July 9, 2001

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

Freddie Mac

Re: Proposed Prompt Corrective Action Regulations, RIN 2550-AA12

Dear Mr. Pollard:

Freddie Mac respectfully submits the following comments with respect to Prompt Corrective Action regulations proposed by the Office of Federal Housing Enterprise Oversight ("OFHEO") and published in the Federal Register on April 10, 2001.[1] Through these regulations, OFHEO proposes (1) to establish a system of procedures to be taken in response to specified internal or external events that may have an impact upon Freddie Mac or Fannie Mae (collectively, the "Enterprises") and (2) to codify the procedures that OFHEO will use in response to declines in the capital levels of the Enterprises.

I. Summary

Freddie Mac supports the strong safety-and-soundness regulatory structure created in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "1992 Act"). To ensure that the Enterprises are well capitalized, Congress created minimum, critical and risk-based capital standards. Congress also provided OFHEO with examination authority to ensure that OFHEO can effectively monitor the condition of the Enterprises, adding the requirement that the results and conclusions of that examination activity must be reported in OFHEO's Annual Report to Congress. To address any significant threats to safety-and-soundness or capital adequacy, Congress granted OFHEO specific administrative enforcement and prompt corrective action authority, both of which provide for increased OFHEO authority as an Enterprise's capital levels decrease.

A framework of regulations can make the implementation of a statutory regulatory structure more effective. However, regulations also can make the implementation of a statutory scheme less effective, unnecessarily weakening a strong structure put into place by Congress. As we discuss below, we believe that the proposed Prompt Supervisory Response ("PSR") procedures would weaken the current supervisory structure by creating predetermined, rigid procedures to address situations best served by OFHEO actions tailored to particular facts and circumstances. Moreover, the proposal would

[1] 66 Fed. Reg. 18694.

bypass other procedures and requirements established in the 1992 Act. For these and other reasons, we believe that OFHEO should withdraw the PSR portion of its proposed regulations.

With respect to OFHEO's proposed Prompt Corrective Action regulations, we recommend that OFHEO modify various provisions to conform to the regulatory capital and enforcement structure and procedures established in the 1992 Act. In addition, we also make recommendations we believe make the implementation of the regulatory structure clearer and more effective.

II. Prompt Supervisory Response

Subpart A of proposed 12 C.F.R. Part 1777 defines ten internal and external events (other than capital levels) that may constitute "early warnings" of substantial losses to an Enterprise. OFHEO articulates a prescribed series of responses ("Levels I through IV") that it will take if one of these triggering events should occur.

Freddie Mac recognizes the value of analyzing indicators other than capital to appraise the financial safety and soundness of the Enterprises, and does not question the ability of the Director to take appropriate action against an adequately capitalized Enterprise within the regulatory framework established by the 1992 Act. However, we believe that OFHEO should withdraw the PSR portion of the proposed regulations because: (a) predetermined triggering events could cause affirmative harm; (b) mandatory supervisory responses are inappropriate; (c) the proposed PSR process is unnecessary; and (d) the proposed PSR process circumvents procedures established by the 1992 Act.

a. Predetermined Triggering Events Could Cause Affirmative Harm

In its proposal, OFHEO specifies ten events that "might reasonably indicate that the Enterprise is experiencing or will soon experience some form of unusual stress,"[2] but OFHEO offers no explanation for how it made this determination. An empirical analysis of historical performance would demonstrate no meaningful correlation exists between the triggers specified by OFHEO and future financial stress. Depending on a broad range of other circumstances, some triggers will be set too low and others will be set too high. It is only when evaluated in the broader context of an Enterprise's entire business that the relative level of any particular trigger can have any meaning.[3]

We believe that any attempt to create a structure of supervisory responses triggered by a predetermined set of events could have significant adverse consequences. Each trigger would create a presumption in capital markets that the occurrence of the specified triggering event places an Enterprise at risk. Thus, if a triggering threshold is crossed, an

[2] *Id.* at 18695.
[3] The Enterprises' future financial performance depends upon the interplay of many intricate variables. No single variable in isolation can predict the emergence of safety-and-soundness issues and the corresponding need to initiate the enumerated supervisory responses.

Enterprise may find itself burdened with significantly greater investor inquiries – even if the triggering event has incorrectly predicted the occurrence of a future safety-and-soundness issue.

In addition, undue focus on the triggers would create burdens clearly not justified by any regulatory benefits. For example, the Enterprises would need to develop and maintain processes to rebut any presumption that each triggering event puts the Enterprises at risk, even where there is no significant change in risk. To the extent that it believes that a triggering event could create a misleading assumption about actual risk, an Enterprise would find it necessary to develop strategies to reassure the public that the threshold is meaningless. In addition, the proposed PSR process would create incentives for the Enterprises to change their business practices to avoid the triggers. For example, the interest-rate risk trigger would create incentives for the Enterprises to revise their internal measures of risk and board reporting of interest-rate risk.

Our observations concerning the specific proposed triggers are attached to this letter as Appendix A.

b. Mandatory Supervisory Responses Are Inappropriate

It is unrealistic to determine in advance exactly what supervisory action would be appropriate. Under the proposal, OFHEO always would be required to send a Level I letter whenever a PSR triggering event occurred. To the extent that the proposed triggers are poorly-specified or unrelated to actual risks, OFHEO would be placing itself in a position where it would be required to go through the motions of sending a mandatory letter even where OFHEO is aware that the triggering event raises no safety-and-soundness concerns.[4] Even if a safety-and-soundness issue were raised, a formal letter might not be the most effective supervisory response (*i.e.*, an informal and flexible response may resolve an issue more quickly and effectively). We believe OFHEO should afford itself the flexibility to respond in the most effective manner to the unique circumstances presented by any safety-and-soundness issue.

c. The Proposed PSR Process Is Unnecessary

In proposing a novel, rigid oversight structure, OFHEO fails to identify any inadequacies in its existing processes that the proposed PSR process would remedy.[5] Moreover, OFHEO's Director has asserted that OFHEO's existing supervisory processes are more than adequate. He recently stated:

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[4] 66 Fed. Reg. 18696 (acknowledging that a Level I letter may be issued in cases where there is no regulatory concern).

[5] Executive Order 12866 asserts the fundamental principle that "Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need." E.O. 12866 § 1(a) (Sep. 30, 1993). The proposed PSR regulations do not appear to meet any of these requirements.

> By staying apprised of the Enterprises' risks and business activities on a timely basis, the examiners are able to evaluate an extensive array of risk-related factors and to assess the Enterprises' financial safety and soundness. . . . Quite simply, our examination group provides me with an accurate and timely understanding of the Enterprises' financial condition on an ongoing basis.[6]

We also note that no other financial institution regulator has instituted any comparable process. In sum, we see no necessity for the proposed PSR process as an overlay to an effective supervisory process.[7]

d. The Proposed PSR Process Circumvents Procedures Established by the 1992 Act

Under the proposal, a Level I letter may direct an Enterprise to "take appropriate action,"[8] and a Level III supervisory response can direct the Enterprise to submit an action plan and/or direct the Enterprise to correct deficiencies in the action plan.[9] Codification of such a process would bypass the procedural protections and statutory thresholds that the 1992 Act established.[10] Nothing in the 1992 Act authorizes OFHEO to issue such directives or to compel an Enterprise to follow such directives outside of the statutory procedures established under the 1992 Act.

Recommendation

We recommend that OFHEO withdraw the PSR portion of its proposed regulations.

III. Capital Classification and Other Orders Under Section 1366

Subpart B of OFHEO's Prompt Corrective Action rulemaking proposal sets forth procedures related to: (i) OFHEO's determination of the capital classification of the Enterprises; (ii) the submission and review of capital restoration plans by the Enterprises, if necessary; (iii) the issuance of orders under the Discretionary Supervisory Actions portion of § 1366 of the 1992 Act; and (iv) the appointment of a conservator for a significantly undercapitalized or critically undercapitalized Enterprise. As such, Part B largely restates and summarizes relevant portions of the 1992 Act. Freddie Mac's comments and recommendations on specific provisions of Part B follow.

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[6] Testimony of the Honorable Armando Falcon, Jr., Director, Office of Federal Housing Enterprise Oversight, before the U.S. Senate Subcommittee on Housing and Transportation (May 8, 2001).

[7] The proposal itself acknowledges that, "Unless the development in question has occurred precipitously, OFHEO would have in all likelihood already have commenced a supervisory dialog with the Enterprise about the situation . . . ." 66 Fed. Reg. at 18696.

[8] Proposed § 1777.11(a)(2)(iii).

[9] *Id.* at § 1777.11(c).

[10] *See, e.g.*, 1992 Act §§ 1371, 1372 (cease-and-desist authorities); see also 1992 Act § 1368 (notice of classification and enforcement actions); see also proposed § 1777.1(b) (effectively acknowledging that PSR procedures would be triggered in situations where OFHEO would lack a sufficient factual basis for initiating cease-and-desist proceedings).

a. Discretionary Authority to Set Capital Requirements

OFHEO asserts that it has the authority to require the Enterprises to hold additional capital beyond minimum and risk-based requirements "when the circumstances indicate additional capital is necessary or appropriate in light of the overall strength of the Enterprise or the markets."[11] The legal theory underlying that assertion appears to be that "[n]othing in subpart B of this part or subtitle B of the 1992 Act limits OFHEO's authority otherwise to address circumstances that would require additional capital through regulations, orders, notices, guidance, or other actions."[12]

Congress did not intend to grant OFHEO discretion to disregard the statutory capital requirements or the statutory classification process that Congress created in the 1992 Act, and to impose discretionary capital standards whenever OFHEO deemed it necessary to do so. Rather, Congress created a "tightly integrated set of capital standards and enforcement levels"[13] as a cornerstone of the 1992 Act, and Congress clearly and unambiguously established what those standards would be and how OFHEO would apply them. That "stair-step progression of regulatory powers" "increases the authority of the Director as an enterprise's capital decreases."[14] The minimum and core capital provisions set forth specific capital ratios,[15] and the risk-based capital provisions expressly provide that the final risk-based capital rule must establish a test that, when applied to an Enterprise, determines "the amount" of required capital.[16] By Congressional design, the resulting unambiguous capital requirements are not subject to further interpretation.

The issue of whether OFHEO has authority to increase required capital levels beyond the capital requirements expressly established by statute was addressed directly at the time OFHEO's regulatory structure was being considered.

> Mr. FRANK. I would like to ask the chairman about the authority the Director of the GSE Oversight Office has to take actions that are outside the scope of the specific responsibilities set forth in titles II and III concerning capital enforcement.
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> It is my understanding that the bill contains all the Director's authorities and those that are not specified are not meant to be implied.

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[11] 66 Fed. Reg. 18698.
[12] Proposed § 1777.2(b).
[13] H. R. Rep. No. 206, 102d Cong., 1st Sess, 62 (1991).
[14] *Id.* at 63.
[15] 1992 Act §§ 1362; 1363.
[16] *Id.* at § 1361(a).

For example, the test of title I, particularly section 103(a) regarding the Director's duty to ensure that the enterprises are operating safely and with adequate capital "in accordance with this Act."

I understand that to grant the Director the authority to set and enforce maximum capital levels within the designated risk-base formula, pursuant to section 201 and to implement and to enforce 202 and 203, the minimum critical capital sections only.

Mr. GONZALEZ. The gentleman from Massachusetts is correct. Let me say with respect to his question about section 103(a) and 103(b), that 103(a) in general terms, specifies or rather sets forth the specific authorities in section 103; but these are not [to] be construed, as you well point out, as additional grants of authority even indirectly.

In particular, although the statute does not expressly prohibit the Director from establishing higher or different formulas for critical, minimum and risk-based capital, the intent is that the statutory formula define the outer boundaries of regulatory authority.

Unlike the situation in banking law, in this bill the Congress crafted a very complex and sophisticated measure of appropriate capital after almost 3 years of debate. We are not, in section 102, delegating the power to revisit the decisions we made to the Director. We built into the framework a requirement that the enterprises must at all times meet all the standards, including a very tough stress test.

The Director also has substantial authority under Titles II and III to make capital reclassifications and take enforcement actions if the enterprises are not operating in a financially sound manner.

If the Director at any future time believes there should be an increase in the minimum or critical ratios, or in any respect in the statutory formula for risk-based capital, that recommendation must be brought to the Congress for our decision.[17]

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[17] 138 Cong. Rec. H11101 (Oct. 3, 1991). While we note that there exists other floor debate on whether the lack of an express prohibition against increasing capital requirements should be viewed as a grant of authority to do so, 138 Cong. Rec. S9354 (July 1, 1992), it is well-settled that statutory silence cannot be interpreted as a grant of regulatory authority. *See, e.g., Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995) ("We refuse, once again, to presume a delegation of power merely because Congress has not expressly withheld such power."); *American Bus Assoc. v. Slater*, 231 F.3d 1, (D.C. Cir. 2000) (Sentelle, J., concurring) ("Congress's failure to grant an agency a given power is not an ambiguity as to whether that power has, in fact, been granted. On the contrary, and as this Court persistently has recognized, a statutory silence on the granting of a power is a denial of that power to the agency."); *Backcountry Against Dumps v. EPA*, 100 F.3d 147, 150 (D.C. Cir. 1996) (holding that EPA lacks authority to approve Indian tribe's solid waste process plan because relevant statute "says nothing about municipalities submitting their own waste

Specifically, the proposal implements the assertion that OFHEO can increase required capital levels by inserting a new basis for a discretionary reclassification of an Enterprise to a lower capital classification beyond the two enumerated in the 1992 Act. That new basis would authorize OFHEO to reclassify an Enterprise whenever "reclassification is deemed necessary to ensure that the Enterprise holds adequate capital and operates safely."[18] That additional basis also could be read to authorize discretionary reclassification for reasons unrelated to capital.

The 1992 Act provides for discretionary reclassifications, authorizing the Director to reduce an Enterprise's classification by one level from the classification level that would apply based on the Enterprise's capital levels.[19] That discretion is not open-ended. Under the 1992 Act, the Director is authorized to reclassify an Enterprise only under the following two sets of circumstances:

- The Enterprise "is engaging in conduct not approved by the Director that could result in a rapid depletion of core capital"; or
- "[T]he value of the property subject to mortgages held or securitized by the enterprise has decreased significantly."[20]

Where Congress has so clearly spoken regarding an area of regulation, there is no room for an assertion that an interpretation or some implicit authority would enable a regulator to disregard the statutory scheme and impose its own, purely discretionary capital requirements, or use discretionary reclassification for other purposes. In sum, the statute does not authorize the additional basis for reclassification, nor is OFHEO otherwise empowered to create that additional basis.[21]

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permitting plans to the EPA"); *Railway Labor Executives' Ass'n*, 29 F.3d 655, 670 (D.C. Cir. 1994) (en banc) ("Agencies owe their capacity to act to the delegation of authority, either express or implied, from the legislature."); *see also Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) ("An agency literally has no power to act . . . unless and until Congress confers power upon it.").

[18] *Id.* at §§ 1777.20(a)(5)(i); 1777.20(c)(5)(i).

[19] *Id.* at § 1364(b).

[20] *Id.*

[21] Such a reclassification could result in an Enterprise's agreeing to hold more capital. *See* OFHEO's discussion at 61 Fed. Reg. 35607, 35608-35609 (July 8, 1996) (final OFHEO minimum capital regulations). That is, OFHEO could reclassify an Enterprise based on one of the two enumerated bases for doing so, the Enterprise could devise a capital restoration plan in which it proposes to increase its capital levels as a means of addressing the circumstances prompting the reclassification, and the Director could agree that it is necessary and appropriate for the Enterprise to increase its capital levels and approve such a plan. *See* 1992 Act § 1369C. However, this possibility does not amount to a grant of authority to require additional capital whenever OFHEO deems it is necessary.

Recommendation

Freddie Mac recommends that OFHEO revise proposed sections 1777.20(a)(5) and 1777.20(c)(5) to conform to the precise language and standards set forth in § 1364(b) of the 1992 Act, and revise proposed § 1777.2(b).

b. Discretionary Reclassification Authority Is an Extraordinary Remedy

In the preamble to its proposed regulations, OFHEO suggests that the threshold for initiating a discretionary reclassification is less than that specified by the 1992 Act. OFHEO asserts:

> [T]he statute does not require OFHEO to find that depletion of the Enterprise's core capital is underway or imminent, but requires that such depletion is a possible consequence of the conduct in question.[22]

Omitted from this discussion is the word "rapid," which is used to modify "depletion" in the statutory text.[23] Conduct "that could result in a rapid depletion of core capital" necessarily means actions more extreme than just conduct for which depletion of core capital "is a possible consequence." We are troubled by this apparent attempt to reduce the standard for discretionary classification.

Recommendation

Notwithstanding the omission in the preamble, OFHEO's proposed regulatory text includes the word "rapid." Accordingly, we have no specific recommended modifications.

c. Provision on Multiple Reclassifications Would Bypass Statutory Procedures

Proposed § 1777.20(b)(2) provides that, if the conduct or condition forming the basis for a discretionary reclassification has not ceased or been eliminated or remedied to OFHEO's satisfaction within such reasonable period as is determined by OFHEO to be appropriate, OFHEO may consider such failure to be the basis for additional reclassification.

The 1992 Act, however, provides a specific remedy for such failures in the discretionary reclassification provisions under §§ 1365(b) and 1366(b)(5). The type of failure that would be addressed in proposed § 1777.20(b)(2) is addressed in terms of a capital restoration plan. A failure to submit a capital restoration plan that complies with statutory requirements or to make good faith, reasonable efforts necessary to comply with an approved plan and schedule can be the basis for a discretionary reclassification, as is

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[22] 66 Fed. Reg. 18699.
[23] *See* 1992 Act § 1364(b).

addressed in proposed § 1777.23(h)(1). This specific remedy, along with the statutory requirement that conduct approved by the Director cannot form the basis for discretionary reclassification,[24] ensures that, so long as an Enterprise complies with the terms of an approved capital restoration plan, the Enterprise will not be subject to additional reclassifications based on the same conduct or conditions that formed the basis for the original reclassification. Proposed § 1777.20(b)(2) is both inconsistent with the statutory scheme and is, in any case, unnecessary.

Recommendation

We recommend that OFHEO delete proposed § 1777.20(b)(2).

d. Discretionary Reclassification Prior to the Expiration of the Transition Year

Proposed § 1777.20(c) contemplates that OFHEO has the ability to reclassify an adequately capitalized Enterprise as "undercapitalized," even during the period prior to the expiration of the one-year period beginning on the date of the effectiveness of OFHEO's risk-based capital regulations. OFHEO also asserts in the preamble to its proposed rules that "pending phase-in of the risk-based capital level, an Enterprise that meets the minimum capital level could be classified as undercapitalized through discretionary reclassification by OFHEO."[25]

The 1992 Act is very clear on the effective date of reclassification authority. First § 1364(d) provides that "notwithstanding any other provision of this section," which includes discretionary reclassification, an Enterprise shall be classified as adequately capitalized until the expiration of the one-year transition period, so long as it meets its minimum capital requirement. In addition, the authority to take actions against undercapitalized Enterprises set forth in § 1365(c) of the 1992 Act unambiguously indicates that supervisory actions (both mandatory and discretionary) against an undercapitalized Enterprise are unavailable until the expiration of a one-year period following the date of effectiveness of OFHEO's risk-based capital regulations.[26]

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[24] 1992 Act § 1364(b). Proposed § 1777.20(a)(5)(iii) states that OFHEO will not reclassify an Enterprise based on "action or inaction that was given specific approval by the Director of OFHEO in connection with the Director's approval of the Enterprise's capital restoration plan . . . ." It is important to note that OFHEO is without authority to reclassify an Enterprise based on *any* conduct approved by the Director. It does not matter whether the Director's approval of that conduct was in connection with a capital reclassification plan, or in any other context or manner.

[25] 66 Fed. Reg. 18699.

[26] Under the statutory classification scheme set forth in the 1992 Act, a classification of "undercapitalized" is a logical impossibility prior to the existence of a final risk-based capital rule; the express provisions of § 1364(d) and § 1365(c) remove any question that OFHEO has the discretionary authority to assign such classification until one year following the date of effectiveness of OFHEO's risk-based capital regulations.

Recommendation

Freddie Mac recommends that OFHEO remove proposed sections 1777.20(c)(2) and 1777.20(c)(5)(i)(A). In addition, OFHEO should make conforming modifications to proposed § 1777.21(a)(1)(iv).

e. Notices of Proposed Capital Classification

In several places in proposed § 1777, OFHEO indicates that it may, upon the occurrence of specified events, elect to reclassify an Enterprise "without additional notice."[27] Reclassifying an Enterprise without express notice violates the notice requirement that OFHEO establishes for itself in proposed § 1777.21(a)(1)(i).[28] Section 1368 of the 1992 Act also specifies:

> Before taking any action referred to in subsection (b) [covering capital classifications and reclassifications, discretionary reclassifications, and discretionary actions for significantly undercapitalized Enterprises], the Director shall provide to the enterprise written notice of the proposed action, which states the reasons for the proposed action and the information on which the proposed action is based.[29]

Congress clearly established a 30-day response period for any Enterprise that receives such a notice.[30] While the 1992 Act permits OFHEO to combine a notice of proposed classification or reclassification with a notice of proposed discretionary supervisory action, it does not permit a notice of classification to be combined with a notice of potential future reclassification based on possible future events. Only after OFHEO has provided the required advance notice, has provided the required response period, has considered and addressed any response, and has notified certain Congressional committees, may OFHEO take its action.[31]

Also, proposed § 1777.21(b)(2) says that OFHEO could issue a new notice of capital classification based on OFHEO's review of a capital classification notice that OFHEO previously issued under § 1777.21(a). The provision appears to propose that OFHEO

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[27] *See* proposed §§ 1777.21(a)(1)(ii), 1777.23(c)(1), 1777.23(c)(3).
[28] Proposed § 1777.21(a)(1)(i) essentially paraphrases § 1368(a) of the 1992 Act, adding the phrase "as appropriate" after specifying the requirements for providing notice prior to classifying or reclassifying an Enterprise. It is unclear why OFHEO elects to paraphrase, rather than quote the statutory provision as closely as possible; by paraphrasing, OFHEO unnecessarily introduces potential ambiguity into its regulatory codification. More troubling, however, is OFHEO's inclusion of "as appropriate" to qualify its notice obligations. While OFHEO never explains the addition of this phrase, it presumably has been added in an effort to limit OFHEO's notice obligations. Of course, OFHEO cannot use a rulemaking to exempt itself from a statutory obligation.
[29] 1992 Act § 1368(a).
[30] *Id.* at § 1368(c).
[31] *Id.* at § 1368(d).

may issue new classification notices based on an Enterprise's response to a capital classification notice, although this is not clear.

Recommendation

Freddie Mac recommends that OFHEO modify its proposed regulations to remove any provisions that indicate that it may reclassify an Enterprise without providing a notice based on facts that have already occurred, and clarify the meaning of proposed § 1777.21(b)(2).

f. Requirement to Provide Notice of Material Developments

Proposed § 1777.21(b) requires an Enterprise to provide notice of "any material development that may reasonably be expected to cause the Enterprise's core or total capital to fall to a point that could result in assignment of the Enterprise to a lower capital classification."

Recommendation

We recommend that OFHEO clarify that this notice requirement addresses only situations where the Enterprise has reason to believe that it has failed to meet a capital requirement, in contrast to developments that could at some future time possibly have an adverse impact on capital levels.[32]

g. Exhaustion of Administrative Remedies

Proposed § 1777.27(b), exhaustion of administrative remedies, suggests that a court reviewing a final classification or reclassification would be barred from considering any objection, argument or information not presented to OFHEO in response to a notice of proposed classification or notice of intent to issue an order, as a failure to exhaust administrative remedies.

Exhaustion of administrative remedies is a concept designed to prevent premature judicial challenges to administrative actions*, i*.e., challenges to agency actions that the agency still has an opportunity to change. Under the procedures in the 1992 Act and the proposed regulation, a final classification or order is a final agency action. Neither the statute nor the proposed regulations provide any additional administrative processes available to challenge the action administratively before it becomes a final agency action – there are no additional administrative remedies to exhaust. Therefore, as a final agency action, a final classification or reclassification is directly reviewable by the United States Court of Appeals for the District of Columbia Circuit. The proposal cannot change that.

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[32] *See* comparable banking agency regulations at 12 C.F.R. §§ 6.3(c) (Office of the Comptroller of the Currency); 208.42(c) (Board of Governors of the Federal Reserve System); 325.102(c) (Federal Deposit Insurance Corporation); 565.3(c) (Office of Thrift Supervision).

The proposal also appears to attempt to modify the scope of judicial review. However, Congress established the scope of judicial review of final classifications or orders in § 1369D of the 1992 Act and in 5 U.S.C. § 706. OFHEO cannot bind federal courts to a more limited scope of review by issuing a regulation. While it would be important for an Enterprise wanting later to challenge a classification to ensure that it has established an adequate administrative record to support the challenge,[33] reviewing courts may consider any issues, arguments or information they are entitled to consider by law.[34]

Recommendation

Freddie Mac recommends that OFHEO remove proposed § 1777.27(b).

h. Conflicting Classification Proposals; Comments on Prior Classification Proposals

Proposed § 1777.21 sets forth a classification notice and response process similar (but not identical) to the process that OFHEO previously proposed to be included as § 1750.21 of its risk-based capital rules. In effect, proposed § 1777.21 would amend the current classification scheme in § 1750.5, which OFHEO indicates it would remove after § 1777 is adopted.[35]

Recommendations

Freddie Mac submitted comments concerning the classification schemes included in OFHEO's risk-based capital proposal. For purposes of the classification notice and response process proposed in § 1777.21, we hereby incorporate our prior comments by reference, including our recommendations as to an overall reporting scheme, our recommended reporting procedures intended to improve the operational workability of the reporting and classification process and our recommended classification override process for dealing with anomalies.[36] Also, the current regulation and the previously proposed regulation included greater specificity in the required contents of a notice; we recommend that proposed § 1777.21 incorporate that same level of specificity.

i. Capital Distributions During Transition Year

Proposed § 1777.22(a) and § 1777.22(c) set forth limits on Enterprise capital distributions on or after and before "the effective date of OFHEO's regulations establishing the risk-based capital level."

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[33] *See* 5 U.S.C. § 706.
[34] Furthermore, the statutory procedures under § 1368 of the 1992 Act call for the Enterprise to respond to proposed actions by providing information relevant to the Director's consideration in determining the form of action to take or whether to take any action at all. It would be unrealistic to expect an Enterprise to raise all possible challenges to an action without knowing what that action ultimately will be or whether there will be any action at all.
[35] 66 Fed. Reg. 18700, n. 20.
[36] Comments of Freddie Mac, pp. 190-197, 203-207 (Mar. 10, 2000).

As we discussed in our comment on OFHEO's second risk-based capital proposal,[37] Congress intended that the risk-based capital test have no regulatory effect during the one-year transition period. The current proposal is an opportunity for OFHEO to clarify that the lack of regulatory effect also applies to the charter provisions regarding capital distributions. The proposal also is an opportunity to address practical issues, as it may take a period of time after OFHEO issues its final risk-based capital rule before OFHEO and the Enterprises have in place processes to determine actual, current risk-based capital requirements.

Recommendation

OFHEO should modify proposed § 1777.22 by clarifying that the timing threshold is "the effective date of § 1365 of the 1992 Act," as OFHEO does in proposed § 1777.20.

j. Paraphrased Provisions from 1992 Act

Throughout this proposal (as well as other recent proposals made by OFHEO as part of its "regulatory codification" project), provisions of the 1992 Act are summarized or paraphrased, often using different language than is contained in the statute. In certain instances, changes are made without comment. In other instances, the notice describes the codification as true to the 1992 Act when in fact it is not.

For example, OFHEO states in its preamble that its proposed definition of "capital distribution" at § 1777.3 "is taken from [§ 1303(2) of the 1992 Act]," expressly asserting that it "is not at this time proposing to cover any category of payments beyond those listed in the statutory definition."[38] However, the paraphrased language OFHEO used imposes a prior approval requirement before it will consider certain employee stock ownership plan distributions as exempt from the its proposed definition. The 1992 Act definition contains no such requirement.

Similarly, proposed § 1777.23(h)(1)(i) fails to follow the statutory language in ways that could change its meaning from what the statute clearly provides. Specifically, the 1992 Act provides that OFHEO may reclassify an undercapitalized Enterprise as significantly undercapitalized if "the Director determines that the enterprise has failed to make, in good faith, reasonable efforts necessary to comply with" its capital restoration plan.[39] In its proposal, OFHEO omits the term "in good faith" to qualify the efforts of an Enterprise.[40] In addition, the proposal moves the word "reasonable" so that the regulation would read as follows: "If OFHEO determines, in its discretion, that an Enterprise has failed to make efforts reasonably necessary to comply with" its capital restoration plan.[41]

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[37] *Id.* at pp. 208-210.
[38] 66 Fed. Reg. 18699.
[39] 1992 Act § 1365(b)(2).
[40] Proposed § 1777.23(h)(1)(i).
[41] *Id.*

There is a significant difference between *reasonable efforts* at compliance and *efforts reasonably necessary* to comply.

As another example, OFHEO is authorized to appoint a conservator for an enterprise under certain circumstances, but is not required to do so, even where a basis exists for such an appointment, when OFHEO makes a requisite written finding, with the written concurrence of the Secretary of the Treasury. [42] In proposing a rule implementing this statutory provision, OFHEO fails to state that the Director may determine not to appoint a conservator.[43] Because OFHEO does not explain this omission, its purpose is unclear.

Throughout this comment, we have attempted to cite the specific instances in which OFHEO's proposed language differs from the 1992 Act in a way that might have a substantive impact. However, we cannot be certain that we have identified all of such instances; we remain concerned that many of the seemingly benign variations may be sources of disputes or confusion in the future.

Recommendation

Unless OFHEO is intentionally and expressly interpreting a statute, its regulations should copy the text of the 1992 Act *verbatim* or should incorporate the statutory provisions by reference.

IV. Definitions

The proposed definitions of "affiliate" and "Enterprise" at § 1777.3 essentially track the statutory definition at § 1303(1) of the 1992 Act. However, the proposal's discussion suggests that OFHEO will apply those terms in a very fluid manner, so that they would mean different things under different circumstances, in different contexts with respect to different provisions.[44]

The 1992 Act defines both terms "for purposes of this title,"[45] *i.e.,* for purposes of the 1992 Act. The 1992 Act includes provisions relating to regulation by the Department of Housing and Urban Development, as well as provision relating to capital standards and examination. All of those provisions apply equally to "the Enterprises." Surely Congress did not intend that definitions could apply selectively to different provisions of the 1992 Act. To the extent that a defined term is interpreted, that interpretation must apply throughout the 1992 Act.

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[42] *Id*. at § 1367(a).
[43] Proposed § 1777.28(b).
[44] *See* 66 Fed. Reg. 18698.
[45] 1992 Act § 4802.

Recommendation

The proposed regulatory definitions of "affiliate" and "Enterprise" essentially track the statutory definition so we have no specific recommendation with respect to them.

V. Conclusion

Freddie Mac supports the strong safety-and-soundness regulatory structure created in the 1992 Act. Freddie Mac believes that incorporation of the recommendations set forth in these comments would enhance OFHEO's implementation of that structure. We would be happy to discuss any of these comments at your convenience.

Very truly yours,

Maud Mater
Executive Vice President and General Counsel