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**By Messenger and Electronic Mail ([regcomments@ofheo.gov](mailto:regcomments@ofheo.gov))**

September 23, 2002

**Freddie  
Mac**

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*We Open Doors*<sup>®</sup>

Alfred M. Pollard, Esq.  
General Counsel  
Office of Federal Housing Enterprise Oversight  
1700 G Street, NW  
Fourth Floor  
Washington, DC 20552

Re: Proposed Amendments to Risk-Based Capital Regulation, RIN 2550-AA26

Dear Mr. Pollard:

Freddie Mac appreciates the opportunity to comment on amendments to the Risk-Based Capital Regulation<sup>1</sup> proposed by the Office of Federal Housing Enterprise Oversight ("OFHEO") and published in the Federal Register on September 12, 2002.<sup>2</sup> Through these amendments, OFHEO proposes to make certain corrections and modifications to the Rule, including changes to the calculation of the risk-based capital requirement to better account for the effects of Financial Accounting Standard 133 ("FAS 133").

Freddie Mac has long supported the implementation of a risk-based capital stress test. Reaching the point where the test can be used for capital classification represents a tremendous accomplishment, born of continuous hard work and dedication to the task.

## **I. SUMMARY**

Freddie Mac agrees with the substance of the proposed amendments. The correction of typographical errors and the substitution of sources for data where the original source is no longer available are essential to operate the stress test in accordance with its intended specifications, and we support updating various specifications from time to time to reflect more up-to-date data. Also, we believe that the proposed amendments relating to FAS 133 will better integrate that accounting standard into the calculation of the risk-based capital requirement by making the treatment of FAS 133 in the calculation of the risk-based capital requirement more consistent with the treatment of

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<sup>1</sup> 12 C.F.R. Part 1750, as amended (the "Rule").

<sup>2</sup> 67 Fed. Reg. 57760.

FAS 133 in the Rule's calculation of Total Capital.<sup>3</sup> We support those proposed amendments notwithstanding the fact that we expect that one amendment related to FAS 133 would increase our capital requirement by a substantial amount in the current environment.<sup>4</sup>

While we support the substance of the proposed amendments, we have substantial concerns about the possibility of an immediate effective date for amendments that could increase Freddie Mac's capital requirements by more than \$1 billion for the first capital classification to take risk-based capital requirements into account. However, we would support OFHEO's making all of the other amendments effective immediately when issued.

We also have reservations about the proposed use of guidelines to update certain specifications outside of the text of the Rule, particularly because the Rule would not specify the methodology that the guidelines would apply.

We discuss each of our specific concerns about the proposed amendments in greater detail below.

## II. EFFECTIVE DATE OF PROPOSED AMENDMENTS

Three of the 17 proposed amendments could increase Freddie Mac's risk-based capital requirements,<sup>5</sup> one quite significantly,<sup>6</sup> yet the proposal is silent as to their effective dates. The omission of a proposed effective date, combined with the unusually short (10-day) comment period, raises the possibility that OFHEO would consider making these amendments effective – and possibly raising Freddie Mac's risk-based capital requirement by more than \$1 billion – within days of the end of this quarter. This would be particularly unreasonable at this time because the third-quarter capital classification will be the first one in which OFHEO will take the Enterprises' risk-based capital requirements into account.

Such an immediate effective date would be contrary to (1) the minimum delay in effective date required under the Administrative Procedure Act (APA), (2) the intent of

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<sup>3</sup> Our support of the FAS 133-related amendment (proposed § 3.12.3 [a] 9) is based on the actual proposed text of this amendment and not on the more general preamble discussion, which does not precisely describe the proposed amendment. Compare proposed § 3.12.3 [a] 9 to 67 Fed. Reg. at 57761.

<sup>4</sup> Given that OFHEO estimates that the FAS 133-related portion of the proposed amendments would have resulted in an increase in Freddie Mac's capital requirement of more than \$1.6 billion for a recent period, we question the conclusion that the proposed amendments "are not economically significant for purposes of Executive Order 12866." See 67 Fed. Reg. at 57761.

<sup>5</sup> Items designated as 1.m ("Revise Table 3-68 in paragraph 3.8.3.6.1 [e] 2"); 1.n ("Revise paragraph 3.10.3.2 [a] 2"); 1.r ("Add new paragraph 3.12.3 [a] 9 after paragraph 3.12.3 [a] 8). 67 Fed. Reg. at 57762.

<sup>6</sup> Item 1.r, *id.*

Congress, (3) the best practices of federal regulators of financial institutions and (4) OFHEO precedent.

We recommend that, OFHEO provide the 30-day delay in effective date required by the APA with respect to the three amendments that could increase capital requirements. The first application of these amendments then would be the classification at December 31, 2002. As for the other, corrective amendments, we would have no objection to their being effective immediately. We also recommend that OFHEO establish a general policy that future amendments having a substantive impact on capital requirements would apply as of the end of the first reporting period beginning 60 days or more after publication of a final rule.

## A. Discussion

### 1. APA Requirements

The APA establishes the legal minimum of a 30-day delay in the effective date of any rulemaking, except for rules granting or recognizing an exemption or relieving a restriction, interpretative rules or statements of policy, or as otherwise provided by the agency for “good cause found and published with the rule.”<sup>7</sup> Regulations adopted outside of required APA procedures run the risk of being unenforceable.<sup>8</sup>

The proposal gives no notice of an intention to find good cause for immediate effectiveness of the amendments<sup>9</sup> and we believe that there is no factual foundation for such a finding.<sup>10</sup> Notably, the impact of the proposed amendment would be

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<sup>7</sup> 5 U.S.C. § 553(d)(3). In contrast to the clear application of the APA’s requirements for a 30-day delay in effective date for *amendments* to the Rule, OFHEO determined that the 1992 Act provision that the *final* Risk-Based Capital Rule “shall take effect upon issuance,” 1992 Act § 1361(e)(1), overrode the provisions of the APA that otherwise require a 30-day delay in the effective date for substantive rules and did not give the Director discretion to change that timetable for the final Rule. See 66 Fed. Reg. 47730, 47792 (Sep. 13, 2001). While the final Risk-Based Capital Rule had an immediate effective date, the 1992 Act specifies that the results of the stress test are not considered in capital classifications for one year following issuance. 1992 Act §§ 1364(d), 1365(c). This statutory requirement for all intents and purposes extended the effective date of the Risk-Based Capital Rule to the first reporting period beginning one year following issuance of the final rule.

<sup>8</sup> See 5 U.S.C. § 706(2)(D) (Court reviewing agency action shall “hold unlawful and set aside agency action, findings, and conclusions found to be . . . without observance of procedure required by law”).

<sup>9</sup> OFHEO states that the reason for the short comment period is because the proposal “is not expected to generate significant commentary.” 67 Fed. Reg. at 57761.

<sup>10</sup> Courts have interpreted the availability of the “good cause” exception narrowly. See, e.g., *American Fed’n of Gov’t Emp. v. Block*, 655 F.2d 1153, 1156 (D.C. Cir. 1981) (The good cause exception “will be narrowly construed and only reluctantly countenanced”) (internal quotation and citations omitted). The same court continued, “As the legislative history of the APA makes clear” the good cause exceptions “are not ‘escape clauses’ that may be arbitrarily utilized at the agency’s whim.” *Id.* (quoting S. Rep. No. 752, 79th Cong., 1st Sess. (1945)) (emphasis in original). The D.C. Circuit has also indicated, “In determining whether good cause exists” to dispense with the 30-day requirement, “an agency should balance the necessity for immediate implementation against principles of fundamental fairness which

substantial: OFHEO concludes that the FAS 133 amendment would *increase* Freddie Mac's capital requirement by *29 percent*,<sup>11</sup> an increase that, in many environments, could reasonably take some period of time to accommodate. An Enterprise needs to be able to estimate the effects of any substantive modifications to the Rule's specifications and to be able to adapt to such modifications.

## ***2. Congressional Intent***

The immediate impact of the proposed changes also is contrary to the Congressional recognition that the risk-based capital is sufficiently complex to require time for the Enterprises to adjust to changes. Congress noted that the Director "needs to be sensitive to the need for the GSEs to plan their business strategies with the capital requirements in mind"<sup>12</sup> and cautioned that "frequent, significant changes could interfere unreasonably with that process."<sup>13</sup>

## ***3. Agency Best Practices***

Federal banking agencies routinely provide more than the minimum time mandated by statute for institutions to adjust to material changes in capital requirements, and do not make significant changes effective immediately. Most recently, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision permitted delayed application of a jointly issued change to bank and thrift risk-based capital rules, changing the treatment of recourse obligations, beyond the minimum delay in effective date required by law.<sup>14</sup> While those agencies were permitted by law to make the change effective beginning with the first reporting period occurring 30 days after publication in the Federal Register,<sup>15</sup> they gave regulated institutions the

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require that all affected persons be afforded a reasonable amount of time to prepare for the effective date of its ruling." *Omnipoint Corp. v. FCC*, 78 F.3d 620, 630 (D.C. Cir. 1996) (internal quotation and citation omitted).

<sup>11</sup> See 67 Fed. Reg. at 57761 (FAS 133 amendment would have increased Freddie Mac capital requirement by \$1.652 billion if implemented at March 31, 2002); OFHEO Press Release (June 27, 2002) (posted at [www.OFHEO.Gov](http://www.OFHEO.Gov)) (releasing March 31, 2002 risk-based capital results for Freddie Mac and Fannie Mae, showing a \$5.68 billion capital requirement for Freddie Mac).  $\$1.652 \text{ billion} / \$5.68 \text{ billion} = 0.29$ .

<sup>12</sup> S. Rep. at 23.

<sup>13</sup> *Id.* Congress also strongly recognized the need for time to adjust when it mandated that OFHEO must wait a full year after OFHEO issues the risk-based capital rule before OFHEO can take risk-based capital into account when classifying the Enterprises' capital adequacy. See 1992 Act § 1364(d). The one-year transition period suggests a view that immediate implementation of what is effectively a new, and higher, risk-based capital requirement would be unreasonable.

<sup>14</sup> 66 Fed. Reg. 59614, 59628-29 (Nov. 29, 2001).

<sup>15</sup> See 5 U.S.C. § 553(d) (APA provision prescribing 30-day effective date); 12 U.S.C. § 4802(b) (statute requiring that a regulation issued by a federal banking regulatory agency take effect on the first day of the calendar quarter following publication in final form if the regulation imposes "reporting, disclosures or other new requirements" on insured depository institutions).

option of delaying application of the modified rule by more than a full year after publication if the rule would increase an institution's regulatory capital requirements.<sup>16</sup> The agencies did so to provide their regulated institutions with ample time to adjust to the new rule so that they were able to implement changes in reporting requirements and adjust their business strategies.<sup>17</sup>

#### **4. OFHEO Precedent**

OFHEO also has established a precedent of modifying the Rule consistent with statutory obligations and Congressional intent. OFHEO delayed the effective date on its March 15, 2001 amendments relating to the treatment of counterparty credit risk and refunding assumptions by 30 days.<sup>18</sup> Also, OFHEO denied requests to extend the comment period on the proposal of those amendments to avoid a one-quarter delay in applying that set of specifications, stating, "Applying the new specifications to new data from the Enterprises before the risk-based capital rule becomes fully enforceable in September 2002 will allow the Enterprises to adjust to the revised Rule and for OFHEO to study its effects."<sup>19</sup>

#### **B. Recommendation**

We strongly recommend that, with respect to three amendments that could increase capital requirements, OFHEO provide the 30-day delay in effective date required by the APA. Adherence to this requirement would make the first application of these amendments the classification as of the end of the fourth quarter of 2002. We have no objection to immediate effectiveness of the remainder of the proposed amendments.

With respect to future substantive changes to the Rule, we recommend that OFHEO adopt a policy of making such changes effective not earlier than the end of the first reporting period beginning on or after 60 days after publication of a final rule. A period of 60 days prior to the beginning of a quarter would enable an Enterprise to integrate the change into its capital management and compliance systems, and the full quarter would enable the Enterprise to incorporate the changes into its business strategies. Such a policy also would comply with the requirements under the APA for enforceability and would be similar to the minimum transition time required for the federal bank and thrift regulatory agencies. While it may be possible for the Enterprises to implement some changes more quickly, we believe that a policy of making substantive changes effective only as of the end of the first reporting period beginning 60 days or more after the publication of such changes would set a reasonable baseline.

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<sup>16</sup> 66 Fed. Reg. at 59629.

<sup>17</sup> *Id.* Notably, it is highly unlikely that any of those regulated institutions would have its capital requirement increased by as much as 29 percent as a result of the amended recourse rule.

<sup>18</sup> 67 Fed. Reg. 11850.

<sup>19</sup> *Id.* at 11860.

### III. PROPOSED USE OF GUIDELINES

We do not believe it is appropriate to rely on guidelines as a substitute for establishing stress test specifications in the Rule. While there may be a role for guidelines in establishing some of the procedures associated with applying the stress test as specified in the Rule, we believe that the Rule can meet the 1992 Act completeness standard only if all the specifications necessary to apply the risk-based capital test have been incorporated in the Rule following the notice-and-comment process.

#### A. Discussion

##### 1. *Statutory Completeness Standard*

The 1992 Act expressly requires the risk-based capital rule itself to be sufficiently specific and complete to enable someone other than the Director to apply the test in the same manner as the Director.<sup>20</sup> Moreover, Congress considered and rejected an approach that would permit OFHEO to specify the stress test specifications through a combination of regulations and accompanying guidelines.<sup>21</sup> Notwithstanding such clear indication of Congress' intent, OFHEO proposes to include stress test specifications by reference to guidelines, and does so without any explanation or justification for such deviation from statutory requirements. Furthermore, OFHEO proposes to incorporate into the Rule stress test specifications determined through guidelines that have not yet been released. This aspect of the proposed amendments is especially troublesome if, as discussed earlier in this letter, OFHEO considers making the proposed amendments effective this quarter.

In our view, the express requirements of the Rule and its legislative history create a strong presumption in favor of specifying all aspects of the stress test through regulations issued pursuant to the APA's notice-and-comment process.<sup>22</sup> Even were OFHEO to determine that the use of guidelines was an absolute necessity to keep the stress test up-to-date for specifications that must be updated frequently, the statutory

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<sup>20</sup> See 1992 Act § 1361(e)(2) ("The [risk-based capital] regulations shall be sufficiently specific to permit an individual other than the Director to apply the test in the same manner as the Director.").

<sup>21</sup> The Senate bill precursor to the 1992 Act had provided that "[t]he regulations *and any accompanying guidelines* shall be sufficiently specific to enable each enterprise to apply the test to that enterprise in the same manner as the Director . . .," S. 2733, § 201(e)(3), S. Rep. No. 464, 102d Cong., 2d Sess. 114 (1992) ("S. Rep.") (emphasis added). The 1992 Act, however, did not include the reference to guidelines, and provides that the regulations alone must meet a specificity standard. 1992 Act § 1361(e)(2). Therefore, the statement in the committee report that "[o]rders or guidelines may be used for some of the finer details to permit flexibility to make small changes on a rapid basis when necessary," S. Rep. at 23, cannot be read as an indication of congressional intent to carve out an exception to the specificity requirement of § 1361(a)(2). Moreover, the committee also expressed concern that such use of guidelines or orders could interfere with the need of the Enterprises to plan their business strategies with the capital requirements in mind. S. Rep. at 23.

<sup>22</sup> 1992 Act § 1361(e)(1) (risk based capital statute expressly incorporating by reference the notice-and-comment requirements of 5 U.S.C. § 553).

completeness requirement still would require that the Rule specify the precise methodology or criteria the guidelines must apply to make those updates. Any specified use of a guideline in the Rule needs to be sufficiently complete to eliminate the risk of material variability in capital requirements arising from the use of the guideline.<sup>23</sup>

## ***2. Application of Standards to Proposed Amendments***

While we are not concerned that the specifications OFHEO would establish in the guidelines to which the proposal refers would necessarily be unreasonable, we nevertheless believe that each of those sets of specifications should be incorporated into the Rule to the extent possible. We discuss each specific proposed use of guidelines below.

### **a. Interest-Rates**

In order to calculate the yield for the 30-year Constant Maturity Treasury (“CMT”),<sup>24</sup> OFHEO proposes to reference an estimate produced by “Guideline # 402.” OFHEO indicates, “Guidance in determining interest rates is available under OFHEO Guideline # 402, ‘Risk Based Capital Process for Capturing and Utilizing Interest Rates Files,’ which is available on OFHEO’s website.”<sup>25</sup>

The proposal provides no compelling reason to omit the calculation methodology for the 30-year CMT from the Rule itself. Changes in the availability of interest rate indices occur relatively infrequently and almost always with a significant amount of advance warning. Thus, there is no necessity to turn to the guideline approach rather than incorporating an estimation methodology directly into the Rule consistent with the statutory completeness requirement<sup>26</sup>

### **b. AOLT V Table**

The proposed amendments would replace a static table containing fixed weighted average amortized original LTV (“AOLT V”) values with a blank table, accompanied by a footnote indicating that the table “is updated as necessary with RBC Report

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<sup>23</sup> A further reason to avoid an application of the Rule that depends on guidelines is that such an application necessarily creates an additional body of documentation that one would need to consult in order to duplicate OFHEO’s application of the stress test. Use of guidelines also creates additional opportunities for inconsistent documentation and version-control issues.

<sup>24</sup> The yield of this instrument is necessary to perform the stress test calculation, however the U.S. government no longer offers the instrument.

<sup>25</sup> 67 Fed. Reg. at 57764. This guideline was not yet issued at the time of OFHEO’s proposal.

<sup>26</sup> In contrast, we believe that a good candidate for the use of guidelines to modify stress test specifications might be the updating the identify of data sources (e.g., Bloomberg Ticker references), so long as the selection criteria are included in the Rule. Such updates are absolutely essential, are likely to occur frequently and on an irregular basis and should have no impact on the Enterprises’ calculated capital requirements.

combined Enterprise single-family sold loan group data in accordance with OFHEO guideline # 404.”<sup>27</sup> Thus, it is proposing to replace an already populated table with a blank template whose values will be derived from a yet-to-be-announced guideline, using a methodology not specified in the Rule that would be different from the methodology OFHEO had used to populate the table currently in the Rule.<sup>28</sup>

While we support annual updates of the AOLTIV values, the proposal has provided no evidence of necessity for relying on guidelines to make such updates. Updates can be made on a predictable schedule so there should be no reason why the AOLTIV table could not be amended by way of an annual rulemaking. In addition, OFHEO’s proposed use of a guideline to update AOLTIV values does not specify the methodology for calculating the updated figures. The Rule itself should make clear how updated values would be calculated, thereby providing the public and the Enterprises with the APA’s procedural protections for potentially significant changes in the means of determining stress test specifications.<sup>29</sup>

#### c. Average Loan Size

The proposed amendments would update the “Relative Loan Size” variable in Table 3-3 as follows: “Average loan size for the appropriate quarter is provided by OFHEO in accordance with OFHEO guideline # 403, based on data from both Enterprises.”<sup>30</sup>

We have no objection to the specification of updated average loan size values from time to time. If OFHEO were to determine that quarterly updates were necessary and that it was impracticable to incorporate quarterly updates in the Rule, the statutory completeness standard would still require the Rule to specify the methodology for those updates, to the extent possible.

### **B. Recommendation**

In order to comply with its statutory completeness obligation, OFHEO must establish stress test specifications in the Rule rather than through guidelines. If OFHEO determines that the proposed uses of guidelines in the current amendments are the only practicable alternatives to establish stress test specifications that must be updated

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<sup>27</sup> 67 Fed. Reg. at 57766.

<sup>28</sup> 67 Fed. Reg. at 57760 (Noting that the proposal would amend “Table 3-59, which incorrectly reported values for the weighted average Original LTV, rather than the weighted average Amortized Original LTV (AOLTIV) of the combined Enterprise portfolios by Original LTV category, as of 2Q2000”).

<sup>29</sup> If, as discussed earlier, OFHEO were to make the proposed amendments effective for the current quarter, changes to the AOLTIV Table through an unreleased guideline would be particularly problematic because there is a significant possibility that such changes will have a material impact on the Enterprises’ capital requirements in that they will be based on a change in methodology and will immediately capture some two years of updates. *See id.*

<sup>30</sup> *Id.* at 57762. This guideline was not yet issued at the time of OFHEO’s current proposal.

frequently,<sup>31</sup> we believe that OFHEO nevertheless must include in the Rule detailed descriptions of the precise methodologies that such guidelines would apply.<sup>32</sup>

Freddie Mac recognizes that OFHEO may wish to amend the Rule quickly, precluding it from taking the steps we believe are necessary with respect to this rulemaking. If so, Freddie Mac recommends that OFHEO incorporate the necessary specifications and/or methodologies in the text of the Rule in a subsequent rulemaking.

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Again, thank you for the opportunity to comment on these proposed amendments. Please let us know if there is any additional information you might need as you consider our comments and determine the final form of the amendments.

Very truly yours,



Maud Mater

Executive Vice President and General Counsel

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<sup>31</sup> Another alternative approach to periodic updates would be to base the average loan size or AOLTIV table values on each Enterprise's portfolio and to make the values required data elements to be submitted as part of each Enterprise's the RBC Reports.

<sup>32</sup> Such methodologies should specify that a change in a guideline would be effective only as of the end of the first reporting period beginning 60 days or more after the publication of such change.