



June 10, 2004

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

Attention: Comments/RIN 2550-AA24

Re: Corporate Governance  
69 FR 19126 (April 12, 2004)

Dear Mr. Pollard:

America's Community Bankers ("ACB")<sup>1</sup> is pleased to comment on the Office of Federal Housing Enterprise Oversight's ("OFHEO") proposed amendments<sup>2</sup> to its corporate governance regulation for Fannie Mae and Freddie Mac ("the Government Sponsored Enterprises" or "GSEs").

### **ACB Position**

We support OFHEO's efforts to strengthen corporate governance requirements for the GSEs to the extent that these regulations are consistent with requirements already applicable to other publicly traded companies. As a general matter, ACB is on record supporting legislative and regulatory initiatives for all public companies that promote "best practices" in corporate governance and require financial transparency. Requirements that go beyond what has recently been adopted for all public companies should best be left to board of director discretion.

However, we do not believe that the requirement that the GSEs must change auditing firms at least every ten years is in the best interests of the GSEs. We believe that the

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<sup>1</sup> America's Community Bankers represents the nation's community banks. ACB members, whose aggregate assets total more than \$1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

<sup>2</sup> 69 Fed. Reg. 19126 (April 12, 2004).

required rotation of auditing firms would be unnecessarily disruptive and counterproductive.

### **Corporate Governance Requirements**

In the past few years, the federal government has increased its involvement in regulating such areas as accounting firm oversight and corporate governance that traditionally have been left to individual states. The Sarbanes-Oxley Act of 2002<sup>3</sup> (“Sarbanes-Oxley”) and the rules issued by the Securities and Exchange Commission (“SEC”) to implement the law addressed a broad spectrum of corporate governance structure and operations, including CEO/CFO certification of financial reports, auditor independence, audit committee duties and responsibilities, code of ethics disclosure, and internal control evaluation and disclosure.

The New York Stock Exchange, the NASDAQ Stock Market, and the American Stock Exchange also have adopted corporate governance-related requirements for listed companies that, in some instances, go beyond the requirements of Sarbanes-Oxley. The GSEs are subject to all of the corporate governance standards of Sarbanes-Oxley and the New York Stock Exchange. Further, each GSE must choose to follow the corporate governance practices and procedures of the law of the jurisdiction in which it is located, Delaware General Corporation Law, or the Revised Model Business Corporation Act, to the extent not inconsistent with federal law.

We believe that the GSEs should be subject to the same governance standards that apply to other publicly traded companies. Specifically, the GSEs should be subject to the provisions of Sarbanes-Oxley, the SEC implementing regulations, and any applicable stock exchange listing requirements. These laws, regulations and listing requirements went through substantial review, analysis and public comment, and represent best practices in the area of corporate governance.

We believe that many of the provisions of the OFHEO proposal that go beyond these best practices are the types of requirements and choices that are best left to each company’s board of directors. For example, a company’s board is in the best position to determine whether the same person should hold the role of chairman and chief executive officer depending on the individuals involved and the board dynamic. Boards also are in the best position to determine whether there should be a policy that provides for age or term limitations for directors. We urge OFHEO to consider leaving decisions about these and other matters that go beyond the requirements for other public companies to the respective GSE board of directors.

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<sup>3</sup> Pub. L. 107-204 (2002).

## Changing Auditing Firms

OFHEO is proposing to require the GSEs to change external auditing firms at least every ten years.<sup>4</sup> The proposal requires Fannie Mae to change external auditors no later than January 1, 2006 and Freddie Mac by January 1, 2009. Under Sarbanes-Oxley, public companies already are required to rotate the lead external audit partner and the reviewing partner at least every five years. We think this is a prudent requirement for all publicly traded firms, including the GSEs.

We oppose the requirement that the GSEs change auditing firms every ten years. There could be significant disruption to the business and costs associated with such a requirement while the benefits are uncertain. Sarbanes-Oxley required the Comptroller General of the United States (the “GAO”) to examine and report on the potential effect of limiting the number of years that a registered public accounting firm could be the auditor of a public company.<sup>5</sup> The GAO report issued in November 2003 concluded that mandatory audit firm rotation might not be the most efficient way to strengthen auditor independence and improve audit quality considering the additional financial costs and the loss of auditor knowledge that is not carried forward to the new auditor.<sup>6</sup> The GAO concluded that the potential benefits of a mandatory rotation requirement were harder to predict and quantify while it was clear that there would be an increase in costs.

The GAO recommended that the SEC and the newly formed Public Company Accounting Oversight Board monitor the existing requirements for enhancing auditor independence and audit quality under Sarbanes-Oxley before considering an auditor rotation requirement. Of course, even without a mandatory requirement, the audit committees and boards of directors of each GSE should examine on a regular basis whether a change in the external auditor is necessary or appropriate. Leaving this decision to GSE discretion would help address the practical problem resulting from the consolidation in the accounting industry. The major external auditing firms have dwindled to “The Big Four” and the GSEs may not have sufficient options to fulfill a rotation requirement.

Also, while requiring a “fresh look” at a GSE’s accounting practices and financial condition may have a certain appeal, the goals of a rotation requirement may not be met and the requirement may have unintended consequences that could adversely impact safety and soundness. All of the expertise and institutional knowledge that was gained over the years by an audit firm would be lost and the new auditors would have to get up to speed with the GSE’s complex financial statements in a short time period for the preparation of quarterly reports. This is even more of an issue now that auditors also must provide an opinion on a public company’s internal control structure under Sarbanes-Oxley. It would take additional time for new auditors to gain the high level of

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<sup>4</sup> 69 Fed. Reg. 19132.

<sup>5</sup> *Id.* at Section 307.

<sup>6</sup> Public Accounting Firms: Required Study on the Potential Effects of Mandatory Audit Firm Rotation, GAO Report No. GAO-04-216, released on November 21, 2003 (available at [www.gao.gov/atext/d04216.txt](http://www.gao.gov/atext/d04216.txt)).

understanding of internal controls now required by auditing standards for Fannie Mae. The requirement also will apply to Freddie Mac once it registers its common stock with the SEC.

Not only could this lead to mistakes in the financial statements over the first few years of the new engagement, it could reduce the opportunity to ferret out fraud. Unscrupulous management could take advantage of the time it takes new personnel to develop a complete understanding of operations and defraud the company. If the new auditors did not uncover a fraud initially because they were not yet fully knowledgeable about the GSE's processes, the fraud could then go on undetected for years.

### **Conclusion**

In summary, ACB supports required adherence by the GSEs to all regulations applicable to other publicly traded companies. Requirements in the proposal that go beyond what is applicable to other public companies should be best left to board of director discretion. In addition, we do not support the proposed requirement that the GSEs rotate external auditing firms.

ACB appreciates the opportunity to comment on this important matter. If you have any questions, please contact Janet Frank at (202) 857-3129 or [jfrank@acbankers.org](mailto:jfrank@acbankers.org).

Sincerely,



Charlotte M. Bahin  
Senior Vice President, Regulatory Affairs