

Opening Statement
Chairman Michael G. Oxley
Financial Services Committee

**Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises**
OFHEO's Final Report on Fannie Mae

Tuesday, June 6, 2006

Mr. Chairman, coming on the heels of Senator Warren Rudman's work, OFHEO's staff is to be commended for giving us a comprehensive report on the agency's special exam of Fannie Mae.

I congratulate former OFHEO Director Falcon for initiating the examination and former Acting Director Blumenthal for completing this report. Mr. Lockhart, congratulations are in order for you on your nomination by President Bush to head OFHEO, and I look forward to your presentation today, as Acting Director.

OFHEO's story of Fannie Mae is unfortunately fact not fiction. We're told that Fannie Mae's best-in-class image was a façade. According to the report, the company's board of directors was a complacent entity controlled by senior management, which systematically withheld vital information. Management routinely violated GAAP to maximize bonuses and mislead shareholders. The report details that Fannie Mae sought to oversee OFHEO, instead of the other way around, even orchestrating a HUD Inspector General investigation and a reduction in appropriations for the purpose of discrediting the agency, as well as the report that we review today.

According to this report, in October 2004, Fannie Mae's former Chairman/CEO Raines and CFO Howard made "inaccurate statements" in sworn testimony before this Subcommittee, when they denied that expense deferrals had been made.

Compensation for senior executives, tied to earnings-per-share targets, dwarfed basic salary and benefits. From 1998 to 2003, more than half of \$200 million dollars in compensation received by the top five executives was EPS-related. OFHEO found that the message at Fannie Mae was clear—EPS results mattered, not how they were achieved.

Last March, in an SEC filing, Fannie Mae reported accounting errors in over twenty separate categories. There is no doubt that those accounting errors were in part due to a weak and outdated internal control system. It is only in 2005, when making certain that the company complied with the Section 404 internal control requirements of the Sarbanes-Oxley Act, that Fannie Mae's senior management

finally admitted “the company’s internal control over financial reporting was ineffective.”

The failure of internal controls and the audit function at Fannie Mae reinforces the need for the Sarbanes-Oxley Act. In fact, if not for the Sarbanes-Oxley Act, I wonder how much of this would have come to light.

OFHEO and the SEC have imposed one of the largest penalties ever paid by an individual company, making Fannie Mae the Enron of the financial services industry. \$350 million of the \$400 million penalty will go the FAIR Fund, which was strengthened by Sarbanes-Oxley, and will ultimately be returned to investors. The rest goes to the U.S. Treasury.

This report reminds us how crucial it is for Congress to approve legislation to strengthen regulation of the GSEs. We need to prevent abuses from developing and permit swift enforcement if they do.

At OFHEO’s request, Fannie Mae has agreed to cap the growth of its mortgage portfolio. I would point out again to those who characterize it incorrectly that the House bill gives the new GSE regulator clear, discretionary authority to require portfolio adjustments. OFHEO’s action shows why the regulator should have the flexibility to respond, not be directed by Congress. It’s imperative that this new regulator have the authority to adjust portfolios as called for under the House-passed Baker bill.

I concur that Treasury possesses the authority to approve GSE debt issuances. A 2004 Congressional Research Service legal analysis stated, “If Congress wanted to limit the Treasury Department’s approval authority, then Congress could have done so. Because Congress chose instead to use broad language in describing Treasury’s authority, it follows that a broad interpretation of that authority would likely be judged to be reasonable.” I understand that the Department of Justice has given Treasury a similar opinion.

While I endorse the belief that Treasury possesses this authority, I do not offer an opinion as to whether the Department should use it at this time. Congress correctly provided Treasury with broad discretion in this area, just as we should do in the area of portfolio powers.

I only note that the Administration’s rhetoric suggests that the matter is urgent, and I would like to see that sense of urgency find a better outlet than repeatedly asking Congress to tie the new regulator’s hands on portfolio authority.

If OFHEO’s report doesn’t motivate our colleagues in the Senate to act on legislation, nothing will. Only after full Senate action is complete will we be able to work together on a conference committee to send the President a GSE bill this Congress.