

STATEMENT OF MARTIN F. BAUMANN

CHIEF FINANCIAL OFFICER

FREDDIE MAC

BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND  
GOVERNMENT SPONSORED ENTERPRISES

OF THE

U.S. HOUSE OF REPRESENTATIVES

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Thank you, Chairman Baker, Ranking Member Kanjorski and Members of the Subcommittee. It is a pleasure to be here today.

My name is Martin F. Baumann. I am the Executive Vice President and Chief Financial Officer of Freddie Mac. I joined Freddie Mac in April 2003. I was hired to build a strong finance function in Freddie Mac and to restore confidence in the company's financial reporting. I am committed to developing an exemplary finance function that produces accurate, timely, well-controlled and transparent financial reports.

Prior to joining Freddie Mac, I worked at PricewaterhouseCoopers for more than 30 years as a partner, as deputy chairman of the World Financial Services Practice, and as the Global Banking Leader. At PricewaterhouseCoopers, I was responsible for certifying the financial statements of some of the largest United States and international banking, insurance and other financial services companies.

I welcome the opportunity to be here today to discuss Freddie Mac's remediation program and compliance with the Consent Order between Freddie Mac and the Office of Federal Housing Enterprise Oversight (OFHEO).

Last year was a challenging year for Freddie Mac. In January, we announced a restatement of prior-year earnings and in June, our Board of Directors made changes in the company's senior management.

We have been working hard to regain the confidence of all of our stakeholders. We are implementing a corporate-wide remediation program to ensure that the accounting and financial control issues that led to the need for the restatement will never happen again. We have completed the restatement of prior-year financial results. This past December, OFHEO completed its special examination of Freddie Mac. At the same time, we entered into a Consent Order and Settlement with OFHEO that resolves matters relating to our restatement. We appreciate the Subcommittee's patience as we have worked through this process.

Freddie Mac's mission is to ensure a stable supply of low cost mortgages for America's families – whenever and wherever they need them. For more than 30 years, Freddie Mac has helped meet the home financing needs of families at all income levels, in all communities, and in all parts of the country. We recognize our special responsibility to homebuyers, the public, the Congress and investors. Despite our difficulties last year, we maintained our focus on fulfilling these responsibilities.

Freddie Mac's highest priorities are remediation and compliance with the Consent Order, along with bringing our financials current. We are firmly committed to building an environment that delivers comprehensive and understandable information incorporating the highest level of financial transparency, accounting controls, compliance, and professional standards.

Now, Freddie Mac is focused on the future. We are headed in the right direction, and we have the right leadership to reach our goals in our new Chairman and Chief Executive Officer Richard F. Syron. Dick has extensive industry expertise, and corporate leadership and financial experience, having led a Fortune 500 firm, served as chairman and chief executive officer of the American Stock Exchange, and served as the president of the Federal Reserve Bank of Boston and as president of the Federal Home Loan Bank of Boston. He is committed to our important public mission and to regaining the full confidence of the public and our stakeholders.

Before addressing our remediation and compliance efforts, allow me to say a few words about the completion of our restatement of prior financial results.

### **Completing our Restatement and Fulfilling our Mission in 2003**

On November 21, 2003, the Freddie Mac Board of Directors and our management team announced the release of the company's restated and revised financial results for the years 2000 through 2002. The restatement was a significant step in Freddie Mac's progress toward achieving accurate and timely financial reporting.

Freddie Mac completed this restatement while maintaining our business fundamentals and delivering on our congressional mandate to make mortgage credit more available for America's families. We remain fully committed to our mission of helping make housing more affordable for more Americans and maintaining liquidity in the housing market, which, for the past several years, has bolstered the US economy.

In fulfilling our mission, Freddie Mac plays an important role in maintaining the strength of the housing sector, a sector that directly accounts for approximately 15 percent of the Gross Domestic Product (GDP) and has accounted for 36 percent of the growth in GDP over the last two years.<sup>1</sup> Furthermore, we have contributed to growth in the economy by helping homeowners refinance into lower rate mortgages and redeploy some of their housing equity.<sup>2</sup> These benefits are directly attributable to the long-term, prepayable fixed rate mortgage, which our activities make widely available.

The restatement did not affect the fundamental strength of Freddie Mac's business. Freddie Mac's business operations remain strong and interest-rate risk and credit risk remain low. Our risk profile remains conservative, with an average duration gap of zero

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<sup>1</sup> These percentages are based on data published by the Bureau of Economic Analysis, U.S. Department of Commerce for 1996 through 2003 and data for the same years available upon request from Freddie Mac.

<sup>2</sup> See Remarks by Federal Reserve Chairman Alan Greenspan before the Annual Convention of the Independent Community Bankers of America, Orlando, Florida, March 4, 2003, available online at [www.federalreserve.gov](http://www.federalreserve.gov).

for November 2003, unchanged from October. In fact, we maintained a low duration gap throughout 2003.

Now, let me return to the focus of my testimony: Freddie Mac's remediation program and compliance with the Consent Order between Freddie Mac and OFHEO.

### **Remediation Program**

Freddie Mac is currently engaged in an active remediation program. The steps that we are taking combine the steps required by the Consent Order with the actions that were underway in our preexisting remediation program.

Freddie Mac's Board of Directors has been working closely with management to carry out a remediation program that will advance our mission and serve all of our stakeholders. During the spring of 2003, the Governance Committee of the Board of Directors tasked me with the development of a remediation program to ensure that the factors contributing to the need for the restatement would not recur. Thereafter, the Board of Directors approved a comprehensive remediation program that has been and is effecting far-reaching changes in the company's financial reporting, control and management functions.

Freddie Mac's Board of Directors is actively overseeing management's implementation of the remediation program. During 2003, the Board's Governance Committee overseeing the remediation program, and the Audit and Ad Hoc Committees overseeing the restatement, held individual or joint committee meetings on 55 separate occasions to review the progress on the restatement and consider aspects of remediation implementation. Throughout this period, we provided periodic updates on our remediation program to OFHEO.

On December 9, 2003, Freddie Mac entered into a Consent Order and Settlement with OFHEO. On the same day, OFHEO released the report of its special examination of Freddie Mac.

Under the terms of the Consent Order, Freddie Mac agreed to undertake remedial actions relating to corporate governance, internal controls, internal audit, internal accounting capabilities, risk management transactions, and public disclosures and regulatory reporting. The Consent Order and the company's completion of the required resulting remedial actions are essential to restoring full confidence in Freddie Mac.

The Consent Order added further key items to our existing remediation program resulting in an enhanced comprehensive remediation program designed to ensure the integrity of Freddie Mac's financial reporting, controls and governance, and also to prevent a recurrence of the problems that led to the need for the restatement. We have been

working closely with OFHEO to make sure that we take the remediation steps required by the Consent Order on a timely basis. Actions must be completed within various timeframes, and the Board of Directors and senior management have emphasized to Freddie Mac employees the importance of timely compliance.

Our commitment to implementing the requirements of the Consent Order and the remediation program is unwavering. The remediation program underway at Freddie Mac is moving the company forward.

The activities we have already undertaken as part of the remediation, and our continuing plans, including fulfilling the requirements of the Consent Order, demonstrate our commitment to create a corporate culture in which the type of problems that led to the restatement will never happen again.

### **Key Remediation Steps**

In implementing the Consent Order, Freddie Mac will be building upon its very significant efforts to improve the quality and depth of internal accounting personnel, the strength of the accounting function, and management oversight of that function. This has been, and continues to be, a key priority of the company in the wake of the restatement.

The goals of Freddie Mac's remediation program are to ensure that we have the highest level of accounting expertise, compliance with generally accepted accounting principles and regulatory reporting, and fully accurate, timely, and transparent financial reporting.

Keeping in mind our unwavering commitment to meeting the terms and the spirit of the Consent Order, today I would like to highlight some of the important steps Freddie Mac has already taken.

Freddie Mac has made significant progress in strengthening resources and personnel dedicated to accounting, control and reporting issues. The company has added over 100 professionals in the accounting, reporting and control areas, including a significant number of new officers and senior managers.

Freddie Mac has also retained leading experts in the areas of public disclosures and corporate governance to assist the company in designing and implementing processes and practices in these areas. In October 2003, we hired a Senior Vice President — Chief Compliance Officer who is responsible for overseeing Freddie Mac's compliance with policies, procedures and practices, including compliance with laws and regulations. Additionally, in October 2003, we created the position of Chief Enterprise Risk Officer. This executive has oversight responsibility for credit and market risk.

We are also working to create and implement new infrastructure and systems to ensure the quality, integrity, transparency, and timeliness of our financial reporting. These enhancements will create durable, automated systems that will keep up with the sophistication of our risk management and business activities.

In addition, we have taken steps to ensure that Freddie Mac's corporate culture promotes integrity, high ethical standards, and the importance of compliance. Virtually all of our employees have completed a corporate-wide training program on the company's Code of Conduct and the provisions of the Sarbanes-Oxley Act.

### **Looking Ahead**

Through the extraordinary efforts of Freddie Mac's Board of Directors, current management team, and employees, we have met the challenges of the past year, and we are looking forward to continuing to improve our reporting, governance, and financial controls.

Together with Freddie Mac's new Chairman and CEO as well as our senior management team, I will ensure that we set the right "tone at the top." Throughout this difficult and challenging period, Freddie Mac has focused on ensuring that we will emerge a stronger, more disciplined company. And, we have done so while remaining fully committed to fulfilling our mission.

While the restatement represented an important milestone, now that it has been completed, Freddie Mac is focused on bringing our financials completely up-to-date. The company expects to provide an annual report for 2002 and to hold the related annual stockholders' meeting in the first quarter of 2004. Our objective is to release quarterly and full-year 2003 results by June 30, 2004 and to provide the 2003 annual report and hold the related stockholders' meeting as soon as possible thereafter.

Freddie Mac remains irrevocably committed to completing the process of voluntarily registering its common stock with the Securities and Exchange Commission under the Securities Exchange Act of 1934, with the objective of completing the process as soon as possible after the company's return to timely reporting. Freddie Mac reaffirmed this commitment in a letter to Treasury Secretary John Snow on July 14, 2003, in our restatement announcement and in other public statements.

In 2004, we look forward to working with Chairman Baker, Congressman Kanjorski and the Members of this Subcommittee as you consider regulatory oversight proposals. Freddie Mac has long supported a strong regulator as critical to the achievement of our mission.

## **Conclusion**

As I have outlined today, Freddie Mac is bringing our financial statements current and building for the future. We have taken significant steps toward achieving our goal of exemplary financial reporting and controls. The work that we have done, and continue to do as part of our remediation program, together with our commitment to fulfilling the requirements of the Consent Order, will enable us to reach that goal. While we complete this work, we are continuing to fulfill our important public mission, maintain our safety and soundness, and meet our business objectives.

Thank you for the opportunity to appear today. I look forward to working with Chairman Baker, Ranking Member Kanjorski and the Members of this Subcommittee. I would be happy to answer any questions the Subcommittee might have.

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