

Roger E. Birk

11988 S. E. INTRACOASTAL COURT
TEQUESTA, FL 33469

December 13, 2001

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

Re: Proposed Corporate Governance Regulations

Dear Mr. Pollard:

I respectfully submit these comments on the regulations proposed on September 12, 2001 by the Office of Federal Housing Enterprise Oversight ("OFHEO") relating to corporate governance practice and procedures at Fannie Mae.

I am writing to you as a concerned former member of the Board of Directors of Fannie Mae ("Board"), serving from 1985 through May 2001. As a Board member, I served as the Chairman of the Nominating and Corporate Governance Committee from June 1994 to May 2001. I also have significant experience as a senior executive of major financial institutions, having served as the President and Chief Operating Officer of Fannie Mae from November 1987 through January 1992 and, prior to that, as Chairman, Chief Executive Officer and President of Merrill Lynch & Co. I have also served on a number of other corporate boards, including Mutual of America Capital Corporation, Penske Corporation and WellPoint Health Networks, Inc. In these positions, I have gained significant insight into how large U.S. corporations function and into the practices that enhance board effectiveness. Based on my considerable experience in corporate governance, I find the proposed OFHEO regulations highly intrusive and inconsistent with well-established practices in the business world. There is no reason for Fannie Mae to be subject to corporate governance standards so significantly different than those in place at other large, publicly-traded corporations. To ensure the continued strength and success of Fannie Mae, OFHEO should withdraw the proposed regulations.

My concerns are not theoretical. In my opinion, the Fannie Mae Board is doing its job and doing it well. Given the OFHEO-proposed vague new standards, the directors may be forced to spend more time looking over their shoulders and less time acting in the best interests of Fannie Mae. Equally important, it will become more difficult to attract

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outstanding and experienced directors to serve on the Board. OFHEO should not create uncertainties and disincentives by subjecting Fannie Mae directors to a more expansive duty of care, undefined conflict of interest policies, and greater potential liability.

Under its current proposal, OFHEO will be modifying the well-developed standards that currently exist under state law and the Model Act. While the stated objectives of the proposal are laudatory, the proposed regulations combine the worst of two approaches: they impose a rigid and unnecessary set of corporate governance standards on Fannie Mae and, at the same time, add vague new requirements that will be difficult to interpret and enforce. This will create confusion regarding what standards apply to Board members, thereby causing thoughtful director candidates to decline to serve.

The proposed regulations would require Fannie Mae to elect to be bound by the "corporate governance law" of the jurisdiction in which it is located, Delaware law, or the Model Business Corporation Act (the "Model Act"). But then, rather than simply requiring that Fannie Mae comply with the law selected, OFHEO goes on to articulate its own set of standards that the corporation's board members must meet. These standards are said to be based on the current legal standards set forth in state law and the Model Act. In fact, they are inconsistent with the Model Act and other state laws and significantly different from the rules of any other regulator.

Over the years, state statutory and common law has developed a practical and functional system that requires a director to act on an informed basis and in a manner that he or she reasonably believes to be in the best interest of the corporation. This is a system that works. By establishing these duties of care and loyalty as the clear standards of conduct for board members, and protecting board members from personal liability if they satisfy these duties, corporations have been able to attract top-quality directors and take full advantage of the knowledge and experience of their directors in establishing and monitoring corporate strategic goals. Instead of simply stating that the corporate law elected by Fannie Mae governs, OFHEO's proposal imposes additional – and, in my view, unnecessary, contradictory and overly burdensome – requirements on Fannie Mae.

For example, in its proposal OFHEO fundamentally alters the basic rules of corporate governance. For U.S. corporations, the standard duty of care requires a director to act in good faith and in a manner that the director *reasonably believes* is in the best interest of the corporation. OFHEO's proposal eliminates the "reasonable belief" element and, in its place, imposes an absolute duty that a director act in the best interest of the corporation, with OFHEO having the authority to review the director's decision after-the-fact to

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determine whether the director's decision was in fact in the best interest of the corporation. This in effect, eliminates the business judgment rule. Under the business judgment rule, there is a presumption that, in making a business decision, a director acted in the best interests of the company. To overcome this presumption, a litigant must prove that a director breached his fiduciary duties by, for example, not making an informed decision in good faith or acting with gross negligence in reaching his decision.

With the business judgment rule in place, directors are able to analyze information that is reasonably available and make a business decision about what they think is in the best interest of the corporation, without fear of being second guessed in subsequent shareholder suits or other litigation. A corporation and its directors are protected from liability if the board acts reasonably and in good faith, but, nonetheless, ends up making the wrong business decision; Fannie Mae and its Board should have this same protection. I am concerned that, by eliminating the reasonableness standard from the duty of care and replacing it with an absolute duty, OFHEO will force Fannie Mae's Board to try to micro-manage the company's operations. In my experience, this is not an appropriate or effective role for a corporate board.

The OFHEO proposal also expands the duty of loyalty to include a vague and undefined prohibition against "apparent conflicts" of interest. In attempting to implement this provision, the Board will be left without clear guidance, and OFHEO regulators will be given unfettered authority to penalize directors for actions that appear to OFHEO to create a conflict, but that never rise to the level of an actual conflict. Given this vague standard, Fannie Mae's Board will be reasonably concerned about having their actions invalidated on conflict of interest grounds or being subjected to OFHEO-imposed penalties. Directors will also be concerned about being accused of a conflict of interest based on such a vague standard. Given these concerns, the Board may be unable to act on many important issues.

In addition to imposing a more expansive standard of conduct and responsibility on Fannie Mae's directors, the OFHEO proposal also limits Fannie Mae's ability to indemnify its directors. OFHEO has the authority, under certain circumstances, to impose penalties on a director up to \$100,000 a day for which indemnification may not be available. This rule will subject Fannie Mae's directors to greater personal liability than board members of other regulated financial institutions and large corporations.

In my view, subjecting Fannie Mae directors to an expanded standard of care and exposing them to greater personal liability will make it significantly more difficult for

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Fannie Mae to recruit top-quality directors. As Chairman of Fannie Mae's Nominating and Corporate Governance Committee for many years, I was responsible for interviewing potential candidates for the Board and collecting and presenting to the Board names of potential nominees for election to the Board. The best candidates to serve as directors have many companies competing for their time and efforts. If Fannie Mae is not able to offer its directors a level playing field with regard to duties and indemnification, these candidates may well decide to take their talents elsewhere and not share them with Fannie Mae. From a safety and soundness point of view it doesn't make sense for a regulator to take action that will discourage service by the best candidates.

The proposed regulations also provide that Fannie Mae may indemnify a director only if the board concludes, after due investigation, that the director acted in good faith and in a manner he or she believed to be in the best interest of the corporation and that the indemnification payment will not have a material adverse affect on Fannie Mae's safety and soundness. In addition, the director being indemnified must agree, in writing, to reimburse Fannie Mae for any payments that subsequently become prohibited payments under the regulations. The proposed regulations classify as a prohibited payment any indemnification of a director for any civil money penalty assessed by OFHEO or for any legal expenses incurred by a board member in connection with an administrative proceeding initiated or undertaken by OFHEO that results in a civil money penalty being assessed on, or a cease and desist order being issued to, the director. These prohibitions go far beyond any provision of state law or the Model Act. In my judgment, prospective directors seeing these standards will be deterred from serving because they will not want to run the risk that the advancement of costs of legal defense, and their right to indemnification will depend on some future assessment of the financial condition of the company, or on whether OFHEO decides to commence an administrative proceeding.

Finally, I must emphasize that there is no justification for OFHEO to impose these unique and burdensome rules on Fannie Mae. The proposed regulations reject the rules that govern virtually every business in the United States without any evidence that the new rules are necessary, advantageous or workable. I know from first-hand experience that Fannie Mae's Board is a highly efficient and effective board that works closely with Fannie Mae's management to help Fannie Mae achieve its public mission, while simultaneously protecting the financial interests of shareholders. The Board plays an integral role in setting and implementing Fannie Mae's strategic goals. The Board closely monitors management's efforts to achieve the company's goals and benchmarks.

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If you have any questions about my views, I would welcome the opportunity to discuss with OFHEO officials, as I have in the past, corporate governance issues relating to Fannie Mae.

Sincerely,

~~Roger E. Birk~~