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Lisa M. Ledbetter
Vice President and Deputy General Counsel
Legislative & Regulatory Affairs

Tel: (703) 903-3189
Fax: (703) 903-4503
lisa_ledbetter@freddiemac.com

8200 Jones Branch Drive
MS 211
McLean, VA 22102-3110

By Comments Online process at: <http://comments.cftc.gov>

April 11, 2011

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

Re: Notice of Proposed Rulemaking: Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants; RIN 3038-AC96

Dear Secretary Stawick:

Freddie Mac is pleased to submit these comments in response to the Notice of Proposed Rulemaking regarding Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, published by the Commodity Futures Trading Commission (the Commission) on February 8, 2011 (the Proposal)¹ under Section 731 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 affordable homeownership and 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 as our Conservator.

Summary

Freddie Mac supports the Commission's goal of promoting timely and accurate documentation of all swaps. We are concerned, however, that the Proposal imposes potentially unnecessary and unworkable burdens on the swap valuation and collateral administration process for bilateral swap transactions not subject to centralized clearing. Accordingly, as discussed below, Freddie Mac recommends that the Commission modify the Proposal to provide that a swap dealer or major swap participant would comply with the requirements for documenting the terms of a swap trading relationship with respect to valuation terms when it executes a negotiated version of an industry-accepted form of agreement providing for a commercially reasonable valuation methodology.

Discussion

Freddie Mac has substantial experience in transacting over-the-counter (OTC) interest rate swaps that will become subject to Commission regulation under the Dodd-Frank Act. As is

¹ 76 Fed. Reg. 6715.

typical for this market, Freddie Mac and its counterparties use counterparty-specific negotiated versions of the International Swaps and Derivatives Association (ISDA) Master Agreement and related Credit Support Annex (CSA). Each such ISDA agreement and CSA sets forth comprehensive terms governing the trading relationship between the parties, including provisions for netting of transactions, valuation of net exposures, and the pledge, return, use and administration of collateral, among other things.

In Freddie Mac's view, such agreements should be deemed sufficient to meet the statutory requirements of § 4s(i) of the Commodity Exchange Act (CEA), added by § 731 of the Dodd-Frank Act, which require "timely and accurate confirmation, processing, netting, documentation and valuations of all swaps." However, under the Proposal, the Commission would add additional specific requirements for swap documentation that would, in our view, impose an unnecessary burden on the process of documenting and managing the relationship between swap counterparties.

Under proposed § 23.504(b)(4), market participants would be required to include terms in their documentation under which

the parties agree on the methods, procedures, rules and inputs for determining the value of each swap.... To the maximum extent practicable, the valuation of each swap shall be based on objective criteria, such as recently-executed transactions or valuations provided by independent third parties such as derivatives clearing organizations.... Such methods, procedures, rules, and inputs ... shall be stated with the specificity necessary to allow [the parties], the Commission and any applicable prudential regulator to determine the value of the swap independently in a substantially comparable manner... [and] shall include alternative methods for determining the value of the swap in the event of the unavailability or other failure of any input required to value the swap, provided that the alternative methods for valuing the swap comply with the requirements of this section.

Freddie Mac believes that the foregoing provisions are unnecessarily specific and unduly restrictive. In Freddie Mac's experience, while the parties to OTC interest rate swaps endeavor to eliminate subjective elements from valuation computations, eliminating all discretion of the parties to compute valuations both assumes a level of precision which may not be possible and, effectively, may produce a commercially unreasonable result based upon application of a predetermined contractual rule set. Moreover, Freddie Mac believes such contractual precision, and the elimination of all discretion in valuations, for OTC transactions is unnecessary.

Freddie Mac uses the 1992 version of the ISDA agreement which provides for two types of valuation computations: "Market Quotation" and "Loss." While Freddie Mac prefers to use an averaging of multiple market quotes from leading dealers in making valuations as provided by the "Market Quotation" method (and believes its counterparties also prefer to use objective quotes), in some cases it is necessary to interpolate between observed quotes to accurately value a position. In other cases, quotes may not be available at all or in sufficient numbers or, otherwise, may produce results that are not "commercially reasonable." In such cases, under the 1992 ISDA agreement, the valuation methodology reverts to "Loss," which includes amounts a counterparty reasonably determines in good faith to be its total losses and costs, including counterparty-specific costs such as funding costs and costs of "breakage" and replacement of

hedges, among other things.² The foregoing methodologies have served Freddie Mac well over the years both in administering the movements of collateral for performing counterparties and closing out defaulting counterparties. We note that Freddie Mac's current swap valuation methodology provides a level of verification and validation assurance that is fully sufficient for both financial and regulatory reporting purposes.

In Freddie Mac's view, by eliminating all discretion in valuation, the Proposal could, unnecessarily and to the detriment of contracting parties and the market as a whole, result in commercially unreasonable valuations or the inability to produce valuations at all.³ Accordingly, Freddie Mac recommends that the Commission modify the Proposal to provide that the requirements of CEA § 4s(i) with respect to documentation of the valuation of swaps are met when the parties execute a negotiated version of an industry-accepted master agreement providing for a commercially reasonable valuation methodology.

* * *

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

² In fact, the market is moving in the direction of greater discretion, as reflected in the 2002 ISDA agreement, which affords the parties additional discretion in the calculation of swap valuations.

³ The Commission has indicated that the specificity for documentation of valuation methodologies required under the Proposal "is an important complement to previously proposed § 23.502 (portfolio reconciliation) which requires swap dealers and major swap participants to resolve a dispute over valuation within one business day" (see 76 Fed. Reg. 6719). Freddie Mac has previously commented, however, that the imposition of such a deadline may be unrealistic and should be replaced with a "commercial reasonableness" standard. See Freddie Mac Letter to David A. Stawick re: Notice of Proposed Rulemaking: Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants; RIN 3038-AC96 (Feb. 28, 2011).