ISDA

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Mr. Alfred Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Electronic Delivery: RegComments@ofheo.gov

Dear Mr. Pollard:

ISDA appreciates having the opportunity to comment on OFHEO's improvements to the Risk-Based Capital Rule (66 FR 65146) published on December 18, 2001. We are encouraged by OFHEO's modifications but believe additional adjustments are necessary in order for the rule to accurately reflect OTC derivatives exposure measurement. We offer the following comments for your consideration.

Stress Test Haircut – Derivative Counterparties

OFHEO correctly notes that current derivative counterparty exposures are marked to market at least weekly and that high quality collateral is posted against any significant exposures by counterparties with less than a AAA rating.

OFHEO's proposal also appropriately recognizes the 10-day horizon over which the Enterprises could be exposed to changes in the values of their derivative contracts. As we have previously noted, this is the horizon that major market participants assume for their own modeling.

However, by our calculations, OFHEO's haircuts remain 10 times higher than ISDA's proposed haircuts. We believe our proposal accurately and conservatively reflects OTC derivatives exposure measurement and mitigation techniques used in the market and urge OFHEO's adoption of our proposal.

Comparison between ISDA and OFHEO capital requirements on a "cash flow" basis

10 year swap, 10 year phase-in (as per our letter to OFHEO dated 10 October)

Rating	***ISDA haircut*** *Notional %*	***ISDA haircut*** *Cashflow %*	***OFHEO haircut (12/18/01)*** *Cashflow %*
AAA	0.010%	0.05%	0.5%
AA	0.015%	0.10%	1.25%
A	0.030%	0.15%	2%
BBB	0.060%	0.30%	4%

Additionally, the amendments to the Risk-Based Capital Rule proposed in December, include haircut charges for foreign currency swap counterparties that are applied differently than the haircuts for other swaps. Section 3.8.3.10 of the proposal states that haircut charges for foreign currency swap counterparties are applied to the pay (dollar denominated) side of the currency swaps, or to the cash outflows of the synthetic debt instrument. We propose that OFHEO apply haircuts for foreign currency swaps based on the net amount owed, which is the normal application for haircuts. We are concerned that, at the proposed levels, the haircuts for foreign currency transactions will have negative implications for Enterprise access to foreign debt markets. Regulations that increase the cost of this access beyond any reasonable estimate of the risks are not in the public interest.

Netting of Derivative Counterparty Exposures

We also appreciate OFHEO's recognition of the counterparty credit risk mitigation effects of netting attained through the use of master netting agreements. Enforceable netting contracts permit risk managers to determine counterparty credit risk more precisely. The risk reduction attainable through netting is significant: according to the Bank for International Settlements, the global mark-to-market value of outstanding OTC derivatives at the end of June 2001 just over $3.0 trillion; close-out netting reduced the net amount to just over $1.0 trillion (BIS, *The global OTC derivatives market at end-June 2001*, December 20, 2001).

OFHEO correctly recognizes that master netting agreements allow the Enterprises to net their exposures at a counterparty level rather than netting at the individual contract level. To achieve this goal, OFHEO proposes to model the terms of master netting agreements and then apply specified haircuts to the resulting net amount due, if, any from each derivatives counterparty. We believe further information is necessary to determine the accuracy of OFHEO's software modeling the terms of master netting agreements. We also recommend a detailed explanation of OFHEO's methodology utilized to determine the difference between pre-implementation of netting and post-implementation of netting is also recommended.

For transactions with counterparties subject to a master netting agreement, we recommend that OFHEO adopt ISDA's suggested haircuts. In practice, this is likely to apply to virtually all Enterprise transactions. The ISDA haircuts incorporate the effects of netting through the prevailing market practice of measuring current exposure and potential future exposure. We believe this approach would correspond more closely to actual risks.

Phase-In

OFHEO correctly adjusted the phase-in period from five years to ten years. ISDA welcomes this modification and believes this adjustment places the haircuts in better proportion with actual risk.

Conclusion

OFHEO's responsiveness and desire to formulate regulations appropriate to the market is to be commended. We appreciate the many improvements made in the December 18, 2001 proposed amendment and hope that you will consider adopting our suggestions in the final regulation. Please do not hesitate to contact Stacy Carey, Policy Director, or David Mengle, Head of Research in our New York office at (212) 332-1200 or Emmanuelle Sebton, Head of Risk Management, in our London office at (207) 330- 3550.

Sincerely,

Robert G. Pickel

Robert G. Pickel
Executive Director and Chief Executive Officer