OVERSIGHT OF THE FEDERAL HOUSING FINANCE AGENCY

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OVERSIGHT AND INVESTIGATIONS

OF THE

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OVERSIGHT OF THE FEDERAL HOUSING FINANCE AGENCY

Thursday, December 1, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:55 p.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Fitzpatrick, Pearce, Posey, Renacci, Canseco, Fincher; Capuano, Waters, Miller of North Carolina, Himes, and Carney.

Also present: Representatives Miller of California, Garrett; and Green.

Chairman NEUGEBAUER. This hearing will come to order. We will have opening statements by each side. We remind all Members that their entire written statement will be made a part of the record.

Also, I ask unanimous consent that Mr. Garrett and Mr. Miller be allowed to sit in with this subcommittee. They are not members of this subcommittee, but they are members of the full Financial Services Committee. If there is no objection, then so ordered.

We will start with opening statements, and I will begin. This hearing is really about, I think, three things. One is stopping any wasteful spending that might be going on in the Enterprises, because about 3 years ago and about $170 billion ago, the American taxpayers inherited the opportunity to own two mortgage companies, and they weren't willing investors. And so, one of the things that we want to make sure of is that we are being good stewards of their money and their investment; and more importantly, in the future, of making sure that down the road, we get the taxpayers out of the mortgage business so that they are not on the hook.

The second thing is a part of what is going on within the Enterprises to begin to shrink the footprint that these two Enterprises have, because as long as these Enterprises, along with the FHA, dominate the mortgage market, it is going to be extremely difficult to bring private capital back into the mortgage market. In fact, today the American taxpayers basically dominate, are on the hook for almost every mortgage that is originated in this country. And quite honestly, I think the American people find that an area that they are not very interested in.

I think the third thing, too, is what kinds of things are going on corporately within the entities that would begin to shrink that footprint so that we do create the space they need, but, more importantly, looking forward towards an exit strategy, because long term, I think it has been indicated by both the Administration and other Members of Congress that we don't think it is in the best interests of the American taxpayers to be in this business long term.

We are going to hear testimony today from the two CEOs as well as their conservator about what is going on inside the entities. There are some troubling things that have surfaced, and we want to have an opportunity to discuss that, and expenses that some people feel are extravagant. Some people feel that at this time, where these entities are bleeding and losing money and having to have infusions by the American taxpayers, there ought to be a very frugal attitude within the Enterprises.

Also, I think we want to learn more about the relationship between the conservator and the two entities and how that interaction is taking place, and the coordination, and, more importantly, what kinds of plans and measures are in place so that we begin to ascertain if we are, in fact, making progress in this area.

So I think this is a very important hearing for the American taxpayers, and I look forward to hearing from the witnesses in their various testimonies. I appreciate their coming today. With that, I now yield to the ranking member, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman, and I want to thank the gentlemen for being here today and enlightening us on a few of these issues.

I want to be clear. From my perspective, I think that the original missions of Fannie Mae and Freddie Mac are absolutely essential. I cannot envision an America going forward without something to take that place, either by the same name or a different name. But I am talking about the original mission, not the mission that ended up getting us in trouble. I don't see them as profit-making centers. I don't see them doing anything other than simply helping the middle class afford to get into homeownership. That is all they were meant to do. They did it successfully for a long time, and then they lost their vision, as far as I am concerned. Basically, bottom line, they got greedy, and they got sloppy, and the oversight people got greedy or allowed greed and got sloppy.

My hope is that you are rectifying that, but some of the things that I have seen during this period have troubled me. And for me my interest is, yes, the short term of it, what is going on now, but I don't want to give those people who never liked the concept of Fannie and Freddie the ammunition in order to be able to kill the middle class going forward.

So for me, the transition is pretty important. I have been vocal on certain things that have happened, and I may be vocal again today. But I want to be clear as to what my interests are. My interests are making sure that when we get out of this mess: number one, we don't repeat it; and number two, we have something left standing in some category that will be able to ensure that the middle class will be able to continue to afford a home.

With that, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

I also want to ask unanimous consent that the gentleman from Texas, Mr. Green, be allowed to participate in this hearing. We appreciate his attendance as well.

I now recognize Mr. Fitzpatrick, the vice chairman of the subcommittee, for 2 minutes.

Mr. FITZPATRICK. Thank you, Mr. Chairman. Thank you for the hearing, and thanks to the panel as well.

Recent media reports and subsequent work from your office and the subcommittee have brought to light some practices that deserve, I believe, the subcommittee's scrutiny here today, and I look forward to expanding some of the facts. There is documentation of some rather shocking expenditures at Fannie Mae and Freddie Mac.

While we certainly understand the need to be able to operate effectively and to staff the GSEs with talented individuals, I am sure you recognize that our constituents are on the hook for hundreds of billions of dollars. There is some justifiable outrage when they read about lavish parties, hefty compensation packages, and conferences costing hundreds of thousands of dollars, so there are a lot of questions that need to be answered.

As you may know, I have introduced legislation to statutorily cap the amount of money the GSEs can get from the Treasury. I believe it is necessary because the American taxpayers deserve assurance that there is an end to this line of credit. But for the time being, of course, it is their money that is being spent sponsoring these events and buying these meals.

If there is justification for these expenses, I think that the taxpayers are willing to consider that. I suspect, however, that this may just be business as usual, and unfortunately, after requiring an almost $200 billion bailout, business as usual is just not acceptable anymore. So I look forward to the testimony to get a better understanding of the matter.

With that, Mr. Chairman, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Texas, Mr. Canseco, is recognized for 1½ minutes.

Mr. CANSECO. Thank you, Mr. Chairman, and thank you for calling this very important hearing.

Despite the false narrative told by the majority party of the previous Congress as to the roots of financial crisis, more and more Americans are coming to realize just how big of a role Fannie Mae and Freddie Mac played in the economic boom and bust that we all still are trying to recover from.

Today, taxpayers have been forced to bail out Fannie and Freddie to the tune of $170 billion, and some project that amount could at least double. Before 2008, many Americans were unaware of the incredible risk that was building up on the balance sheets of these two entities, but since hearing about recent extravagant bonuses being paid to executives and legal fees to former executives being put up on the taxpayer tab, it has become very clear to the American people that Fannie and Freddie all along have played by a very different set of rules.

To be sure, FHFA and Acting Director DeMarco are to be commended for many of their efforts, including resisting Administration pressure to further politicize the GSEs and doing all that they can to limit taxpayer losses. Yet, there is still room for improvement, as a recent FHFA Inspector General report highlighted that too much deference has been given to Fannie and Freddie decisionmaking.

We must recognize the GSEs function only by reason of the American taxpayers, and that current compensation practices and legal fee reimbursements are an inappropriate use of taxpayer money. I look forward to today's hearing closely examining FHFA's oversight of Fannie and Freddie, and listening to our witnesses on this very important matter. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the ranking member of the Capital Markets Subcommittee, Ms. Waters from California, is recognized for 2 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman, for convening this hearing. I think it is important that this Congress continues to conduct robust oversight on both the GSEs and their conservator, the Federal Housing Finance Agency. I am sure that Mr. DeMarco is a little tired of coming before us at this point, but I appreciate him again joining us here today.

I understand that the main focus of this hearing is administrative expenses at the GSEs, executive compensation, the fact that Fannie and Freddie were sponsors of a Mortgage Bankers Association conference a few months ago. These things, of course, are important for Congress to scrutinize in the course of our oversight over the GSEs, but I think by focusing so heavily on these issues, we run the risk of playing "gotcha" and neglect to focus on bigger issues; for example, whether the Enterprises are for loan modifications that are consistent with FHFA's statutory mission to maximize assistance to homeowners in order to minimize foreclosures.

As you know, Mr. DeMarco, I have talked with you quite a bit about principal write-downs, which I consider just absolutely essential to getting a handle on stabilizing our housing market, not just because they could provide the most sustainable modifications to borrowers, but because significant research suggests that they could actually, again, as I said, stabilize the wider economy and provide better long-term returns to taxpayers. I hope that we have a chance to discuss this again in more detail.

I also think that this committee should pay increased attention to buy-back settlements entered into between GSEs and the banks who originated and sold them loans. We need to be sure that the Enterprises are getting the best possible deal for the taxpayer and not leaving money on the table in order to maintain business relationships with banks, as one FHFA Inspector General report recently suggested.

I would also applaud Mr. DeMarco for the nearly $200 billion lawsuit against 17 financial institutions for alleged violations of Federal securities laws and common law in the sale of private-label MBSs to the Enterprises. I appreciate his rigor in trying to recoup losses borne by the taxpayer, and ultimately I think that pursuing these claims will result in lower losses to the American public.

So I look forward to hearing particularly from Mr. DeMarco today, and I thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now, the gentleman from California, Mr. Miller, is recognized for 2 minutes.

Mr. MILLER OF CALIFORNIA. Chairman Neugebauer, I want to thank you very much, and Ranking Member Capuano, for allowing me to be part of this hearing today. I think this is a very important hearing, and it is very timely. And I think we need to look at facts when we are debating any issue of importance, especially the financial sector of this country and the housing sector specifically.

Before 2007, GSEs were consistently profitable. Nobody wants to talk about that. Fannie Mae had not reported a full-year loss since 1985, and Freddie Mac never had a loss once they became shareholder-owned. And GSE default rates have always been lower than the private sector's.

Now, much of the debate is about people worried about taxpayer exposures to the mortgage finance system that includes any kind of a government backstop or government guarantee. But let us look at what the problem is today. When we lent banks money with the first part of TARP, we charged them 5 percent interest. We are charging Freddie and Fannie 10 percent interest. And much of the losses in Freddie and Fannie today are paying that 10 percent interest to the government today.

But if you look at the data on mortgage default rates, it is very clear what went wrong. Everybody messed up: 38.7 percent of subprime ARMs are seriously delinquent; 26.5 percent of subprime ARMs are seriously delinquent; 5.4 percent of jumbo primes are seriously delinquent. On the GSEs, 4 percent of Fannie Mae loans are seriously delinquent, and 3.5 percent of Freddie Mac loans are seriously delinquent. That is bad, but they are still outperforming the private sector regardless of how bad it is. Now, to say let us throw the baby out with the bathwater, and let us blame them for all the losses is unreasonable. Let us go back and say, what did they do wrong, and how do we fix it?

It is a huge problem, but to say we are just not going to deal with them at all is unreasonable. A large number of foreclosed properties are putting pressure on the marketplace today. If we could stop the foreclosures from being placed in the market today, you wouldn't have market values plummeting like they are today.

I have introduced a bill to deal with that. In fact, I introduced a bill this last year that Barney Frank, and Chairmen Bachus and McCarthy all cosponsored, allowing the banks and GSEs to hold those foreclosed properties, lease them up to 5 years, and let them go slowly on to the marketplace rather than forcing downward pressure on a marketplace like we are today.

So before we make any drastic moves and recommendations, let us say what went wrong, how do we fix it, and who is performing the best? Have Freddie and Fannie made mistakes? Absolutely, without a doubt, but they are still outperforming everybody else. So that has to be part of the debate. You can't say, they are awful, let us get rid of them, when they are the best performers in the marketplace. If you are going to deal with the worst out there, let us make subprime ARMs illegal, let us make prime loans illegal, let us make subprime loans illegal, because they are performing worse than Fannie and Freddie. But that is unreasonable. That is the private sector.

We do need to make sure the private sector dollars come in to take the market share of the economy and to take the risk out there, and the goal is to get market share to the private sector. But let us not say that the conduit for those private markets dollars are Fannie and Freddie and they should just be put aside without an alternative. They need to go, but there needs to be an alternative for them that takes them back to their original goals and guidelines.

But I am looking forward to the testimony today, and thank you, Mr. Chairman, for allowing me the time.

Chairman NEUGEBAUER. I thank the gentleman.

And I will remind all Members again that if you have an opening statement, you can submit that for the record.

Now, I would like to introduce our panel: Mr. Charles Haldeman, who is CEO of Freddie Mac; Mr. Ed DeMarco—and it says in my script here that you are Acting Director, and I am going to take out the "Acting" part, Ed, because after 3 years, I think you are the Director—Director of the Federal Housing Finance Agency; and Mr. Michael J. Williams, president and CEO of Fannie Mae.

Gentlemen, thank you for being here. I ask you to limit your opening remarks to 5 minutes. Your full testimony will be made a part of the record.

Mr. Haldeman?

STATEMENT OF CHARLES E. HALDEMAN, CHIEF EXECUTIVE OFFICER, FREDDIE MAC

Mr. HALDEMAN. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, thank you for inviting me to speak with you today. My name is Ed Haldeman, and I am the CEO of Freddie Mac.

I recognize the importance of this hearing. With a country living through the worst housing crisis since the Great Depression, I understand why the oversight of Freddie Mac is so important.

Let me be clear. Freddie Mac is mindful of the taxpayer support we have received, and we take very seriously our obligation to use the support prudently and efficiently. With this in mind, I will discuss with you how we are running the company under conservatorship.

Let me begin by saying that the Freddie Mac of today is a new company. We have a new management team. The management team running Freddie Mac today is not the one we had preconservatorship. For example, I became CEO in August 2009, almost a year after Freddie Mac entered conservatorship, and 14 of our 18 management committee executives have been changed during my tenure. We have a new emphasis on strong credit standards. We focus on safety and soundness and responsible lending, purchasing higher-quality loans with lower loan-to-value ratios and higher credit scores.

We have a new approach to expenses. We take seriously our obligation to reduce spending responsibly wherever possible. We project that by the end of 2011, we will have reduced annual general and administrative spending by more than $150 million below 2009 levels.

We have a new approach to the retained portfolio. We reduced the size of the retained portfolio by almost 25 percent, which is beyond what is required of us. We have a new approach to executive salaries. We reduced overall compensation by 40 percent for the top 10 percent of our officers. We have an enhanced focus on assisting families in need, helping 575,000 families avoid foreclosure since 2009. Finally, we have a new culture, one that emphasizes leadership and accountability.

All of this has contributed to significantly improved results in our new book of business. Our preconservatorship business has generated the vast majority of our credit expenses. In contrast, our book of business since 2009 has generated income well above credit expenses. The improvement in quality is dramatic. Our serious delinquency rate for the 2006–2007 book of business is approximately 10 percent. In contrast, the serious delinquency rate of the new 2009–2011 book of business is about one-fortieth of that, or approximately one-quarter of 1 percent. We have achieved all of this while providing more than $1.1 trillion in critically needed mortgage liquidity, financing homes and rental housing for more than 5.8 million American families since 2009. We also enabled over 4 million homeowners to refinance, saving them collectively about $10 billion during the first year alone.

Clearly, we could not have achieved these results without support from FHFA, Treasury, and the American taxpayer. But I want to make clear that the ultimate beneficiary of that support is not private shareholders, but homeowners, renters, and the housing finance system. In all these ways, since conservatorship, we have a new set of priorities and a fundamentally new company.

In closing, as CEO of Freddie Mac, I believe strongly that one of the most important things we can do for the housing market is to clarify the future of the secondary mortgage market. That clarity is important to investors, important to lenders, and important to families who own or hope to own a home. That clarity also will help achieve our shared goal of attracting more private capital to the mortgage market. Without that clarity, it will become increasingly difficult to maintain the stability of our company. This, in turn, will make it increasingly difficult for our company to play its important role in maintaining the stability of the housing market. For all of these reasons, I hope that Congress will resolve this important issue sooner rather than later.

Thank you again for this opportunity to speak with you today.

[The prepared statement of Mr. Haldeman can be found on page 46 of the appendix.]

Chairman NEUGEBAUER. Mr. DeMarco, you are recognized for 5 minutes.

STATEMENT OF EDWARD J. DEMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY

Mr. DEMARCO. Thank you, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. Thank you for having me here.

As requested, my written statement provides updates on a range of topics regarding FHFA's oversight of Fannie Mae and Freddie Mac, or the Enterprises as I will refer to them, and the Federal Home Loan Banks. I would be pleased to discuss any of those issues with you.

In the few minutes that I have, though, I would like to provide you with a general overview of how the conservatorships have evolved over the past 3 years. FHFA placed Fannie Mae and Freddie Mac into conservatorship less than 6 weeks after the Agency itself was created, and before FHFA had any meaningful opportunity to build its own infrastructure or implement its new authorities granted in the legislation that created FHFA.

While conservatorship is meant to be short term, it has turned into a multiyear event. I would like to recap it in the form of a multichapter story, a story we are still writing. Importantly, however, the final chapter of this story needs to be written by Congress.

Chapter one was the establishment of the conservatorships themselves in September 2008, with the Treasury support agreements, the Board and executive management changes, and the effort to assure employees and market participants alike that the companies were open and operating so that America's housing finance system would continue to operate. From day one, FHFA made clear it was entrusting day-to-day operations to the new company management, but reserving for itself key strategic and critical business decisions.

The next chapter began in earnest in early 2009 with the effort to establish a uniform, robust loan modification program to assist borrowers in troubled, mostly nontraditional mortgages. Development of both the HAMP program and the Enterprises' proprietary modification programs continued throughout the year. These activities are fundamental to various aspects of FHFA's conservatorship mandates, including mitigating losses on the Enterprises' preconservatorship book of business.

The last half of 2009 and the first half of 2010 were dominated by the actual implementation of these programs, working through the backlog of delinquent mortgages and trying to provide people with the capacity and the desire to stay in their homes the opportunity to do so.

In the next chapter, attention turned in the second half of 2010 to emerging issues in mortgage servicing, and especially foreclosure processing. This year, FHFA made a significant advancement in the cause of addressing these issues by implementing its Servicing Alignment Initiative, thereby improving the clarity, simplicity and consistency of Enterprise mortgage service and standards and responding to the identified deficiencies.

Most recently, we announced major refinements to the Home Affordable Refinance Program, or HARP, in an effort to reduce the credit risk on the Enterprises' preconservatorship book of business by enhancing the opportunity for underwater borrowers in seasoned loans to refinance at today's lower rates.

Unlike these chapters, each of which is focused on working through the preconservatorship book of business, the next chapters will be more forward-looking. As we go into 2012, I anticipate FHFA building on the steps we have already begun to improve the future mortgage finance system. Several of these steps are described in my written statement, but there will be more to come to actually implement these and other changes.

In closing, I would like to reiterate that the final chapter is for Congress and the Administration to write. The ultimate resolution of the conservatorships and the future legal framework for the country's housing finance system needs to be determined by lawmakers.

Mr. Chairman, thank you again for this opportunity, and I look forward to responding to the committee's questions.

[The prepared statement of Mr. DeMarco can be found on page 36 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

And now, Mr. Williams, you are recognized for 5 minutes.

STATEMENT OF MICHAEL J. WILLIAMS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FANNIE MAE

Mr. WILLIAMS. Chairman Neugebauer, Ranking Member Capuano, and members of the committee, thank you for inviting me to speak with you today about FHFA's oversight of Fannie Mae, the company's current condition, and our financial outlook.

I understand why Congress is interested in these issues, and I appreciate the importance of these issues to both Congress and to our country. As CEO, I am responsible for ensuring that we fulfill our important mission and act as good stewards of the taxpayers' unprecedented investment in the company.

Let me begin by discussing how we work with FHFA to operate the company effectively in conservatorship. When Fannie Mae was placed in conservatorship, FHFA replaced the CEO and the Board of Directors, who then recruited a new management team. FHFA delegated responsibility for running the day-to-day operations to management with oversight from the Board. In turn, FHFA retained key responsibilities as conservator.

As we managed the company in the interests of our primary investor, the taxpayer, we have taken actions to strengthen Fannie Mae and limit losses on the legacy book of business: first, we are funding the market and building a strong new book of business; second, we are making strategic investments to minimize losses; and third, we are substantially reducing our expenses. These are exactly the actions that will enable us to achieve the goals of conservatorship and protect the taxpayers' interests.

As the leading provider of funding to the mortgage market, Fannie Mae's role has never been more important. We have helped 6 million homeowners to refinance into a safer, lower-cost mortgage; we have enabled 1.7 million homeowners to be able to purchase a home; and we have provided financing for nearly 1 million units of quality, affordable rental housing.

We are building a new book of business with appropriately conservative underwriting standards that will enable sustainable homeownership. The new book is now almost half of our overall book of business, and these are high-quality loans that we currently expect to be profitable over the life of the loan.

In addition to funding the mortgage market, we are reducing credit losses. The substantial majority of the company's credit losses are attributable to single-family loans purchased or guaranteed from 2005 through 2008. It is important to understand that we cannot reverse past decisions with respect to these loans. We will, however, continue to manage them aggressively to limit taxpayer exposure, and we have made measurable progress.

We built one of the Nation's largest foreclosure prevention operations to help families avoid foreclosure, stabilize neighborhoods, and limit credit losses. We made a prudent decision to hire 1,800 people, many in our Dallas loss mitigation operation, and dedicated them to these activities. As a result, we have helped nearly 1 million families to avoid foreclosure.

When foreclosure is the only option, we help stabilize communities by maintaining and improving the properties we acquire and selling them to new owners. We pay careful attention to expense control. Our core administrative expenses, which exclude these investments in loss mitigation, are down 16 percent this year. Our personnel costs are also down 14 percent, and we have eliminated positions at all levels of the company. These are examples of decisive actions we have taken to manage Fannie Mae responsibly in conservatorship.

Finally, let me address the company's financial outlook. According to FHFA's October 2011 report, we may have positive net income as early as 2013. This is before the payment of the dividend to the government. This is largely the result of actions we have taken to reduce credit losses while building that strong, new book of business.

However, our current annual dividend obligation is $11.3 billion. That exceeds the company's annual net income for any year in its history. While we expect to return to operating profitability, we do not expect to earn profits in excess of our annual dividend obligation to the Treasury.

In closing, I am confident that we are making sound business decisions that protect the interests of the taxpayers and will assist struggling homeowners. We are reducing costs where appropriate, and we are investing where necessary to achieve the goals of the conservatorship.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Williams can be found on page 57 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Also, I would ask unanimous consent that—without objection, that we submit the written testimony from Inspector General Steven Linick of FHFA. Without objection, it is so ordered.

And now, for the question period.

One of the things that I think, Mr. Williams, that you mentioned is that you have had a reduction in your payroll expenses of about 16 percent. Did I hear you say that?

Mr. WILLIAMS. Yes, Congressman, this year.

Chairman NEUGEBAUER. Is that overall, or is that one particular area in which you have had a reduction in 16 percent?

Mr. WILLIAMS. We have reduced our core administrative expenses, which exclude those credit loss mitigation activities by 16 percent, Congressman.

Chairman NEUGEBAUER. But I believe if you look at your numbers in the two Enterprises, total payroll is actually up in both Enterprises. You are saying in one area you are reducing them, but in other areas you are increasing them; is that right?

Mr. WILLIAMS. Congressman, we made strategic investments in loss mitigation because we felt that was in the best interests of the taxpayer to reduce credit losses long term.

Chairman NEUGEBAUER. I just want to be careful because I don't want—one of the accounting methods that we use around here is if we decrease in one area and we increase the other, we always just want to talk about the areas that we are decreasing; we don't necessarily want to talk about the areas where we are increasing.

But one of the things that I think is troubling to many of us is when we look at, for example, the budget here, and the fact that we would—I think in Congress we expect under conservatorship, particularly the word "conserve," and to begin to look at ways to minimize additional advances from the Treasury, because, as you pointed out, they are kind of expensive. But, the little things here that lead me to wonder what is going on in the bigger picture is that I see that we have in your budget $5.1 million in meals and social activities for employees. And I think for those kinds of things to show up in the budget, it would appear to me that the Enterprises are being a little bit tone deaf to exactly what is going on.

You are on the front line of understanding how a lot of families across this country are going through some hard times. And then we look at some of the other activities, and I think some of my other colleagues are going to talk about that, but really what—that, I believe, is a symptom to me, and I am hoping it is only a symptom, that the Enterprises really feel like what is in order here is business as usual.

Now, I am impressed, and I wouldn't expect anything other than the asset quality for your new origination to increase. It should. But one of the things that concerns me is as we have this business-as-usual mentality, is that it basically continues to crowd out, I think, the ability for the private sector to come in. And quite honestly, one of the reasons that your numbers are getting better is because of the sheer volume of business, because basically the Enterprises are getting a majority of the business. I believe if you were getting more traditional levels of business, the advances would have been much higher.

So, Mr. Williams, what do you say to the American people that, yes, we are being stewards of your money, but the evidence in some cases points otherwise?

Mr. WILLIAMS. Congressman, we do believe we are being good stewards of the money. We have consciously gone out and reduced expenses, gone after other areas where we can reduce losses, where we can reduce our expenses and cut costs. We have taken our compensation level for executives down by 50 percent. We have reduced the number of senior officers by 30 percent. We are going through all areas of the company where we can reduce our expenditures and do this in a timely fashion. We do believe it is important to invest in our loss mitigation areas so that we can continue to help homeowners and reduce our long-term credit losses.

Chairman NEUGEBAUER. So do the Enterprises have a conservator plan; in other words, this is how we are going to operate, these are things we are going to do in our loss mitigation area, this is the way we are going to reduce our footprint, this is our overall strategy? And how do you interface with Mr. DeMarco in executing that plan?

Mr. WILLIAMS. Congressman, we interface with Mr. DeMarco quite frequently, I can assure of you of that. We meet regularly. We are aligned on the goals of the conservatorship, which is to stabilize the companies, to make sure we provide the needed liquidity to the market that is needed at this critical time in our country, and also do everything that we can to help homeowners and reduce credit losses going forward.

Chairman NEUGEBAUER. I just want to—you have answered part of my question. The first part of the question was, do you have an actual conservator plan that you are operating under so that we have specific goals and objectives of what you are trying to accomplish?

Mr. WILLIAMS. We have a number of initiatives that we are working on.

Chairman NEUGEBAUER. Initiatives—I want to know if there is a plan, a written plan of your mission and your goals and the direction you are headed with this Enterprise?

Mr. WILLIAMS. Congressman, we do have goals and objectives that are completely aligned with the conservator's—

Chairman NEUGEBAUER. Is there a written plan?

Mr. WILLIAMS. A written plan?

Chairman NEUGEBAUER. Yes. It is a yes-or-no question.

Mr. WILLIAMS. I cannot tell you there is a written plan.

Chairman NEUGEBAUER. So there is no written plan.

Mr. WILLIAMS. There are goals and objectives that are aligned with the conservator's plan.

Chairman NEUGEBAUER. I thank the gentleman.

Ranking Member Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Haldeman, you have been doing this for a while, and you come to it with a fair amount of experience. I would like to ask you, 10 years from now, after we do whatever we do, and when this is done, do you envision this country having some entity that plays the role that Fannie and/or Freddie play currently in the mortgage industry?

Mr. HALDEMAN. By your introductory comment that I have been doing this for a while, you didn't mean at Freddie Mac?

Mr. CAPUANO. You are familiar with the industry.

Mr. HALDEMAN. Yes, the financial services industry, absolutely. I have been with Freddie Mac since August of 2009. It is—I talk to our employees a great deal about the future, because as you can imagine, they have a lot of uncertainty, insecurity, and anxiety about the future, and what I say is, I can't imagine our country without a secondary mortgage market. Could you imagine us going back to the time when the originator holds the mortgage for 30 years? I certainly can't. I think we will not go back to those times.

I think we will always have a secondary mortgage market. And what I say to employees is that we have talent, we have expertise, we have infrastructure, we have technology, we have relationships, and I think the country should find a way to use that in the secondary mortgage market.

Mr. CAPUANO. Mr. DeMarco, do you agree with that, again, looking in your crystal ball 10 years from now, based on your knowledge and experience?

Mr. DEMARCO. Yes, Mr. Capuano. Clearly, a country that has a $10 trillion or $11 trillion single-family mortgage market is going to need plumbing that will allow local lenders that are making mortgages of an average size of, let us say, $200,000, but that aggregates up across this country to $10 trillion or $11 trillion—it is going to need plumbing, it is going to need the infrastructure to connect global capital markets to be able to get that size and capacity down to local lenders.

Mr. CAPUANO. Mr. Williams, do you agree or disagree with that?

Mr. WILLIAMS. Yes, Congressman, I do agree.

Mr. CAPUANO. The reason I ask is because in the final analysis, the day-to-day activities, what you are doing, we are going to talk about that today, but when everything is said and done, as I said in my opening statement, I am interested in making sure that the next generation of middle-income people can afford to buy a home in a reasonable way. Again, hopefully they will hit good scores and everything else, and reasonable people will be able to buy a reasonable home.

I will tell you that some of the activity that has happened doesn't help that. And it is not about the specifics of what you have done within the Agency, but you understand you are no longer operating in private companies, you are now operating in the public world.

And I would like to ask you, Mr. Haldeman, do you know the total salary and bonuses paid to your highest-paid employee this past year? I am not looking for a name, just a number.

Mr. HALDEMAN. Highest paid, you mean the top paid, top—

Mr. CAPUANO. Just one. Who made the most money?

Mr. HALDEMAN. At Freddie Mac?

Mr. CAPUANO. Yes.

Mr. HALDEMAN. Yes. It was me.

Mr. CAPUANO. Other than you.

Mr. HALDEMAN. Yes, I know.

Mr. CAPUANO. How much?

Mr. HALDEMAN. Other than me, it was approximately—it was somewhere between $3 million and $3.5 million.

Mr. CAPUANO. Between $3 million and $3.5 million.

Mr. Williams, do you know, again other than you?

Mr. WILLIAMS. Yes, Congressman.

Mr. CAPUANO. How much would that be?

Mr. WILLIAMS. It would be between $2.8 million and $3 million.

Mr. CAPUANO. So, in the $3 million range.

And do you understand that after what Freddie and Fannie had been through—it was before your watch, I am not trying to lay this on you—do you understand the outrage that the American people feel when we are looking at an agency that has gotten us to the brink of difficulties—gotten us in difficulties, beyond the brink—and has gotten a lot of taxpayer funding? And it is awfully hard, for me it is impossible, to understand why an individual working for an entity such as yours, not a private company, has to make that kind of money.

I am not against people making money. God bless them. But go into the private market. It is almost impossible for us to understand. I had to vote for a bill the other day to limit these kinds of things because, honestly, I am outraged, and not about the individual. That is why I don't want names; I am not looking to lay it on anybody. But in this situation, that kind of activity, the kind of activity—$5 million on meals and entertainment. I think meals and entertainment, within the normal course of events, is a reasonable business expense. You should be able to serve coffee at your breakfast meetings. That is fine by me. But it is outrageous to my constituents and to me when I turn around and I defend the purposes of the agencies every day, and I will continue to do so.

And I will agree with my other colleagues that you didn't do anything worse than anybody else, but you did—not you, but your predecessors did it, and we now have to dig you out of it; it is our obligation to society. But I guess what I am saying is in order for people like me to be able to help meet that vision—not help you or your current employees, although I am not against anybody, that is not my goal. My goal is for the next generation to have someone like you doing what you try to do now, and you are making it tougher.

Mr. HALDEMAN. Congressman—

Mr. CAPUANO. Go ahead, Mr. Haldeman.

Mr. HALDEMAN. I totally get the outrage. I get the outrage about executive compensation in total; I get the outrage about compensation at Freddie Mac in particular. I understand exactly what you are saying, and I struggle with it all the time, too.

Let me tell you about the dilemma, and maybe you can help me resolve the dilemma. I came here in August of 2009, and there was not a CEO of Freddie Mac, there was not a chief operating officer, and there was not a CFO. It felt to me that the right thing to do was to do everything we can to try to keep the machinery together, to keep it operating, to keep it functioning well, to not have mistakes and not have it go down the drain.

And there are many, many functions that have to be performed at Freddie Mac that require very specialized expertise where we have to get a CFO who is capable of running any complicated bank in the country. We have to have investment people who can run a $700 billion portfolio. If you are running a $700 billion portfolio, and you make a mistake that is one-tenth of 1 percent, it costs you $700 million. So these are very sophisticated things, very complex, and I felt we needed to pay that kind of compensation, which troubles me and troubles you, in order to get people so that we wouldn't have those kinds of mistakes.

Mr. CAPUANO. I appreciate it, and if I could just finish up, because I know I am over my time.

That is a fair and reasonable explanation, but if you were to make that decision, it would have helped and would help going forward for you to present to us and the general public not just your thinking, but also backing up as to determining so that I can sit here and say, do you know what? Like it or not, that is what a person in this position makes across the world. There are plenty of companies that can do that or not, or they don't. So as opposed to simply picking a number and being outraged at a number, I will then be able to say, well, it is in the ballpark, everybody in those positions makes this kind of money, and at least it is defensible. At the moment, it is nothing more than a number in an agency that has caused this country a lot of trouble.

And for me, the most important thing to come out of this hearing is that you walk away knowing that you live in a fishbowl now, and you have to act as if there is a fishbowl if you want the end that we have all discussed.

And I apologize for going on, Mr. Chairman. Thank you for your indulgence.

Chairman NEUGEBAUER. Now, the chairman of the full Financial Services Committee, Chairman Bachus, is recognized.

Chairman BACHUS. Thank you, Mr. Chairman.

Mr. DeMarco, I do believe you may have the toughest job in Washington. And I realize that the reasons for that have been beyond your control and really to a certain extent beyond the control, Mr. Haldeman, of you and Mr. Williams.

You work for the two GSEs that were recipients of the largest bailout in the history of the country; maybe AIG is close. And there is outrage at the failure of Fannie and Freddie and a lot of outrage about the activity that went on. Gretchen Morgenson's book outlines many of the problems.

I also recognize that as I saw the case with that new AIG president and the General Motors president, they took a lot of slings and arrows for what their predecessors did. And so, I do have sympathy for you.

I think we all have to realize, though, that the world has changed, and Members of Congress are realizing that on many occasions, and altering our behavior. And I think that is a good, positive thing because we have to restore the confidence of the American people. And my legislation, I believe, does that. Now, does it have a negative of making it more difficult to hire capable people? It probably does.

I do say this: I think that anyone considering a top management or executive position at either one of the firms would have to think, do I want all the baggage that comes with that? Because they are going to forever have on their resume that they were at Fannie or Freddie. People are not going to pay attention to the dates or the facts or any of that. And I had a discussion with Mr. DeMarco yesterday where he pointed out to me that many people are not taking these jobs because they are concerned about liability issues. Why take a job for $200,000 if you might have an exposure to $5 million worth of legal expenses or lawsuits or even criticism which damages your reputation? And I told him that I think this Congress ought to work with him.

So I apologize to you and to the employees who are there at Fannie and Freddie that in many cases, you are being sacrificial lambs for those who came before you.

But as far as compensation, I think we are just going to have to change our ways. I think we are just not going to be able to—as highlighted in today's paper, we are not going to be able to go to

Chicago and spend two-thirds of a million dollars at a reception even if it benefits the business.

I thought one of the most unfair criticisms was when we criticized the presidents of Ford and General Motors for flying here in their corporate jets and wanted to know why they didn't get in their cars and drive here from Detroit, Michigan. And the next time, they drove here from Detroit, Michigan. Now, that is going too far. I thought that was ridiculous, and I still do.

So I will promise you, but I will say this, and I will close with this, some of the salaries are for people, and they are good people, they have been there, but they were there before, and they are still there. And at a certain point, I think that the decision just had to be made, do they want to stay on for these new—whether we pass this legislation, do they want to stay for that? And I am hopeful we will get good public servants.

But we will work with you on the liability issues and other issues because those do need to be addressed, and I, for instance, would not take a job for $200,000 that had a legal exposure of millions of dollars, particularly with the grief that would come with working at your companies right now for things that went on long before you agreed to come in and try to fix things.

So I would hope all members of the committee will not—their outrage needs to be able taken out on the failure of this Congress years ago not to beef up regulation. And it is up to this Congress if we want to limit salaries to do so, and that is why I filed this legislation. It is not up to you to refuse salaries for your employees and potential employees. So thank you very much.

Chairman NEUGEBAUER. The Chair recognizes Ms. Waters from California for 5 minutes.

Ms. WATERS. Thank you very much.

Mr. DeMarco, I mentioned that I wanted to talk about principal write-downs. I want to talk about REO and the REO pilot program that was in the papers today, but I have to get to something else first.

In August, Fannie Mae paid $500 million to Bank of America to purchase the servicing rights to more than 400,000 mortgages in its portfolio. According to your staff, Fannie initiated the purchase to allow it to transfer the servicing of the mortgages to another, presumably better servicer, to improve borrower outcomes and minimize losses to Fannie going forward. To be honest, I understand that Fannie had a contract with Bank of America, and that it would be more expensive to sue them for poor performance, but I am not happy that Fannie had to purchase the servicing back from a company that was doing such a poor job.

My question is this: Does Bank of America continue to get service business from Fannie and Freddie, and, if so, why would the GSEs give businesses to a company whose servicing has been found to be so problematic that Fannie had to buy back loans in order to properly service them?

Mr. DEMARCO. I am not too happy about it either, Congresswoman, but it was respectful of the existing business contracts that were in place. It was a prudent market transaction that was made, and it did get to exactly what you said. It was designed to both minimize or reduce potential losses to Fannie and Freddie, and improve borrower outcomes by getting these high-risk mortgages in the hands of a servicer that had a better demonstrated capacity to work with these kinds of difficult situations to get the borrower into a better outcome.

And so it met our mandate of trying to minimize foreclosures, and maximize assistance to borrowers, and also reduce our credit losses. It did reflect existing contractual arrangements at the time, and this is something that we are—I can assure you we are looking at those sorts of contract terms on a go-forward basis.

Ms. WATERS. Are they still getting new business from you?

Mr. DEMARCO. Bank of America is still a major originator of mortgages and seller of mortgages to Fannie and Freddie, so yes.

Ms. WATERS. There is some kind of contradiction in that, isn't there?

Mr. DEMARCO. There are some difficulties here.

Ms. WATERS. So why do you continue to give them business?

Mr. DEMARCO. They are a significant originator, and we are dealing with the problems with the mortgage servicing part through the business terms that exist today with regard to servicing contracts.

Ms. WATERS. I am concerned about the servicing business. As a matter of fact, we were beginning to focus, and I have been focusing for a long time, on services. They are at the crux of this problem that we have, not just with you, but with everybody. But I want to know why they are still doing the servicing. Just because they are the originators?

Mr. DEMARCO. That is something that they own. They have those servicing rights, and those servicing rights have been transferred. There has been a tremendous amount of work done by both companies to go into Bank of America, work with Bank of America on enhancing the way they go about doing the servicing. And we have an important initiative that we have, the servicing alignment, is to get greater clarity not just to Bank of America, but all servicers about the steps that they are supposed to follow in order to provide remediation when a borrower goes delinquent. This is not just a single-institution problem, this is an industry problem, and we are all very challenged by it.

Ms. WATERS. I agree. But I spent some time getting permission from some of my constituents to help work with them to try to get loan modifications, and it just so happens that Bank of America was the servicer. And I spent hours on the telephone. I can't tell you what I went through. So I do understand that.

Quickly, before my time is up, the REO pilot programs. You told me you got the ideas back. You told me we were going to go out to bid. I like the idea of the financing part of this, but I hope you are not going to be financing speculators to come in and get big blocks of REO properties, are you?

Mr. DEMARCO. We are really focused on doing this in a way that is targeted at individual geographic markets. We want to make this as competitive as possible so that local investors can also be meaningful participants. That is important to us as conservator, because I think the more competitive we can make these transactions, the greater value that we will realize for taxpayers. And by inviting and creating an environment in which local equity participants and people with local market knowledge participate, I think that helps to give a greater probability that we are going to have folks who are really dedicated to seeing good outcomes in those local communities. And it also gets that local community knowledge into the game. So that is all part of what we are trying to build into our review of these.

Ms. WATERS. Thank you very much.

And we want to work very close closely with you to understand the program so that we can articulate it in our communities that have been so devastated by these foreclosures, and people want to participate. So we will work with your people.

Thank you very much. I yield back the balance of my time.

Mr. DEMARCO. Thank you, Congresswoman.

Chairman NEUGEBAUER. Now, the vice chairman of the subcommittee, Mr. Fitzpatrick.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

I know that we all appreciate the efforts that the Enterprises have made so far to reduce expenditures. Hopefully, we can agree that there is still more to be done. Chairman Bachus was mentioning earlier in his remarks about—I think he was referring to a New York Times article or column, Morgenson's column—it might have been in today's paper—entitled, "Fannie and Freddie, Still the Socialites," which reviewed, as this subcommittee also reviewed, Enterprise expenditures relating to an industry conference that was held in October in Chicago. The conference was only 2 days long, but the tab was pretty hefty.

According to the article, the Enterprises spent, combined, about $700,000 at the 2-day conference, including $74,000 in dinners alone. Freddie Mac spent nearly $50,000 on just two dinners, and Fannie Mae spent nearly $25,000 on two dinners.

So my question is for Mr. Williams and Mr. Haldeman. Given the extraordinary taxpayer support that has already been received, about $170 billion, how do you justify these expenses to my constituents in Bucks County or to the taxpayers of the United States generally?

Mr. HALDEMAN. Maybe I will start. And, Congressman, I think we have to begin by saying, you are right. We can do a better job. But let me talk about top-line spending before I get to the individual line item because it was where the chairman started.

As I indicated, I came to the company in August of 2009, and one of the things that I started to talk about right away was that we needed to consistently bring down our total spending of the company year after year after year. And that is precisely what we have done at the top line. If you take our total spending to run Freddie Mac for 2009 and compare it to where we are now, we have reduced that top line of spending by $150 million a year. That is almost 10 percent, and that is not one subset, Mr. Chairman, or one line item, it is the total spending of the company. And we brought it down in 2010, and we are bringing it down in 2011, and we are going to do the same thing in 2012. And that is how I have managed the company at the top.

Within that, we have division budgets, and I monitor those. But there is some ability of managers below me to make decisions on spending, and I don't think we did as good a job as we should have on that MBA program. Do I think it is a legitimate business expense and it was good that we sent a lot of people there? Absolutely. And it is a very, very efficient way to interact with and educate a broad range of seller servicers. Literally, every seller servicer in the country comes to that one location in Chicago, and it is the most efficient way I know of to make sure that we can educate them about our credit policy and what we expect from them on the servicing side.

Mr. FITZPATRICK. Do you understand the outrage of the taxpayers when they read that in the newspaper?

Mr. HALDEMAN. I do. Yes.

Mr. FITZPATRICK. It is one thing to attend a conference. It is another thing to sponsor a conference which you do with taxpayer dollars

Mr. HALDEMAN. And we did not do it perfectly. Since I have been there, each year when we have done—we have attended the Mortgage Bankers Association, and we have brought our spending down year by year. I think we have to do it faster. And there were some things that were done that we are going to take care of next year.

Mr. FITZPATRICK. I appreciate it.

Mr. Williams, given that Fannie Mae is in conservatorship, do you have discretion as to how to spend those dollars, the dollars that I am referring to on the conference? And were these dollars budgeted?

Mr. WILLIAMS. Congressman, I do appreciate your concern as well as the committee's on the topic. We have taken this seriously. In fact, we have, since conservatorship, reduced sponsorship and attendance at these conferences by over 50 percent.

Why we felt this was a good business decision was that this was a conference that was going to be attended by over 3,000 industry participants. It gave us the opportunity to hold over 200 meetings with industry players that would allow us to address the important issues facing not only the industry, but are also important to the conservatorship, such as servicing alignment, the rollout of HARP 2, servicing compensation, increasing guarantees and many other strategic issues.

Mr. FITZPATRICK. Could Fannie Mae have held those meetings and accomplished those meetings without spending $74,000 on dinner in 2 days? Could you have gone to Chicago without the dinners and held the meetings?

Mr. WILLIAMS. Congressman, we held many meetings during the course of those days. The dinners were, too, part of it in which it gave us an opportunity to meet with industry players. We will do a better job, but we felt this was a very good business decision.

Mr. FITZPATRICK. Mr. DeMarco, do you believe spending $74,000, as we have talked about here this afternoon, does that advance the interest of the conservatorship?

Mr. DEMARCO. Mr. Fitzpatrick, attendance at the conference certainly did. Certain individual expenditures probably could have been done away with and still met the essential business proposition of meeting with the entire industry and conducting a tremendous amount of business and business education in one place. So attendance and being an active participant was certainly meeting the conservatorship goal. I wouldn't want to say that every individual expense was necessary, no, sir.

Mr. FITZPATRICK. Okay. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Miller is recognized.

Mr. MILLER OF NORTH CAROLINA. Mr. DeMarco, you and I have discussed on many occasions Fannie and Freddie's or FHFA's policy of not reducing principal in modifying mortgages. And I provided you two economic studies, one by the New York Fed, the other by Amherst Securities, that examined the arguments and reached different conclusions. They concluded that foreclosures usually resulted in a 50 to 75 percent loss of principal, that reductions in principals of 10 to 40 percent to get an underwater homeowner back to even usually resulted in better-performing loans, and I provided you those studies. They concluded that it makes good economic sense for the creditor to reduce principal to get an underwater homeowner back above water. And you have said that your private analysis reached a different conclusion.

Given the importance of this question, why have you not made that private analysis public?

Mr. DEMARCO. I think I will be making it more public on this point, Mr. Miller, in response to continued inquiries from you and others. But if I could address these two studies that you raised.

The first, the Amherst study, when I first started reading it, I started to get a concern, well, wait a minute, maybe there is something going on here. Then as I went through it, I realized that what was meant by "principal forgiveness" there wasn't just writing off principal, it also included principal forbearance, and that was actually part of what was going on there.

Mr. MILLER OF NORTH CAROLINA. Mr. DeMarco, that is not true. The study actually says specifically that principal reduction is—this is a quote from the study: "It is reasonable to think that the success rate on principal forgiveness would be better than forbearance, as the borrower is closer to being re-equified." That is not a word you hear very often.

So it does appear that the study does specifically address the differences between forbearance and—it may not have statistics that could distinguish it, but they concluded that actually principal reduction would more likely result in a performing mortgage than forbearance.

Mr. DEMARCO. I have in front of me here the results on our modified loans and the redelinquency rates, and this also goes to the—

Mr. MILLER OF NORTH CAROLINA. Isn't it like 44 percent?

Mr. DEMARCO. The redelinquency rates? Let me tell you for—

Mr. MILLER OF NORTH CAROLINA. According to Freddie's reports, the mortgages from 2 years ago that were modified, 44 percent are now 3 months past due. Is that incorrect?

Mr. DEMARCO. That is incorrect. I am looking at 9 months after modification, we have 60-day delinquency rates of 15 percent. That means 85 percent of these loan modifications are still performing 9 months after they were made permanent. This is down substantially. It used to be up in the 40 percent range, sir. You are quite right about that, Mr. Miller. It used to be up in the low forties at

9 months later, but it has dropped from that all the way down to 15 percent. Right now, what we have for loans that were originated in the first quarter of 2011, 6 months later were down to less than 10 percent redefaults.

Mr. MILLER OF NORTH CAROLINA. The last time you were here, I asked you about the settlement by—it was actually by the Bank of New York Mellon as the trustee for Bank of America mortgages, essentially put back claims, and the provisions in that requiring that Bank of America refer out the servicing of those mortgages. It is hard to conclude from what you said earlier and from this settlement that anyone regards Bank of America as doing a very good job of servicing. And you said that the agreement did not actually require principal reduction, which is correct. But it does specifically say, does it not, that servicers must consider all loss mitigation options, including principal reductions?

Mr. DEMARCO. It may, Congressman. I don't recall the precise wording. I did recall correctly, I am glad to hear you say, that it did not mandate that.

Mr. MILLER OF NORTH CAROLINA. It doesn't mandate it, but it says it doesn't consider anything to reduce their losses, including modification. There have been stories in the last couple of days at the OCC's required self-audits by the various OCC banks that they are servicing, and approximately 5,000—close to 5,000 appear to be of servicemembers in violation of the Servicemembers Civil Relief Act. Do you know if either of those were Fannie or Freddie mortgages?

Mr. DEMARCO. I don't know, but I do know this has been an important issue, Congressman. And it is one that we have worked on with Mrs. Petraeus at the CFPB and with the Department of Defense, and Fannie and Freddie have provided updated clarity and communication to their seller servicers regarding that. And their standards actually were already quite satisfactory to the CFPB and to the Defense Department. But it did appear as though there was confusion on this point, and we have already acted to get improved communications. I don't know whether Mr. Haldeman or Mr. Williams want to comment more on that?

Mr. MILLER OF NORTH CAROLINA. Mr. Chairman, I know that the light is red, but, Mr. DeMarco, you said that we would shortly be hearing more on the subject of principal modification and your own analysis. Are you going to be providing your study to the public, and if so, when? And why have you not done it already?

Mr. DEMARCO. I have certainly explained this numerous times in committee hearings, and I have provided written communication before to quite a number of Members of Congress on it, including you. I just this week got yet another much more detailed request, and we are evaluating that request. It has quite a number of components to it, and we have tried to be responsive to all Members of Congress when they request information from us.

Mr. MILLER OF NORTH CAROLINA. But your analysis has to be in writing. You don't just talk about this over the water cooler. You have this in writing.

Mr. DEMARCO. We have done the analysis, Mr. Miller, and we will get it out to folks.

Chairman NEUGEBAUER. The gentleman from New Mexico, Mr. Pearce, is recognized for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

Mr. Haldeman, you had talked, on page 2 of your testimony, about helping families avoid foreclosure. Can you kind of expand on what you are doing there?

Mr. HALDEMAN. Yes. Since 2009, we have worked—helped, benefited 575,000 families, and that would be all inclusive of all the various tools that we use to try to help families. So it would be traditional modifications, HAMP modifications, forbearance plans, short sales, deed in lieus, a whole range of tools that we use to try to keep people in their homes.

Mr. PEARCE. Thank you.

Mr. DeMarco, on page 5, you mention that you are bringing a lawsuit against 18 institutions to recover certain losses, and you are bringing those lawsuits because you feel that the institutions did not act fairly in the relationship; is that correct?

Mr. DEMARCO. It has to go with the securities disclosures that these institutions had on security instruments that were purchased by Fannie and Freddie. And we believe we have evidence supporting that the disclosures of what were the characteristics of the loans in those securities did not match what was actually there.

Mr. PEARCE. I don't have exact documentation, but it looks likes Mr. Johnson may have ended up with $100 million, $10 million a year for 10 years; Mr. Raines maybe $28 million. There may be indications that certain accounting techniques were used so that they would accelerate their bonuses. Have you brought any actions against previous Directors, previous CEOs?

Mr. DEMARCO. This predates me, Congressman, but the predecessor—one of the predecessor agencies to FHFA, the Office of Federal Housing Enterprise Oversight, did bring such a civil action against—

Mr. PEARCE. Did we get any return?

Mr. DEMARCO. We did. I don't know the numbers offhand, Congressman. This was all made public at the time. But we can get that to you. And, yes, there were penalties associated with that, with each company.

Mr. PEARCE. Thank you.

Mr. Williams, I should know a little bit better. I don't, though, so if you would help me out. Do you have a board of directors that you answer to?

Mr. WILLIAMS. Yes, we do, sir. They were installed—

Mr. PEARCE. Can you pull your microphone up a little closer?

So you answer to a board of directors. Are you publicly traded?

Mr. WILLIAMS. There are shares, sir. But the real shareholder, all rights of the shareholders have been conveyed to the conservator, and the conservator is the person who appoints both the board of directors and approves the management team.

Mr. PEARCE. How much were your losses during the last 12 months? Roughly, just roughly.

Mr. WILLIAMS. Roughly $15 billion. And bottom line—

Mr. PEARCE. Did you have to go to a—did you have to float a bond series or something like that? Did you have to go to the bank? How did you make up those operating losses?

Mr. WILLIAMS. The funds that are needed to provide the net worth for the company are provided by the U.S. Treasury upon request from the conservator.

Mr. PEARCE. Now that is, I think, my problem with your testimony when you declare that we are a private business. I don't know any other private business that could go to the bank and get funds. They have a possibility of going bankrupt. If they are mismanaged, then the market takes care of that mismanagement. And I am not sure that the market is being allowed to take care of anything right now, which causes me to say it is acting much more like a government agency than a private business. So if you have observations about that, I would welcome them. But for me sitting on this side of the desk, it sounds like you are much more a government agency. In other words, we see agencies all the time overspend their budgets, and they just come back for more. So just that one clarification is critical for me.

Mr. DeMarco, have you run tests about how you could start selling off parts of your mortgages, get private investors in there? In other words, when you all are taking—you are taking certain steps, forbearance or whatever, the help—as Mr. Haldeman suggests, have you compared what would happen, the costs stream to the agency, if you just accepted bids from the outside to take blocks of loans compared to what you are having to do to make those loans start processing? In other words, there is a lot of money out there that would invest, I think, at the right price.

Mr. DEMARCO. Right. I think that is right, Congressman. I can say several things about that. First, both companies have been shedding assets. Certainly, there are retained portfolios. That is, what they are financing on their own balance sheet has been declining over the last few years, and there is a whole programmatic system in place for that to continue. There have been efforts to sell outside of that progression, identify opportunities to sell blocks of assets and realize value.

My exchange with Congresswoman Waters about real estate owned is also to your point of looking at efforts to take assets off the balance sheets of Fannie and Freddie and get them back into private hands on a more rapid basis. And then finally, on a go-forward basis, we are looking at several ways of having more of the credit risk that Fannie and Freddie are taking on right now on a new business production in identifying ways to have some portion of that credit risk actually be financed by private capital and have private capital bear a portion of that credit risk. And I believe in the coming year you are going to see actual—more executions that follow that approach.

Mr. PEARCE. I appreciate it.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

Now, the gentleman from Delaware, Mr. Carney.

Mr. CARNEY. Thank you, Mr. Chairman. Thank you for having this hearing today.

I have three lines of questioning that I would like to explore. The first really is just to go back to Mr. Pearce's question about the recovery efforts on security disclosures and representations that were made. There was some reference to that in the Financial Crisis Inquiry Commission report that was presented here some months ago, and in that report, they talk about moneys that were recovered through that process. Could you update us on those recoveries?

Mr. DEMARCO. I am sorry sir. I am not familiar with the particular—

Mr. CARNEY. Dollar amounts?

Mr. DEMARCO. The dollar amounts or, frankly, what exactly the FCIC had. I can speak to the fact that we have filed these lawsuits with regard to certain private-label mortgage-backed securities that Fannie Mae and Freddie Mac have purchased where we believe that there are deficiencies in the securities offerings that were part of those transactions. We are seeing this emerging in the marketplace. There have been more and more lawsuits filed by all sorts of different parties regarding the securitization process for private labels.

Mr. CARNEY. Does Fannie or Freddie do that separately or independently?

Mr. WILLIAMS. Congressman, we have a separate activity that is based on our loss mitigation unit that goes back and looks at loans from that period of time, from 2005 to 2008 in particular, and looks at whether those loans should be repurchased because they did not meet our underwriting guidelines.

Mr. CARNEY. Right. There is a warranty, right, and instrument that says if they didn't meet the underlying guidelines, that they could be repurchased, right?

Mr. WILLIAMS. Correct.

Mr. CARNEY. So how aggressively are we pursuing those representations?

Mr. WILLIAMS. Congressman, I believe we are being very aggressive. We have stood up as part of the conversation that I was having with the chairman about the growth in our loss mitigation activities. That is one of the big areas that we have grown because we are going back and looking at all the loans that we have—

Mr. CARNEY. Is there a way that we can get a report on that? Or is there public information available on that? That would be helpful. You can answer that later because my time is ticking.

You have talked a little bit about your foreclosure prevention efforts. Is there something that we can do or other programs or changes in existing programs that would facilitate your efforts?

Mr. DEMARCO. I think at this point we have—a lot has changed with these various programs, and a lot of programs have been put in place. We need to give them time to work. I think things like the recent changes to HARP.

Mr. CARNEY. The changes to HARP, are some of those changes—would they be appropriate for HAMP as well in terms of some of the streamlining that was in HARP?

Mr. DEMARCO. They are really targeted at two really different sets of situations.

Mr. CARNEY. I know that, but there were kind of administrative tightenings and changes that were put in place in HARP, as I understood it, that maybe could apply to HAMP. You don't think so. Okay.

Mr. HALDEMAN. Congressman, the way that I would answer that would be that over the course of time, the HAMP program has become more aligned and more efficient. That was not the case in the spring of 2009.

Mr. CARNEY. So that is happening as an administrative matter?

Mr. HALDEMAN. Precisely right.

Mr. CARNEY. Perfect.

Lastly, I would like to ask Mr. DeMarco, I guess, what you think of—or it was Mr. Haldeman who mentioned that one of the big questions out there is to clarify the future of the secondary mortgage market. And, of course, there has been a big discussion within this committee and members of this committee and pieces of legislation, what to do with Fannie and Freddie, unwind them, and so on and so forth. Of course, we had the Treasury Secretary in here months ago presenting the President's White Paper, which presented a series of options from complete privatization to some hybrid model.

Could you share with us your opinion on what the future ought to look like, Mr. DeMarco?

I will let you each have a shot at it, I guess.

Mr. DEMARCO. I would say simply, Congressman, that I really do believe that this is a critical public policy matter for lawmakers to decide, and the essential decision point for lawmakers is out of a $10 trillion or $11 trillion single-family mortgage market, what portion of that mortgage market warrants the American taxpayer standing behind that set of mortgages as the ultimate credit guarantor of the mortgages? And then on the other side, that leaves the rest of that $10 trillion or $11 trillion single-family market to be financed through normal financial mechanisms, through private financial institutions, exercising private credit assessments and putting private capital at risk.

Mr. CARNEY. How would you answer that question?

Mr. DEMARCO. I think that the answer is that it is going to be a mix of both. Clearly, I don't see the FHA program or VA—as credit guarantee programs will certainly exist. One of the things Congress could do is make determinations about adjusting the mission and the potential market scope of those programs and leave the rest to the private sector. Or it could go further, and it could say in addition to FHA/VA, there are some other portions that will have an ultimate government guarantee.

My experience over time as a career civil servant is that over time, government credit guarantee programs get a little hard to manage and keep the pricing associated with the risks that are involved. So it is a challenge. But on the other hand, we certainly have seen that the private sector can be challenged in assessing credit risk as well.

Mr. CARNEY. We saw that, didn't we?

I would like to hear from the other two, but I don't have any time left. So I appreciate your answers to my questions. Thanks.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from California, Mr. Miller.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman.

I have often asked the question, what went wrong, and when did it occur? Mr. Williams, you are the first one to publicly answer that question without being asked. You said that in 2005 to 2008, the bad loans were written. And if you know when they were written, you know what caused them, and you know how to fix them. I am assuming both sides have fixed the problem that occurred between 2005 and 2008. Is that a statement of fact?

Mr. HALDEMAN. I believe we have, and it is a different credit policy.

Mr. MILLER OF CALIFORNIA. That has been a debate I have always tried to engage somebody in, and nobody would ever answer.

The other question was raised by my good friend Maxine Waters and others, accountability on the part of lenders. I have always believed that has to be paramount. If lenders write bad loans, they don't have proper oversight, use underwriting standards that are unreasonable, they should buy the loans back, and perhaps if they do that enough times, they will stop doing that.

But one structure I have always felt was confusing and should never have occurred was a hybrid model of Freddie and Fannie, whereby the taxpayers are on the hook, and the private sector made the money. We guaranteed it as a government, and the private sector made all the profits. That is unreasonable.

But I do like what I have heard, and I agree with it. There has to be some facility as a conduit for the flow of private sector dollars to the secondary market. I think that has to occur in the future. Probably 15 percent of the money we receive in this country for loans comes from other countries, and if there was not a government guarantee, those funds would not be coming to this country, and many of the investors who invested in Freddie and Fannie and bonds would not make the investment if there was not a guarantee on those loans.

But a question that I have great concern over is the situation you are in today. And if you aren't required to pay this 10 percent dividend, Freddie and Fannie, what would your assets be today and possibly in the future? What would they be? And would you still be borrowing from the Treasury if you weren't required to make this huge payment?

Mr. HALDEMAN. I can refer you to an analysis that FHFA completed and published in October of 2011 where they took a look at the future draws, dividend payments for Freddie Mac going into the future, and they have three different scenarios that they look at tied to many things, but including house prices, how severe, whether we will have a double-dip recession, whether housing prices will go down. There are three scenarios. And under two of those scenarios, including the most likely or the base case, Freddie Mac will not need any incremental draw after 2011, and that is despite paying the 10 percent dividend that you cite.

Mr. MILLER OF CALIFORNIA. If you weren't paying the 10 percent today, what would your assets be currently? And would Treasury be on the hook for anything?

Mr. HALDEMAN. Yes, they still would be, Congressman. But maybe one way I can say that, do the math off the top of my head, which is dangerous. Our draw thus far is $72 billion. We have paid $15 billion. These are all round numbers. We have paid $15 billion in 10 percent preferred dividend. If I use your interest rate, which I remember from your opening remarks, of 5 percent, that would have saved $7.5 billion. So instead of $72 billion, it would have been $64.5 billion, I think is the math. So, we still would have been substantially in a draw.

Mr. MILLER OF CALIFORNIA. If you had that $15 billion back right now, how much would you be drawing?

Mr. HALDEMAN. It would be $72 billion minus $15 billion.

Mr. MILLER OF CALIFORNIA. But what you have already received, would you need more funds this year or next year if you hadn't paid that $15 billion back?

Mr. HALDEMAN. I am hesitant to answer that. But even having paid the 10 percent interest, we are not going to have any—under the base case, we won't have a draw on 2012—

Mr. MILLER OF CALIFORNIA. So your assets would be $15 billion rather than considering a draw that you are not getting. So we are taking what liquidity you have away from you by charging you 10 percent.

On Fannie, the same question, Mr. Williams. If we didn't charge that 10 percent that we are charging in interest today, would you still need to go to the Treasury right now for additional funds?

Mr. WILLIAMS. Congressman, we have paid over $17 billion in dividends. Referring to the same report as Mr. Haldeman noted, as we move forward, payment of the dividends will be the largest part of our draw, but we will continue to draw.

Mr. MILLER OF CALIFORNIA. So if you didn't have to pay that, your draw might be very close to zero?

Mr. WILLIAMS. In the future.

Mr. MILLER OF CALIFORNIA. And that is something this Congress needs to consider, that we charge the banks 5 percent. We are charging Freddie and Fannie 10 percent, so we are almost dooming the failure, because every dime they take in that would be profit, they are giving back to the taxpayers in interest, and then we are making them borrow more money to charge them more interest on. It seems like a never-ending circle that we have caused to happen.

But I guess the big thing is I think there needs to be some form of facility to do what you do, whether Freddie and Fannie is wrapped into a facility or whatever we do, to guarantee the flow of money. But if there was no facility there, Mr. DeMarco, to do this, is the private sector going to fill that position today?

Mr. DEMARCO. It would take an adjustment period for the private sector to be able to do so. I do believe it could, but it would take an adjustment period.

Mr. MILLER OF CALIFORNIA. Mr. Chairman, thank you for your time and patience.

Chairman NEUGEBAUER. Now, to the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

And thank you as well, Ranking Member Capuano.

And to the witnesses, I thank you.

Do you have in the GSEs any ARMs that have not adjusted?

Mr. WILLIAMS. As I look at our products, sir, it is predominantly—

Mr. GREEN. I can barely hear you.

Mr. WILLIAMS. Our products are predominantly 15-, 20-, and 30-year products, so I would look at it and say in terms of ARMs products, it is a small portion of what we have, and I can probably follow up and give you a number at a future point.

Mr. GREEN. It is a small portion. Would you guess that to be 10 percent or more?

Chairman NEUGEBAUER. Mr. Williams, some of our Members up here are having a hard time hearing. If you would speak louder and a little clearer, please?

Mr. WILLIAMS. Thank you, Mr. Chairman. I hope that is better.

Chairman NEUGEBAUER. Yes, it is.

Mr. WILLIAMS. As I was saying, Congressman, our product set is predominantly 15-, 20-, and 30-year products. We will be happy to follow up with you on percentage.

Mr. GREEN. ARMs—I understand that you are saying fixed rate. Is that what you are saying? I am talking about adjustable-rate mortgages.

Mr. WILLIAMS. Congressman, that was my point, that most of our products are fixed-rate, 15-, 20- and 30-year products.

Mr. GREEN. Okay. Mr. Haldeman, would you respond, please, sir?

Mr. HALDEMAN. Yes. ARMs are a smaller percentage of what we do. But if I understand your question correctly, there still would be some that have not adjusted yet because some of them adjust, for example, in the fifth year. So there would be some that have not yet adjusted, if I understand your question correctly.

Mr. GREEN. And, Mr. DeMarco, permit me to ask you this: I know you have exhibited some frustration in terms of dealing with the servicers, and I appreciate your frustration. Like the Member from California, I, too, have had my level of frustration dealing with the servicers. Notwithstanding all of the laws that we have passed to limit their liability and encourage them to do things, given that we seem to be in a position to write down principal that is not being written down, let us put that aside and just talk about refinancing. What is the situation with refi?

Mr. DEMARCO. Fannie Mae and Freddie Mac together have refinanced about 9 million loans in the last couple of years, and we introduced this Home Affordable Refinance Program in early 2009 and made some major enhancements to it just a month or so ago. And what this program is designed to do is it is designed to help those borrowers who have a Fannie Mae or Freddie Mac-owned mortgage where they are underwater on the mortgage or near underwater, and some of these people were having a hard time being able to refinance. We have enhanced their opportunity to be able to refinance their mortgage. So we expect that this is going to contribute to some additional refinances for people who have previously been unable to do so.

Mr. GREEN. The question has been raised as to why not refinance without being underwater? There are many persons who can pay the current interest rates, but they can't handle the higher rates that they have now. And these are hardworking people who qualified, but they just can't do it. Why would we have to wait until they are underwater to refinance?

Mr. DEMARCO. Oh. Well, I am sorry, Congressman, I didn't mean to leave you with that impression. For those that are not underwater, I think there are really quite ready market mechanisms and lenders willing to refinance them. And certainly, Fannie Mae and Freddie Mac would be pleased to have those mortgages refinanced.

But there is not a market impediment to them being able to exercise that right due to normal functioning of the way our markets work. There was an impediment for borrowers who had a current loan-to-value ratio above 80 percent, and we have, I believe, taken some pretty good steps to remedy that. But those who already have at least 20 percent equity in their home today shouldn't have an impediment to refinancing.

Mr. GREEN. I understand. And I have gone through the refi, and I know that it is not as easy as one might think.

The point that I am making to you is this: If we know that people are currently making payments that are much higher than they would make if they got a refi, why would we not encourage the refi of these loans before they get in trouble and try to get them into a payment that they can afford?

Mr. DEMARCO. Mr. Green, it is a fair question. We are certainly not discouraging it, and I believe we are encouraging it, and the opportunities are there. But if you are seeing, in your community or in the marketplace, impediments that we should be addressing, I would be happy to take a look at that, because certainly, I agree with you.

Mr. GREEN. Mr. DeMarco, if I may, the equity that you called to our attention, that becomes an impediment. Let us assume that they don't have the 20 percent equity, but a refi would allow them to stay in the home. Why don't we consider simply refinancing to get through these loans that are creating problems for us?

Mr. DEMARCO. The HARP program is designed to deal with those. But there have been proposals made, why don't Fannie and Freddie simply take the mortgage; and if it is 6.5 percent, just cross out the 6.5 and put 4.5 or 4 percent, send a letter to the borrower saying, hey, you are now at this lower interest rate? That is not permissible. That would be a violation of several things. But creating a market opportunity for that borrower to be able to refinance is something that we have done and we are trying to encourage, because I would certainly agree with you that that would enhance both the borrower's situation as well as Fannie and Freddie's position as guarantor.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. GREEN. Mr. Chairman, may I just ask one additional liberty?

Chairman NEUGEBAUER. Very quickly.

Mr. GREEN. All right. Thank you.

In doing this—and I understand that you are separated from certain other entities that do these things—but would congressional assistance put you in a position so that you could do it? Would that create a problem for you? If you had something from Congress, would Congress be of assistance in this area? Could Congress be of assistance?

Mr. DEMARCO. I would be happy to go back and think about it. Offhand, I can't think of any particular thing. I think that what we have done in the HARP program is meaningful. Congress could certainly be of assistance in figuring out what the end game is with respect to the conservatorships. That would certainly be helpful.

Mr. GREEN. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. DeMarco, I want to kind of go back to this plan issue. Did you know that for 2011, Fannie Mae is, I think, planning to spend $6 million on advertising, and Freddie Mac is going to spend $600,000?

Mr. DEMARCO. The specific numbers, no, sir. I do have an understanding with them, and they should speak for themselves, that the company's advertising is focused on the immediate question of informing the marketplace, borrowers, and servicers with regard to the changes that have been made in loss mitigation programs, and to encourage the outreach with regard to loss mitigation so that borrowers who are in troubled mortgages know that there is a place to go and there is a path to follow to be able to get assistance.

Chairman NEUGEBAUER. I think my point is one of them has about $2 trillion worth of business on the books, the other one has about $3 trillion worth of business, but a tenfold difference. I think what this hearing is about today is—Mr. Williams says there is really not a written plan. Mr. Haldeman, do you have a written plan on where you are going with Freddie Mac?

Mr. HALDEMAN. We are working with our board and FHFA on a 3-year plan going forward.

Chairman NEUGEBAUER. But we are 3 years into this conservatorship. So I think what I want to say—one of the points of this hearing and one of the things from my personal perspective is I think it is time for the entities to come together with some strategic plan, be able to begin to look at how we are spending the money that we are getting, because we are going to continue to advance. I think the last report that you made, Mr. DeMarco, said that could go up to $230 billion to $300 billion. We are at $170 billion now.

And I think, Mr. DeMarco, you are the boss. These guys work for you. And I know you have more of a hands-off approach on that, and you feel like you have hired capable people. But our job is—the people sitting up here—is to make sure that we begin to minimize to the greatest extent possible the additional money that the taxpayers have to put into these entities. And what I would like to see is for you all to have some comprehensive plans, talking about reducing the footprints, talking about internally, the culture within that, of making sure the employees understand that they are not on somebody else's dime right now. They are on the American taxpayers' dime.

And I would hope that we could see some fruits from that as we move forward, because I hope you were a little embarrassed by the fact that these headlines were not very flattering and don't give a lot of confidence to the American people. And it overshadows maybe some of the better things that you are doing on behalf of the taxpayers. But little things matter. And right now, $10 million, $5 million, $600 million, $600,000, those are real numbers to the American people.

And so, I would hope in the future that we can see some comprehensive strategic planning, and then I think it would be very helpful for the three of you then to come back sometime after the first of the year and lay out some strategic plans so that we all have a vision and make sure that the conservator and the Congress and the conservator and the entities themselves are all on the same page. And quite honestly, right now I am not sure that I have the confidence that we have that connectivity.

Mr. DEMARCO. Thank you for those comments, Mr. Chairman. We will take them to heart, and I will commit to you that you will see a plan that outlines in a more comprehensive way where we are going in the next chapters with conservatorship. But I must hasten to add that while I will be pleased to develop that, make it available not just to the subcommittee, but to the public so the American taxpayer can see that, I will continue to make my request and state my willingness and desire to work with the entire Congress and the Administration to see the final chapter of this written so that we can bring this to an end.

Chairman NEUGEBAUER. Thank you.

Ms. Waters?

Ms. WATERS. Thank you so much, Mr. Chairman.

Earlier, I spoke with Mr. DeMarco about my concern about their having to pay Bank of America to take back the servicing because they were doing such a bad job. I have another issue here. In September, the FHFA Inspector General reported on a $2.87 billion settlement entered into by Bank of America and Freddie Mac. The IG found that Freddie only reviewed troubled loans for bank repurchase claims 2 years after origination, even though an FHFA senior examiner and Freddie Mac's internal auditors noticed that the housing boom loans' foreclosures peaked 3 to 5 years after origination. The IG said this shift in foreclosure patterns among housing boom loans means that most troubled loans are not being reviewed regardless of their potential for viability for repurchase claims. In fact, Freddie Mac has not reviewed for repurchase claims over 300,000 foreclosed loans originated between 2004 and 2007. These loans have an unpaid principal balance exceeding $50 billion.

The basic point that the IG was making was that Freddie could have left money on the table when it settles with banks over loans that weren't originated according to their standards. Further, the IG said that an internal Freddie memo said that one advantage of pushing through the settlement was that it would improve Freddie's business relationship with Bank of America. I don't even know why you all want to continue to do business with Bank of America.

But anyhow, what do you think of this IG report or preserving ongoing business relationships and appropriate criteria by which to gage whether a settlement is appropriate? Before this IG report, the Congress knew very little about the multibillion-dollar settlements entered into between banks and Fannie and Freddie. Can you commit to Congress that you will consistently provide the type of transparency that this IG report provided as you enter into future settlements? Talk to us about this, Mr. Williams.

Mr. DEMARCO. If I may, Congresswoman, it was Freddie Mac. I would be happy to address this since the IG report was addressed to FHFA.

Ms. WATERS. Okay. Please do.

Mr. DEMARCO. The IG report, at the end of the day, had two recommendations to the Agency, each of which the Agency has agreed to carry out, neither of which go to whether there was a—one had to do with an internal sort of policy for our supervision staff that we are addressing. The other had to do with something we already had under way, and the recommendation we agreed to was to continue that work of examining the loan review process.

This gets into a rather technical area to try to explain what was going on with regard to the issues raised by the IG in this report, but if I may have a moment, there has been a lot of misreporting about this, and I would like to clarify a couple of things. And Mr. Haldeman is welcome to add his view.

But FHFA had a senior examiner who raised a question regarding a subset of loans that were on Freddie Mac's books—they were interest-only loans and pay-option ARMs—and whether the sampling strategy that was used by Freddie Mac corporate in doing quality control review of these two types of loans—interest-only loans and pay-option ARMs—was appropriate given the pay adjustment characteristics of these mortgages, and whether these types of mortgages would bear out default characteristics different from other types of mortgages and hence require a different sampling strategy.

This was raised. It was raised. It was something that Mr. Haldeman was aware of when the settlement was done. It was something I was aware of. And it was factored into the settlement. So we identified that issue, signed up a potential cost or risk into it, and it was factored into the settlement.

Since then, this has received a tremendous amount of scrutiny by our Inspector General, by our own team, by Freddie Mac's own team. And I will tell you that 11 months later, almost 12 months later now, after all this scrutiny, if this transaction was put in front of me, with everything I have been able to learn subsequently, I would sign off on this settlement again today.

There was not $1 billion of taxpayer money left on the table. This was a commercially reasonable settlement that was done. The issue that was raised by our own examiner was a legitimate issue. We have continued to look into it. We believe the judgment was appropriately assigned in making the settlement, and I think that while it is a legitimate issue to have raised, we have gone through it, and I am quite satisfied with the transaction that we took here. And it is also something that underwent a substantial amount of review within Freddie Mac by the management team, by the Board of Directors, by an outside firm retained by the company to review this, and a good deal of scrutiny by my own team in making a recommendation to me to sign off on this settlement.

There are always things that can be learned from these processes. The IG has pointed some out, and we are taking the appropriate action based on his recommendations.

Ms. WATERS. Okay. Fine. My question to you is about—

Chairman NEUGEBAUER. I am sorry. I am going to have to ask the gentlewoman to suspend. Her time has expired. We have, I think, a couple more Members who want to ask quick questions, and they have called votes here.

Ms. WATERS. I just want a commitment to provide transparency.

Mr. DEMARCO. Yes, ma'am.

Chairman NEUGEBAUER. Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. I think I will do Ms. Waters a favor and pursue this question. I know you said that the criticism of Freddie's settlement was misreported, but I didn't just read press reports. At the time, I read the IG report. Now, it is not fresh in my mind at this time, but it was very critical. It is not that it was misinterpreted as being critical. I read it. It was critical.

Mr. DEMARCO. No question about it. It was very critical.

Mr. MILLER OF NORTH CAROLINA. It said that you settled the suit too cheaply, and it said that you settled too cheaply, or Freddie settled too cheaply for the wrong reason, which was to improve your business relationship.

Mr. DEMARCO. I am sorry, Mr. Miller. The report did not reach a conclusion.

Mr. MILLER OF NORTH CAROLINA. He quoted emails that left that impression. It was a very critical report. I think Ms. Waters' question is the same as mine. There is pending litigation involving tens of billions of dollars for the private-label security, PLS mortgage-backed securities, the private-label mortgage-backed securities that you all bought. There are other put-back claims. How much conservatorship ultimately costs taxpayers may largely depend on how that litigation is resolved. We have an Inspector General's report that is very critical of how Freddie has settled one set of claims already.

Can the Inspector General review these claims in advance before the settlement is entered into so that someone can look at this and make sure that these are not settled too cheaply and settled too cheaply for the wrong reasons, as the email suggested?

Mr. DEMARCO. Mr. Miller, that is a question for the IG, but I would view it as highly—I would expect the answer is the IG doesn't review things before they are decided or actions are taken. The typical activity of an IG is to review an action after—

Mr. MILLER OF NORTH CAROLINA. Can you get someone detached, someone else to look at it?

Mr. DEMARCO. Yes, Mr. Miller. To that, yes. To that point, I believe that we will be taking a different review process to enhance the additional review and opinion that we get in helping us to assess the settlements.

Mr. MILLER OF NORTH CAROLINA. And who will that be?

Mr. DEMARCO. I don't have that answered yet, Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. I yield back.

Chairman NEUGEBAUER. Mr. Carney is recognized.

Mr. CARNEY. Thank you, Mr. Chairman, and Ranking Member Capuano, for the additional time.

I just want to go back to the last question that I asked. I didn't have enough time to ask the two gentlemen on either end.

Mr. Haldeman, I think it was, said that one of the important matters is, I guess, for us to determine the future of the secondary market. How would you see that? We did have the Treasury come in and present the Administration's White Paper. How would you answer that question?

Mr. HALDEMAN. Yes. When I took the job, they told me I couldn't lobby or advocate, and I have taken that responsibility pretty seriously. And so, I really don't want to put on the table my personal view.

Mr. CARNEY. Could you frame the issue for us a little bit, like Mr. DeMarco did? He didn't really answer the question either, I don't think.

Mr. HALDEMAN. The issue for me is to what extent, if any, should the government play a role in the housing finance market? And I am sort of a free market kind of person, but I do think there could be a legitimate role for the government as some sort of ultimate guarantor for which a Freddie or Frannie or a participant in the industry could pay an insurance premium to get that kind of ultimate guarantee. The benefit of that ultimate guarantee, as Congressman Miller said on this side, would be that I think you would have a greater chance to get foreign capital coming into our country and coming into our mortgage market if we had that ultimate guarantee. But I think it is critically important that the institutions have to pay an insurance premium to get that guarantee.

Mr. CARNEY. If there wasn't a guarantee, do you think we would have a 30-year fixed-rate mortgage product?

Mr. HALDEMAN. I worry about that. I don't think it would be nearly so available to as many people as it is today.

Mr. CARNEY. Thank you.

Mr. Williams?

Mr. WILLIAMS. Yes, Congressman. I think it is much like Mr. Haldeman noted. We are not in a position to actually advocate a specific solution. I think, first of all, it is very important that we have a responsible transition to reform to make sure that we do not destabilize the housing market as we go through it.

I think, to your question, the key things the policymakers will need to evaluate are how do you support a 30-year fixed-rate mortgage in this market? How do you provide deep liquidity that we have in the mortgage market today? How do you make sure that low-, moderate-, and middle-income Americans have the same access to mortgage financing that upper-income Americans do? And how do you support balanced housing policy, meaning affordable rental housing as well as homeownership? And I think those are really the four to five key questions that policymakers need to decide as they look at the solutions that are on the table.

Mr. CARNEY. Thank you very much.

Mr. DeMarco, would you like to take another shot at it?

Mr. DEMARCO. I think I am done. Thank you.

Mr. CARNEY. Thanks very much.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentlemen, and I thank the panel. This has been a good hearing.

The Chair notes that some Members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

Again, thank you for being here, and this hearing is adjourned.

[Whereupon, at 4:48 p.m., the hearing was adjourned.]

A P P E N D I X

December 1, 2011

Statement of

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Before the House Financial Services
Subcommittee on Oversight and Investigations

December 1, 2011

Embargoed until delivery – 2PM EST

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Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee, I am pleased to be invited here today to discuss the Federal Housing Finance Agency's (FHFA) oversight of our regulated entities, Fannie Mae, and Freddie Mac, and the Federal Home Loan Banks (FHLBanks).

The main focus of my testimony will be on key topics related to FHFA's role as the Enterprises' conservator and regulator. I will update you on the financial condition of the Enterprises in conservatorship. Then I will review FHFA's approach to preparing for increased private market participation in housing finance and describe significant activities that FHFA has undertaken during the past year to further our conservatorship goals. Finally, I will report on the condition of the Federal Home Loan Banks (FHLBanks).

INTRODUCTION

I think it may be useful for me to begin with a brief overview of what it means for Fannie Mae and Freddie Mac to be in conservatorship and what legal responsibilities FHFA operates under as conservator.

The determination to place Fannie Mae and Freddie Mac, or the Enterprises as I will refer to them, in conservatorship was made as the financial crisis of the autumn of 2008 was taking shape. At that time, the private mortgage securitization market had already vanished, house prices were declining rapidly, and the Enterprises' eroding financial condition and inability to access capital markets threatened a collapse of the country's housing finance system. FHFA, with financial support from and substantial consultation with the Treasury Department, placed the Enterprises into conservatorship on September 6, 2008.

Conservatorship, along with financial support from Treasury, permitted the government to take greater management control of the Enterprises and give investors in the Enterprises' debt and mortgage-backed securities confidence that the Enterprises would have the financial capacity to honor their financial obligations. The alternative, receivership, was rejected at the time, in part because such action would have placed greater limits on the timing and approach for the Congress and the incoming Administration to analyze and respond to the problems confronted by the Enterprises and the country's housing finance system. At the time, Treasury Secretary Paulson referred to conservatorship as a "time-out" to allow markets to continue to function while policymakers considered and acted on a permanent resolution. More than three years later, we are still waiting for that resolution.

As conservator, FHFA stands in the place of each company's shareholders, boards, and management, with the responsibility to "preserve and conserve the assets and property" of the companies. The statute also charges the conservator with the responsibility to place the companies in "a sound and solvent condition." At the time the conservatorships were established, FHFA was less than six weeks old as an agency, and had fewer than 400 employees. To accomplish these responsibilities, FHFA made the practical judgment that the most effective means to carry out these functions was to replace the boards and senior management, and then delegate to new boards and management day-to-day responsibility. Since then, reconstituted boards of directors have worked with FHFA to define the operational goals in conservatorship and to support FHFA in its work to guide and oversee management in fulfilling these goals. Likewise, the new CEOs and executive officers have worked with FHFA to these same ends.

As conservator and regulator, FHFA has three principal mandates set forth in law that direct and motivate FHFA's activities and decisions involving the Enterprises.

First, as I have noted, FHFA has a statutory responsibility as conservator of the Enterprises to "take such action as may be: necessary to put the regulated entity in a sound and solvent condition; and appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." As FHFA has stated on numerous occasions, with taxpayers providing the capital supporting the Enterprises' operations, this "preserve and conserve" mandate directs us to minimize losses on behalf of taxpayers.

Second, even though the Enterprises are in conservatorship, without further statutory changes they have the same mission and obligations as they did prior to being placed into conservatorship. FHFA has a statutory responsibility to ensure the Enterprises "operate in a safe and sound manner" and that "the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets." We typically refer to this requirement as "supporting a stable and liquid mortgage market."

Third, under the Emergency Economic Stabilization Act of 2008, FHFA has a statutory responsibility to "implement a plan that seeks to maximize assistance for homeowners and use its authority to encourage the servicers of the underlying mortgages, and considering net present value to the taxpayer to take advantage of ... available programs to minimize foreclosures."

These three mandates form the basis for how FHFA views its responsibilities as conservator of the Enterprises. In view of the critical and substantial resource requirements of conserving assets and restoring financial health, combined with a recognition that the Enterprises operate today only with the support of taxpayers, FHFA has focused the Enterprises on their existing core business, including minimizing credit losses. This means that FHFA is not permitting the Enterprises to offer new products or enter new lines of business. Their operations are focused on their core business activities and loss mitigation. This type of limitation on new business activities is consistent with the standard regulatory approach for addressing companies that are financially troubled. And it is even more pertinent for the Enterprises given their uncertain future and reliance on taxpayer funds.

As a final introductory comment, the Enterprises' equity holders retain an economic claim on the companies but that claim is subordinate to taxpayer claims. As a practical matter, taxpayers are not likely to be repaid in full, so Enterprise stock lower in priority is not likely to have any value. Prior to conservatorship, much executive compensation, and indeed some staff compensation, was in the form of company stock, so the value of such compensation has essentially vanished. Finally, the company leaders most responsible for the business decisions that led to the Enterprises ending up in conservatorship had either left the company before conservatorship, at the time of the conservatorship, or shortly thereafter. The boards of directors were also replaced.

Thus, the leadership working at the Enterprises today is not the same as those chiefly responsible for the business decisions that led to conservatorship and that continue to drive the financial results. Moreover, they are there to further the goals of conservatorship and ensure the country has a functioning secondary mortgage market while lawmakers deliberate the future structure for housing finance. The boards, executives, and staff have been and are working with FHFA in its efforts to minimize taxpayer losses, provide stability and liquidity to the market, and maximize assistance to homeowners to avoid foreclosure. They do so knowing that the long-term outlook is that neither Enterprise will continue to exist, at least in its current form, in the future.

THIRD QUARTER 2011 FINANCIAL PERFORMANCE AND CONDITION OF THE ENTERPRISES

Providing Liquidity to the Market
Since conservatorship, Fannie Mae and Freddie Mac have been the largest issuers of mortgage-related securities in the secondary market, guaranteeing roughly three-quarters of single-family mortgage-backed securities (MBS) issued.

Capital
Combined Treasury support as a result of financial performance in the third quarter of 2011 was \$13.8 billion. The Single-Family Credit Guarantee segment continued to drive losses as credit-related expenses remained high. Additionally, the Investments segment results turned negative in the third quarter of 2011, due primarily to a significant decrease in interest rates and a widening of credit spreads on non-agency securities. This was partially offset by a two percent increase in net interest income. In addition, \$4.1 billion of the \$13.8 billion draw is to pay interest to the Treasury on previous draws.

Credit Quality of New Single-Family Book of Business

The quality of new business remained high in the third quarter of 2011. The percentage of new business volume with FICO scores below 620 remained below two percent and the average loan-to-value ratio (LTV) for new business was roughly 70 percent for both Enterprises, reflecting in part the high degree of refinance activity.

Loss Mitigation Activity
Since conservatorship, the Enterprises have completed two million foreclosure prevention transactions, of which one million have been permanent loan modifications and another 960,000 have been other forms of assistance that have allowed homeowners to retain homeownership. Significantly, loans modified since late 2009 continue to perform substantially better than loans modified before then. Separately, another 270,000 transactions have resulted in households leaving their homes but without going through foreclosure. Most of these actions have been short sales.

Projections of Financial Performance
To provide additional information on future Enterprise financial performance, beginning in October 2010, FHFA published financial projections of the Enterprises' financial performance across different house price scenarios. Those initial projections were updated a few weeks ago, and the projected combined cumulative Treasury draws (which includes 10 percent dividend payments to Treasury) through the end of 2014 range between $220 and $311 billion. In general, these financial projections show that under less stressful house price scenarios, the cumulative draws from Treasury would stabilize in the next year or so, with the Enterprises earning enough income to cover dividend payments to Treasury.

FHFA INITIATIVES

Recent Congressional efforts to begin serious discussion of a gradual transition to greater private capital participation in housing finance and greater distribution of risk to participants other than the government are important. FHFA has already begun taking actions in support of these objectives. Since conservatorship, underwriting standards have been strengthened and several price increases have been initiated to better align pricing with risk, and we will continue to gradually increase guarantee fee pricing to better reflect that which would be anticipated in a private, competitive market. Also, we will soon be exploring more private sector risk-sharing opportunities. Such steps are consistent with actions already taken in conservatorship and we are examining further options along these lines in support of a stable transition over time.

While debate over the future of the housing finance system progresses, FHFA has and will continue to focus on meeting the goals of the conservatorships through a series of initiatives aimed at retaining value in the business operations of Fannie Mae and Freddie Mac, maintaining their support for the housing market, and mitigating losses to taxpayers.

Recovering Certain Losses
Consistent with FHFA's mission to preserve and conserve the Enterprises' assets on behalf of taxpayers, this year we filed lawsuits against 18 financial institutions to recover certain losses suffered by Freddie Mac and Fannie Mae that we believe are the legal responsibility of others. We believe that the loans in these private-label mortgage backed securities (PLMBS) had different and more risky characteristics than the descriptions contained in the marketing and sales materials provided to the Enterprises for those securities.

Real Estate-Owned Request for Information
In August, FHFA, in conjunction with the Department of Housing and Urban Development (HUD) and the Treasury Department, issued a Request for Information (RFI) seeking input on new options for selling single-family real estate owned (REO) held by Freddie Mac, Fannie Mae, and FHA. We are looking for approaches to reduce the REO portfolios of the Enterprises in a cost-effective manner, as well as to reduce the losses on individual distressed properties. We are seeking alternatives that will maximize value to taxpayers and increase private investments in the housing market, including approaches that support rental and affordable housing needs. We are not trying to develop a single, national program for REO disposition. We are most interested in proposals tailored to the needs and economic conditions of local communities. Based on the input of RFI responders we understand the magnitude of the task at hand. FHFA is proceeding prudently, but with a sense of urgency, to lay the groundwork for the development of good initial pilot transactions.

Uniform Mortgage Data Program
In May 2010, FHFA directed the Enterprises to develop uniform standards for data reporting on mortgage loans and appraisals. This Uniform Mortgage Data Program is designed to improve the consistency, quality, and uniformity of data that are collected at the front end of the mortgage process. By identifying potential defects at the front end of the mortgage process, the Enterprises will improve the quality of mortgage purchases, which should reduce repurchase risk for originators. This initiative will be phased in over the rest of this year and next.

Loan Level Disclosures
Earlier this year, I announced that FHFA is considering ways to enhance loan-level disclosures on Enterprise MBS, both at the time of origination and throughout a security's life. I believe that improving Enterprise MBS disclosures over time will help establish consistency and quality of such data. Moreover, it will contribute to an environment in which private capital has the information needed to efficiently measure and price mortgage credit risk, thereby facilitating the shifting of this risk away from the government and back into the private sector.

Servicing Alignment Initiative
Our Servicing Alignment Initiative (SAI), which we announced last April, responded to concerns about how delinquent mortgages were being serviced. SAI meets the conservatorship objectives of minimizing losses and assisting homeowners with alternatives to foreclosure. FHFA instructed Freddie Mac and Fannie Mae to establish a single, consistent set of procedures for servicing Enterprise mortgages, from the time they first become delinquent. The updated framework, which went into effect on October 1, prioritizes early borrower outreach, streamlines documentation requirements, simplifies mortgage modification terms and requirements, and establishes a schedule of performance-based incentive payments and penalties aimed at ensuring that servicers review foreclosure alternatives in a timely manner. We are also working to align and improve Fannie Mae and Freddie Mac policies regarding unemployment forbearance to reflect the realities of the current job market.

Foreclosure Attorney Networks
In October, as an adjunct to SAI, FHFA directed Freddie Mac and Fannie Mae to change the way foreclosure attorneys are selected in an effort to produce uniform foreclosure processing standards to assist servicers, homeowners, and lenders. Under current practice, in certain states each Enterprise designates law firms eligible under the Enterprise's criteria to undertake foreclosure work and mortgage servicers then select and work with these firms. FHFA instructed Fannie Mae and Freddie Mac to transition away from current foreclosure attorney network programs and move to a system where mortgage servicers select qualified law firms that meet certain minimum, uniform criteria. These efforts will lead to greater transparency and benefit delinquent borrowers who become subject to the foreclosure process. FHFA is now working with other regulators and industry stakeholders to create uniform qualifications and oversight of foreclosure attorneys.

I am hopeful that these new directives, which create uniform procedures for servicing delinquent loans and processing foreclosures, will gain acceptance beyond the Enterprises and become "best practices" throughout the industry.

Servicing Compensation Initiative
The last initiative I will discuss today, the Joint Servicing Compensation Initiative, made up of FHFA, Fannie Mae, Freddie Mac, and HUD, is one of the initiatives we have directed the Enterprises to undertake designed to broadly consider changes that will lead to improvements in the operations of the Enterprises and the overall mortgage market. The goals of the Joint Initiative are to improve service for borrowers, reduce financial risk to servicers, and provide flexibility for guarantors to better manage non-performing loans, while promoting continued liquidity in the To Be Announced mortgage securities market. In addition to those specific goals, the Joint Initiative seeks broader options for mortgage servicing compensation that lead to enhanced competition in mortgage servicing and origination, and that can be replicated across multiple future states of housing finance.

At the end of September, the Joint Initiative released a discussion document seeking comments on two alternative servicing compensation structures for servicing single-family mortgages. One proposal would establish a reserve account within the current servicing compensation structure. The other proposal would create a new fee-for-service compensation structure that would replace today's fixed fee approach. We requested that comments be submitted by late December, after which they will be considered and evaluated by the Joint Initiative.

Home Affordable Refinance Program
On October 24, 2011, we announced a series of changes to the Home Affordable Refinance Program (HARP). These changes should make HARP refinances accessible to more households with mortgages owned or guaranteed by the Enterprises. Changes to the program include: eliminating or reducing certain risk-based fees; removing the current 125 percent LTV ceiling; waiving certain representations and warranties; eliminating the need for certain property appraisals; improving the process for carrying over mortgage insurance coverage; and extending the end date for HARP to December 31, 2013.

Importantly, such refinances should also reduce the Enterprises' credit risk, and thus losses to taxpayers. HARP, even with the new enhancements, is not a mass refinancing program; it was designed to help a defined set of borrowers with Fannie Mae and Freddie Mac mortgages that are underwater or nearly underwater.

It is impossible to project accurately how many homeowners will benefit from the enhancements to HARP because of unknowable factors, such as future interest rate fluctuations and the desire of borrowers to enter into a refinance transaction. Since HARP was introduced in 2009, more than 900,000 homeowners have refinanced through the HARP program. We believe the announced changes may double the number of homeowners helped through HARP.
Since industry participation in HARP is not mandatory, implementation schedules will vary as individual lenders, mortgage insurers and other market participants modify their processes.

Separately, the Enterprises have refinanced approximately nine million mortgages since 2009.

EXECUTIVE COMPENSATION

Now I will turn my attention briefly to the subject of executive compensation for Fannie Mae and Freddie Mac executives, a topic that has attracted much attention recently from the Congress, the press and the public. The House Financial Services Committee has already passed legislation that would put Enterprise executives' salaries in line with those at the Federal Financial Regulatory Agencies and put Enterprise employees on the Federal government's GS-pay scale. I testified before the Committee last year as to why I do not think that would be a good idea.

At the outset, let me state that the best way to address concerns with executive compensation is action by Congress to restructure the nation's housing finance system and dissolve the conservatorships. In the absence of that resolution, FHFA will continue to evaluate the appropriateness of executive compensation at the Enterprises given their ongoing activities.

As conservator, I need to ensure that the companies have people with the skills needed to manage the credit and interest rate risks of $5 trillion worth of mortgage assets and $1 trillion of annual new business that the American taxpayer is supporting. I have concluded that it would be irresponsible of me to risk this enormous contingent taxpayer liability with a rapid turnover of management and staff, replaced with people lacking the institutional, technical, operational, and risk management knowledge requisite to the running of corporations with thousands of employees and more than $2 trillion in financial obligations each. That conclusion is further buttressed by the realization that, from an Enterprise executive's or staff's point of view, continued employment at an Enterprise risks substantial job and career uncertainty. The public scrutiny and criticism is often harsh, and almost everyone expects the Enterprises to cease to exist, at least in their current form, in the future. At the same time, the taxpayer is backing Enterprise financial commitments that have 30-year lives, and we will need expert management of those guarantees for years to come. Given the amount of money at risk here, small mistakes can easily be amplified to losses far greater than the compensation paid to Enterprise executives.

In short, as Congress considers executive compensation at the Enterprises, the basic fact is that despite the large amounts of government support provided to the Enterprises they remain private companies with uncertain futures, not government agencies. They employ thousands of people. We cannot maintain operational effectiveness while suddenly treating them as ongoing government agencies – something they are not. Major changes to compensation, for executives or staff, cannot be done safely and soundly in a short period of time and attempting to do so would pose substantial risk to the mortgage market and a greater risk of loss to taxpayers.

FEDERAL HOME LOAN BANK SUPERVISION

While much attention remains focused on the Enterprises, we continue to fulfill FHFA's statutory mandate to oversee the FHLBanks.

Third Quarter 2011 Performance and Condition of the FHLBanks
Total assets of the FHLBanks declined by $31 billion in the third quarter of 2011 and by $100 billion during the first three quarters of the year. From a peak in 2008 of $1.4 trillion, combined assets have nearly halved to $778 billion at September 30, 2011. Advances (collateralized loans to members) are driving the decline, as balances have fallen from a 2008 high of $1.0 trillion to just $415 billion, or about the level of advances last seen in the first quarter of 2000. More recently, advances declined $13 billion in the third quarter of 2011, and $63 billion year-to-date through September. The decline, in part, reflects high levels of liquidity at member banks with a consequent decline in the demand for advances. As of September 30, 2011, advances comprised 53 percent of assets, non-MBS investments were 19 percent, agency and federal MBS were 15 percent, mortgage loans were seven percent, and PLMBS were four percent. Though PLMBS assets are relatively small, their distribution among FHLBanks is uneven, leading to pockets of concentration at some FHLBanks.

The FHLBanks principally fund themselves by issuing consolidated obligations in the capital markets. Market access remains excellent, and spreads to comparable Treasury securities are narrow. Total regulatory capital at September 30, 2011, was $55.4 billion or 6.5 percent of assets.

Net income is declining at the FHLBanks as fewer earning assets generate less net interest income, and as lower interest rates reduce the return on the FHLBanks' invested capital. Offsetting these factors is a decline in credit-related other-than-temporary impairment (OTTI) on PLMBS, though this remains a potentially volatile item, with the possibility to increase should collateral performance or the broader housing market deteriorate further. On a year-to-date basis through September 30, 2011, all FHLBanks were profitable, though some did have quarterly net losses. Combined net income was $475 million for the third quarter of 2011 and $1.1 billion year-to-date. This is down from comparable periods in 2010, when net income was $680 million in the third quarter and $1.3 billion year-to-date through September 2010. A significant factor in the lower quarterly net income was mark-to-market losses on derivatives. These derivatives are part of a prudent risk-management strategy, and the losses should reverse as the derivatives approach maturity. Credit OTTI charges were lower in 2011 relative to 2010—credit OTTI totaled $775 million in the first three quarters of 2011, down from $905 million for the same period in 2011. To date, the FHLBanks have reported a total of $4.4 billion in credit-OTTI charges on PLMBS, which amounts to about five percent of the peak balance of this asset category. PLMBS remain a supervisory concern.

Resolution Funding Corporation
In 2011, the FHLBanks satisfied their collective obligation to make payments related to the Resolution Funding Corporation, a funding mechanism used during the savings and loan crisis. Related to this accomplishment, the FHLBanks collectively entered into a Joint Capital Enhancement Agreement, which requires each FHLBank to allocate 20 percent of its net income to a restricted retained earnings account, from which it cannot pay dividends and which serves to enhance the joint-and-several liability features inherent in FHLBank consolidated obligations.

Federal Home Loan Bank of Chicago
On September 31, 2011, FHFA approved the capital plan of the FHLBank of Chicago, a requirement of the 2007 Consent Order with that FHLBank. Implementation is expected on January 1, 2012. Until then, the FHLBank of Chicago remains the only FHLBank still operating under a pre-Gramm Leach Bliley Act capital structure.

Federal Home Loan Bank of Seattle
The FHLBank of Seattle faces a declining advance franchise, a problematic PLMBS portfolio, and insufficient retained earnings. Although the FHLBank has capital equal to 6.8 percent of assets, FHFA has exercised its discretion to classify the FHLBank as "undercapitalized." The FHLBank of Seattle has operated under a Consent Order to resolve outstanding capital and supervisory matters since October 2010.

Voluntary Mergers
Earlier this week, FHFA published in the *Federal Register* a final rule outlining the regulatory process for FHLBanks to undertake voluntary mergers. This rule fulfills a mandate in the Housing and Economic Recovery Act of 2008 to "promulgate regulations establishing the condition and procedures for the consideration and approval of any voluntary merger" authorized by the Act.

Mr. Chairman, thank you again for this opportunity. I look forward to responding to the Subcommittee's questions.

Testimony of Charles E. Haldeman
Freddie Mac CEO
Hearing of the Oversight Subcommittee
House Financial Services Committee
December 1, 2011

Chairman Neugebauer, Ranking Member Capuano, and Members of this Subcommittee: thank you for inviting me to speak with you today. I am Ed Haldeman, Chief Executive Officer of Freddie Mac. I joined Freddie Mac in August 2009, almost a year after the company was placed into conservatorship by the Federal Housing Finance Agency (FHFA). I joined Freddie Mac from Putnam Investments, where I served as President and CEO for several years beginning in 2003. I have been a financial services professional for more than 35 years.

I appreciate the importance of this hearing and I thank you for inviting me to attend. This hearing covers FHFA's oversight responsibility, as both our regulator and conservator. With that in mind, I want to discuss with you from a management standpoint how we are running the company under conservatorship.

As we address the important issue of oversight of Freddie Mac and Fannie Mae, I want to make something very clear: the Freddie Mac of today is a new company with a new team and new focus. Let me provide some examples.

- ***New management team***: The management team running Freddie Mac today is not the team we had pre-conservatorship. I am the third CEO since conservatorship and 14 of our 18 management committee executives have turned over since my tenure began two years ago.

- ***New emphasis on strong credit standards:*** We are placing renewed emphasis on safety and soundness and responsible lending, putting on the books higher-quality loans, with lower loan-to-value ratios and higher credit scores. Our focus is on helping borrowers own homes that they can afford and keep.

- ***New approach to expenses:*** We take seriously our obligation to use taxpayer support efficiently and effectively, and to responsibly reduce spending wherever possible. As of September 30, 2011, we reduced annual G&A expenses by more than $120 million from 2009 levels. We also project that by the end of this year we will have reduced annual G&A by more than $150 million below 2009 levels. While we recognize members of this Subcommittee may have questions about particular expenditures, our overall efforts to reduce expenses and improve the efficiency of our operations are producing real results.

- ***New approach to the retained portfolio:*** Consistent with the terms of Treasury financial support, we have reduced the size of our retained portfolio every year in conservatorship. Its size today is almost 25 percent below its peak, and we are working with FHFA to identify ways to prudently accelerate the rate of contraction.

- ***New approach to executive salaries:*** We reduced overall compensation of the top ten percent of our new senior executive team by 40 percent. We have done this in part by eliminating some senior executive positions, filling others at lower salaries, and asking some executives to perform tasks representing multiple job responsibilities.

- ***New focus on helping families avoid foreclosure:*** We helped 575,000 financially stressed families avoid foreclosure since 2009, about 80 percent of whom have been able to stay in their homes, and we are working every day to help thousands more at-risk borrowers. At the same time, we are implementing an FHFA directive to substantially improve how servicers work with delinquent borrowers.

- ***New emphasis on leadership:*** We have developed a new culture at Freddie Mac, one that emphasizes responsible and accountable leadership. This is a particular priority of mine and I would be happy to discuss it further with the Subcommittee.

- ***All of this has contributed to significantly improved results in the quality of our new book of business:*** Our pre-conservatorship business has generated the overwhelming majority of our credit expenses. In contrast, our book of business under conservatorship -- mortgages we've purchased since 2009 -- have generated guarantee income well above credit expenses – $779 million during 2010 and $805 million through the first nine months of 2011. Serious delinquency rates, which currently exceed 10 percent for mortgages purchased during 2006-07, are about 0.25 percent for mortgages purchased from 2009-11. And even including our pre-conservatorship book of business, Freddie Mac's single-family serious delinquency rate is less than half that of the overall market.

  We have achieved this change while providing more than $1.1 trillion in critically needed mortgage liquidity since 2009. We financed homeownership and rental housing for more than 5.8 million American families since 2009 – including 1.25 million so far in 2011. We also enabled nearly 4.1 million homeowners to refinance into lower cost mortgages, saving them in aggregate about $10 billion in interest costs during the first year after refinancing.

Clearly, we could not have achieved these results without the support we receive from FHFA, Treasury and the American taxpayer. But I want to make clear that our new team uses this support to provide liquidity, help avoid foreclosures and aid in our nation's housing and economic recovery. In other words, the ultimate beneficiaries of the support Freddie Mac has received are taxpayers, homeowners, renters, and the housing finance system we serve.

Freddie Mac is run by a new management team

The management team running Freddie Mac today is not the team we had before conservatorship. We have a new CEO, chief financial officer, head of our single family business unit, head of our multifamily business unit, head of our investments business unit, interim general counsel, chief risk officer, chief compliance officer, head of human resources, and chief information officer. All of these leaders are either new to Freddie Mac or in new roles since conservatorship.[1] In fact, 14 of our 18 management committee executives have turned over since my tenure began two years ago. Our top management team also reflects Freddie Mac's commitment to diversity. We also have many new non-executive employees who have joined Freddie Mac since being placed in conservatorship.

I want to highlight for the Subcommittee the dedication and work of our employees under conservatorship. Without any assurance of a long-term career with the company, they are putting their considerable skills to work to help stabilize the housing market, continue to make mortgage credit available when no other sources of liquidity were available, reduce taxpayer losses, and, very importantly, help at-risk families avoid foreclosure. They remained focused on the company's vital housing mission and have done everything that has been asked of them. They have kept the machinery of the company running smoothly. For these and many other reasons, I am proud of the work our employees are doing for our nation.

Freddie Mac's new book of business generates positive revenue

As we have helped fulfill the nation's mortgage liquidity needs, we also have been building a strong foundation of responsible lending practices in order to produce better quality loans. Our goal is to create sustainable homeownership opportunities for America's families, ensure fewer unexpected costs for our lenders, drive better loan performance, and minimize Freddie Mac's dependence on taxpayer dollars. We believe these actions are essential to placing the housing finance system on a better foundation of responsible lending practices.

The result is that mortgages we have purchased since 2009 are of higher credit quality overall, with lower loan-to-value ratios and higher borrower credit scores, than the mortgages we guaranteed prior to 2009. Single-family serious delinquency rates,[2] which as of September 30, 2011 are at 10.54 percent for the 2006 book of business and 11.21

[1] Some of this turnover is the result of voluntary departures of some executives, underscoring the challenges we face in attracting and retaining qualified and experienced executives and employees while under conservatorship.

[2] Defined as three monthly payments or more past due.

percent for the 2007 book of business, are only 0.41, 0.17 and 0.03 percent for the 2009, 2010, and 2011 books of business, respectively.[3]

While we continue to face losses from the pre-conservatorship book of business, our guarantee revenues on mortgages purchased from 2009-2011 exceed our credit-related expenses. During 2010, guarantee income from mortgages we purchased during 2009-2010 exceeded credit-related expenses on those loans by $779 million. Through the first nine months of 2011, guarantee income from mortgages in our 2009-2011 book of business has exceeded credit-related expenses on those loans by $805 million.

Moreover, our overall book, including our pre-conservatorship assets, is of a significantly higher quality than the market at large and far better than the subprime market. Freddie Mac's serious delinquency rate on all single-family mortgages as of September 30, 2011 is 3.51 percent. In contrast, the primary market's overall serious delinquency rate on first lien single-family mortgages was 7.89 percent – and about 13.8 percent when loans owned or guaranteed by Freddie Mac and Fannie Mae are removed from the calculation. The subprime market's serious delinquency rate, in comparison, was over 25 percent.[4]

In an appendix to this statement, we provide charts and tables further illustrating the differences between Freddie Mac's pre-conservatorship book of business and the mortgages we have purchased under conservatorship.

Freddie Mac has substantially cut overall general and administrative spending

I understand that Freddie Mac's expenditures under conservatorship are a matter of interest to this Subcommittee. Freddie Mac is mindful of the taxpayer support we have received, and we take very seriously our obligation to use this support prudently and to continue challenging ourselves to spend more efficiently. Accordingly, we have focused on cutting expenses wherever possible to reduce administrative costs without compromising our ability to manage the company safely and soundly.

As of September 30, 2011, we reduced annual G&A expenses by more than $120 million from 2009 levels. We also project that by the end of this year, we will have reduced our overall annual G&A by more than $150 million since 2009. Much of these savings have come from reducing the number of employees through restructuring and not filling some vacant positions. In 2011 alone, we expect to reduce the number of employees by 9 percent. We also have reduced and consolidated executive positions where appropriate. For example, we no longer have a chief operating officer, and we combined the chief credit officer and chief enterprise risk officer functions.

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[3] Calculated based on the loans remaining in the single-family guarantee portfolio as of September 30, 2011.

[4] Overall market and subprime data as of September 30, 2011 from the National Delinquency Survey of the Mortgage Bankers Association.

The overall trend is clear: we have substantially reduced general and administrative expenses and will continue striving to do so.

Freddie Mac is helping fulfill the nation's mortgage liquidity needs

One of the principal objectives of the conservatorship has been to help ensure sufficient liquidity to fulfill the nation's housing needs. Freddie Mac supports the policy goal of attracting private capital back to the market and reducing government's role in the mortgage market over time. However, until the private mortgage market recovers, we are tasked with helping ensure that mortgage financing remains available to aid in housing market and economic recovery. As a result, Freddie Mac and Fannie Mae together continue to provide roughly two-thirds of mortgage liquidity today.

Since the start of 2009 we have provided more than $1.1 trillion in liquidity and financed homeownership and rental housing for nearly 5.8 million families. During the first nine months of 2011 alone, we purchased more than $250 billion in mortgages, financing homeownership for 1 million families and rental housing for more than 250,000 families.

We also have been tasked with helping financially strapped families reduce their mortgage costs through refinancing their mortgages. Since the beginning of 2009 we have enabled nearly 4.1 million families to take advantage of record low interest rates and refinance into lower-cost home mortgages. Savings to borrowers from refinancing are significant: the typical borrower refinancing today saves about $2,500 per year in interest costs on a $200,000 mortgage, and we estimate that in the aggregate, borrowers whose mortgages we refinanced are saving about $10 billion in interest costs during the first year after refinancing. Recently announced changes to the Home Affordable Refinance Program will enable us to help even more borrowers – including many with underwater loans – refinance into lower cost loans.

Freddie Mac is helping hundreds of thousands of families avoid foreclosure

At this critical time, foreclosure prevention remains one of Freddie Mac's top priorities. Since the housing crisis began, we have helped nearly 575,000 struggling borrowers avoid foreclosure. Of these borrowers, approximately eight out of 10 were able to stay in their homes.

Freddie Mac takes our duty to prevent avoidable foreclosures very seriously – and we have long been recognized as an industry leader in identifying and addressing delinquencies before they become foreclosures. In addition to helping borrowers through our loss mitigation tools, we have worked closely for years with national nonprofits and housing counselors to educate borrowers about foreclosure prevention and mortgage fraud. We support these efforts through a number of online resources, including an award-winning financial literacy curriculum.

Our recent efforts to help as many families as possible include:

- Paying servicers more to find a non-foreclosure solution than to foreclose.
- Participating in hundreds of foreclosure prevention workshops nationwide.
- Opening Borrower Help Centers to provide free counseling for distressed borrowers in cities especially hard hit by the foreclosure crisis.
- Partnering with nonprofits to hold direct-to-homeowner auctions of Freddie Mac-owned properties in cities across the country.

Under a directive from FHFA, we are also engaged in a Servicing Alignment Initiative (SAI) with Fannie Mae. This initiative, announced last April, responded to concerns about how delinquent mortgages were being serviced. SAI meets the conservatorship objective of assisting homeowners with alternatives to foreclosure. FHFA instructed Freddie Mac and Fannie Mae to establish a single, consistent set of procedures for servicing delinquent mortgages. The updated framework, which went into effect on October 1, prioritizes early borrower outreach, streamlines documentation requirements, simplifies mortgage modification terms and requirements, and establishes a schedule of performance-based incentive payments and penalties aimed at ensuring that servicers review foreclosure alternatives in a timely manner.

Freddie Mac uses taxpayer funds to support the nation, not to enrich private shareholders

I readily acknowledge that Freddie Mac has been able to achieve these results only because of the substantial and continued support we receive from the Treasury. Thus, as we address our expenses, it is fair for taxpayers to ask what we do with their support.

The new management team at Freddie Mac uses taxpayer support to keep the mortgage market stable, liquid and affordable and to help families avoid foreclosure. None of these funds have been used to benefit our private shareholders. In other words, the ultimate beneficiaries of the support we receive are homeowners, renters, and the housing finance system we serve.

Under the terms of our Preferred Stock Purchase Agreement with Treasury, Freddie Mac is paying dividends each quarter, returning to taxpayers $14.9 billion through September 30, 2011.

Prospects for the company's solvency

This Subcommittee has asked for our views on prospects for the company's solvency. Freddie Mac's future need for additional capital support from Treasury depends upon a number of variables.

FHFA recently reported to Congress projections about future GSE capital draws, based on assumptions about operations, loan performance, macroeconomic and financial market conditions and house prices. Under two out of three economic and housing market scenarios, FHFA projects that Freddie Mac would require no additional draws from Treasury after 2011 and would draw a cumulative $75-76 billion in taxpayer funds through 2014. When dividend payments are subtracted from the gross cumulative amount of our Treasury draws, Freddie Mac's projected cumulative net draw through 2014 under the two scenarios would drop to $36 billion. However, under a third scenario, which assumes a "double-dip" recession and further declines in house prices, FHFA estimates Freddie Mac through 2014 would require a cumulative draw of $92 billion, or a net draw of $49 billion when dividend payments are subtracted.[5]

There is significant uncertainty about our long-term financial sustainability. Depending on future economic and housing market conditions, we may request additional draws under our agreement with Treasury in future periods. Moreover, our dividend obligation to Treasury will be a driving force behind future draw requests. Although we may experience period-to-period variability in earnings and comprehensive income, it is unlikely that we will regularly generate net income or comprehensive income in excess of the annual dividends that we must pay to Treasury over the long term.

To understand why this is so, it is important to recognize the context of the financial support we receive from Treasury, especially as it relates to the prospects for the company's solvency.

Federal support of Freddie Mac often is characterized as a bailout, and much of the public anger directed toward the company appears rooted in a belief that our equity shareholders and former executives are benefiting from taxpayer funds. In fact, the owners of Freddie Mac – the common and preferred shareholders – were not bailed out. On the contrary, as former Treasury Secretary Henry Paulson stated, the decision by the Bush Administration to place Freddie Mac and Fannie Mae into conservatorship "wasn't a bailout... [the companies'] common and preferred shareholders were being wiped out."[6] Thus, not only have our private shareholders not received any of the funds the company has received to date from the Treasury, their equity investments in Freddie Mac have fallen to less than one percent of previous values, and FHFA as conservator stands in their shoes.

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[5] Projections of the Enterprises' Financial Performance, October 2011, pgs. 4-5. Under the terms of Freddie Mac's Preferred Stock Purchase Agreement with Treasury, dividend payments are not deducted from the amount of prior draws outstanding. FHFA's report expressly states: "The projections reported here are not expected outcomes. They are modeled projections in response to "what if" exercises based on assumptions about Enterprise operations, loan performance, macroeconomic and financial market conditions, and house prices. The projections do not define the full range of possible outcomes. Actual outcomes may be very different. This effort should be interpreted as a sensitivity analysis of future draws to possible house price paths."

[6] Henry M. Paulson, Jr., *On The Brink: Inside the Race to Stop the Collapse of the Global Financial System*, Hachette Book Group, New York, 2010, pg. 14.

Furthermore, the terms of Freddie Mac's Preferred Stock Purchase Agreement with Treasury were explicitly designed to make it difficult if not impossible for the company to emerge from conservatorship and for shareholders to recoup any value from their investments. Freddie Mac and Fannie Mae are required to pay a ten percent dividend on funds received. As former Treasury Secretary Paulson and other Treasury officials from the Bush Administration have stated, this was by design to ensure that the GSEs could not emerge from conservatorship and that shareholders would not benefit from federal support.[7] In practice, the dividend is set at a level resulting in Freddie Mac paying more than 100 percent of our profits to Treasury over the long term, necessitating additional requests for Treasury funds.

Let me be clear: I am neither criticizing this arrangement, suggesting that the quarterly dividend is the sole reason for our continued need for Treasury support, nor asking Congress to reduce or eliminate our dividend obligation. This was a public policy decision made at the highest levels during a time of crisis. Moreover, I want to emphasize our appreciation for the support we have received. I raise the issue, however, because our critics point to any draw as evidence of current mismanagement. Given the structure and purpose of the draw, that is not a fair assertion.

Housing finance reform

Housing finance reform, including determining the long-term future of the GSEs, poses a set of complex issues and challenges for policymakers. From my perspective as Freddie Mac's CEO, I believe addressing these issues sooner rather than later would be in the best interests of Freddie Mac, the housing finance system, and the nation as a whole.

As Acting Director DeMarco has stated on several occasions, conservatorship is not a viable long-term state of being for the GSEs. Continued lack of clarity about our future is harmful to our companies and poses heightened risks to taxpayers. Freddie Mac is engaged in a wide array of business activities relating to the underwriting, origination, securitization and servicing of home mortgages. To run our business safely and soundly – and protect taxpayers' investment in our company – we need highly skilled and experienced executives and employees. Because of our current status and uncertain future, it is increasingly difficult for us to retain such people, let alone successfully recruit new professionals.

[7] In a May 12, 2011 guest post on the House Financial Services Committee blog, former Treasury Assistant Secretary Philip Swagel wrote, "In recent quarters, the large dividend payments on the government-owned preferred shares have given rise to the seemingly unusual situation in which Fannie and Freddie are now profitable in their operations but usually still make net losses because of the payments to the government. As a result, the two firms take more government capital in order to turn around and pay some of the money back to the Treasury as dividends. . . This is by design. . . [Shareholders] got exactly what happens to shareholders of insolvent firms: a loss of their investment."

Enacting housing finance reform also will hasten the return of private capital to the residential mortgage market by providing investors with greater clarity about the structures, rules, and risks of mortgage investment.

Conclusion

In closing, let me reiterate that I understand the concerns underlying this Committee's hearing today. Under conservatorship, we have significantly reduced overall administrative spending and executive compensation. We have a new senior management team providing leadership and direction for an outstanding group of employees. Together, they are keeping borrowers in their homes, building a quality book of new business, and keeping the housing market liquid and stable during an ongoing economic crisis. We are being effective stewards of taxpayer support by using that support to fulfill our mission.

Thank you for giving me this opportunity to testify today.

APPENDIX: Freddie Mac's 2009-11 vs. pre-2009 books of business

As we have helped fulfill the nation's mortgage liquidity needs, we also have substantially improved the credit quality of the mortgages we have purchased since entering conservatorship. While Freddie Mac continues to experience credit losses from the pre-2009 book of business, the 2009-2011 book has generated guarantee income greater than credit expenses.

The table below summarizes key data on single-family mortgages Freddie Mac guaranteed as of September 30, 2011.[8] It shows that mortgages in our single-family guarantee portfolio originated during 2009-2011 overall are of higher credit quality with lower loan-to-value ratios, higher borrower credit scores and significantly lower serious delinquency rates than the mortgages in our guarantee portfolio that were originated prior to 2009. Today 50 percent of the single-family mortgages we guarantee are from the 2009-2011 book of business.

Single-Family Credit Guarantee Portfolio Data by Year of Origination, as of September 30, 2011

Year of Origination	% of Portfolio	Average Credit Score	Original LTV Ratio	Current LTV Ratio	Current LTV Ratio >100%	Serious Delinquency Rate
2011	10 %	752	71 %	70 %	5 %	0.03 %
2010	20	755	70	70	5	0.17
2009	20	754	68	72	5	0.41
2008	7	726	74	91	33	5.20
2007	10	706	77	112	59	11.21
2006	7	710	75	111	54	10.54
2005	8	717	73	95	37	6.20
2004 and prior	18	720	71	60	9	2.63
Total	100 %	735	72	79	19	3.51

The next table shows information about net amount of management and guarantee income and credit expenses by year of origination for our single-family guarantee portfolio for the first nine months of 2011, segmented by the year of origination of the mortgages we guarantee.[9] It shows that while credit-related expenses exceed

[8] Reproduced from Table 2 on page 5 of Freddie Mac's SEC Form 10-Q disclosure for the third quarter of 2011, filed on November 3, 2011.

[9] Reproduced from Table 14 on page 29 of Freddie Mac's SEC Form 10-Q disclosure for the third quarter of 2011, filed on November 3, 2011. We currently believe our management and guarantee fee rates for guarantee issuances after 2008, when coupled with the higher credit quality of the mortgages within our new guarantee issuances, will provide management and guarantee fee income, over the long term, that exceeds our expected credit-related and administrative expenses associated with the underlying loans. Nevertheless, various factors, such as continued high unemployment rates or further declines in home prices, could require us to incur expenses on these loans beyond our current expectations. See Freddie Mac's SEC Form 10-K for the year ended 2010 and SEC Form 10-Q for the third quarter of 2011, filed on November 3, 2011, for a more complete listing of Risk Factors.

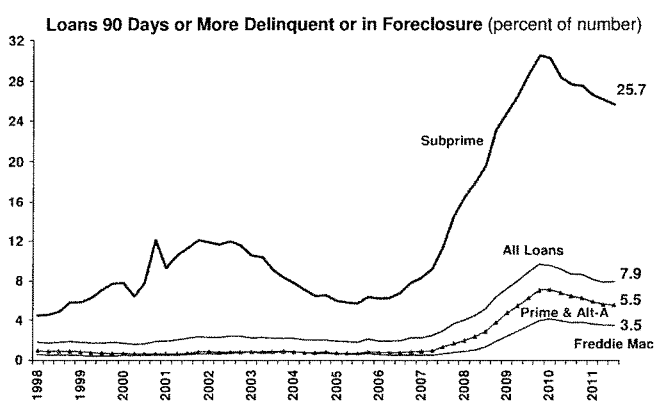
management and guarantee income for the pre-2009 book of business, through the first nine months of 2011 management and guarantee income from mortgages in our 2009-2011 book of business has exceeded credit-related expenses by $805 million.

Segment Earnings Composition — Single-Family Guarantee Segment, January 1-September 30, 2011

Year of origination	Management and Guarantee Income	Credit Expenses	Net Amount
	(in millions of $)		
2011	$ 202	$ (40)	$ 162
2010	555	(199)	356
2009	498	(211)	287
2008	292	(879)	(587)
2007	283	(3,320)	(3,037)
2006	172	(2,483)	(2,311)
2005	194	(1,525)	(1,331)
2004 and prior	435	(1,039)	(604)

This next table compares Freddie Mac serious delinquency rates with those of the overall market, the prime market, and the subprime market. While Freddie Mac's numbers include both the pre-2009 and 2009-2011 books of business, this chart shows that even with mortgages purchased prior to conservatorship, Freddie Mac serious delinquency rates are more than two percentage points lower than the prime market, less than one-half that of the overall market, and less than one-seventh that of the subprime market.[10]

Single-Family Serious Delinquency Rates: Freddie Mac vs. the Market



[10] Overall market and subprime data as of September 30, 2011 from the National Delinquency Survey of the Mortgage Bankers Association. Serious delinquency is defined as three monthly payments or more past due or in the process of foreclosure, as reported to us by our servicers.

Testimony of Michael J. Williams
President and Chief Executive Officer, Fannie Mae

U.S. House of Representatives
Committee on Financial Services

December 1, 2011

Chairman Neugebauer, Ranking Member Capuano, members of the Committee, thank you for inviting me to speak with you today about the Federal Housing Finance Agency's (FHFA) oversight of Fannie Mae, the company's current condition, and the company's financial outlook.

As Fannie Mae has been the recipient of unprecedented taxpayer investment, I understand why Congress is interested in these issues and I appreciate the importance of these issues to both Congress and our country. As the Chief Executive Officer of Fannie Mae, I am responsible for ensuring that we fulfill our important mission of sustaining and repairing the nation's housing finance system while, at the same time, acting as good stewards of the taxpayer's investment in our company.

FHFA's Oversight of Fannie Mae

Let me begin by discussing how we work with FHFA, our regulator and conservator, to manage the resources we have received and to operate the company effectively as conservator. When Fannie Mae was placed in conservatorship, FHFA succeeded to all of the rights of the shareholders, the board of directors, and the management. Accordingly, we understand that FHFA has the right to determine the company's goals and activities in conservatorship.

Upon conservatorship, FHFA determined that, given the limited resources of the agency, the most prudent way for it to fulfill its responsibilities in conservatorship was to replace the Chief Executive Officer and the Board of Directors at the company, which it did. FHFA worked closely with us to put in place a new executive leadership team. The people running Fannie Mae today are not the people who ran it prior to conservatorship.

FHFA delegated specified authorities to the new Board and the new management team, retaining certain key decisions for itself as conservator. Under FHFA's delegations, management is responsible for day-to-day operations of the company, subject to the oversight of our Board of Directors. FHFA as conservator has the authority to rescind or modify at any time the delegations of authority to management and the Board. FHFA has directed us to focus on the company's core business, and not to undertake new products or new activities. In addition, pursuant to the delegations and our senior preferred stock purchase agreement with the Treasury, FHFA and Treasury must approve certain types of actions. For example, FHFA, in consultation with Treasury, must approve any compensation arrangements for senior management.

All of this is a very significant change from the way the company operated prior to conservatorship. While FHFA and its predecessor, the Office of Federal Housing Enterprise Oversight (OFHEO), was our prudential regulator in the days before conservatorship, FHFA has a much more active role in overseeing the management and operations of the company today.

We are required to seek FHFA's input and approval on a much wider range of issues than before. FHFA maintains a continuous presence at our company, and there is constant communication between the two organizations. It is a credit to the leadership of both FHFA and Fannie Mae that we have successfully transitioned to this new relationship in short order and with little disruption.

Of course, another big change between today and the company before conservatorship is that the taxpayer is our principal investor. In accordance with conservatorship, we do not operate the company for the benefit of private shareholders as we did in the past; instead, we run the company with the interests of the entire housing finance system in mind and seek to protect taxpayer interests. However, this is not to suggest that we have become a government agency. In accordance with the Housing and Economic Recovery Act, Fannie Mae is a private business using private-sector talent, skills, and experience to achieve our goals. However, while still a private sector company, Fannie Mae is not operating "business as usual." As I have indicated, much has changed. But we are using our people — among the most knowledgeable and experienced in housing finance — to address the many challenges facing the company and the housing finance system, which we believe will create value for our primary investor, the U.S. taxpayer.

We have taken a number of actions to strengthen the company and limit losses on the legacy book of business that was acquired before conservatorship. We are making necessary strategic investments to minimize future losses, and have significantly reduced expenses in other areas. These are exactly the actions that we believe will enable us to achieve the goals of conservatorship and protect taxpayer's interests.

An Assessment of Fannie Mae's Current State

Let me briefly provide context on the role Fannie Mae plays in today's market. During uncertain economic times, funds for mortgages tend to dry up as banks and other investors who supply financing flee the market. This was evident at the beginning of the housing downturn when the private label securities market literally vanished after reaching an historic share of the market during the run-up. The departure of liquidity stalls mortgage lending, which in turn negatively impacts construction, home sales, and financing for apartments. As the government has recognized with its very large investments in Fannie Mae and Freddie Mac, a prolonged failure of mortgage lending would have a devastating ripple effect on the nation's economy.

Today, Fannie Mae's role in funding the mortgage market has never been more important. We provide funding for more than 40 percent of the single-family market and almost 35 percent of the multifamily market. Since 2009, we have provided more than $2 trillion in mortgage funding that has helped approximately 6 million households to refinance. We have helped approximately 1.7 million homeowners purchase a home, and we have provided financing for nearly 1 million units of quality, affordable rental housing. Through our early funding program, we have also provided over $290 billion in short-term liquidity for small and medium-sized lenders so they can continue to meet the demands of their customers during unsettling economic times.

Banks — including many small and medium-sized lenders — simply would not continue lending on this scale without liquidity from Fannie Mae. I understand that Fannie Mae and the industry will be different in the future. I also recognize the need for responsible GSE reform. But Fannie Mae's role in today's market is absolutely critical, and fulfilling that role is the fundamental reason the government has invested so much to keep Fannie Mae functioning effectively.

To achieve the goals of conservatorship, it is imperative that we strengthen the company. As it relates to our financial position, we focus on two priorities. The first is building a new book of business with appropriately conservative underwriting standards that support sustainable homeownership. The new book, which consists of loans purchased or guaranteed since January 2009, is almost half of our overall book of business. These are high-quality loans that we currently expect to be profitable over their lifetime. This new business will continue to become a larger percentage of the company's overall book, while the pre-2009 loans will continue to become a smaller percentage of the overall book. As a result, we believe that the company will eventually return to operating profitably, before the payment of dividends to Treasury is taken into account, as I will discuss in a moment.

The second priority is to reduce credit losses on loans purchased prior to conservatorship. The substantial majority of the company's credit losses are on loans that were purchased or guaranteed between 2005 and 2008. We cannot reverse the decisions that were made in the past with respect to this book of business, nor can we change the fact that some of these loans have or will suffer losses. However, we can and will continue to manage these pre-conservatorship loans aggressively to limit taxpayer exposure. We have devoted substantial resources to reduce losses on these loans, and we have made measurable progress. Fannie Mae's serious delinquency rate is now 4.0 percent, which is nearly 30 percent below its peak in early 2010, and close to half of the industry average.

To meet these priorities and respond effectively to the housing crisis, the company has been required to make substantial investments in people and technology, and servicer oversight. For example, Fannie Mae built one of the nation's largest foreclosure prevention operations to help families avoid foreclosure, stabilize neighborhoods, and, in turn, limit credit losses. To date, we have helped nearly one million families avoid foreclosure, through an array of solutions. A credit operation of this size and scope previously had not existed at Fannie Mae or in the industry.

We work directly with distressed homeowners through a network of 12 Fannie Mae Mortgage Help Centers in hardest hit communities across the country to supplement the work of lenders. In addition to our brick-and-mortar efforts, we also offer innovative online tools such as KnowYourOptions.com and WaysHome to help homeowners find the right solution for their individual situation. Unfortunately, foreclosures are not always avoidable. When foreclosure is the only option, we help stabilize communities by properly maintaining and improving the properties we acquire, and selling them to new owners, giving preference to families who will live in them. Since the housing crisis hit, the volume of Real Estate Owned (REO) sales and execution handled by the company is eight times greater than pre-crisis levels. As a result of our efforts and investments, Fannie Mae is now able to process over 20,000 properties in a month, compared to 5,400 properties a month in 2008 when we entered conservatorship.

While we have and will continue to reduce headcount in some areas, the housing crisis required Fannie Mae to hire approximately 1,800 people – many of whom are limited term employees working in our credit loss reduction and Making Home Affordable (MHA)-related operations – to focus specifically on foreclosure prevention and loss mitigation. Since 2009, our ability to drive productivity in the credit loss management area has improved. The credit operations are delivering better results for less money in 2011 than in previous years.

Many different types of expenses relate to our efforts in foreclosure prevention and credit loss reduction. For example, Fannie Mae has invested more in advertising over the past two years. It's important to understand why we made this investment. Our advertising now is almost exclusively dedicated to foreclosure prevention and credit loss reduction initiatives. We learned soon after the housing crisis began that low awareness of potential solutions creates a strong barrier to families getting help. Through advertising, Fannie Mae educates borrowers about their options and helps them avoid foreclosure.

Fannie Mae is also undertaking a number of initiatives that will make the industry stronger. For example, we are developing new tools and standards to ensure greater visibility into the quality of the loans that are delivered into the secondary market. The loan quality initiative will reduce future risks for lenders, investors, borrowers, and ultimately the taxpayers.

Another key aspect of our strategy to strengthen the industry is improving servicing standards and execution. In June 2011, with FHFA and Freddie Mac, we developed new standards for mortgage servicers. The new servicing standards are designed to result in earlier, more frequent, and more effective contact with borrowers to avoid foreclosures and mitigate losses. The standards also aim to improve servicer performance by providing monetary incentives for exceeding loan workout benchmarks and imposing fees on servicers for failing to meet loan workout benchmarks or foreclosure timelines. These efforts, the Loan Quality Initiative and the Servicing Alignment Initiative, represent important efforts we are undertaking now to build a sustainable housing finance system for the future.

We have executed on our business plans with careful attention to expense control, however, the work we are undertaking requires a large operation. In 2010, we incurred $2.6 billion in total administrative expenses. Fannie Mae undertakes a formal budgeting process each year that is approved by the Board and reviewed with FHFA. We look to manage all expenses prudently.

Fannie Mae evaluates all proposed expenses with an eye toward delivering long-term value. Since being placed in conservatorship, we have reduced expenses in many areas while investing in resources for areas of greatest need. Management made these decisions in consultation with FHFA. I take our decisions seriously. So far in 2011, core administrative expenses (that is, all of our administrative expenses except certain extraordinary expenses and costs associated with credit loss management) are down 16 percent from 2010. Core headcount is down by 10 percent from 2010. Personnel-related costs for employees and contractors are down by 14 percent in 2011, and we have eliminated positions at all levels of the company. The company has reduced the use of contractors by nearly 40 percent since 2008. Total compensation for contractors is also down by 30 percent since 2008. We expect headcount and total expenses to be under plan by the end of the year. Importantly, we are taking these actions while also remaining the single largest provider of funding to the market.

In short, I believe that Fannie Mae is fulfilling effectively its mission of providing critical funding to the mortgage markets, buying and guaranteeing high-quality loans pursuant to conservative underwriting parameters. As noted, we currently expect these loans will be profitable over their lifetime. We are also fulfilling our goal of managing the legacy book of business written prior to conservatorship, doing our best to reduce losses and minimize the taxpayer's exposure to these assets acquired in a different time. And finally, we are working hard to help families to avoid foreclosure when possible, and to stabilize communities that have been hit hard by the housing crisis. I am confident that, without the government's support of Fannie Mae, our housing finance system would be in much worse shape than it is today.

Financial Outlook

Finally, you have asked for my assessment whether Fannie Mae can eventually make money and repay taxpayers the immense investment they have made in the company. I believe that, over time, Fannie Mae can deliver value back to the taxpayer. However, I do not believe the company will be able to repay all of the taxpayer's investment due to our dividend payments to Treasury.

As you know, pursuant to our senior preferred stock purchase agreement with the Treasury, Fannie Mae is required to pay an annual cumulative dividend to Treasury of 10 percent on all funds advanced. To date, Fannie Mae has paid $17.2 billion to Treasury in dividends on the senior preferred stock and we expect to pay dividends to Treasury for years to come. Currently, our annual dividend obligation to Treasury is $11.3 billion, which exceeds our reported annual net income for any year since the company's inception.

According to FHFA's October 2011 report, *Projections of the Enterprises' Financial Performance,* Fannie Mae may have positive net income, before payment of the dividend, as early as 2013. This is because the new book of business we have been acquiring since 2009 is expected to be profitable, and the build up of reserves to cover losses on our pre-conservatorship book of business may be complete by then. Although we expect to eventually return to operating profitably before payment of dividends to Treasury, we do not expect to earn profits in excess of our annual dividend obligation to Treasury.

Conclusion

In closing, I am confident that we are making smart business decisions, reducing costs where appropriate, and investing where necessary to achieve the goals of conservatorship, and to contribute to building a strong, sustainable housing system for the future. I believe we have built a strong leadership team and organization that is executing on the key priorities established for the conservatorship. I believe that the nation's housing finance system has benefited greatly from the government's investment in Fannie Mae and that, if the company continues to exist in some form in the future, the company will continue to provide value for this investment over the coming years.

Thank you and I look forward to your questions.

Statement for the Record from
Federal Housing Finance Agency Inspector General Steve A. Linick
Hearing on "Oversight of the Federal Housing Finance Agency"
House Subcommittee on Oversight and Investigations
December 1, 2011

Thank you, Chairman Neugebauer and Ranking Member Capuano, for inviting me to submit a statement for the Record. I appreciate the opportunity to summarize the work and findings of the Federal Housing Finance Agency Office of Inspector General (FHFA-OIG) to date.

As you know, I am the Agency's first Inspector General and my office began operations following my swearing in on October 12, 2010. Over the past fourteen months, we have made great strides in hiring a professional staff and getting the organization up and running. We have published 10 reports and have commenced 48 criminal or civil investigations. Just this week, we issued our second Semiannual Report to Congress.[1]

FHFA-OIG oversees FHFA's operations and programs. This oversight includes the Agency's regulation of the 12 Federal Home Loan Banks, Fannie Mae, and Freddie Mac and the GSEs' approximately 12,000 employees, as well as the conservatorships of Fannie Mae and Freddie Mac, which own or guarantee $5 trillion in mortgage assets and have received $183 billion in taxpayer money. In addition to promoting the economy, efficiency, and effectiveness of FHFA's operations, FHFA-OIG works to prevent and investigates fraud involving FHFA, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

In carrying out its mission, FHFA-OIG conducts, supervises, and coordinates audits, investigations, and other activities relating to the programs and operations of FHFA. An important facet of FHFA-OIG's mission is promoting transparency in FHFA's program administration and oversight of GSE operations, as well as public understanding of matters affecting FHFA, the GSEs, and housing policy.

Emerging Trends

Our reports have revealed a number of emerging trends. They credit FHFA's work in several areas, both as regulator of the GSEs and conservator of Fannie Mae and Freddie Mac (the Enterprises). For example, FHFA-OIG has found:

- FHFA has eliminated golden parachute compensation awards to terminated Fannie Mae and Freddie Mac executives;
- FHFA has taken steps to mitigate its shortage of qualified examiners;

[1] Available at http://www.fhfaoig.gov/Content/Files/second%20semiannual%20report.pdf.

- FHFA has taken steps that may improve Enterprise repurchase claims recoveries, thereby reducing Enterprise losses; and
- FHFA has positively responded to FHFA-OIG's recommendations to improve FHFA's effectiveness and efficiency and to reduce its vulnerability to fraud, waste, and abuse.

On the other hand, FHFA-OIG also has identified deficiencies in FHFA operations, and these deficiencies appear to reflect two significant and related trends. First, FHFA often relied on determinations of the Enterprises without independently testing and validating them, thereby giving undue deference to Enterprise decision-making. Second, FHFA's allocation of resources may have affected its ability to oversee the Enterprises and enforce its directives. As detailed below, both trends have emerged in a number of our reports.

I. FHFA Has Not Independently Tested and Validated Enterprise Decision-Making

In four reports, FHFA-OIG identified significant instances in which FHFA has displayed undue deference to Enterprise decision-making. Without adequately testing or validating data, FHFA has deferred to the Enterprises regarding: (1) Freddie Mac's assessment of mortgage repurchase claim issues involving Bank of America; (2) the Enterprises' participation in the Making Home Affordable programs (MHA); (3) the Enterprises' decisions regarding executive compensation; and (4) numerous transactions of the Enterprises.

The Agency's actions in each case reflect its approach as conservator to delegate most business decisions to the Enterprises. In each case, it relied upon review and corporate governance processes already in place at the Enterprises. However, FHFA-OIG concluded that some matters are sufficiently important to warrant greater involvement and scrutiny by the Agency.

a. FHFA Deferred to Freddie Mac's Analysis of Repurchase Claim Exposure

At the end of 2010, FHFA approved a $1.35 billion settlement of mortgage repurchase claims Freddie Mac asserted against Bank of America. In approving the settlement, FHFA relied on Freddie Mac's analysis of the settlement without testing the assumptions underlying the Enterprise's existing loan review process. An FHFA-OIG report found that FHFA did not act timely or test concerns raised by an FHFA senior examiner about limitations in Freddie Mac's existing loan review process for mortgage repurchase claims. The senior examiner was concerned that the loan review process Freddie Mac used for repurchase claims failed to account adequately for changes in foreclosure patterns among loans originated during the housing boom. According to the senior examiner, this could potentially cost the Enterprise a considerable amount of money.[2]

[2] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-006.pdf.

b. FHFA Provided Limited Oversight of the Enterprises' Administration of the Home Affordable Modification Program

The Department of the Treasury (Treasury) initiated the MHA programs. A key initiative of MHA is the Home Affordable Modification Program (HAMP), which involves servicers agreeing to modify mortgages for borrowers facing default or foreclosure. In early 2009, the Enterprises began participating in HAMP. They started modifying mortgages in their portfolios and entered into five-year agreements with Treasury to manage the program and oversee participants' compliance with program requirements. An FHFA-OIG report found that FHFA largely removed itself from overseeing the negotiations of the five-year agreements. FHFA believed its appropriate role was to ensure the Enterprises were legally authorized to administer HAMP, not to participate actively in negotiations between the Enterprises and Treasury. Thus, FHFA did not engage in any formal substantive review to evaluate the agreements' feasibility, risks, or the suitability of the Enterprises to serve as Treasury's financial agents. This lack of engagement may have contributed to the agreements' omission of significant details concerning payments to the Enterprises, the scope of their responsibilities, and processes to resolve differences. As a consequence of the omissions, significant problems developed in these areas almost from the beginning, requiring FHFA and the Enterprises to devote substantial time and resources to resolve ambiguities.[3]

c. FHFA Did Not Fully Analyze Factors Related to Executive Compensation at Fannie Mae and Freddie Mac

For 2009 and 2010, the Enterprises awarded their top six officers over $35 million in compensation. FHFA reviewed and approved these compensation awards based on the Enterprises' determinations and recommendations. However, an FHFA-OIG report found that FHFA did not independently test or validate the means by which the Enterprises calculated their recommended compensation levels and did not consider factors that might have resulted in reduced executive compensation costs. These factors included the lower levels of compensation paid to senior officials at federal agencies supporting the housing market and whether compensation awards should be discounted to reflect the significant level of federal financial support provided to the Enterprises.[4]

d. FHFA Does Not Perform Sufficient Transaction Testing of Enterprise Activities

Transaction testing is the method employed by financial institution examiners to arrive at independent impressions about the financial and operational conditions of an institution, as well

[3] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-003.pdf.
[4] Available at
http://www.fhfaoig.gov/Content/Files/Exec%20Comp%20DrRpt%2003302011%20final,%20signed.pdf.

as its compliance with applicable laws and regulations. An example of transaction testing would be reviewing a regulated entity's loan files to test the veracity of statements concerning loan underwriting and performance. During an evaluation of FHFA's capacity to examine the GSEs, a senior FHFA manager acknowledged to FHFA-OIG that examiners too often accept assertions made by Enterprise managers rather than validate such assertions through appropriate transaction testing.[5]

II. FHFA's Resource Allocations May Have Affected Its Ability to Oversee the GSEs and Enforce Its Directives

In four reports, FHFA-OIG identified instances in which FHFA's resource allocations may have affected its ability to oversee the GSEs and enforce its directives. For example, FHFA may have too few examiners to meet its oversight responsibilities. In addition, FHFA may not have assigned sufficient priority and resources to handle consumer complaints or address new and emerging risks that may impact the GSEs. Additionally, FHFA-OIG found that FHFA (along with its predecessor agency, the Office of Federal Housing Enterprise Oversight (OFHEO)) has permitted five years of compliance delays by Fannie Mae, which has been under directives to implement an effective operational risk management program.

a. FHFA May Not Have Enough Examiners to Meet Its Regulatory and Conservatorship Oversight Responsibilities

FHFA has critical regulatory responsibilities with respect to the GSEs and conservator responsibilities regarding the Enterprises. To satisfy these responsibilities, Congress provided FHFA significant budget and hiring authority. Nonetheless, an FHFA-OIG report noted that FHFA-OIG had previously found shortfalls in the Agency's examination coverage, and this finding was corroborated by statements of senior FHFA officials. Internal Agency reviews also corroborated that FHFA has too few examiners to ensure the efficiency and effectiveness of its examination program. Additionally, only 34% of the Agency's line examiners are accredited federal financial examiners. FHFA has taken steps to mitigate its shortage of qualified examiners, but it needs to move quickly and aggressively in this area. Last winter, for example, the Acting Director announced and implemented a substantial restructuring of FHFA's supervision units and reassigned numerous staff. These steps, which also include plans to add examination staff and implement an examiner accreditation program, are designed to enhance FHFA's supervision program. Further, although FHFA's near-term plans include hiring up to 44 additional staff in the supervision divisions, FHFA-OIG concluded that there is substantial uncertainty as to whether this number of additional examiners will enable FHFA to overcome its

[5] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf.

examination capacity shortfalls and ensure the success of the Agency's 2011 reorganization of its examination structure.[6]

b. FHFA Did Not Allocate Sufficient Resources to Handle Consumer Complaints

Due in part to deteriorating financial conditions in the housing market, FHFA and OFHEO experienced a substantial increase in consumer complaints about the Enterprises. A number of these complaints contained important information about alleged foreclosure processing abuses and fraud. However, an FHFA-OIG report found that FHFA did not adequately process consumer complaints. This deficiency occurred because FHFA did not establish sound internal controls and did not assign sufficient priority and resources to complaint processing. For example, FHFA-OIG found that FHFA assigned only two employees – on a part-time basis – to handle consumer complaints.[7]

c. FHFA Did Not Identify and Address New and Emerging Risks Potentially Impacting the GSEs

FHFA did not begin to schedule comprehensive examination coverage of foreclosure issues, including allegations of abuse by its default-related legal services vendors, until after news stories about alleged abuses surfaced in mid-2010. FHFA had not previously considered risks associated with foreclosure processing to be significant. However, an FHFA-OIG report found that there were multiple indications of foreclosure issues prior to mid-2010 that could have led FHFA to foresee the heightened risk in foreclosure processing abuses. These indications included significant increases in the volume of foreclosures (which accompanied the collapse of the housing market), rising consumer complaints alleging improper foreclosures, contemporaneous media reports about foreclosure abuses by the Enterprises' law firms, and public court filings highlighting such abuses.[8]

d. FHFA Has Not Enforced Directives Regarding Fannie Mae's Operational Risk Program

Between 2006 and 2011, FHFA and OFHEO repeatedly found that Fannie Mae had failed to establish an acceptable and effective operational risk management program despite outstanding Agency requirements to do so. FHFA possesses broad authority to enforce its directives. However, an FHFA-OIG report found that FHFA did not take decisive action to compel Fannie Mae's compliance.[9]

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[6] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf.
[7] Available at http://www.fhfaoig.gov/Content/Files/AUD-2011-001.pdf.
[8] Available at http://www.fhfaoig.gov/Content/Files/AUD-2011-004.pdf.
[9] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-004.pdf.

OIG Operations

In addition to monitoring and reporting on FHFA's progress implementing report recommendations, FHFA-OIG will continue to release new audits and evaluations covering key areas. FHFA-OIG maintains a detailed Audit, Evaluation, and Survey Plan that focuses strategically on the areas of FHFA's operations posing the greatest risks and providing the greatest potential benefits to FHFA, Congress, and the public. Originally developed with input from an independent, third-party risk assessment, the Audit, Evaluation, and Survey Plan reflects continuous feedback from FHFA-OIG's reviews of current events and comments from FHFA officials, members of Congress, and others. Broadly, FHFA-OIG's audit and evaluation strategies include reviews of the following FHFA activities:

- Regulatory efforts and its management of the Enterprise conservatorships. This is a particularly high-risk area because Treasury has invested $183 billion of taxpayer funds in the Enterprises. As conservator, FHFA must regulate and oversee the Enterprises in an efficient, effective, and transparent manner so as to minimize taxpayer costs, conserve Enterprise resources, and meet all statutory mandates.

- Oversight of the Federal Home Loan Banks and their associated risks, including investment portfolio management and concentrations, credit underwriting, and administration.

- Internal operations, such as privacy and allegations of fraud, waste, or abuse.

The Audit, Evaluation, and Survey Plan identifies a number of other ongoing and planned reviews of specific FHFA programs.

As a further part of our mandate to combat fraud, waste, and abuse, FHFA-OIG operates an active Office of Investigations that has made significant contributions to a range of mortgage-related investigations. While many of them remain confidential, FHFA-OIG and its law enforcement partners, which include federal agencies, U.S. Attorneys' Offices, and state and local entities nationwide, have released details about several high-profile mortgage fraud investigations involving Colonial Bank and Taylor, Bean & Whitaker Mortgage Corporation, Marshall Home and Margaret Broderick, and Home Owners Protection Economics, Inc.

The Office of Investigations also operates the FHFA-OIG Hotline, which allows concerned parties to report information directly and in confidence regarding possible fraud, waste, or abuse related to FHFA or the GSEs. FHFA-OIG honors all applicable whistleblower protections. Should you or your constituents wish to report any allegations of fraud, waste, or abuse, the

Hotline can be reached at 1-800-793-7724, by fax at 202-408-2972, or through our website at www.fhfaoig.gov.

My staff and I look forward to continuing to work with you and the subcommittee to provide independent and objective assessments of the work of FHFA. The continuing fragility of the nation's housing market remains a significant source of ongoing concern. Further, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks continue to be key market participants, and FHFA continues to face significant challenges. We are hopeful that our findings and recommendations will be of assistance in meeting those challenges.

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

February 22, 2012

The Honorable Stephen Fincher
U.S. House of Representatives
1118 Longworth House Office Building
Washington, DC 20510

Dear Representative Fincher:

In response to the questions for the record that you submitted to the Federal Housing Finance Agency (FHFA) following the December 1, 2011, Oversight and Investigations Subcommittee hearing, I am providing the following information.

Question: What is your take on the staffing levels at Fannie and Freddie and do you think, as a regulator, that Fannie could save money and still limit any losses if it were to reduce its staff?

Response. Staffing levels are adequate today to perform the significant role each company plays, supporting approximately half of the $10 trillion mortgage market. The job requires that each company recruit and retain employees with a high level of knowledge and expertise. Were the workforce to be reduced in size or skill level, it is not readily apparent that the companies could perform all of their various duties and responsibilities, fulfill their statutory mandates and avoid safety and soundness concerns that could contribute to losses. Fannie Mae has a larger, and more troubled, mortgage book than Freddie Mac and has different, and more resource intensive responsibilities as the Treasury Department's financial agent than does Freddie Mac. While we will continue to seek cost savings through prudent staff reductions over time, I am comfortable with the appropriateness of those levels today.

If you have further questions, please do not hesitate to contact Peter Brereton, Associate Director for Congressional Affairs, on my staff at (202) 649-3022.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
Acting Director

xc: The Honorable Randy Neugebauer

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Freddie Mac's response to Rep. Fincher's Questions for the Record From the December 1, 2011 hearing of the Oversight Subcommittee, House Financial Services Committee

January 30, 2012

Fannie had 5,820 employees in 2009 but now has 7,085. It claims that the new employees are necessary to limit credit losses and mitigate the effects of the housing crisis. At the same time, Freddie has consistently reduced staff positions – this year alone, by 9%, or 456 employees. Why is Freddie able to reduce staff (presumably while working to limit losses) while Fannie is not?

During our years under conservatorship, Freddie Mac has closely monitored our headcount as well as our general and administrative expenses. We have consistently reduced positions and expenses whenever possible, and have maintained productivity by ensuring that transition plans were in place for each reduction in staff.

When a worker leaves employment at Fannie or Freddie, do you consider whether the position should be eliminated or not?

While we have been reducing staff positions as a part of Freddie Mac's normal operating processes and our ongoing focus on workforce planning, we also consider eliminating a position each time it is vacated. Our workforce planning process calls for us to ascertain whether or not the departing worker's position is still needed, whether or not the work being performed should be moved down or upgraded higher within the organization, and/or whether that work can be redistributed among other positions or resources within that, or another workgroup.

FannieMae

Fannie Mae Responses to
Questions for the Record from Congressman Stephen Fincher

Subcommittee on Oversight and Investigations, December 1, 2011 hearing entitled
"Oversight of the Federal Housing Finance Agency."

Congressman's Questions Shown in bold italics

1. Why did Fannie Mae hire hundreds of employees to build up its Credit operation while Freddie Mac has been steadily decreasing staff and also achieving results in that area?

While our credit organization has increased headcount, our core headcount has decreased by 10 percent since 2010. Fannie Mae has increased its employee base in the Credit Organization in order to maximize the number of borrowers assisted and our loss mitigation efforts, and to execute our role as administrator of the Making Home Affordable Program. The difference in our current staffing levels relative to Freddie Mac is comparable to the difference in our book sizes. Fannie Mae's book is currently 1.5 times larger than that of Freddie Mac.

With a significantly larger book of business and incrementally larger number of loans to mitigate, we have focused on several key areas including:

- reducing our serious delinquency (SDQ) rate
- providing workout solutions to borrowers
- reaching out to borrowers, through our Mortgage Help Centers, WaysHome and knowyouroptions.com
- conducting more servicer oversight
- managing the disposition of an REO inventory that has grown two-fold since 2009
- pursuing more repurchase requests

By pursuing these actions, we will help homeowners; reduce credit losses; and protect taxpayer resources. Our approach is working as seen through our results:

- From its peak in February 2010, we have **reduced our SDQ rate** by 159bps to 4.00% in November 2011 and narrowed the gap between our rate and that of Freddie Mac from 139bps in February 2010 (at its peak) to 43bps in November 2011;

- We have more than **doubled the number of modification and foreclosure alternative solutions** completed with borrowers which is also twice the number completed by Freddie Mac;
- Through continued evaluation and changes to our modification structures and processes including use of trial periods, we **improved the performance of our modifications** significantly since the end of 2009;
- In 2011, we **opened 6 additional Mortgage Help Centers to give us a total of 12** across the country and met with over 9,500 borrowers to help educate them of and find the right solution for their individual situation;
- We **established a servicer rating program (Servicer Total Achievement & Rewards (STAR))** in order to encourage improvements in customer service and foreclosure prevention outcomes for homeowners by rating servicers on their performance;
- Since 2009, Fannie Mae has **disposed of twice as many REO properties** than Freddie Mac and continues to manage an inventory of foreclosed properties more than double the size of Freddie Mac;
- Since 2009, we have more than **doubled our collections** associated demands for lenders to repurchase of loans or compensation for losses sustained associated with loans that do not meet our underwriting or eligibility requirements. During the first nine months of 2011, lenders repurchased from us or reimbursed us for losses on approximately $8.8 billion in loans, measured by unpaid principal balance, pursuant to their contractual obligations. In addition, as of September 30, 2011, we had outstanding requests for lenders to repurchase from us or reimburse us for losses on $9.5 billion in loans, of which 25.4% had been outstanding for more than 120 days.

As we have grown our Credit Organization to address current conditions, we have done so in a way that will allow us to quickly adapt to continued changes and ensure we are minimizing costs while maximizing our borrower outreach and loss mitigation efforts. In addition, we approach the sale of REO differently than Freddie Mac by utilizing more in-house resources in order to minimize costs and ensure effective oversight of the management of our REO inventory.

As we begin 2012, we are balancing our goals of assisting borrowers, stabilizing neighborhoods, and disposing of foreclosed properties with our obligation to mitigate losses and carefully protect taxpayer resources.

2. When a worker leaves employment at Fannie or Freddie, do you consider whether the position should be eliminated or not?

Any time a worker leaves our employment there is a review to determine if the position is still needed or whether the work can be absorbed within the business unit. There is an active review and approval process before a position would be considered eligible to be filled.

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