

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates

INT 22-01 Dates Discussed

April 4, 2022; May 24, 2022

INT 22-01 References

SSAP No. 43R—Loan-Backed and Structured Securities

SSAP No. 86—Derivatives

INT 22-01 Issue

1. This interpretation is to address questions on the accounting and reporting for Freddie Mac “When-Issued K-Deal (WI Trust) Certificates” (WI Program). Ultimately, the question is whether the structure should be initially captured in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* or as a forward contract in scope of *SSAP No. 86—Derivatives*.
2. The design of the WI Program is summarized as follows:
 - a. Investor acquires WI Trust certificates, which are backed by cash held in the WI Trust and pay a fixed coupon amount funded from a Freddie Mac guarantee.
 - b. Within 90 days, the trust uses the cash to acquire newly issued K-Deal structured pass-through certificates (SPCs) meeting certain pooling parameters laid out in the respective WI Offering Circular Supplement. K-Deal SPC (s) are Freddie Mac-issued structured pass-through certificates backed by the corresponding class of certificates issued by a separate REMIC trust that holds multifamily fixed-rate mortgage loans. The cash flows from the mortgage loans held by the REMIC trust provide pass-through payments to holders of the K-Deal SPCs.
 - c. An investor can choose to continue to hold the WI Trust certificates or exchange dollar-for-dollar their WI-securities into the underlying K-Deal SPCs. In either case, the investor receives a pass-through of cash flows generated by the mortgages held in the REMIC trust and the performance of the K-Deal SPCs is guaranteed by Freddie Mac. If continuing to hold the WI Trust certificates – rather than convert the certificates to K-deal SPCs – the K-Deal SPCs are held by the WI Trust, who in turn passes the cashflows to WI Trust investors. The WI Trust certificates benefit from Freddie Mac payment guarantee which guarantees that any cashflows collected from the K-Deal SPCs will be paid to the WI certificate holders.
3. Additional characteristics on this program include the following:
 - a. The WI Trust certificates are public securities and tradeable shortly after pricing.
 - b. The WI Trust certificates are backed by a Freddie Mac guarantee from acquisition.
 - c. From acquisition of the WI Trust certificates, the investor receives fixed coupon amounts reflective of the investment terms of the K-Deal SPCs.

- d. The WI Trust is obligated to acquire, and Freddie Mac is required to sell, the K-Deal SPCs at the amount stated at the time of initial investment. Meaning, the investor is not at a risk of loss, nor will experience any variation in outcome due to underlying variables that occur from the time of initial investment in the WI Trust until the K-Deal SPCs are acquired. If market forces change the purchase price of the K-Deal SPCs during the 90-days after initial acquisition of the WI Trust certificates, then Freddie Mac is still required to sell the K-Deal certificates at the terms agreed to at original investment. Ultimately, the investor is guaranteed an investment in K-Deal SPCs that reflects the notional value of the WI Trust-certificates and coupon terms at initial acquisition. (For example, if the investor acquired \$100 million of WI Trust certificates at acquisition, when the K-Deals are subsequently acquired, the entity will receive \$100 million of K-Deal SPCs with the same payment terms regardless of any market impacts.)
- e. In the event that Freddie Mac is unable to acquire the K-Deal SPCs within the 90-day period, Freddie Mac is required to return the principal to the investor as well as provide a yield maintenance payment calculated using the full coupon payments that would have been received over the course of the investment.
- f. In the event that the investor elects to exchange the WI Trust certificates to the K-Deal SPCs, the investor receives an equivalent principal amount of the K-Deal SPCs of the same class. Although the investment will have a change in CUSIP, any such exchange is not deemed to be a taxable event as described in the respective Offering Circular Supplements for the WI Certificates. As such investors will not recognize a gain or loss on the exchange and investors will be treated as continuing to own the interests that were owned immediately prior to the exchange. Stated differently, any gains or losses on the exchanged WI-Certificates are “rolled into” the investors’ new K-Deal Certificate position.

4. The question of whether the structure is a loan-backed or structured security, or a derivative is primarily focused on the initial acquisition and the 90-day (or less) timeframe before the WI Trust acquires K-Deal certificates. The question is whether the initial 90-day acquisition of the WI Trust certificate, prior to the trust’s acquisition of the K-Deal certificates, represents a forward contract required to be accounted for under *SSAP No. 86—Derivatives*. Key excerpts from SSAP No. 86 are as follows:

- a. The definition of a derivative instrument from SSAP No. 86, paragraph 4:
 - 4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:
 - a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or
 - b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.
- b. The definition of a forward contract from SSAP No. 86, paragraph 5.d.:
 - 5.d. “Forwards” are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument.

5. This interpretation intends to clarify whether investments in the Freddie Mac WI Program shall be initially captured in scope of *SSAP No. 86—Derivatives* or captured in scope of *SSAP No. 43R—Loan-Backed and Structured Securities*.

INT 21-01 Discussion

6. This interpretation clarifies that investments in the Freddie Mac WI Program shall be captured in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* from initial acquisition, and not as a derivative forward contract, for the following reasons:

- a. The WI Program is fully guaranteed by Freddie Mac and ensures that the investor will receive pass-through certificates, backed by mortgage loans held in trust, that reflect the terms of the investment set at original acquisition. In the event that the K-Deal certificates cannot be acquired, Freddie Mac is guaranteed to provide payment to the investor that reflects the full principal and interest per the original terms of the agreement, which reflects the payments that would have been received overtime if K-Deal certificates had been acquired.
- b. The definition of a forward contract in *SSAP No. 86* reflects an agreement between two parties that commit one party to purchase and another party to sell the instrument underlying the contract at a specified future date. With the WI Trust Program, the investor does not have a future commitment to acquire securities, as the investor acquires the WI Trust certificate on day one of the transaction and the investor is not required to convert the WI Trust certificates at any time. This WI Trust certificate is not a derivative instrument, as at the time of acquisition, the certificate reflects a tradeable investment in a trust structure backed by cash and a Freddie Mac guarantee of cash flows in accordance with terms established at original acquisition. In addition to having no variation to the investor as a result of an underlying interest, there is no requirement on the investor to take delivery of a different investment. The ability to convert the WI Trust certificate to a K-Deal certificate is strictly an election to the investor and is not a requirement to receive the pass-through cash flows per the terms of the initial investment.
- c. The WI Program, and resulting obligation of Freddie Mac, ultimately reflects an investment where the investor receives pass-through cash flows generated from mortgage loans acquired and held in trust. This investment dynamic is within the scope of *SSAP No. 43R—Loan-Backed and Structured Securities*, paragraphs 2-4:
 2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.
 3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.
 4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor only has direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing

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the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

- d. The WI Program, and treatment as a SSAP No. 43R security, is consistent with the current guidance for TBA securities when an insurer intends to take possession of the resulting mortgage-backed security. A TBA security reflects the pre-purchase of mortgage-backed securities prior to the finalization of the security issuance. Pursuant to the annual statement instructions, TBA securities are to be reported on Schedule D-1: Long-Term Bonds unless the structure more closely resembles a derivative. This determination depends on how a company uses the TBA. (For example, if a company intended to assume the mortgage-backed security once issued, the TBA would be captured on Schedule D-1 at initial acquisition. If a reporting entity was to continually trade/roll TBA exposures, this would be more characteristics of a derivative and would be captured on Schedule DB as a derivative.)

INT 22-01 Consensus

5. The Statutory Accounting Principles (E) Working Group reached a consensus that investments in the WI Trust Program shall be captured in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* from initial acquisition.

6. If a reporting entity elects to convert WI Trust SPC securities into K-Deal SPC securities, the guidance in the Annual Statement Instructions, Schedule D, Part 3 and Part 4 shall be followed. Per that guidance, the transition from a WI Trust to a K-Deal shall not be reported as a disposal or acquisition. As the terms and cost basis of the SPC certificates would be identical, and the change would only reflect a CUSIP number change, a disposal and reacquisition shall not be recorded.

7. Excerpt from Annual Statement Instructions, Schedule D, Part 3 and 4:

This schedule should include a detailed listing of all securities that were purchased/acquired during the current reporting year that are still owned as of the end of the current reporting year (amounts purchased and sold during the current reporting year are reported in detail on Schedule D, Part 5 and only in subtotal in Schedule D, Part 3). This should include all transactions that adjust the cost basis of the securities. Thus, it should not be used for allocations of TBAs to specific pools subsequent to initial recording in Schedule D, Part 3 or other situations such as CUSIP number changes.

INT 22-01 Status

8. No further discussion is planned.

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