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By email to RegComments@fhfa.gov

December 4, 2012

Alfred M. Pollard
General Counsel
Office of the General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Re: Stress Testing of Regulated Entities; RIN 2590-AA47

Dear Mr. Pollard:

Freddie Mac is pleased to submit these comments in response to the Notice of Proposed Rulemaking regarding Stress Testing of Regulated Entities, published by FHFA in the Federal Register on October 5, 2012 (the Proposal).¹ FHFA issued the Proposal to implement Section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which requires certain financial companies with total consolidated assets of more than \$10 billion, and which are regulated by a primary federal financial regulatory agency, to conduct annual stress tests to determine whether the companies have the capital necessary to absorb losses as a result of adverse economic conditions. Separately, other financial regulatory agencies (Banking Agencies) have recently finalized analogous stress testing rules for the entities that they regulate (Bank Stress Test Rules).²

Introduction

Freddie Mac generally supports the Proposal and FHFA's decision to follow the overall approach of the Bank Stress Test Rules. Our comments recommend that, in finalizing the Proposal, FHFA provide the regulated entities with sufficient time for implementation, which we believe must be at least nine months following its effective date. In addition, we recommend that FHFA adopt, where appropriate, the approach of the Bank Stress Test Rules in certain instances where the Proposal varies from those final rules. Finally, we recommend that FHFA make certain other revisions and clarifications.

I. Implementation

The Proposal does not specify an intended effective date, but would require Freddie Mac to report results of the annual stress test "[o]n or before January 5 of each year." Proposed

¹ 77 Fed. Reg. 60948. FHFA extended the original comment period by an additional 30 days, through December 4, 2012. 77 Fed. Reg. 66566.

² See Office of the Comptroller of the Currency (OCC) "Annual Stress Test," 77 Fed. Reg. 61238 (Oct. 9, 2012); Board of Governors of the Federal Reserve System (Board) "Annual Company-Run Stress Test Requirements for Banking Organizations with Total Consolidated Assets Over \$10 Billion Other Than Covered Companies" ("Stress Test Rule"), 77 Fed. Reg. 62396 (Oct. 12, 2012); Federal Deposit Insurance Corporation (FDIC) "Annual Stress Test," 77 Fed. Reg. 62417 (Oct. 15, 2012).

§ 1238.5(a). Furthermore, the Proposal requires the regulated entities to “establish and maintain a system of controls, oversight, and documentation, including policies and procedures, designed to ensure that the stress testing processes used by the regulated entity are effective....” Proposed § 1238.4(d)(1). Because it is difficult for Freddie Mac to take meaningful implementation steps until after FHFA has promulgated the final rule, we believe that a realistic implementation timeframe would require at least nine months from the date that the Proposal is finalized.

Development of appropriate stress-testing systems and processes can take a significant period of time. Notably, the Banking Agencies have provided most banks with a substantial amount of implementation time under the Bank Stress Test Rules. For example, the Board gives bank holding companies with over \$50 billion in consolidated assets that have not previously participated in annual supervisory stress testing until the November 15, 2013 cycle to comply. See 12 CFR § 252.143(a). Similarly, the Board generally requires companies that become subject to the stress test requirements (after the effective date of the final rule) to conduct their first stress tests in the fall of the calendar year following their becoming subject to the rule. *Id.* at § 252.143(b).

Furthermore, the Proposal establishes more oversight requirements than do the Bank Stress Test Rules, potentially extending the implementation schedule for FHFA-regulated entities. The Proposal requires both the board of directors and senior management of each regulated entity to “approve and annually review their controls, oversight, and documentation, including policies and procedures to ensure compliance” with the stress test rules. Proposed § 1238.4(d)(2). In contrast, the Bank Stress Test Rules do not require board review and approval of “controls” and “oversight.”³

In light of the timing issues addressed above, we recommend that FHFA establish an initial report submission deadline of 270 days after the effective date of the final rule. The deadlines for the reports for subsequent years could then fall on January 5 of the following calendar year.

II. Appropriate Alignment with Bank Stress Test Rules

We recommend that FHFA adopt, where appropriate, the approach of the Bank Stress Test Rules in certain instances where the Proposal varies from those final rules. We recognize that there are differences between the regulated entities under the Proposal and those entities regulated by the Banking Agencies; however, we believe that it would be desirable for FHFA to align the following areas of the Proposal with the Bank Stress Test Rules.

A. Market Value of Equity

The Proposal requires the regulated entities to calculate how Market Value of Equity “is impacted during each quarter of the stress test planning horizon.” See Proposed § 1238.4(a)(3). We recommend that FHFA not require such calculations because determining the Market Value of Equity in three scenarios over the planning horizon (defined at Proposed § 1238.2 as no less than nine quarters) is a complex undertaking and requires significant

³ As discussed below in Section III, we recommend that FHFA clearly distinguish the roles of management and the board of directors so that the board provides oversight of the regulated entity’s implementation of the final rule, and not approval of controls, documentation, policies and procedures.

judgment and process controls. Notably, the Banking Agencies do not require this calculation under the Bank Stress Test Rules.

B. Public Disclosure of Scenario Results

The Proposal requires the regulated entities to disclose publicly a summary of the results of the stress test, including “[a]ggregate losses, pre-provision net revenue, allowance for loan losses, net income, and pro forma capital levels and capital ratios ... over the planning horizon, under each scenario.” Proposed § 1238.7(b)(5). We recommend that FHFA modify the Proposal to limit public disclosure of stress test results to the severely adverse scenario because disclosure of these calculations for the baseline scenario and the adverse scenario effectively could be viewed as a type of earnings forecast. In finalizing their rules, the Banking Agencies recognized this concern, and revised their proposals so that the Bank Stress Test Rules require the disclosure of losses only for the severely adverse scenario. See OCC “Annual Stress Test,” 77 Fed. Reg. at 61241, 12 CFR § 46.8(d); Board “Stress Test Rule,” 77 Fed. Reg. at 62402, 12 CFR § 252.157(b); FDIC “Annual Stress Test,” 77 Fed. Reg. at 62420, 12 CFR § 325.207(c).

C. Reporting Regarding Sensitivity to Rate Shocks

FHFA notes that it is considering requiring the regulated entities to report, for the baseline scenario, the sensitivity of the book value of capital and market value of equity to parallel interest rate shocks. 77 Fed. Reg. 60950. We recommend that FHFA not require this reporting element because Freddie Mac already provides comparable sensitivity disclosure. See, e.g., Freddie Mac’s Form 10-Q for the period ending September 30, 2012, “ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK” at 108-109. In addition, the Banking Agencies do not require such reporting under the Bank Stress Test Rules.

III. Other Recommendations

In addition to our comments above, we recommend that FHFA revise its proposed requirements regarding the oversight role of the regulated entity’s board; revise its proposed alternative date for capturing trading and counterparty exposure data; clarify its requirements concerning the level of detail necessary for quantitative disclosures; and replace certain other reporting after the Proposal is finalized.

- Board Oversight Role – The Proposal requires the board of directors and senior management of each regulated entity to “approve and annually review their controls, oversight, and documentation, including policies and procedures to ensure compliance” with the stress test rules. Proposed § 1238.4(d)(2). We believe that this requirement could be interpreted as assigning a role to the board that is beyond its appropriate oversight role, and requiring the board to have responsibilities for activities that are properly within the role of management. Therefore, we recommend that FHFA revise the Proposal to clarify that the board should provide oversight of the regulated entity’s implementation of the final rule, while senior management would be responsible for approving stress testing controls, documentation, policies and procedures. Further, we believe that FHFA should recognize that the board may delegate its oversight responsibilities to an appropriate committee of the board.
- Trading and Counterparty Exposures – The Proposal specifies that the stress test “data related to the regulated entity’s trading and counterparty exposures” would be used as of

a fourth quarter date specified each year, rather than as of September 30. Proposed § 1238.3(a)(1). We recommend that data related to trading and counterparty exposures be included along with all of the other data that is captured as of September 30, and tailored, as necessary, to our business model. Unlike some banks, trading is not a business line of Freddie Mac, nor is it likely to be a business line of the other regulated entities. Changes in the fair value of trading exposures may be offset, in whole or in part, by changes in the fair value of other balance sheet components similarly reflected in comprehensive income, such as available-for-sale assets, derivatives, and debt for which the fair value option has been elected. Using different "as-of" dates for trading versus non-trading exposures could provide an unbalanced picture of losses that may result from adverse economic conditions. Similarly, our counterparty exposures primarily reflect long-term positions rather than rapidly evolving risks arising from short-term trading activity.

- SEC Filing Standard – FHFA notes that it is considering, under the requirement for quantitative disclosures in the annual report, "comparable level of detail to SEC filings" for income statement and balance sheet reporting. 77 Fed. Reg. 60950. We ask that FHFA clarify what this provision requires.
- Replacing Current Financial Projections – Since 2009, FHFA has requested that Freddie Mac conduct annual financial projections, and FHFA has published the results in 2010, 2011, and 2012. These projections include three scenarios provided by FHFA, including a stress scenario. We recommend that the current FHFA financial projection process be replaced with the stress testing regime that will be established once the Proposal is finalized, in order to avoid duplicative reporting.

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We hope that these responses are helpful. Please do not hesitate to contact me at 703-903-2494 if you have any questions.

Sincerely,



Wendell J. Chambliss
Vice President and Deputy General Counsel
Mission, Legislative and Regulatory Affairs Department
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