8200 Jones Branch Drive
McLean, VA 22102-3110

We make home possible®

May 15, 2014

By email to *RegComments@FHFA.gov*

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Constitution Center
Eighth Floor (OGC)
400 7th Street, SW
Washington, DC 20024

Attention: Responsibilities of Boards of Directors, Corporate Practices and Corporate Governance Matters; Public Comment – RIN 2590 – AA59

Dear Mr. Pollard:

Freddie Mac is pleased to comment on the proposed rule ("Proposed Rule") published by the Federal Housing Finance Agency ("FHFA") on January 28, 2014[1] to amend its regulations by relocating and consolidating certain Federal Housing Finance Board regulations applicable to the Federal Home Loan Banks (the "FHLBs") and Office of Federal Housing Enterprise Oversight ("OFHEO") regulations applicable to Freddie Mac and Fannie Mae (the "Enterprises") that pertain to the responsibilities of boards of directors, corporate practices and corporate governance matters. The Proposed Rule would consolidate most of those existing regulations into a new FHFA regulation, parts of which would apply to both the FHLBs and the Enterprises (together, "regulated entities") and parts of which would only apply to the FHLBs or only to the Enterprises. While most of the content of the new regulation has been derived from the existing regulations, with modifications as FHFA has deemed necessary to apply certain provisions to all regulated entities, the proposal would add a new provision on risk management and a new definition of "credit risk." The proposal also would amend the FHFA rule on Prudential Management and Operations Standards (the "Standards") to make clear that the introductory general responsibilities of boards of directors and senior management are part of the Standards, and would repeal a separate provision of the OFHEO regulations related to minimum safety and soundness requirements.

We believe that the Proposed Rule is generally a well-balanced approach to integrate the existing regulations into a new FHFA rule. We have identified a few areas we believe could be revised to provide better clarity and certainty.

[1] 79 Fed. Reg. 4414 (January 28, 2014).

I. General Comment on Responsibilities of Senior Management and the Board of Directors

The Proposed Rule indicates responsibilities of the senior management and boards of directors of the regulated entities that may not fully align with their traditional roles and responsibilities. We are concerned that the Proposed Rule may interfere with the directors' ability to avail themselves of the protection of the business judgment rule under the applicable jurisdiction. Use of the terms "ensure," "ultimate responsibility," "direct the operations," "administer the affairs" and "documenting" could suggest that the board of directors has more than an oversight role for certain actions and steps that are properly the responsibility of management. In this regard, we also note the statement in § 1239.4(a) that "management of each regulated entity shall be vested in its board of directors." In addition, in some instances, the language of the Proposed Rule refers to management and the board of directors together, which could be read as management and the board members having the same responsibilities and would appear to blur the distinction between the roles accorded senior management and the board of directors, which are not the same. For example, see § 1239.11(a)(2), stating that the board of directors and senior management shall ensure that the risk management program aligns the regulated entity's overall risk profile with its mission objectives.

We respectfully suggest clarifying that the board of directors is responsible for overseeing senior management, and that management has ultimate responsibility for running the day-to-day business of the regulated entity. One way to provide this clarity is to replace the terms highlighted in the prior paragraph with oversight-oriented language, for example, replacing "ultimate responsibility" with "responsible for overseeing" or "oversight responsibility" when referring to the board. In addition, replacing the term "ensure" with language focused on oversight would recognize that the role of the board of directors is oversight rather than management.

We also note that, while management can take reasonable steps to establish, implement and monitor the matters set forth in the Proposed Rule, it is difficult to "ensure" such actions or requirements. Rather, management should have responsibility for "taking reasonable steps to address" each of the areas in the Proposed Rule.

Last, we note that there are now multiple sources of FHFA requirements related to risk management and the roles of management and the board of directors – ranging from the Proposed Rule, the Standards, the 2006 OFHEO Corporate Governance Examination Guidance and several recent FHFA Advisory Bulletins from the examination staff. We are concerned that having so many sources of requirements creates confusion as to the applicable standard and raises compliance risk. We are also concerned that the multitude of requirements is

significantly expanding the board's role with respect to risk management, oversight and reporting beyond the traditional role of a board of directors – which could affect our ability to attract and retain directors. We recommend clarifying the applicability of requirements that precede the Proposed Rule and reducing and rationalizing overlapping requirements so that there is greater clarity of FHFA's expectations.

II. Specific Comments on the Proposed Rule

§ 1239.2 Definition of Credit Risk

The Proposed Rule includes a new definition of credit risk, which is defined as "the potential that a borrower or counterparty will fail to meet its financial obligations in accordance with agreed terms." We believe that the proposed definition is both too broad and too narrow. We recommend replacing "financial obligations" with "contractual obligations," as we believe that the term "financial obligations" would be too limiting and is also vague. We also believe that the reference to the "potential" that a borrower or counterparty will fail to meet its obligations is too broad and vague. And, we believe that credit risk should be defined in terms of an actual failure. Therefore, we recommend revising the definition of credit risk to be "the risk that a borrower or counterparty will fail to meet its contractual obligations in accordance with agreed terms."

§ 1239.2 Definition of "executive officer"

The proposed definition of the term "executive officer" would include not only specified senior officers and their direct reports, as is currently the case, but also the "chairperson or vice chairperson of the board of directors" of an Enterprise (and their direct reports, of which Freddie Mac's Non-Executive Chairman has none). Inclusion of the board chairperson (and vice chairperson, if one is elected) in this definition is inconsistent with the common usage of this term and with the requirement in the Proposed Rule that the chairperson not be a member of management, which both Enterprises implemented a number of years ago.

Moreover, the inclusion of board members in this definition does not appear to work with the body of the Proposed Rule. The term "executive officer" is used twice in the provisions applicable to the Enterprises. In one case, in § 1239.10, the requirement for a code of conduct and ethics expressly applies both to "board members [and] executive officers," so inclusion of potentially two board members in the definition of "executive officers" is redundant. In the other instance, § 1239.4(c)(3) requires directors to have in place policies and procedures to assure oversight of the responsiveness of executive officers in providing reports to FHFA and addressing FHFA supervisory concerns. The board chairperson and/or vice chairperson do not have reporting obligations to FHFA, nor are they directly responsible for responding to FHFA

supervisory concerns, and it would be inappropriate for the board to be required to have policies and procedures in place concerning the actions of its chairperson and/or vice chairperson in this regard. We therefore recommend that the positions of board chairperson and vice chairperson be removed from the definition of "executive officer."

§ 1239.4 Duties and responsibilities of directors

(a) Management of a regulated entity.

As indicated above, the rule proposal and accompanying text appears to impose on the board of directors more substantive responsibility for across-the-board, day-to-day management than we believe is currently the case or is appropriate in light of prevailing governance principles and the board's oversight responsibilities. In this regard, the first two sentences of subsection (a) would add to the existing regulatory provision in § 1710.15(b) a statement that "management" is vested in, and is a non-delegable responsibility of, the board – that the board has "ultimate responsibility."[2] However, § 303(a)(1) of the Freddie Mac Act, our statutory charter, provides that "[w]ithin the limitations of law and regulation, the Board of Directors shall determine the general policies that govern the operations of the Corporation." Similarly, Virginia corporate law, which Freddie Mac has elected to govern its corporate governance practices and procedure, provides that "the business and affairs of the corporation [shall be] managed under the direction of [the] board of directors" (§ 13.1-673.B of the Virginia Stock Corporation Act ("VSCA")).

These authorities, and corporate governance practices generally, contemplate a board that determines the policies of the corporation and directs its management, but not one that is responsible for all aspects of management, as the Proposed Rule could be read to require. Imposition of such a broad standard could be read, we believe inappropriately, to make directors legally responsible for every action, or failure to act, by management, no matter how detailed. The regulations should not be amended in a way that might be read to impose such an unsustainable burden on directors. We believe that the existing regulatory provision, § 1710.15(b), appropriately defines the role and responsibility of the board of directors with respect to management of the corporation and we recommend that it not be modified, i.e., that the two new sentences at the beginning of this section be removed.

---

[2] Section 1239.4(a) states: "The management of each regulated entity shall be vested in its board of directors. While boards of directors may delegate the execution of operational functions to officers and employees of the regulated entity, the ultimate responsibility of each entity's board of directors for that entity's management is non-delegable."

(b) Duties of directors.

Subsection (b)(1) of this section would add to the regulations an express duty of care for directors that incorporates an "ordinarily prudent person" standard, rather than continuing the reliance of the current regulations on the applicable state law provision. The applicable provisions of Virginia law, which Freddie Mac has elected to follow pursuant to FHFA regulations, intentionally avoid the complexity and subjectivity of the proposed "prudent" or "reasonable" person standard, applying instead a simpler and more certain standard that examines a director's "good faith business judgment of the best interests of the corporation," amplified by case law that focuses on the process followed by directors in making their decisions. (See §13.1-690 of the VSCA and the accompanying Joint Bar Committee Commentary (Revised 1999)). Freddie Mac does not believe that any policy or regulatory objective would be furthered by imposing a subjective standard that could increase the exposure of our board members to private litigation.

Subsection (b)(2) would require directors to "administer the affairs of [Freddie Mac] fairly and impartially." We believe that "fairly and impartially" is neither a meaningful nor appropriate standard to apply to corporate directors, and that it could cause confusion concerning, or conflict with, our directors' existing obligations to advance the interests of corporate shareholders, as currently represented by the Conservator, as well as a variety of ethical standards imposed by statute, regulation, rule and common law and by the required Board code of conduct. Moreover, for the reasons discussed above in our comments on subsection (a), we believe that the statement that our directors are to "administer the affairs" of Freddie Mac, regardless of the standard imposed, would inappropriately shift to the board a responsibility that should be exercised by senior management. For these reasons, we recommend elimination of the provisions in subsection (b)(2). To the extent that FHFA believes that the provisions of subsection (b)(2) should be retained, we recommend that they be made applicable exclusively to directors of the FHLBs by moving them to Subpart E – Bank Specific Requirements.

Subsection (b)(3) would require directors to have, or to obtain within a reasonable time, a specified level of knowledge and ability with respect to finance and accounting matters. First, we believe that adequate financial expertise on the board of directors has already been captured under the existing requirements in the rules of the New York Stock Exchange and the Securities and Exchange Commission that audit committee members be "financially literate," that at last one member have "accounting or related financial management expertise," and that the company disclose whether one audit committee member is a "financial expert." Those terms are now well understood after a number of years and, particularly in the context of a regulatory duty, it is not necessary to impose another set of regulatory requirements using vague and undefined terms such as "working familiarity" and "basic finance and accounting practices." However, if FHFA concludes that a separate standard on this topic is needed for the

Enterprises, we recommend that it be revised to avoid such potentially ambiguous phrases. A slightly revised alternative, which we believe would accomplish the same objectives without relying on those undefined terms, would be to call on the board of directors to elect directors who have "sufficient familiarity with finance and accounting practices to permit them to read and understand the regulated entity's balance sheet and income statement and to ask substantive questions of management and the internal and external auditors."

In any event, we do not believe it is appropriate to impose such a requirement in the form of a duty that is a responsibility of individual directors. While it is reasonable to anticipate that Freddie Mac directors would satisfy this requirement, it is possible that under certain circumstances, the board could conclude, for example, that it would be in the company's best interest to elect a director with other specialized expertise – such as in the field of technology – even if that individual lacked the specified knowledge and/or ability with respect to finance and accounting matters and, perhaps, even the ability to obtain such knowledge and/or ability. If the board of directors were to reach that conclusion and elect such a person as a director, it would not be appropriate to place that individual in the position of having breached a regulatory duty and, potentially, to be subject to legal liability as a result. To avoid such an anomalous result, we recommend that this provision be revised to take the form of guidance for the board to follow in electing directors, and that it be moved to proposed § 1239.20(a), which addresses board membership. We also recommend that the revised provision permit the board to deviate from this standard if, in the board's judgment, election of such an individual would be in the best interests of the company.

Subsection (b)(4) would require directors to direct Freddie Mac's operations in conformity with certain statutes that govern the company. While "directing" Freddie Mac's operations (as opposed to "managing" them, as discussed above) is consistent with the applicable statutory principles and best practices, we are concerned that when used in reference to compliance with detailed statutory requirements as in this proposed provision, the term "directing" could be construed to mean effectively the same as "managing." We recommend instead that this provision be revised to require directors to "oversee" Freddie Mac's operations in conformity with the specified statutes' requirements, which we believe more accurately describes the appropriate role of the board of directors in connection with statutory compliance.

(c) Director Responsibilities

Subsection (c)(1) would require that the board of directors have in place adequate policies and procedures to assure its oversight of certain enumerated matters. We understand this provision would not require that the board of directors establish its own policies and procedures for each of the enumerated items, but rather that the board of directors oversee that management has established adequate policies and procedures for each of the same. In this regard, we

recommend revising the language to require that such policies and procedures "be in place," or otherwise make clear that they can be management-level rather than board-level policies and procedures.

§ 1239.5 Board committees

(c) Charter

Subsection (c) would require that each committee "adopt" its own charter and that those charters be "approved" by the board of directors, thereby transferring from the full board of directors to each of the committees the authority to adopt committee charters. Our current process, which we believe is consistent with normal governance practices, authorizes the board of directors to adopt committee charters in order to fulfill its responsibility under the Bylaws to establish committees and delegate authority to them. Indeed, it is unclear how the proposed provision would work when the board of directors determines that it should create a new committee, because it would appear to preclude the board of directors from specifying the committee's responsibilities in a charter when it establishes the committee. Moreover, only the full board of directors is in a position to determine the appropriate allocation of responsibilities among the various committees, which it also accomplishes by adoption and/or revision of committee charters. Under the current regulatory provisions and our Bylaws, a committee is able to recommend charter amendments to the board of directors whenever the committee concludes that such amendments may be warranted, and suggested amendments are solicited from the committees during the annual board and committee self-assessment process. Moreover, directors are of course able to express to the full board of directors their views concerning their respective committees when they participate in board discussions and actions concerning the committee charters. For these reasons, we recommend that the responsibility for adopting committee charters remain with the full board of directors and that this proposed provision that each committee "adopt" its own charter be omitted.

(d) Frequency of meetings

In addition to the existing requirement that committees meet with sufficient frequency to carry out their obligations, § 1239.5(d) would require each committee to meet "regularly" and "with sufficient timeliness as necessary in light of relevant conditions and circumstances to fulfill its obligations and duties." Both of these requirements could create issues for the operations of our committees.

For example, the charter of Freddie Mac's Executive Committee provides that it is to meet only when the Non-Executive Chairman determines that a matter should be considered promptly and that it is not feasible to convene a special meeting of the board of directors. The proposed

requirement that all committees meet "regularly" would appear to preclude the existence of our Executive Committee or any other committee that the board of directors might determine should meet only on an "as needed" basis.

The proposed new "timeliness" requirement also could interfere with normal committee operations. There may be times when a need for prompt action makes it preferable, or more feasible, for the full board of directors to act on a matter that is normally a committee responsibility. Such a situation could occur, for example, if the full board of directors is already scheduled to meet, or if the unavailability of certain directors permitted a quorum to be convened for the full board of directors but not for the relevant committee. Although our committee charters provide flexibility for the board of directors to act in lieu of its committees, the proposed new "timeliness" requirement might be read to preclude such action.

We believe that the existing regulatory provision, in current § 1710.12(b), along with other existing legal requirements that the board of directors and its committees carry out their responsibilities, are sufficient to make sure that they do so, and we recommend that the existing provision on committee meeting frequency not be revised.

§ 1239.11 (a) Risk management program – (2) Risk profile

The Proposed Rule would require the board of directors and senior management to "ensure that the risk management program aligns the regulated entity's overall risk profile with its mission objectives." As per our general comments above, referring to management and the board of directors together raises questions about whether they have the same responsibilities. We would suggest language changes to clarify that the board of directors oversees management, such as "Subject to the oversight of the board of directors, senior management is responsible...." We also would request clarification regarding what is meant by our "mission objectives" while in conservatorship. We would interpret our mission objectives while in conservatorship to be the goals of the conservatorship as established by the Conservator scorecard and other corporate scorecard items established by management.

§ 1239.11(c) Risk committee structure and requirements

Regarding the requirements for a risk management program set forth in subsection (c)(1), it is unclear whether all of these requirements are expected at the board level or management level. Under our enterprise risk management framework, a high level enterprise risk management policy is approved at the board level, with more detailed policies and procedures put into place by management to implement the high-level board policy. We request clarification or confirmation that the requirements set forth in this section for a risk

management program can be instituted at the management level, with appropriate reporting to the board of directors for oversight purposes.

Subsection (c)(2)(ii) would require that the dedicated risk management committee "have at least one member with risk management expertise that is commensurate with the regulated entity's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors." We believe that it could prove difficult to recruit a director who meets this "expertise" requirement, which would, as a practical matter, appear to require an individual who has served at a major financial services company as a chief risk officer or in another senior, hands-on risk management position. Moreover, the requirement that such expertise be "commensurate" with the listed factors is vague and difficult to interpret. We suggest that this provision be modified to require that the committee have at least one member with an "understanding" of risk management principles relevant to the specified factors, with subsection (c)(2)(iii) continuing to require, as currently proposed, that other committee members have a more general understanding of "risk management principles and practices relevant to the regulated entity."

Subsection (c)(2)(iv), requiring the committee also to have members with "experience developing and applying risk management practices and procedures, measuring and identifying risks, and monitoring the testing risk controls with respect to financial services organizations," would appear to go even further than subsection (c)(2)(ii), by requiring some or all committee members to have had experience as a chief risk officer or in another senior, hands-on risk management position at a financial services company. As discussed above, we believe that recruiting one such individual to the board of directors would be difficult, and a requirement to recruit several such individuals to serve on the risk committee is likely to prove impossible. We believe that the requirements of proposed subsections (c)(2)(ii), as we suggest above that it be modified, and (c)(2)(iii) would provide a level of risk management expertise on the committee that is both appropriate and feasible to obtain. We therefore suggest that proposed subsection (c)(2)(iv) be omitted.

Subsection (c)(2)(v) would require the risk committee to "fully document and maintain records of its meetings, including its risk management decisions and recommendations." This proposed provision could be read to impose an obligation above and beyond, or otherwise different from, the existing obligation of all board committees to prepare minutes of their meetings. Such an obligation would be unnecessary and potentially confusing. We recommend that the provision be deleted, or that it be revised to specify only that the committee's minutes should record all risk management decisions and recommendations.

§ 1239.11(d) Risk committee responsibilities

We have the same comment as in the section immediately above regarding the requirement for the risk committee to document and oversee the enterprise-wide risk management policies and practices of the regulated entity, as set forth in subsection (d)(1), and request that the reference to "documenting" be deleted.

Regarding the requirement in subsection (d)(2) for the risk committee to "review and approve an appropriate risk management program…", as indicated in our comments on subsection (c)(1) under § 1239.11(c) (Risk committee structure and requirements) above, our enterprise risk management framework involves a high-level enterprise risk management policy being approved at the board level, with more detailed policies and procedures to implement the board-level policy at the management level. As per our earlier comment, we request clarification that the requirements for the risk management program required under the Proposed Rule can be instituted at the management level, with appropriate reporting to the board of directors for oversight purposes.

Subpart E- Bank Specific Requirements
§ 1239.32 Internal control system

In the proposing release for the Proposed Rule, FHFA indicates that this regulation would not apply to the Enterprises, as many of the detailed requirements in the provision are specific to the FHLBs and reflect their unique structure. However, the release also indicates that FHFA is considering whether it should adopt a regulation on internal controls that would apply to all regulated entities, and requested public comment.

We do not believe that FHFA should adopt a regulation on internal controls to apply to all regulated entities, as the Enterprises are already subject to numerous regulatory requirements related to internal controls. In that regard, we reiterate our general comment regarding the impact of overlapping regulatory requirements. We do, however, support a principles-based approach to internal controls, which is what we use in our assessment of our internal controls. Today, in the assessment of internal controls for financial reporting purposes, Freddie Mac uses the principles-based guidance from the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework (1992 Framework)*, which has gained broad acceptance and is recognized as a leading framework for assessing the effectiveness of internal controls. COSO's 2013 update to the 1992 Framework will also be adopted by Freddie Mac; the updates continue the principles-based framework and provide flexibility in application, allowing an organization to sustain internal controls relevant to the entity's operations, specific needs, and circumstances.

Removal of Parts 1710 and 1720

With the proposed removal of Parts 1710 and 1720, it is unclear if there is any impact on examination or supervisory guidances that were promulgated by FHFA or predecessor agencies under those regulations. With respect to a specific guidance, we note that some of the provisions of the 2006 OFHEO Corporate Governance Examination Guidance (the "Corporate Governance Exam Guidance") have been incorporated into the Proposed Rule, but not all. Consequently, we do not know if the provisions of the Corporate Governance Exam Guidance that were not incorporated into the Proposed Rule will be in effect after the Proposed Rule is finalized. We request clarification of the status of existing corporate governance and safety and soundness guidances if Parts 1710 and 1720 are repealed.

Harmonization of the Prudential Standards and FHFA Regulation

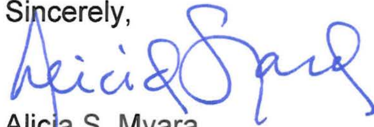
In the proposing release, FHFA recognizes that there is a degree of regulatory overlap between the Standards and existing regulations, which would continue under the Proposed Rule. FHFA indicates that it is not proposing to address in the Proposed Rule all of the potential areas of overlap, but does intend to initiate a separate project to identify any regulations that address topics also covered by the Standards, or would more appropriately be covered by a Standard. FHFA requested comments on how it may best integrate and harmonize its regulations and the Standards.

As indicated in our general comments above, we note that there are now multiple sources of FHFA requirements related to risk management and the roles of management and the board of directors – ranging from the Proposed Rule, the Standards, the Corporate Governance Exam Guidance and several recent FHFA Advisory Bulletins from the examination staff. We are concerned that having so many sources of requirements creates confusion as to the applicable standard and raises compliance risk. We are also concerned that the multitude of requirements is significantly expanding the role of the board of directors with respect to risk management, oversight and reporting beyond the traditional role of a board of directors, which could affect our ability to attract and retain directors. We recommend that FHFA take steps to reduce and rationalize overlapping requirements so that there is greater clarity of FHFA's expectations.

* * * * *

Freddie Mac appreciates the opportunity to provide our views in response to the Proposed Rule. Please contact me if you have questions or require further information.

Sincerely,



Alicia S. Myara
Senior Vice President and Principal Deputy General Counsel