup>, pursuant to Section 712(d)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Freddie Mac was chartered by Congress in 1970 with a public mission to stabilize the nation's residential mortgage markets and expand opportunities for homeownership and affordable rental housing. Our statutory mission is to provide liquidity, stability and affordability to the U.S. housing market. Freddie Mac uses swaps to hedge large-scale commercial risks on an ongoing basis. Freddie Mac currently operates under the direction of the Federal Housing Finance Agency ("FHFA") as our Conservator.

Freddie Mac supports the goals set forth in the Proposal of reducing systemic risk and promoting market integrity through the proper regulation of the swaps markets. With regard to the Proposal's further definition of the terms "swap dealer," "security-based swap dealer," "major swap participant," and "major security-based swap participant," we appreciate the efforts of the Commissions to develop definitions that are clear and objective, that create rational criteria for qualification as one or more of these entities, and that recognize differences in the risk presented by different types of derivatives.

We believe the sequence in which the Commissions are proposing the rules that further define certain terms makes it difficult to provide meaningful comments on these proposals. In particular, the Commissions have not yet proposed rules clarifying the scope and meaning of the terms "swap" and "security-based swap" (collectively, "Swaps"). Therefore, Freddie Mac is not in a position to know whether many of our transactions may be deemed Swaps, much less the reasonableness of the proposed tests for determining when an entity is required to register

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<sup>1</sup> 75 Fed. Reg. 80174.

with one or both Commissions as a result of its Swaps activity (e.g., as a “major swap participant”), or the manner in which such an entity would be regulated.

Therefore, we respectfully request that the Commissions extend the period for commenting on the Proposal, or await finalization of the Proposal, until the term “Swaps” has been further defined and market participants have had the opportunity to consider any proposed definitions. In addition, we think it would be useful for the Commissions to conduct a market survey as to the types and numbers of entities that might qualify as swap dealers or major swap participants depending on how Swaps are ultimately defined.

## **I. The Need for Rules Further Defining “Swaps”**

Section 1(a)(47) of the Commodity Exchange Act, as amended by the Dodd-Frank Act, provides in part that subject to application of an exception (and subject to the authority of the Commissions to further define Swaps), the term “swap” includes a contract:

that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence.

Section 3(a)(68) of the Securities and Exchange Act, as amended by the Dodd-Frank Act, provides in part that a “security-based swap” includes a “swap” that is based on (i) “a narrow-based security index,” (ii) “a single security or loan” or (iii) “the occurrence, nonoccurrence, or extent of the occurrence of any event relating to a single issuer of a security or the issuers of securities in a narrow-based index.”

Without further rulemaking, and in particular without refinement of the concept that Swaps are contracts dependent on contingencies with an economic consequence (including the non-occurrence of contingencies), the above definitions are of uncertain scope. Read broadly, the definitions could be read to provide that virtually any contract is a swap, security-based swap or mixed swap, since it is a fairly unusual financial contract the completion of which is not subject to at least the non-occurrence of certain contingencies. Further, with respect to contracts involving loans (including mortgage loans), the fact that a “loan” is within the second prong of the “security-based swap” definition, but not the other two prongs, creates additional uncertainty as to when a derivative relating to a loan or group of loans is a “security-based swap” or a “mixed-swap” rather than a “swap.”

As we described in our September 20, 2010 letter to the Commissions in response to the Advance Notice of Proposed Rulemaking regarding certain definitions in the Dodd-Frank Act,<sup>2</sup> Freddie Mac regularly engages in various transactions involving mortgages and mortgage-backed securities. For example, we engage in forward purchases of mortgages from lenders, forward purchases and sales of mortgage-backed securities in the “To Be Announced” (TBA) market<sup>3</sup> and the sale of mortgages and mortgage-backed securities into pooling entities as part

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<sup>2</sup> 75 Fed. Reg. 51429.

<sup>3</sup> A TBA trade in mortgage-backed securities represents a contract for the purchase or sale of mortgage-backed securities to be delivered at a future date; however, the specific mortgage-backed security that will be delivered to fulfill the trade obligation, and thus the specific characteristics of the mortgages

of the securitization process. Freddie Mac also backs the mortgages it sells with payment guarantees. We also provide a variety of standby commitments and backstop arrangements to borrowers and lenders in the housing markets to facilitate mortgage origination. These forward purchases, sales and related credit facilities, all of which are subject to FHFA regulation, allow us to fulfill our statutory mission of supporting the housing markets and we do not believe that Congress intended for these transactions to be treated as “swaps” or “security-based swaps.” However, until we know whether the Commissions agree with our understanding and how they will further define “Swaps,” we cannot comment meaningfully on the reasonableness or potential impact of the tests provided in the Proposal or the Commissions’ proposed substantive regulations for swap dealers and major swap participants.

Given the variety of the transactions that are a regular part of Freddie Mac’s activities in support of the housing market, it will be difficult to apply the tests in the Proposal to our book of transactions or consider the effects the Commissions’ proposals could have under various scenarios. That difficulty is multiplied when there is so much ambiguity as to what may be considered a Swap, particularly as to the potential impact of the tests for being a major swap participant. For example, some of Freddie Mac’s mortgage-related and debt securities transactions have embedded interest-rate options, as one would expect in transactions tied to the housing market. Other transactions involve payments or deliveries that are contingent on the non-occurrence of certain negative events, such as a borrower’s default. Others provide for payments that are contingent on the occurrence of events, and still others involve guarantees rather than principal positions. Depending on how the Commissions ultimately define Swaps, the result could be that some, none or all of these transactions are deemed Swaps. Indeed, depending on the Swap definitions, even the process for assessing which of Freddie Mac’s contracts are Swaps could be difficult. Thus, while the Commissions have asked for feedback as to the practical aspects of implementing the Proposal, without rulemaking on the definition of Swaps, we cannot provide a meaningful answer to this question. Equally important, in the absence of greater definitional clarity, we cannot determine the potential impact of the proposed quantitative tests on Freddie Mac’s business.

Greater clarity as to what is a Swap is also critical to an assessment of the method of allocating Swaps to the “major categories” and the risk factors proposed by the Commissions for purposes of determining whether an institution is a major swap participant. For example, assuming that some or all of our mortgage transactions are ultimately determined to be Swaps, they would likely be included in the major categories delineated as “credit swaps” or “security-based credit derivatives” under the Proposal. These categories of Swaps appear to have been created primarily to group credit default swaps and similar contracts. Accordingly, the risk multiplier used for these Swap categories for purposes of calculating “potential outward exposure” is high, and the thresholds for exposures that would be deemed to constitute a systemically significant “substantial position” are low. However, the bulk of Freddie Mac’s forward mortgage purchase agreements are simply commitments to purchase performing mortgages from lenders shortly after they are originated and forward purchase and sale of mortgage-backed securities in the TBA market. These transactions are not particularly risky, and should attract risk multipliers closer to those for interest rate swaps, rather than those appropriate for credit default swaps. In short, the determination as to what is a “Swap” should drive the assessment of the appropriateness of the tests and categories in the Proposal.

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underlying the mortgage-backed securities, are not known at the time of trade, but only announced shortly before the trade is settled.

Additionally, we note that if institutions that participate in the mortgage origination and securitization process determine that they are deemed to be swap dealers or major swap participants by virtue of their related transactions, they will need to assess how the Commissions' proposed substantive regulations would apply to their situations. We respectfully submit that the Commissions should also consider to what extent substantive Swaps regulation is appropriate for this context and to what extent such regulation would need to be tailored for this particular context. Absent such consideration, the potential unintended consequences for the housing and mortgage lending markets could be significant.

## **II. Request for Extension**

In light of the uncertainties described above, we believe it is critical that the Commissions extend the comment period for the Proposal, or await finalization of the Proposal, until such time as the Commissions have had the opportunity to further define the term "Swaps" and obtain feedback from interested parties. In addition, we think it would be useful for the Commissions to conduct a market survey as to what types of entities will likely be defined as swap dealers or major swap participants depending on how Swaps are defined.

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Freddie Mac appreciates the opportunity to provide our views in response to the Proposal. Please contact me if you have any questions or would like further information.

Sincerely,



Lisa M. Ledbetter