February 26, 2001

BY ELECTRONIC MAIL AND COURIER

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

Re: Comments on Proposed Regulations Governing Administrative Enforcement Proceedings, RIN 2550-AA-6

Dear Mr. Pollard:

Fannie Mae appreciates the opportunity to comment on the proposed regulations concerning the authority of the Office of Federal Housing Enterprise Oversight ("OFHEO") and its Director to issue cease-and-desist orders and to impose various other corrective and remedial actions on Fannie Mae and Freddie Mac (collectively "the companies"). *See* Rules of Practice and Procedure, Notice of Proposed Rulemaking, 65 Fed. Reg. 81,775, 81,776 (proposed Dec. 27, 2000) (to be codified in 12 C.F.R. Part 1780) ("NPRM"). Fannie Mae supports the efforts of OFHEO to carry out its safety-and-soundness obligations established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "1992 Act") and appreciates this latest effort by OFHEO to make its regulatory approach more transparent and to increase public awareness of its active role in supervising Fannie Mae and Freddie Mac. Fannie Mae has never been the subject of an enforcement action and is confident that it will continue to operate in a manner that will not require the use of OFHEO's enforcement authority.

While largely concurring with the goals and language of the proposed rule, Fannie Mae is filing these comments to address two particular aspects of OFHEO's proposed regulation that Fannie Mae believes are at odds with the statutory language and underlying goals of the 1992 Act and should be addressed before OFHEO issues a final regulation:

- First, the proposed regulation seeks to endow OFHEO with independent powers to enforce the companies' compliance with their charter acts, even though Congress expressly stated that OFHEO's activities outside of the safety-and-soundness area may

only be taken at the direction of the Secretary of Housing and Urban Development.

- Second, the proposed regulations adopt a definition of "unsafe and unsound practice" that is far broader than the judicially accepted definition of this term, and suggest that OFHEO might review the daily activities of the companies – diverting OFHEO's resources from work on its fundamental mission of ensuring that the companies operate safely and comply with minimum capital standards.

As OFHEO seeks to clarify its rules governing enforcement proceedings, the question is not whether or not Fannie Mae and Freddie Mac should be subjected to rigorous regulatory oversight: we believe the current regime, created by Congress and carried out by HUD, in part, and OFHEO, in other respects, accomplishes that objective. Rather, the question is whether the proposed regulations would create a duplicative and confusing regulatory system – a system that would be inconsistent with express congressional intent and could ultimately weaken the specialized and crucial role that OFHEO plays in ensuring the safety and soundness of the companies.

I. THE FINAL REGULATION SHOULD ACKNOWLEDGE THE SEPARATE AND RESPECTIVE ROLES OF HUD AND OFHEO CONTEMPLATED BY CONGRESS IN DELINEATING THE INDEPENDENT ENFORCEMENT POWERS OF OFHEO.

A. Congress Expressly Limited OFHEO's Independent Authority To Matters Relating To Safety And Soundness.

In the proposed regulation, OFHEO asserts independent authority to initiate cease-and-desist proceedings if a company either (1) engages in unsafe or unsound practices or conditions, or (2) violates certain enumerated laws. *See* 65 Fed. Reg. at 81,779 (proposed Part 1780(b)(1)(iv)). OFHEO's assertion of the second of these two authorities is contrary to the plain language and overall thrust of the 1992 Act, which states that any activities by OFHEO outside of its exclusive authority are to be undertaken only at the direction of the Secretary of HUD.

The 1992 Act carefully delineates the separate functions of OFHEO and HUD because Congress intended that Fannie Mae and Freddie Mac would be rigorously

regulated to ensure adequate capitalization without imposing undue burden on the companies' housing missions. Under the 1992 Act, OFHEO has exclusive authority to perform eleven specified functions, including:

> (5) administrative and enforcement actions under subtitle B, actions taken under subtitle C with respect to enforcement of subtitle B, ***and other matters relating to safety and soundness***.

12 U.S.C. § 4513(b)(5) (emphasis added). The two subtitles referenced in this provision are Subtitle B, which is the section of the 1992 Act that sets forth minimum capital levels for each company, and Subtitle C, which is the section that sets forth OFHEO's authority to undertake cease-and-desist proceedings.

Thus, under the provision of the 1992 Act that sets forth the scope of OFHEO's "exclusive" authority, the Director's independent powers are limited to:

> (1) administrative and enforcement authority with respect to the mandated capital levels in the 1992 Act;
> (2) issuing cease-and-desist orders regarding those capital levels; and
> (3) other matters related to safety and soundness.

Any other regulatory and enforcement activities may be undertaken by OFHEO only at the behest of HUD, and cannot, as the draft rule implies, be undertaken by OFHEO independently. In the words of the 1992 Act: "Any determinations, actions, and functions of the Director not referred to in [Section 4513(b)] shall be subject to the review and approval of the Secretary." 12 U.S.C. § 4513(c). This structure is the result of many hearings and a lengthy, intensive legislative process in 1992. Any other interpretation of this provision would not give effect to congressional intent.

In determining that it has broad, independent power to enforce compliance by Fannie Mae and Freddie Mac with their charter acts outside any authority contained in the 1992 Act, the draft rule improperly reads 12 U.S.C. §§ 4631 and 4636. Although sections 4631 and 4636 do state – when read literally and in isolation – that OFHEO can take an enforcement action against a company that engages in conduct that violates its charter act, those sections must be read consistently with section 4513, which limits the ***independent*** authority of OFHEO to matters involving minimum capital standards or

relating to "safety and soundness." 12 U.S.C. § 4513(b)(5).[1] Because the 1992 Act gives HUD the authority, for example, to determine that a new endeavor by the companies is a "new program," – a finding that might lead HUD to determine whether that "new program" is consistent with the company's charter act – enforcement actions against the companies for violation of their charter acts per se can be commenced by OFHEO *only if* HUD refers the alleged violation to OFHEO and approves the enforcement action.[2]

Not only does the plain language of the 1992 Act limit OFHEO's independent authority to the area of safety and soundness, but the legislative history is very clear regarding Congress' intent. During the floor debate leading to passage of the legislation, several members of both the Senate and House made clear that OFHEO's independent authority was to be limited to safety-and-soundness matters. For example, Senator Donald Riegle (D-MI), (then Chairman of the Senate Banking Committee) echoing the language of the statute, noted that the Director of OFHEO has "full and independent authority" over "sections of the charter acts dealing with capital distribution, financial reporting, executive officer compensation, ***and any other provision relating primarily to safety and soundness***." 138 CONG. REC. S17,921 (daily ed. Oct. 8, 1992) (emphasis

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[1] *See Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (citation omitted) ("It is a 'fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'"); *United States v. Morton*, 467 U.S. 822, 828 (1984) ("We do not . . . construe statutory phrases in isolation; we read statutes as a whole."); *Dole v. United Steelworkers of Am.*, 494 U.S. 26, 35 (1990) ("in expounding a statute, we are not guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy") (citation omitted); *Gustafson v. Alloyd Co.*, 513 U.S. 561, 569 (1995) (court must interpret statute as a symmetrical and coherent regulatory scheme); *FTC v. Mandel Bros., Inc.*, 359 U.S. 385, 389 (1959) (court must "fit" all parts of statute into "an harmonious whole"); *Beecham v. U.S.*, 511 U.S. 368, 372 (1994) ("plain meaning that we seek to discern is the plain meaning of the whole statute, not of isolated sentences").

[2] We also note with agreement that the proposed regulation asserts only enforcement powers with regard to the Charter Acts, and not interpretative authority. Whatever the scope of OFHEO's power to undertake enforcement actions for alleged violations of the charter acts, there is no statutory support for OFHEO undertaking to independently interpret the charter acts, render regulatory guidance concerning them, or opinions regarding their scope. *See* Statement of Rep. Barney Frank, 138 CONG. REC. H11,101 (daily ed. Oct. 3, 1992) (discussing scope of OFHEO's authority).

added).[3] Or, as Chairman Riegle described the basic division of authority between HUD and OFHEO:

> "[T]he Director [of OFHEO] is given exclusive authority to issue all regulations dealing with the [Companies'] safety and soundness. The Secretary [of HUD] is given general regulatory authority over all other issues to ensure that the purposes of the [companies'] charter acts are accomplished." *Id.*

Moreover, the legislative history establishes that, as it moved toward enactment of the 1992 Act, Congress considered, but ultimately rejected, proposals to vest OFHEO with independent enforcement powers that extended beyond safety and soundness.[4] Given this substantial body of materials, it should be clear that the proposed rule is thus contrary, not only to the language of the statute, but also to the indications of congressional intent in the legislative history.

Finally, we note that OFHEO itself has suggested legislative language to accomplish what it now seeks to impose by regulation. In August 2000, OFHEO submitted proposed legislation to the House Banking Committee's Subcommittee on Capital Markets, Securities and Government Sponsored Entities that would have

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[3] Similarly, during the House debate, Rep. Chalmers Wylie (R-OH) stated: "The Director of the Office of Federal Housing Enterprise Oversight will have ***exclusive authority over matters relating to the GSE's safety and soundness***. The Secretary of the Department of Housing and Urban Development, on the other hand, will have exclusive authority over matters relating to housing policy." 138 CONG. REC. H11,104 (daily ed. Oct. 3, 1992) (emphasis added).

[4] The Senate bill (S. 2733) provided OFHEO with sweeping powers, authorizing OFHEO's Director to develop and propose "regulations necessary and proper to carry out this Act and ensure that the purposes of the Charter Acts are accomplished." S. REP. NO. 102-282 at 144, 102 (1992) (setting forth text of Section 601(h) and Section 103 of the Senate bill, respectively). Section 103(a)(6) of the Senate bill also provided that OFHEO's Director would have exclusive authority to "undertake administrative and enforcement actions under this Act." *Id*. The House bill (H.R. 2900) was also more expansive. That bill preserved HUD's designated regulatory role vis-a-vis the companies and subjected the Director's promulgation of regulations under the 1992 Act to the approval of HUD, but did not explicitly limit the Director's enforcement authority. *See* H.R. REP. NO. 102-206 at 4-7 (setting forth text of Sections 103, 108 and 121 (h)). But when the House and Senate agreed to final terms, the compromise bill retained HUD's Charter Act-related and housing-related oversight over the companies and consequently limited OFHEO's independent enforcement authority. OFHEO cannot by regulation acquire powers that Congress once considered giving to it by law, but chose to vest elsewhere.

provided OFHEO with the authority to promulgate regulations and issue orders "to ensure that the purposes of [the 1992 Act and the charter acts] are accomplished" and to promulgate regulations "on other matters related to safety and soundness ***and other applicable laws***." *See* OFHEO Legislative Recommendations § 103(c) (August 2000) (emphasis added). These legislative proposals were not enacted. Moreover, the fact that OFHEO sought to invoke the legislative process to obtain this authority suggests that the agency itself believed, as recently as last summer, that the 1992 Act had not previously granted it that authority.

Thus, it is our view that while OFHEO does have independent enforcement authority with regard to statutory provisions relating to safety and soundness, it does not have that authority with regard to the charter acts themselves; appropriate regulatory oversight concerning the charter acts was commanded by the Congress to be undertaken by the Secretary of HUD, not the Director of OFHEO. In order to avoid a confusing and duplicative regulatory scheme, and to comport with the intent of Congress, we urge that the final rule limit OFHEO's potential enforcement actions under the companies' charter acts to actions where: (1) the safety and the soundness of the companies is at stake; or (2) the Secretary of HUD has requested that OFHEO undertake such action.

B. OFHEO's Enforcement Powers With Respect To The Companies Were Designed and Intended By Congress To Address Fannie Mae and Freddie Mac's Unique Attributes and Mission.

The proposed rule purports to assert broader independent enforcement authority vis-a-vis the companies on the ground that "the Act grants OFHEO broad statutory powers similar to those of the Federal bank regulatory agencies," NPRM, 65 Fed. Reg. at 81,776. Congress did not intend to import the full regime of banking regulation to the companies. To do so would not have made good regulatory or policy sense. This conclusion is reinforced by the simple, logical reason that regulation of two national companies, engaged exclusively in the housing finance business, must necessarily be different from the regulation of banks (of all sizes, reach, and scope) that engage in a vast array of activities. For example, the risk-based capital standards imposed on Fannie Mae and Freddie Mac are completely different from – and more stringent than – those applied to banks.

Moreover, unlike banks, the companies have express statutory missions that relate to the federal government's housing policies, leading Congress to give HUD regulatory authority that relates to these missions. Congress then carved out a specific – but vital

and highly specialized – slice from HUD's then-existing regulatory authority and designated a focused and strong regulator (OFHEO) to oversee that matter: *i.e.*, to ensure that the companies do not become insolvent so that they can continue to fulfill their statutory mission, which includes the provision of liquidity to the housing markets. There is no evidence in the statute that Congress, in doing so, intended either: (1) for OFHEO to supplant HUD; or (2) to create two separate regulators with the same portfolio. To the contrary, Congress was clear that its intent was precisely the opposite.

If, as the draft rule appears to propose, HUD and OFHEO both have independent charter act-compliance enforcement authority over the companies, OFHEO could bring an enforcement action to enjoin activities, even after HUD has determined that those very activities do not violate the charter act (or worse still, after HUD has determined that those activities are important to the fulfillment of the companies' special statutory mission). This approach would thus result in the very types of conflicts that Congress intended to avoid by expressly delineating separate spheres for HUD and OFHEO.

As discussed above, the 1992 Act provides OFHEO with exclusive authority over a very specialized area – ensuring that the companies maintain adequate capital levels and are not at undue risk of insolvency. For that reason, the statute makes clear that OFHEO has exclusive jurisdiction related to safety and soundness and that "[a]ny determinations, actions, and functions of the Director not referred to in [Section 4513(b)] shall be subject to the review and approval of the Secretary." 12 U.S.C. § 4513(c).[5] By seeking to assert the type of broad authority given by statute to other financial regulators under a different regulatory regime, the proposed regulation would contravene the intent of Congress to provide strong regulation for Fannie Mae and Freddie Mac under a regime tailored to the unique situation of the companies.

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[5] *See also* H.R. REP. NO. 102-206 at 55 (1991) ("While [the bill] alters the relationship between the Secretary of HUD and the enterprises by placing all financial oversight responsibilities in the Office and the Director, and removing such power from the Secretary, the Secretary retains general regulatory authority over the enterprises.").

II. THE PROPOSED REGULATION SHOULD BE REVISED TO ADOPT AN APPROPRIATE DEFINITION OF UNSAFE OR UNSOUND PRACTICES.

The NPRM proposes to add a broad, new ground for initiating cease-and-desist enforcement proceedings found nowhere in the 1992 Act. The NPRM would allow initiation of an enforcement proceeding based on:

> Any unsafe and unsound practice (in that it is contrary to prudent standards of operation which might cause loss or damage to the Enterprise, or is likely to cause such loss or damage in the future if continued unabated) or any unsafe or unsound condition.[6]

Fannie Mae believes that the statute does not support the insertion of this new standard in the OFHEO regulatory regime and it should not be included in any final regulation.[7] But assuming statutory support, OFHEO's proposed new standard is overbroad and contrary to well-established judicial interpretation. At a minimum, OFHEO should adopt a standard for definition of "unsafe and unsound practice" that is no more broad than the judicially accepted definition in cases involving enforcement actions.

Unsafe and unsound practices have been interpreted by courts in the context of other financial institutions as "action[s], or lack of action[s]" that would result in "***abnormal risk of loss or damage*** to an institution, its shareholders, or the [insurance] agencies." *MCorp Fin. Inc. v. Board of Governors of the Federal Reserve System*, 900 F.2d 852, 863 (5th Cir. 1990), *aff'd in part, reversed on other grounds*, 502 U.S. 32

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[6] 65 *Fed. Reg*. 81776, 81779 (to be codified at 12 C.F.R. part 1780(b)(iv)).

[7] A careful reading of the statute could lead to the conclusion that Congress intended to limit OFHEO's independent enforcement powers more precisely. The 1992 Act itself suggests that OFHEO may bring such actions only when they are necessary to prevent conduct that violates a specific, enumerated set of statutory "safety and soundness" concerns. *See* 12 U.S.C. §4631 (enumerated, specific, statutory bases for an OFHEO "cease-and-desist" order). Thus, OFHEO's statutory basis for an enforcement action against an "unsafe or unsound" financial practice, if that practice is not itself violative of a specific statutory or regulatory provision, is in doubt. By reading an "unsafe or unsound practices or conditions" standard into one subsection of section 1371(a), the proposed rule would render the other subsections of section 1371 entirely without meaning.

(1991) (emphasis added).[8] Based on this definition, several appellate courts have held that regulators cannot prohibit conduct on "safety and soundness" grounds because it may violate a law[9] or result in a loss of money to the regulated institution. Rather, the conduct enjoined must threaten the very financial integrity or stability of the regulated entity. *See, e.g., Johnson v. OTS*, 81 F.3d 195, 204 (D.C. Cir. 1996) (citations omitted) (the "weight of case law hold[s] that '[t]he unsafe or unsound practice provision . . . refers only to practices that threaten the financial integrity of the association")[10]

Although Congress did not intend to import the entire bank regulatory regime when it created OFHEO, it did adopt the "safety and soundness" phraseology from banking law. However, in contrast to the well-established definition of safety and soundness enforcement in banking law, the proposed regulation would permit OFHEO to initiate an enforcement action merely for conduct that might cause some "loss or damage" regardless of whether the risk of loss would "threaten the capital or financial integrity of the Enterprise." NPRM, 65 Fed. Reg. at 81, 777. Since nearly all business initiatives present some possibility of loss, the proposed definition effectively covers any business activity, regardless of whether the risk it presents is "abnormal" or threatens the financial welfare of a company.

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[8] *See also* Statement of Chairman John Horne, Federal Home Loan Bank Board, published in 112 Cong. Rec. 26,474 (1966) ("Generally speaking, an 'unsafe or unsound practice' embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss of damage to an institution, its shareholders, or the agencies administering the [deposit] insurance funds."); *Northwest Nat'l Bank v. Dept. of Treasury*, 917 F.2d 1111, 1115 (8th Cir. 1990) (citation omitted) (defining unsafe and unsound activities as "'conduct …which might result in abnormal risk of loss to a banking institution or shareholder'").

[9] If the proposed rule's suggestion of independent enforcement authority for OFHEO for violations of the companies' charter acts rests on an implicit assumption that ***any*** activity that violates that Act is *per se* an activity that is unsafe or unsound, that conclusion is incorrect as a matter fact and law.

[10] *See also Seidman v. OTS*, 37 F.3d 911, 926 (3d Cir. 1994) (holding that "[t]he imprudent act must pose an abnormal risk to the financial stability of the banking institution. This is the standard that the case law and legislative history indicates we should apply in judging whether an unsafe or unsound practice has occurred"); *Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990) (describing FDIC's authority under 12 U.S.C. § 1818(b)(1) to issue a cease-and-desist order based on unsafe and unsound practice and citing definition used in *Gulf Federal Savings*).

This was not Congress' intent. To the contrary, the legislative history of the 1992 Act is replete with statements that Congress intended the day-to-day business of the companies to be free from micro-management. For example, the Senate Report states:

> The Committee does not mean for the [OFHEO] Director or HUD Secretary to impose his or her business judgment on, or interfere with, the normal management prerogatives of an enterprise that has sound financial controls, and is adequately capitalized, and profitable . . . However, ***if the exercise of [the enterprise's] business judgment or economic conditions beyond management's control threaten to result in the enterprise becoming undercapitalized,*** the Director will need to intensify oversight activities.

S. REP. NO 102-282, at 25 (1992) (emphasis added). Similarly, in discussing enforcement actions, the Senate Report states: "If an enterprise is adequately capitalized, the Director can bring cease and desist actions … ***only if the violation or conduct threatens to cause a significant depletion of the enterprises capital***, or – with respect to officers and directors – resulted in unjust enrichment, or reflected a knowing violation or disregard of fiduciary duty ***and*** substantial loss to the enterprise." *Id.* at 4 (emphasis added).

Importantly, OFHEO's expansive definition of what could constitute a "safety and soundness" issue would also defeat two vital policy objectives that Congress established in the 1992 Act.

First, it would risk chilling the companies from undertaking the innovative and important efforts that Congress clearly wanted them to advance, as they fulfill their missions of expanding homeownership and making homeownership more affordable and attainable. *See* 12 U.S.C. § 1716 (setting forth purposes of Fannie Mae, which include the provisions of "ongoing assistance to the secondary market for residential mortgages (including activities related to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)"). Second, it would risk "devaluing" OFHEO's vital regulatory role of making the grave and serious judgment that one of the companies has undertaken an endeavor that contravenes the "safe and sound" management of that company. Such a determination, as it is used in the banking area, should be left for instances where a

company has undertaken an endeavor that risks leaving it inadequately capitalized or financially unstable. To employ an "unsafe or unsound" standard in less serious cases risks depriving it of its full meaning and force in the extraordinary cases when it is applicable.

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Thank you for the opportunity to express our views on this important proposal. Please contact me if you have questions or would like clarification of any of our comments.

Sincerely,

[Signed: Ann M. Kappler]

Ann M. Kappler

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