



Finance and Operations Management

121 Presidents Drive, Amherst, MA 01003
Telephone: 413-545-5620 Fax: 413-545-3858
www.som.umass.edu

June 14, 2004

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

Re: Comment Letter on Corporate Governance Rules, RIN 2550-AA24

Dear Mr. Pollard,

On April 12, 2004, the Office of Federal Housing Enterprise Oversight (OFHEO) issued proposed regulations regarding minimum corporate governance standards applicable to Fannie Mae and Freddie Mac. Among other things, these proposed rules would make several sections of the Sarbanes-Oxley Act of 2002 and the New York Stock Exchange (NYSE) Corporate Governance Rules selectively applicable to the enterprises and impose additional requirements, including mandating that the role of chief executive be separated from that of board chairman by the year 2007. The rules would also require the enterprises to establish compliance and risk management programs headed by individuals who report directly to the chief executive officer.

At the outset, it should be noted that in 2002, Fannie Mae voluntarily registered its equity securities with the Securities and Exchange Commission (SEC) and thus is *already* bound by the Securities Exchange Act of 1934 (Exchange Act), and the Sarbanes-Oxley Act. Freddie Mac has announced that it also plans to voluntarily register its stock with the SEC, but has yet to do so. Both enterprises are already subject to NYSE corporate governance and other listing requirements insofar as both have long been listed on the NYSE.

The Administration's goal of securing commitments from Fannie Mae and Freddie Mac to voluntarily register with the SEC was to make them "role models for our system of

investor protection, not exceptions to it.”¹ As a consequence, I believe OFHEO’s first priority should be to ensure that Freddie Mac fulfills its commitment as quickly as possible to submit to SEC jurisdiction, and *full* compliance with the Exchange Act as well as the Sarbanes-Oxley Act. Moreover, to the maximum extent possible, OFHEO should defer to the SEC and the NYSE in defining and enforcing corporate governance standards applicable to the enterprises as publicly traded companies. Creating separate rules for the Enterprises reinforces the notion that they are “exceptions” subject to differing standards of corporate responsibility. It also sets the stage for potential conflicts in interpretation of what the appropriate standards should be.

I appreciate that certain aspects of OFHEO’s proposed rules attempt to promote “higher” corporate governance standards for the enterprises, particularly in the proposed requirement that the position of chief executive be separate from that of board chairman. However, there are widely differing views among securities experts as to whether or not such a requirement promotes shareholder interests. Neither the Congress, nor the SEC has seen fit to require that non-executive Chairmen lead the boards of publicly traded companies. The SEC’s proposal to require non-executive mutual fund board chairmen -- based in part on the role mutual fund boards play in negotiating advisory fees -- has been hotly debated.² Advocates of separating the two functions argue that it promotes board independence and executive accountability. Opponents argue that such a separation can prevent the best-qualified individual from serving as board chairman and point to the many highly successful companies whose governing boards are chaired by the CEO. They argue that independent board directors are in a better position to determine whether it is in shareholders’ best interests to separate the roles of chairman and CEO.

OFHEO should not substitute its own judgment for that of Congress, the SEC or the NYSE on corporate governance matters, absent a clear nexus to OFHEO’s oversight responsibilities of safety and soundness and charter enforcement. The SEC and the stock exchanges are the bodies of expertise in matters of shareholder protection, and other financial regulators generally try to defer to their judgment on such matters. In this case, to date, OFHEO has made no determination of significant regulatory compliance issues at Fannie Mae, much less compliance issues that might be attributed to Fannie’s lack of a non-executive board chairman. An argument could be made that requiring a non-executive chairman at Freddie Mac is necessary to remedy specific past abuses found at that institution. Indeed, in justifying these proposed rules, OFHEO repeatedly cites to its Report of the Special Examination of Freddie Mac.³ However, since issuance of the Special Report, Freddie Mac has hired a new CEO with stellar credentials and who, in any event, has voluntarily agreed to step down as CEO by 2007, while retaining the position of Chairman.

¹ *Hearing before the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the House Committee on Financial Services*, 107th Congress (July 16, 2002) (testimony of Peter Fisher, Under Secretary for Domestic Finance, US Department of the Treasury).

² 17 CFR 270. SEC Proposed Rule: Investment Company Performance Rel. No. IC-26323 (proposed Jan. 15, 2004)

³ OFHEO, Report of the Special Examination of Freddie Mac (Dec. 2003).

Though I believe OFHEO's proposed corporate governance rules stretch the limits of its mission and expertise, the same cannot be said for its proposed rules to require the enterprises to establish separate risk management and compliance programs. Such requirements are directly related to OFHEO's safety and soundness mission. With regard to requiring a risk management program, OFHEO may wish to clarify the responsibilities of the new head of risk management with those of the enterprises' chief financial officers and chief operating officers. OFHEO should also consider whether it is prudent to have a single individual overseeing all risk management functions, particularly given the enormous importance of interest rate and credit risk management to the enterprises' core business function, and the different expertise and skills required for managing other types of risk such as operational risk. OFHEO might also want to consider whether there should be a direct reporting relationship between the head of compliance and the board.

In sum, I would strongly encourage OFHEO to defer to the SEC and the NYSE on corporate governance issues generally applicable to the GSEs as publicly traded companies and instead focus its efforts on ensuring that Freddie Mac registers its equity securities with the SEC as soon as practicable. At the same time, OFHEO should properly consider requiring the enterprises to establish separate risk management and compliance programs, and the appropriate reporting structure for the heads of those entities.

Sincerely,

Sheila C. Bair
Dean's Professor of Financial Regulatory Policy
University of Massachusetts-Amherst