March 27, 2001

By Courier and Electronic Mail

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Office of Federal Housing Enterprise Oversight
1700 G Street, NW
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Washington, DC 20552

Re: Executive Compensation, Notice of Proposed Rulemaking, 65 *Fed. Reg*. 81771 (December 27, 2000), RIN 2550-AA13

Dear Mr. Pollard:

Freddie Mac welcomes the opportunity to comment on the Office of Federal Housing Enterprise Oversight's ("OFHEO") proposed rules on reporting procedures in connection with its review of executive compensation at Freddie Mac and Fannie Mae (the "Enterprises").

Since its creation, OFHEO has exercised its executive compensation review responsibilities without formal procedural rules. OFHEO's *Federal Register* Notice states that the proposed regulation "would largely formalize processes currently used by OFHEO in performing its executive compensation oversight responsibilities."[1] For the most part, we agree with this characterization, but because the proposed rule would replace the current flexible processes with regulations having the force of law, it is important that the rules be clear and consistent. It is also important that the legal assumptions embedded in these procedural standards be correct. We hope our comments will help OFHEO meet these objectives.

Background

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("the 1992 Act") created OFHEO to ensure the continued financial safety and soundness of Freddie Mac and Fannie Mae. The 1992 Act assigned separate and distinct roles to the Enterprises and OFHEO with respect to compensation: it clarified the authority of the Enterprises' Boards of Directors to set executive compensation, and assigned OFHEO the responsibility to review the Enterprises' exercise of that authority in certain limited respects.

[1] 65 Fed. Reg. 81771 (December 27, 2000)

Under the 1992 Act and the Enterprises' Charter Acts, the power to fix compensation of the Enterprises' employees, including that of senior management, is expressly vested in the companies' Boards of Directors in accordance with criteria established by the 1992 Act. The 1992 Act amended §303(c)(9) of Freddie Mae's Charter Act to give its Board the power to

> "... appoint, employ, and fix and provide for the compensation and benefits of officers, employees, attorneys, and agents as the Board of Directors determines reasonable and comparable with compensation for employment in other similar businesses (including, publicly held financial institutions or other major financial services companies) involving, similar duties and responsibilities, except that a significant portion of potential compensation of all executive officers ... of the Corporation shall be based on the performance of the Corporation…."

12 U. S.C. §1452(c)(9).[2] Congress amended §309 of Fannie Mae's Charter Act, 12 U.S.C. §1723a(d)(2), identically. As the House Report explained, "… the Committee recognizes that both Enterprises must compete with private corporations in the private marketplace for talented individuals and, as a result, they must pay marketplace compensation to attract and retain such talent regardless of race and gender."[3]

The 1992 Act assigned OFHEO a different role: to review the Boards' exercise of their authority to set compensation, for the limited purpose of preventing compensation abuses. Thus, §1313(b)(8), 12 U.S.C. §4513(b)(8), gives OFHEO the exclusive authority to "prohibit the payment of excessive compensation by the Enterprises to any executive officer of the Enterprises under section 1318." Section 1318(a), 12 U.S.C. §4518(a), mirroring language inserted in the Enterprises' Charter Acts, provides that the Director shall prohibit the Enterprises

> "...from providing compensation to any executive officer of the Enterprise that is not reasonable and comparable with compensation for employment in other similar businesses (including publicly held financial institutions or major financial services companies) involving similar duties and responsibilities."

Under the 1992 Act, OFHEO's review authority is designed to prevent "excessive" (or abusive) compensation, not to regulate what the Enterprises choose to pay their senior executives or how they choose to structure that compensation.[4] Section 1318(a)

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[2] Prior to the 1992 Act, §303(c)(9) of Freddie Mac's Charter Act did not specifically assign the task of setting compensation to the Board (although the Board has always done so in practice) and –unlike the 1992 Act -- did not prescribe any specific criteria to be applied in setting executive compensation.

[3] H. Rep. 102-206, 102d Cong., 1st Sess. 54 (1991).

[4] Thus, in two important ways relating to compensation, the 1992 Act gives OFHEO no role at all. First, §1318(b) prohibits the Director from setting "a specific level or range of compensation" in carrying out §1318(a). Second, §1318 omits the charter language concerning the performance-based aspects of Enterprise

accordingly limits OFHEO's role to reviewing whether the executive compensation established by the Enterprises' Boards meets the comparability standards of the Charter Acts – that is, reviewing Board action to see that Enterprise pay does not get out of line with pay for similar jobs at similar businesses. [5]

This approach reflects Congress's overall intent that the Enterprises' bring private sector skills and management to their housing missions without undue regulatory interference. As the Senate explained its view of the proper "balance" between regulatory action and the Enterprises' independence:

> " The Committee does not mean for the Director or HUD Secretary to impose his or her business judgment on, or interfere with, the normal management prerogatives of an Enterprise that has sound financial controls, and is adequately capitalized and profitable. Congress created the Enterprises' under private ownership and management to bring the entrepreneurial skills and judgments of the private sector to bear on accomplishment of public purposes relating to housing. The Committee does not mean to upset this unique structure or to encourage any government official to second guess decisions of Enterprise management arrived at through the exercise of honest, unbiased judgment of what is in the best interests of the Enterprise."

S. Rep. 102-282, 102d Cong., 2d Sess. 25 (1992). By amending the Enterprise Charter Acts to direct the Boards to set comparable executive compensation, Congress placed the responsibility for exercising "honest, unbiased judgment" with respect to compensation squarely with the Enterprises' Boards of Directors, not OFHEO. This allocation of responsibilities is consistent with its overall admonition that the Director should not interfere with the "management prerogatives" of a financially sound Enterprise.

Section 303(h)(2) of Freddie Mac's Charter Act, 12 U.S.C. §1452(h)(2), gives OFHEO a narrow but more pro-active role with respect to termination agreements for Enterprises' executive officers. The Charter requires the Director to approve "in advance" any payment "in

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compensation, and so gives the Director no role in reviewing that second aspect of the charters' compensation criteria.

[5] The legislative history of the 1992 Act reflects that Congress's interest in Enterprise compensation matters stemmed mostly from a desire to prevent "excessive" compensation, not a concern that that compensation threatened the financial well-being of the Enterprises. In fact, although drafted in the wake of the thrift crisis, early 1991 versions of the Enterprise legislation (H.R. 2747, S. 1282) concentrated on overall financial safety and soundness and did not contain any specific provisions relating to executive compensation review. When the House passed H.R. 2900 in September 1991, however, it included provisions on both on-going and termination compensation because it "…believed that these provisions and restrictions are necessary because of the public's adverse reaction to the size of the compensation package provided to one of the Enterprise's executive officers upon retirement from the Enterprise." H. Rep. 102-206 at 54. In S. 2733, the Senate followed the House with the aim of imposing "constraints on compensation of Enterprise personnel, including issuance of 'golden parachutes' like that awarded to the former Chairman of Fannie Mae." S. Rep. 104-282 at 44.

connection with the termination of employment " of a Freddie Mac executive officer. As with other compensation, the compensation in connection with a
termination agreement must be "comparable" to such agreements with other officers of public and private entities involved in financial services and housing interests who have comparable duties and responsibilities. Section 309(d)(3)(B) of Fannie Mae's Charter Act, 12 U.S.C. §1723a(d)(3)(B), contains a virtually identical requirement.

In addition to OFHEO's review authority, there are numerous other constraints on Enterprise executive officer compensation. First, the Enterprises make extensive public disclosure, consistent with the federal securities laws and stock exchange rules, of their compensation practices, and are thus subject to the discipline that investors in the marketplace impose on publicly-traded companies. Second, the 1992 Act requires the Enterprises to report to Congress annually on their compensation policies.[6] Third, many of the compensation plans applicable to executive officers are also subject to comprehensive federal regulation, including the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code ("IRC").

Our comments are made in light of this background.

Comments on the Proposed Rules

1. Definition of Executive Officer

OFHEO's authority over executive compensation extends only to the Enterprises' "executive officers," as that term is defined in §1303(7) of the 1992 Act. Section 1303(7)'s definition includes the Enterprises' most senior officers as well as any Enterprise senior vice presidents (SVPs) who are "in charge of a principal business unit, division, or function." Thus, as proposed rule 1770.3(g)(2) recognizes, not all SVPs are "executive officers" under the 1992 Act; instead, only those SVPs who are "in charge" (*i.e.*, direct or manage) of a "principal" (*i.e.,* most important, influential or consequential) "business" (*i.e.*, as opposed to a support) unit, division, or function are covered.

As OFHEO is aware, determining exactly which SVPs meet this definition has sometimes been problematic. When OFHEO conducted its first review of Enterprise executive compensation in 1996-97, it defined covered SVPs as those SVPs with direct reporting relationships to either the Enterprise's Chief Executive Officer or its Chief Operating Officer – the same definition set forth in §1770.3(g)(2)(ii). In its Notice, OFHEO states that such a "functional" definition is appropriate. It seeks to implement this definition by reiterating the SVP language of §1303(7) in proposed rule 1770.3(g)(2)(i).[7]

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[6] Section 303(h)(1) of Freddie Mac's Charter Act, 12 U.S.C. §1452(h)(1); §309(d)(3)(A) of Fannie Mae's Charter Act, 12 U.S.C. §1723a(d)(3)(A).

[7] *Id.*

We acknowledge that this line-drawing exercise has been a difficult one, but upon reflection we believe OFHEO's first application of the statute is still the best. Defining "executive officer" in terms of direct reports to the Enterprise's Chairman or Vice-Chairman has the obvious benefit of being both clear and predictable. This is still a "functional" definition, because it is an effective proxy for the definitional requirement that to be an "executive officer" an SVP must be "in charge of a principal business unit, division, or function;" that reporting relationship reflects the fact that the executive plays a sufficiently important policymaking role within the organization to merit OFHEO review.[8] Moreover, as a practical matter, this definition will operate as review of other SVPs' compensation, since it is highly unlikely in hierarchical organizations like the Enterprises that a subordinate will routinely make more than his or her superior. Accordingly, we recommend that §1770.3(g)(2)(i), which simply reiterates the statutory definition, be deleted from the final rule as duplicative. If OFHEO readopts its 1996 definition, fourteen current Freddie Mac officers will be an "executive officer" for the purpose of compensation review, as opposed to perhaps nineteen officers under the proposed rule.[9]

OFHEO should also clarify the application of §1770.3(g)(2)(ii) in another important way. Proposed §1770.3(g)(2)(ii) covers any "other individual with similar responsibilities" to SVPs "without regard to title." Both the Chairman and Vice-Chairman of Freddie Mac have staff (not SVPs) who report directly to them, but who are not "in charge" of a business function. Since proposed §1770.3(g)(2)(ii) defines "executive officer" in terms of reporting relationships rather than function, the definition as drafted appears to include such staff. OFHEO should make it clear that it does not seek to review that staff's compensation.

2. <u>The Reporting Requirements</u>

General Comments on Proposed §1770.4: We also recommend that OFHEO clarify the reporting rules in proposed §1770.4 to conform the rules with the statement in its Notice that the Director's authority under §303(h)(2) covers only "individual termination packages provided by the Enterprises to their executive officers."[10] This clarification would make it clear that the Director's prior approval is not required for executive officer compensation that (1) is generally

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[8] *Id.*

[9] If OFHEO determines to apply §1303(7) more broadly than we recommend, there are guideposts for it to follow in identifying additional SVPs whose compensation should be subject to review. In this regard, OFHEO should focus on a limited class of those SVPs engaged in directing Freddie Mac's two key business activities -- purchasing residential mortgages and issuing securities in the global capital markets -- and avoid unnecessary reviews of the compensation of third and fourth-tier officers or those SVPs without a direct reporting relationship to the Chairman or Vice-Chairman or engaged in support or subsidiary functions like Legal, Human Resources, or Information Services.

[10] 65 *Fed. Reg.* at 81772.

available to similarly situated executive officers and (2) is received by the officer as part of his or her annual compensation package – even though that compensation may be provided after leaving Freddie Mac in the form of a pension, deferred salary or otherwise.

This clarification can easily be made. While §1770.4(c)(1) – (3) concern actions to provide individualized termination benefits to specific executive officers, proposed §1770.4(c)(4) – (5) would more broadly require the Enterprises to submit information on changes in "post-employment benefit programs" and "termination provisions of other compensation programs" if those changes affect "multiple executive officers." Because these requirements relate to multiple executive officers' overall compensation, and not to an "individual termination package," they should be relocated to §1770.4(b), which governs submissions on overall executive officer compensation pursuant to the Director's authority under §1318.

As drafted, the rules suggest that the Director has prior approval authority over changes in Enterprise compensation programs simply because those changes affect the post-employment benefits of multiple executive officers. We doubt OFHEO intends to suggest the 1992 Act gives it such authority, since under the Enterprise Charter Acts the Director's approval is limited to payments "in connection with the *termination* of employment of any executive officer" and not benefits included in a current executive's total compensation package which may happen to be paid post-employment.[11] The Director's prior approval is necessary only when an executive officer (voluntarily or involuntarily) departs the Enterprise and receives an extra, individualized termination payout in connection with that termination that was not part of the officer's annual compensation package. In this way, the Director's extraordinary prior approval authority remains focused precisely on the issue that Congress had before it when enacting the statute – the unanticipated and embarrassingly large payment to a departing Enterprise senior officer.[12]

In addition to relocating proposed §1770.4(c)(4)- (5), we recommend that OFHEO narrow the section's language to exclude reporting on general welfare and benefit plans made widely available to Freddie Mac employees, and require reporting of only "material" changes to other plans and programs. We recognize that implementation of this suggestion would not provide an

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[11] Otherwise, OFHEO would effectively have the authority to review an executive officer's compensation twice – first under the Director's §1318 powers, and then again in connection with the officer's departure from the Enterprise. Retroactive disapproval of compensation already awarded an executive would raise serious constitutional issues. It would also create enormous uncertainty among senior executives and make it far more difficult for the Enterprises to attract and retain highly-skilled personnel by giving the Director *ex post facto* veto power over many standard elements of the executive's compensation package simply because those compensation elements may extend past an employee's tenure with the firms – including pensions, deferred compensation, stock option plans, and retirees' health benefits.

[12] *See* note 5, *supra*. The Director's prior approval authority is unique among federal financial institution regulators. Bank regulators have the power to consider post-employment benefits when setting overall compensation standards for depositories. *See* 12 U.S.C. §1831p-1(c). But they do not have specific prior approval authority over termination agreements for a depository's executive officers unless the depository with which the officer is affiliated is a troubled institution. *See* 12 U.S.C. §1828(k) and 12 C.F.R. Part 359 (2000), promulgated thereunder.

infallible bright line, but it would ensure that OFHEO does not inadvertently become ensnared in a thicket of mundane compensation
matters beyond its expertise and that bear little relationship to its compensation review authority. As now drafted and organized, the rules suggest that the Director's prior approval authority extends to any change whatsoever in a corporate-wide or officer-wide compensation or benefit plan or program, including:

- Changes to Freddie Mac's employee cafeteria plan, and benefits provided through the cafeteria structure (*e.g*., medical, dental, vision, life insurance, flexible spending accounts, vacation purchase, accidental death and dismemberment insurance). The pricing and plan design of these benefits, which are available to all employees, often change annually. These changes may affect some benefits – such as post-employment health care, COBRA coverage, long-term disability, even accrued vacation benefits – that may be paid to executive officers after the officer departs Freddie Mac.

- Corporate-wide qualified retirement plans (*i.e*., the defined benefit pension plan and the thrift/401(k) plan). To maintain their qualified status, these plans must meet federal nondiscrimination rules, which prohibit discrimination in favor of highly-compensated employees. The proposed rule would require Freddie Mac to report even minor changes in these plans, such as the addition of an investment option in the 401(k) or changes to the terms of the 401(k) loan program.

- Corporate-wide, shareholder approved omnibus stock compensation plan. Under the plan, Freddie Mac can provide a variety of long-term incentives to its employees, including executive officers, such as nonqualified stock options, bonus stock and restricted stock. Awards under this plan are intended to help Freddie Mac attract and retain employees and are therefore not "in connection with" an officer's termination, but provide some benefits which may inure to an employee after termination from the company. Actual awards to executive officers are made by the Human Resources Committee of the Board and would therefore be reported to OFHEO under proposed §1770.4(b)(2). Major changes to the plan would require shareholder approval, but the proposed rule could require Freddie Mac to report to OFHEO even minor programmatic changes such as vesting schedules or pricing dates.

- Officer-wide plans and programs such as the deferred compensation plan and the supplemental executive retirement plan. Like other aspects of an executive officer's compensation, these plans are intended to attract and retain key personnel, and are similar to programs offered by other large corporations. The proposed rule would require submission of not only important changes in plan design, but also routine changes such as timing of payments or changes in interest rates paid on deferred compensation.

The practical difficulties of such a regime are obvious: it would create enormous inefficiencies and expense for the Enterprises while inundating OFHEO with relatively trivial compensation information in which it lacks expertise and should have little interest. It would unnecessarily superimpose a regulatory reporting structure on top of the existing comprehensive federal regulatory structures, such as the ERISA or the IRC, that already apply to many of these plans.[13]

The clarifications we suggest would not in any way impede OFHEO's review of executive compensation, and we certainly do not object to providing OFHEO with the information it needs to exercise that authority. These recommendations are intended only to focus the reporting requirements relating to the Director's prior approval authority on the individualized termination benefits to which §303(h)(2) pertains, and to avoid enmeshing the Enterprises and OFHEO in an expensive regulatory regime which requires the reporting of detailed compensation information that is unnecessary to the practical exercise of OFHEO's authority.

Proposed §1770.4(b)(1) -(2): These proposals appear to require the Enterprises to submit portions of Committee and Board minutes relating to executive compensation within a week of the meeting of the Board of Directors or Committee. Freddie Mac could not comply with this rule, because minutes are prepared after a meeting and are not adopted until the next Board or Committee meeting, and the rules should be amended to require submission of minutes only after they are finalized.

[13] In fact, payments under most of these plans and programs would not be "golden parachute payments" under federal banking law and thus not subject to prior approval by banking regulators -- even in the case of financially troubled depositories. *See* 12 U.S.C. §1828(k)(4)(C) and 12 C.F.R. §359.0 (2000) ("The definition of golden parachute payment does not include payments pursuant to qualified retirement plans, non-qualified *bona fide* deferred compensation plans, nondiscriminatory severance pay plans, other types of common benefit plans, state statutes, and death benefits.").

Proposed §1770.4(b)(8): This proposal would direct the Enterprise's to provide OFHEO with "information regarding the hiring of and payment of compensation to an executive officer for whom a contract remains under negotiation." For several reasons, we believe this requirement should be dropped. First, OFHEO has no role in the hiring of any executive officer of an Enterprise. Second, a contract "under negotiation" is not final and OFHEO has no need to insert itself in any negotiations, nor does it have any regulatory responsibilities with respect to those negotiations. In fact, the involvement of OFHEO in pre-employment negotiations would both complicate and delay such negotiations, impeding an Enterprise's ability to hire key personnel. Third, while it can prohibit excessive compensation, OFHEO has no authority over final employment contracts except to the extent they contain individualized termination provisions. Fourth, the proposal is inconsistent with proposed §1770.5(a), which allows termination provisions subject to the Director's prior approval to be entered into prior to that approval, as long as the contract is clear that the Director's approval may ultimately be required.

Proposed §1770.4(c): OFHEO should clarify this proposal, which would govern the timing of information relating to termination benefits subject to the Director's approval, because it appears to be inconsistent with §1770.5(a). Section 1770.4(c) would require the Enterprises to submit information relating to executive officer termination agreements when entered into or implemented. Section 1770.5(a), however, allows the Enterprises to enter into termination agreements without prior approval, as long as the contract makes clear that approval may be required before any termination benefits can be paid. This latter approach is both practical and preferable, since in actuality most executive officers are not terminated, allowing OFHEO and the Enterprises to avoid the time and expense of reviewing a hypothetical. An Enterprise may choose as a matter of caution to submit a termination agreement for a current executive officer to OFHEO for prior approval, but that choice is best left to the Enterprise.

Proposed §1770.4(d): There are several serious difficulties with proposed §1770.4(d). This provision would direct the Enterprises to submit certain specific information and data to OFHEO before entering into an individual termination agreement with an executive officer so the agency can "calculate an executive officer's total termination or severance benefits package."[14] By far the most problematic aspect of the proposal is that it seems to prevent the Enterprises from entering into an agreement with a potential new officer or departing officer prior to OFHEO approval if that agreement contains individualized termination provisions. This is a departure from OFHEO's current practice, and as a practical matter could present a dangerous bureaucratic impediment to the Enterprises' ability to hire key personnel in an expeditious manner or finalize termination agreements when it is in the best interests of both the Enterprise and the officer that such negotiations be completed quickly. It is also inconsistent with §1770.5(a), which allows an Enterprise to enter into an agreement containing termination provisions as long as the agreement specifies that the termination provisions are not effective until approved.

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[14] 65 *Fed. Reg.* at 81773.

Second, §1770.4(d)(1) requires the Enterprises to submit details on a "program change" to OFHEO before entering into an agreement containing a termination provision. OFHEO should clarify this provision: the proposal gives employment, termination and severance agreements as examples of items for which it wants details. Each of these is an example of an individualized agreement, not programmatic benefits available to executive officers as part of their total compensation package. Since reporting on programmatic changes is already covered by §1770.4(b) – (c), we speculate that OFHEO means that it wants details of individualized *departures* from programmatic termination benefits, and if so, it should clarify the final rule.

Proposed §1770.5(b): This proposal directs the Enterprises to establish and follow written procedures implementing the submission requirements of proposed §1770.4 within 60 days of its effective date. This proposal should be deleted from the final rule
because such micro-management of the Enterprises' internal procedures is unwarranted. The reporting requirements are specific, and thus do not give the Enterprise the operational discretion that would justify externally-imposed written procedures. The final regulations will have force of law with which Freddie Mac must and will comply. Should either Enterprise fail to follow these rules, OFHEO (as explained in §1770.5(d)) has a panoply of enforcement remedies available to punish past violations and prevent future non-compliance.

3. Safety and Soundness Issues

The preamble to OFHEO's proposed rules on executive compensation states that "The legislative history of the [1992] Act and that of contemporaneously enacted federal banking legislation reveal that Congress viewed executive compensation to be a serious safety and soundness concern."[15]There is no legal or practical basis for this statement. As the rule's preamble implicitly acknowledges, neither the Enterprises' Charter Acts nor the 1992 Act specifically treats compensation matters as raising safety and soundness concerns. In fact, the statutory architecture is clear: §303(c)(9) of Freddie Mac's Charter Act allows its Board of Directors to pay executive compensation if in its "honest, unbiased judgment" it determines it to be reasonable and comparable with compensation for similar employment in other similar businesses. Section 1318(a) of the 1992 Act then allows the Director to review that determination and disallow the payment of compensation which is grossly out of line with these criteria and thus not reasonable and comparable under the Charter Act. Section 303(h)(2) of the Charter Act forbids Freddie Mac to pay any executive officer individualized termination benefits without the prior approval of OFHEO's Director.

[15] 65 *Fed. Reg.*at 81772. Accordingly, the preamble states, "OFHEO treats as an unsafe and unsound practice any compensation arrangement that would result in an executive of an Enterprise receiving compensation that is excessive or termination benefits that are not comparable to compensation provided by other businesses to executives doing similar work." *Id*. at 81773.

OFHEO cites the 1992 Act's legislative history and "contemporaneously enacted federal banking legislation" to support its statement that Congress viewed Enterprise compensation as a safety and soundness matter. But the banking legislation on which OFHEO relies – Section 132 of the Federal Deposit Insurance Corporation Improvement Act of 1992, 12 U.S.C. §1831p-1 – is different from the 1992 Act in that it specifically provides that certain compensation practices at insured depositories constitute unsafe and unsound practices as a matter of statute. In fact, Congress specifically rejected a Senate proposal contained in §118 of S. 2733 (1992) that was modeled after FDICIA and would have explicitly tied Enterprise executive compensation to the Enterprises' financial condition.[16] Instead, Congress rejected the FDICIA model (on which OFHEO relies) in favor of the present §1318. This legislative history thus shows that Congress affirmatively declined the opportunity to link OFHEO's review authority over Enterprise compensation matters to the Enterprises' financial condition.

The assertion in proposed §1770.5(c) that an Enterprise's failure to comply with proposed §1770.4 or §1770.5 "may be deemed to constitute an unsafe or unsound practice" is thus without evident basis in either the Charter Acts or the 1992 Act. As we explained in our February 26, 2001 comment letter on OFHEO's proposed rules on administrative enforcement proceedings, the addition of an "unsafe and unsound" standard to the enforcement provisions of the 1992 Act is inconsistent with the overall structure of that Act.[17] With respect to executive compensation, §1318 of the 1992 Act, §303(h)(2) of Freddie Mac's Charter Act, and §309(d)(3)(B) of Fannie Mae's Charter Act already give OFHEO the authority to prevent excessive on-going or termination compensation at the Enterprises. And §1371 of the 1992 Act specifically gives OFHEO broad remedies to enforce any order issued pursuant to those compensation limitations, including rescission of offending employment agreements and recovery of compensation improperly paid.[18]

Section 1780.1(b)(iv) of OFHEO's proposed enforcement rules defines an unsafe and unsound practice as one that is "contrary to prudent standards of operation which might cause loss or damage to the Enterprise, or is likely to cause such a loss or damage in the future if continued unabated."[19] We have previously described to OFHEO why we think this proposal is flawed.[20] Even applying this standard, however, it is difficult to see how an Enterprise's failure to follow the submission requirements of proposed §1770.4 and §1770.5 could constitute an unsafe and unsound practice, because a failure to follow these procedural rules could not by

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[16] Section 118 of S.2733 directed the OFHEO Director to prohibit "excessive" compensation, defining "excessive" in §118(c)(2) as compensation "unreasonable or disproportionate to the services actually performed" in view of, *inter alia*, " the Enterprises financial condition, including the extent to which the Enterprise exceeds or falls below its minimum capital."

[17] *See* letter from Maud Mater to Alfred Pollard, dated February 26, 2001 at pp. 9-10.

[18] *See* §1371(d).

[19] 65 *Fed. Reg*. 81779 (December 27, 2000).

[20] *See* Mater letter at pp. 7-11.

itself be the proximate cause of any loss to an Enterprise. Indeed, neither proposed §1770.5(c) nor the preamble explains how an Enterprise's failure to follow these requirements "might" or could be "likely" to cause "loss or damage" to the Enterprise. What is more, OFHEO's proposal is wholly idiosyncratic: even the banking regulators, with the specific statutory charge to promulgate safety and soundness standards to prevent "excessive" compensation, do not prescribe reporting requirements, let alone describe a failure to adhere to them as an unsafe and unsound practice. *See, e.g.,* "Interagency Guidelines Establishing Standards for Safety and Soundness," Part 364, Appendix A III, 12 C.F.R. Ch. III, Pt. 364, App. A (2000).

We accordingly recommend that OFHEO reconsider its statement that an Enterprise's failure to comply with its executive compensation submission requirements may constitute an unsafe and unsound practice and drop §1770.5(c) from any final rule.

Conclusion

The 1992 Act and the Enterprise Charter Acts reflect Congress's effort to create Enterprises that "bring the entrepreneurial skills and judgments of the private sector to bear on accomplishment of public purposes relating to housing."[21] As part of this effort, it assigned primary responsibility for Enterprise executive compensation to the Enterprise Boards of Directors and to Enterprise management. At the same time, it entrusted OFHEO with the responsibility to review the Enterprises' executive compensation practices to ensure that Enterprise compensation does not grossly exceed private sector norms.

It should be clear from our past cooperation that Freddie Mac acknowledges and accepts OFHEO's role in executive compensation matters and its need to collect complete information to fulfill these responsibilities. We trust OFHEO will read our recommendations in light of this shared experience. Our comments are aimed at encouraging clarity and internal consistency in these rules, and ensuring that the legal assumptions embedded in the proposal accurately reflect the law.

Thank you for the opportunity to comment. If we can be of further assistance, please do not hesitate to contact me.

Sincerely,

Maud Mater

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[21] S. Rep. 102-282 at 25.