



SUITE 13E - 404
555 THIRTEENTH STREET, NW
WASHINGTON, DC 20004

202.637.8281
202.637.5910 FAX
WWW.FMWATCH.ORG

GERALD L. FRIEDMAN
CHAIRMAN

MIKE HOUSE
EXECUTIVE DIRECTOR

March 24, 2003

Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
Fourth Floor
1700 G Street, N.W.
Washington, D.C. 20552

**Re: Disclosure of Financial and Other Information Rule
(68 Fed. Reg. 15 (January 23, 2003))**

Dear Mr. Pollard:

FM Watch appreciates the opportunity to submit its views concerning the proposed regulation of the Office of Federal Housing Enterprise Oversight ("OFHEO"), which sets forth public disclosure requirements with respect to financial and other information by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" and, together with Fannie Mae, the "Enterprises"), published in the *Federal Register* on January 23, 2003 (the "Proposed Rule"). FM Watch is a coalition of financial services and housing-related trade associations working with affordable housing and consumer advocates, taxpayer groups and financial institutions to monitor the activities of Fannie Mae and Freddie Mac.¹

FM Watch appreciates OFHEO's support for improving the public disclosures of Fannie Mae and Freddie Mac, as evidenced by the Proposed Rule, and we commend OFHEO for working closely with the Securities and Exchange Commission ("SEC") and the Department of the Treasury ("Treasury") in preparing the joint study regarding disclosure in the mortgage-backed securities ("MBS") market released on February 3, 2003.² The effort of OFHEO, through the Proposed Rule and other endeavors, to end the major disparities between the securities and financial disclosures of the Enterprises and all other publicly traded firms, is only partially completed. Many disparities continue to exist, particularly regarding the fundamental areas of enforcement of appropriate disclosure, financial reporting and internal control standards for the Enterprises as compared to those imposed on all other publicly traded firms. Without

¹Additional information regarding FM Watch is available at www.fmwatch.org.

² See *Staff Report: Enhancing Disclosure in the Mortgage-Backed Securities Markets, A Staff Report of the Task Force on Mortgage-Backed Securities Disclosure* (Department of the Treasury, Office of Federal Housing Enterprise Oversight and Securities and Exchange Commission) (January 2003, published February 3, 2003) (the "MBS Task Force Report"), available at <http://www.sec.gov/news/studies.shtml>.

Alfred M. Pollard
March 24, 2001
Page 2

the elimination of such disparities, there will never be investor protection and complete and transparent disclosure with regard to the Enterprises.

For these reasons, FM Watch continues to support enactment of legislation that would bring the Enterprises under the full weight of the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act") by repealing their status as exempted securities. We believe this change is essential to protect both investors and taxpayers. However, until the necessary legislation can be enacted, it is essential that OFHEO bring to bear every regulatory power at its disposal, and we commend OFHEO for its commitment to establishing a meaningful disclosure regime for the Enterprises.

We believe OFHEO has the authority to promulgate not only the Proposed Rule as drafted, but also an improved and strengthened one, which this comment letter recommends. In our view, OFHEO's rulemaking efforts can result in enhanced disclosures by the Enterprises and better enforcement of the various requirements of the securities laws that would apply to them and their insiders under the Proposed Rule.

The Proposed Rule

On July 12, 2002, Treasury, the SEC and OFHEO jointly announced an agreement with the Enterprises (the "July Agreement") pursuant to which the Enterprises would register their common stock under Section 12(g) of the 1934 Act and file periodic reports under Section 13 of the 1934 Act. As part of the July Agreement, it was announced that OFHEO would not pursue a securities registration regime for the Enterprises and that a joint study by Treasury, the SEC and OFHEO would be undertaken to study the disclosure applicable to MBS.³ Further, the July Agreement provided that OFHEO would promulgate a rule to require the Enterprises to prepare and file proxy statements and the officers and directors of the Enterprises to file reports on their purchase or sale of common stock of the Enterprises.⁴

OFHEO published the Proposed Rule pursuant to its authority as the "safety and soundness" regulator of the Enterprises and its supervisory program.⁵ The Proposed Rule would require each Enterprise "to prepare disclosures relating to its financial

³ See MBS Task Force Report.

⁴ See Press Release of the Department of the Treasury (Statement of Treasury Secretary Paul H. O'Neill on GSE Voluntary Disclosure Compliance) (July 12, 2002); Press Release of the U.S. Securities and Exchange Commission (Statement by SEC Chairman: On Fannie Mae/Freddie Mac) (July 12, 2002); and Press Release of the Office of Federal Housing Enterprise Oversight (Statement of OFHEO Director Armando Falcon) (July 12, 2002).

⁵ In the Proposed Rule, OFHEO states that it has both explicit and implied authorities to address the Enterprises' disclosure practices. In general, see 12 U.S.C. § 4513, 12 U.S.C. §§ 4631, 4632, and 4636; 12 U.S.C. § 4514; 12 U.S.C. § 4501(6); and the chartering acts for the Enterprises at 12 U.S.C. § 1723a(k)(2) and 12 U.S.C. § 1456(c)(2) and (3).

Alfred M. Pollard
March 24, 2001
Page 3

condition, results of operation, business developments and management expectations that include supporting financial information and certification thereof.”⁶ The Proposed Rule further provides that each Enterprise would be deemed to have satisfied such disclosure obligations if:

- (i) the Enterprise prepares an annual report, quarterly report and current reports, and such other materials that may be required under the rules and regulations of the SEC;
- (ii) the Enterprise files with the SEC all reports, statements and forms required pursuant to Sections 14(a) and 14(c) of the 1934 Act; and
- (iii) the officers and members of the board of directors of the Enterprise file with the SEC all reports and forms relating to the common stock of the Enterprises required pursuant to Section 16 of the 1934 Act.⁷

Need For Parity of Securities Regulation

Nothing in the July Agreement causes any alteration of the existing treatment of securities of the Enterprises as “exempt securities,” “excepted securities”, and “government securities” under the 1933 Act, the 1934 Act, the Trust Indenture Act of 1939 and the Investment Company Act of 1940. In connection with the announcement of the July Agreement, Fannie Mae and Freddie Mac each received a no-action letter from the SEC.⁸ The no-action letters are identical and itemize the federal securities law provisions that continue not to apply to the Enterprises following the registration of their common stock under Section 12(g) of the 1934 Act. The no-action letters confirm, among other things, that:

- Securities issued or guaranteed by the Enterprises are exempt securities under the 1933 Act and may be sold without registration under the 1933 Act;
- Since the Trust Indenture Act of 1939 does not apply to securities issued by the Enterprises, the Federal Reserve Banks may remain the fiscal agent of the Enterprises, and no independent trustee is required, for the Enterprises’ unsecured debt securities or mortgage-backed securities;
- Sections 14(a) and 14(c) of the 1934 Act are inapplicable to the Enterprises; and

⁶ See Proposed Rule, Section 1730.3, 68 Fed. Reg. at 3195.

⁷ See *id.*

⁸ Federal National Mortgage Association, SEC No-Action Letter (July 12, 2002); Federal Home Loan Mortgage Corporation, SEC No-Action Letter (July 12, 2002).

Alfred M. Pollard
March 24, 2001
Page 4

- Section 16 of the 1934 Act is inapplicable to the Enterprises' officers, directors and shareholders.

In view of these gaps in the securities regulatory scheme for the Enterprises, FM Watch believes that the Proposed Rule would be strengthened by making revisions in the four areas addressed below.

Disclosure

FM Watch strongly supports OFHEO's desire to establish a disclosure regime that would impose meaningful discipline on the Enterprises, thereby providing improved protection for taxpayers and investors, and increased parity between the Enterprises and private sector market participants. To assure that the proposed disclosure regime will operate effectively, we recommend that OFHEO specify the manner in which it will review the Enterprises' compliance with SEC disclosure requirements and the sanctions available for application against the Enterprises if violations are determined by OFHEO and/or the SEC to exist.

Specifically, FM Watch recommends that the Proposed Rule:

- provide that the sanctions detailed in OFHEO's corporate governance rule⁹ also would apply in the case of a disclosure violation; and
- make it clear that OFHEO may also use any or all of its safety-and-soundness powers and its power to issue sanctions¹⁰ to address any failure to comply with SEC disclosure standards.

Legal and Reputational Risk

OFHEO has broad safety-and-soundness powers over the Enterprises.¹¹ Failure by an Enterprise to honor commitments made since October 2000 regarding increased disclosure would create significant legal and reputational risk.

- FM Watch recommends that the Proposed Rule should include an additional section addressing the disclosure commitments which have been made by the Enterprises since October 2000, including recent Fannie Mae and Freddie Mac press releases detailing their commitments to make new MBS disclosures. Strict adherence to all commitments undertaken by the Enterprises should be stipulated by OFHEO,

⁹ See 12 C.F.R. Pt. 1710.

¹⁰ See 12 C.F.R. Pt. 1780.

¹¹ See note 5 above.

Alfred M. Pollard
March 24, 2001
Page 5

supervised by its examiners and enforced pursuant to both corporate governance and safety-and-soundness powers.

Similarly, failure by Enterprise insiders to comply with generally accepted investor protection standards would create a range of risks, not the least among them these same legal and reputational ones. Accordingly,

- FM Watch recommends that the Proposed Rule be strengthened by inclusion of a provision affirming that the remedies provided in the securities laws for failure to comply with the SEC regulations imposed on the Enterprises by OFHEO will be available for application by the SEC against the Enterprises.

Insider Transactions

FM Watch recommends that OFHEO clarify that Enterprise insiders are governed by all of the SEC rules applicable to insiders at other publicly traded firms, pursuant to OFHEO corporate governance rules and its safety-and-soundness standards. The Proposed Rule would require the officers and members of the board of directors of the Enterprises to file with the SEC all reports and forms relating to the common stock of the Enterprises required pursuant to Section 16(a) of the 1934 Act. However, insiders of the Enterprises would continue to be exempt from the provisions of Section 16(b) relating to the disgorgement of short swing profits and the provisions of Section 16(c) prohibiting short sales. OFHEO should require that the Enterprises adopt internal rules, stating that it is company policy that:

- employees must comply with the requirements of Section 16(b) and 16(c) of the 1934 Act or face dismissal; and
- any employee who asserts the statutory exemption provided by the Enterprise's charter from the short-swing profit and short sale prohibition provisions as a defense in response to a claim concerning the person's own transactions in the Enterprise's securities would forfeit his or her position with the company.

In addition, we note that while the reporting requirements and trading restrictions of Section 16 also apply to beneficial owners of more than 10 percent of any class of equity securities registered pursuant to Section 12, no provision is made in the Proposed Rule for applying Section 16 to these persons.

Enforcement

FM Watch believes that OFHEO should supplement the Proposed Rule, and the SEC should promulgate its own rule, to make clear the division of responsibilities between OFHEO and the SEC with respect to the Section 13 reports and the proxy materials of

Alfred M. Pollard
March 24, 2001
Page 6

the Enterprises and the trading reports of their insiders. The intended division of authority is unclear. For example, will the SEC assume the sole or primary responsibility for the review of the Section 13 reports, proxy materials and insider trading reports of the Enterprises? Will OFHEO or the SEC assume responsibility for addressing violations with respect to such matters? Will the answers to such questions differ depending upon whether the violation relates to the Section 13 reports on the one hand and the proxy statements and insider trading reports on the other? What enforcement mechanisms will apply in such situations? Lastly, will OFHEO promulgate a rule that would subject the insiders of the Enterprises to the same set of rules regarding the disgorgement of short swing profits and the prohibition against short sales by corporate insiders that apply to the insiders of all other publicly traded companies?

FM Watch believes that it is important to indicate in the Proposed Rule specific answers to these and other similar questions with respect to the filing and content of reports by the Enterprises and their insiders. Accordingly, FM Watch recommends that:

- OFHEO and the SEC draft a Memorandum of Understanding stipulating that SEC sanctions would apply to any failure of the Enterprises to comply with the Proposed Rule, including the enforcement and liability provisions of Rule 14a-9(a)¹² relating to false and misleading proxy statements; and
- OFHEO establish a procedure through which aggrieved investors can bring concerns to OFHEO's and the SEC's attention to ensure swift and effective enforcement. It is necessary that OFHEO establish this procedure because the Enterprises remain outside the realm of most investor relief litigation.

Conclusion

At the time that the July Agreement was announced, FM Watch stated that while the July Agreement reflected a victory for American investors and consumers, it still fell short of the disclosure requirements for every other publicly traded company.¹³ FM Watch continues to believe that enhanced disclosure by the Enterprises is critical to protecting investors, protecting our markets, ensuring the safety and soundness of the

¹² Rule 14a-9(a) provides as follows: "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

¹³ See statements of W. Mike House, Executive Director, FM Watch. Garver, *House Panel Expected To Investigate GSE Pact*, *The American Banker*, July 15, 2002, at 2; Fernandez, *OFHEO Takes Lead on GSE Disclosure -- for the Moment*, *The American Banker*, August 2, 2002, at 1.

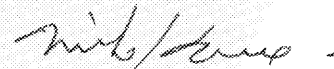
Alfred M. Pollard
March 24, 2001
Page 7

Enterprises, and providing for a fair and a level playing field between the Enterprises and other publicly traded companies. Similarly, it believes that the insiders of the Enterprises should be fully subject to the trading restrictions and limitations imposed on all other public company insiders.

FM Watch strongly supports the OFHEO Proposed Rule as an important interim measure and a significant step in the effort to require the Enterprises and their insiders to conform to the same disclosure and other requirements applicable to other publicly traded companies. We continue to believe, however, that the Proposed Rule and the July Agreement are not a substitute for enactment of legislation that would repeal the exempted security status of the Enterprises and fully subject the Enterprises to the same standards that apply to all other publicly traded companies.¹⁴

FM Watch appreciates the opportunity to comment on the Proposed Rule.

Sincerely,



W. Mike House
Executive Director

¹⁴ During his testimony before the House Financial Services Committee on February 12, 2003, Federal Reserve Board Chairman Alan Greenspan stated in response to a question that he believes the Enterprises should be regulated in the same way as private corporations are regulated with respect to the federal securities laws and disclosure matters. *See Hearing To Receive the Testimony of the Chairman of the Federal Reserve Board of Governors on Monetary Policy and the State of the Economy*, House Comm. on Financial Services, 108th Cong., 1st Sess. (February 12, 2003) (statement of Alan Greenspan, Chairman of the Federal Reserve Board). Securities and Exchange Commission Chairman William Donaldson advised Congress in a written response to questions submitted in connection with his confirmation proceedings that the Enterprises should be "role models" for disclosure and should comply with "the gold standard of disclosure, the disclosure requirements of the federal securities laws." John Connor, *Capital Views: Handle GSEs Like Private Firms - Greenspan*, Dow Jones Capital Markets Report, February 12, 2003.