AN ANALYSIS OF THE POST-CONSERVATORSHIP LEGAL EXPENSES OF FANNIE MAE AND FREDDIE MAC

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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WITNESSES

TUESDAY, FEBRUARY 9, 2011

APPENDIX

AN ANALYSIS OF THE POST-CONSERVATORSHIP LEGAL EXPENSES OF FANNIE MAE AND FREDDIE MAC

Tuesday, February 15, 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 2:23 p.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Fitzpatrick, Bachmann, Pearce, Posey, Hayworth, Renacci, Grimm, Canseco; Capuano, Lynch, Baca, and Miller of North Carolina.

Also present: Representative Garrett.

Chairman NEUGEBAUER. This hearing will come to order. I want to thank everyone for being here. We have a lot going on; we had a vote, and we have some members who are in a meeting, and hopefully they will be able to join us very soon.

This hearing will come to order. And without objection, all members' opening statements will be made a part of the record.

Let me start off by saying this is the first meeting of the Oversight and Investigations Subcommittee of the Committee on Financial Services, and I am delighted to be serving with my good friend, Mr. Capuano, and we have actually had a meeting, and we think that overseeing the agencies and the responsibility of making sure that the American people—taxpayers' money is being well spent, and that rules and regulations are being implemented in an appropriate way are important. And I look forward to working in a very bipartisan way to make sure that this is a productive committee.

We will start off by having our opening statements. I will open with my statement, and then the ranking member with his.

Since September 7, 2008, the U.S. taxpayers have sunk $153 billion into Fannie Mae and Freddie Mac. And according to the Federal Housing Finance Agency, the final tab could be as high as $363 billion.

As if the news couldn't get any worse for the American people, an investigation undertaken by this subcommittee has discovered that the taxpayers have spent more than $162 million defending Freddie and Fannie and their former top executives in civil lawsuits accusing them of fraud. This includes over tens of millions of

dollars for former executives who knowingly and purposely manipulated earnings to increase their own compensation and whose actions directly contributed to the demise of the GSEs.

The history of Fannie Mae under the management of Franklin Raines, Timothy Howard, and Leanne Spencer is a story of abusing their positions to use assets of the Enterprises to further their own interests and careers. The abuse by these individuals was so far-ranging that Fannie and Freddie were forced to restate earnings by over $10 billion, which was followed by a $400 million settlement with the SEC and OFHEO, and losses of tens of billion dollars in market capitalization for Fannie's shareholders.

Unfortunately today, years after they were forced out of the company, these misdeeds of Franklin Raines and his management team have continued their abuse. This time, however, it is against the U.S. taxpayers. As a result of my inquiries, I have discovered that taxpayers have advanced $24.2 million in legal expenses against civil lawsuits accusing them of securities fraud.

These three individuals, who collectively earned $150 million in total compensation from 1998 to 2003, are not just assured of indemnification, but are actually being advanced funds, which means that they have no expenses and are just running up the tab for the U.S. taxpayers. Moreover, their attorneys have every incentive to keep the case going for as long as possible to maximize their fees, which already are in the tens of millions of dollars.

One case in particular has been ongoing since 2004 and has included over 120 fact depositions, various expert depositions, and millions of discovery documents. Unfortunately, the end is nowhere in sight. This open-ended taxpayer commitment was approved by the FHFA, the very entity that has an obligation to conserve the assets of the GSEs in such a way as to minimize taxpayers' exposure. It was approved even though Fannie Mae bylaws clearly state that the indemnification shall not apply to directors and officers who breach their duty of loyalty to shareholders or engage in intentional misconduct, two measures that Franklin Raines and his management team clearly violated.

It is also worth noting that under section 4617 of the Housing and Economic Recovery Act, or HERA, the FHFA has the power to repudiate the indemnification agreements for these individuals. With all of that being said, even if the FHFA still feels obligated to advance legal expenses for Mr. Raines, Mr. Howard, and Ms. Spencer, the contracts state that they are entitled to the advancement of reasonable legal fees, and I think many of—all of my colleagues can agree that many of these fees are not reasonable, given the mounting taxpayer exposure.

The delay tactic of the defendants and the fact that many of these security-related lawsuits have no end in sight, one thing I feel very strongly about is that this subcommittee needs to do everything it can to minimize further taxpayer exposure associated with Fannie Mae and Freddie Mac. I would like to work with Mr. DeMarco and the FHFA to make sure that they are equipped with all the tools necessary to accomplish this objective.

In closing, I would like to state that this particular topic has raised many more questions about continuing operations of GSEs and, accordingly, this will more than likely not be the last of many

hearings to happen in the future. Along these lines, I am also looking forward to working with Chairman Bachus and Chairman Garrett to take a serious look at whether conservatorship of the GSEs is the best structure to protect the U.S. taxpayers.

And with that, I would yield to the gentleman from Massachusetts, Ranking Member Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman. I look forward to working with you, as well. As you stated, we had a meeting that was very productive and very cooperative, and I think it is going to be actually a great term to be able to work together. There are a lot of questions that we both have about a lot of different things that have gone on in the financial services world. This is one of many.

I, for one, really want to hear today about industry standards and whether this situation mirrors industry standards, and if not, why not, and what are we going to do about it? And even if it does, I think we have serious questions of what to do, going forward. To me, those are the biggest questions. I have some understanding of what happens in the private industry world and how it works, but I want to make sure that has been the situation.

And my hope is that the panelists here today address that issue more than anything else. I am not here on a witch hunt for anything or anybody, but at the same time, this is a huge amount of money. On its face, it appears to be unreasonable, but again, I will listen to others if they disagree, and if so, why. And I think that, more than anything else, this hearing is a very good hearing to ask serious questions on an important issue.

And with that, I yield back the balance of my time.

Chairman NEUGEBAUER. Thank you. I will now yield 2 minutes to the gentleman from New York, Mr. Grimm.

Mr. GRIMM. Mr. Chairman, I am going to yield right now. I am waiting for my—I have a couple of questions that I just wrote right before I came in that are being printed up for me.

Chairman NEUGEBAUER. Okay, thank you. Does any other member on this side want to make an opening statement? Mr. Miller?

Mr. BACA. I am Mr. Baca. Excuse me. Thank you very much, Mr. Chairman and Mr. Ranking Member, for calling this hearing today. I also want to thank the witnesses for sharing substantive understanding regarding Freddie Mac and Fannie Mae, as well as the legal expenses incurred.

This hearing is important to the American taxpayers. It is important for us to understand the complexity of the problem caused by the fall of the housing market.

So much damage was caused by allowing an industry to take advantage of our families, and I state, "take advantage of our families" who only wanted to have the American dream, and that is to own a home. They wanted to own their own homes, and now some are homeless. Others are forced to endure the nightmare of foreclosure, and in my district, we have one of the highest foreclosures in the Nation, so I am very much concerned.

Sadly, there are even more Americans who own a home that is not worth the financial obligations they legally were bound to pay because of the housing crisis that caused the market to fall. And this is very depressing, when many of the individuals who ended

up buying their homes ended up paying outrageous prices, and it is not even worth it at this point.

Today, we will hear about the legal fees, another example of a financial loss caused by allowing an industry to go unregulated or, simply stated, they got greedy. Today, we will learn that these legal fees are an additional ramification caused by the Bush Administration's failure to monitor and control the housing industry. So let us put it where it started, not where it was the last 2 years, but where it started, with no oversight and no transparency.

Again, I want to thank the chairman and the ranking member for their leadership on this issue. I look forward to hearing from my colleagues and the witnesses on the issues at hand. I yield back the balance of my time.

Chairman NEUGEBAUER. The Chair recognizes Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

The financial crisis is now well into the litigation stage where everybody is suing everybody for everything. According to published reports, Chase is involved in litigation as a plaintiff against—as a securitizer of mortgage-backed securities suing the lenders who made the mortgages in the first place, saying the mortgages fail to meet the contractual requirements and are defendants in other litigation against the people who bought the mortgage-backed securities, saying that the mortgages are perfectly fine, the very same mortgages.

So we will—I think we can expect more of that, and this is probably the period in this crisis that we learn more from the litigation than we learn from the Financial Crisis Inquiry Commission, SIGTARP, or the Congressional Oversight Panel, from well-motivated lawyers going after their claims.

And this is also the period in which the taxpayers' exposure for ultimate loss for Fannie and Freddie is really going to be determined. It is going to be very easy to hide behind the lawyers and provide further subsidies, back-door subsidies, to an industry that has already gotten too many subsidies by failing to vigorously pursue claims that Fannie and Freddie have or by giving in too easily where Fannie and Freddie are the defendant.

Now, it is not that easy for lawyers to conduct litigation while providing a continuous play-by-play commentary of the facts and the law and of every strategic decision. But it is very entirely appropriate for the taxpayers, and for us as a Congress, to expect that there will ultimately be some openness, some transparency about how the litigation was conducted, litigation that will really determine how much the taxpayers are going to lose from Fannie and Freddie.

So whether I ultimately agree that Fannie and Freddie have—or that FHFA has handled this litigation appropriately or not, I do welcome the oversight into litigation in which Fannie and Freddie are parties. It is the least that we should do.

Chairman NEUGEBAUER. Thank you. If there are no other opening statements, then we will hear from our panelists. First, we will hear from Mr. Edward DeMarco. He is the Acting Director of the Federal Housing Finance Agency, and I believe you have with you Mr. Pollard, who is your general counsel. So Mr. DeMarco, thank you for being here, and you may proceed.

STATEMENT OF EDWARD J. DeMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY, ACCOMPANIED BY ALFRED POLLARD, GENERAL COUNSEL, FEDERAL HOUSING FINANCE AGENCY (FHFA)

Mr. DEMARCO. Yes, sir. Thank you, Mr. Chairman.

Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, thank you for inviting me to address matters relating to legal expenses of Fannie Mae and Freddie Mac and advancement of legal fees for certain former officers.

I share the frustration of members of this subcommittee and others that funds are being advanced to finance the legal defense of former officers at Fannie Mae, funds that effectively increase the cost to taxpayers of the conservatorship.

These former officers have been disgraced by the findings of FHFA's predecessor agency, OFHEO, and they were forced from their jobs as a result of those findings. Yet our frustration cannot interfere with our responsibilities to follow the law, respect the rights of those involved, allow the judicial process to proceed under the oversight of the presiding judge, and allow other government agencies to act under their authorities.

As some of the matters you have asked me to address are currently in litigation in which FHFA participates as conservator, I have accepted the offer of the chairman to have FHFA's General Counsel, Alfred Pollard, here with me during this hearing. Members should know that I am not a lawyer, but many of the subjects of concern involved technical legal matters.

The Federal Housing Finance Agency has consistently viewed indemnification as a prerequisite for attracting and retaining skilled officers and directors. Indemnification, properly administered, is in the best interest of Fannie Mae and Freddie Mac, and therefore fits within FHFA's goal of preserving and conserving assets.

At the same time, properly structured indemnification includes guidelines for denying indemnification and requiring repayment of advanced fees in certain circumstances. Overturning existing contracts or policies would be a determination with potential adverse consequences and would be inconsistent with standard business practice.

At the time of the conservatorship, FHFA announced it intended for the Enterprises to operate as going concerns with new CEOs and Boards of Directors, and that they were to continue normal business operations in support of the mortgage markets. This included the need to attract and retain skilled professionals. These officers and directors, therefore, could be sued just as before conservatorship, thus the need for retaining indemnification.

The determination by FHFA not to interfere with indemnification in advancement of legal fees for former Fannie Mae executives was based on Fannie Mae's corporate bylaws, governing Delaware State law, the provisions of statute governing FHFA's oversight of Fannie Mae, and court cases addressing such an action.

FHFA believed the continued advancement of funds was in line with the conservatorship framework and that actions to interfere would be counterproductive due to the ability of individuals denied to sue the agency for such actions. Also, such action would raise secondary issues related to other employees and their view of the

validity of indemnification of their legal expenses and their willingness to continue their employment at the Enterprises.

At the time the Enterprises were placed into conservatorship, it was important to avoid losing personnel who could help reduce costs to the taxpayer from their large portfolios and business activities and who could be distracted by an absence, or potential absence, of indemnification. Securing new CEOs, Boards of Directors, and employees for the Enterprises would not have been possible without indemnification.

Even in ordinary times, the Enterprises are large corporations and incur significant legal expenses. Clearly, in conservatorship, their legal expenses continue and the mortgage market crisis has led to even greater legal costs. Beyond legal expenses associated with pre-conservatorship lawsuits, the companies have substantial legal expenses related to lawsuits by homeowners, investigations by government agencies, and expenses related to securing recovery of damages from their counterparties.

In all of these activities, the legal issues are very complex and litigation involves significant expenses associated with extensive discovery, document production, expert witnesses, and other costs involved in judicial and regulatory proceedings.

Clearly, Mr. Chairman, controlling expenses has been the concern that you have highlighted by calling this hearing. I believe that FHFA can build on its existing work with the Enterprises to control legal and other expenses in a way that protects taxpayers. Likewise, I believe we can inform the courts and other regulators of the expenses involved and the role of the taxpayers while the Enterprises are in conservatorship.

Thank you for this opportunity, and I would be happy to answer questions.

[The prepared statement of Acting Director DeMarco can be found on page 39 of the appendix.]

Chairman NEUGEBAUER. Thank you.

Our next panelist is Mr. Michael Williams. He is the Chief Executive Officer of the Federal National Mortgage Association. I believe you are accompanied by your General Counsel, Mr. Mayopoulos. Is that correct? Mr. Williams, you may proceed. Thank you.

STATEMENT OF MICHAEL J. WILLIAMS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE), ACCOMPANIED BY TIMOTHY J. MAYOPOULOS, GENERAL COUNSEL, FEDERAL NATIONAL MORTGAGE ASSOCIATION

Mr. WILLIAMS. Chairman Neugebauer, Ranking Member Capuano, and members of the committee, good afternoon. My name is Mike Williams, and I am the President and Chief Executive Officer of Fannie Mae. I was named to that role in April of 2009 after the company had been placed in conservatorship.

Fannie Mae is playing a critical role in stabilizing the Nation's fragile housing market. Since 2009, Fannie Mae has provided more than $1.2 trillion in mortgage liquidity, helped one million families to buy homes, and enabled 3.8 million homeowners to refinance into lower-cost mortgages. In that time, we have also provided over

$30 billion of financing for more than 570,000 units of affordable rental housing.

Fannie Mae has also substantially strengthened its underwriting standards and set new guidelines for the industry on loan quality. As a result, we are building a profitable new book of business. We are committed to putting a very strong foundation in place for a sustained recovery in housing, which is key to getting the U.S. economy back on track.

The committee has asked me to discuss Fannie Mae's post-conservatorship legal expenses. As CEO, I am keenly aware of Fannie Mae's responsibility to manage expenses prudently. Fannie Mae is currently facing an unprecedented volume of complex legal matters. For example, various members of the plaintiffs' trial bar are pursuing class-action lawsuits against Fannie Mae, including one brought on behalf of the Attorney General of Ohio. Plaintiffs and their lawyers are seeking billions of dollars. Fannie Mae has substantial defenses in these lawsuits and is vigorously defending the company and the taxpayers from this potential liability.

Fannie Mae has also been the subject of numerous agency and congressional investigations. In cooperating fully, we have incurred significant expenses collecting, processing, reviewing, storing, and producing tens of millions of pages of data and documents.

We also incur legal expenses in the aggressive pursuit of claims against entities that owe Fannie Mae money. To date, we have been successful in recovering sums well in excess of our legal costs.

In addition to our legal expenses, Fannie Mae is obligated to advance certain legal expenses incurred by current and former officers. This obligation derives from Article 6 of our bylaws, which Fannie Mae's shareholders adopted in 1987. It is also governed by the contracts that Fannie Mae's Board has entered into with each of its officers and directors.

Our conservator affirmed these contracts in 2008. Where they apply, the company's obligation is to advance legal expenses, and that is always mandatory. If Fannie Mae were to refuse to honor this obligation, we would undoubtedly be sued and likely be subject to additional costs.

Corporations throughout America make provisions similar to ours in order to attract and retain strong and experienced officers and directors. Since 2009, Fannie Mae has put in place a new Board of Directors and senior executive team. It would not have been possible for the company to recruit and retain these professionals without offering advancement protections and applying them consistently.

Since 2005, Fannie Mae's General Counsel has used the services of a third-party vendor to review all legal bills for individuals entitled to advancement. Currently, we use a legal invoice audit firm that has provided services for some of the largest corporations in America and various government entities. The vendor negotiates billing rates and determines reasonableness and necessity of all charges.

In closing, we take seriously our responsibility to manage effectively the resources that we have been provided. Today, I am joined by our General Counsel, Timothy Mayopoulos, and we look forward to taking your questions, Mr. Chairman.

[The prepared statement of Mr. Williams can be found on page 48 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Williams. I do want to remind everyone that, without objection, your written statements will be made a part of the record.

I will start the questioning. Mr. DeMarco, under section 4617 of the Housing and Economic Recovery Act of 2008, the conservator or receiver of the GSEs may disaffirm or repudiate any contract if the conservator determines that the performance of these contracts is burdensome and that the repudiation of the contract will promote the orderly administration of the affairs of the GSE. You evidently made a determination that paying these legal fees and continuing to defend these individuals was not burdensome to the corporation. How do you justify that?

Mr. DEMARCO. Mr. Chairman, yes, that determination was made. It was made at the time the conservatorship was established by my predecessor, and the determination was made by my predecessor for the reasons that are outlined in my testimony, that this advancement of legal fees was required by FHFA's own regulation, that the indemnification that was in place was required by FHFA's own regulation, was consistent with Fannie Mae's bylaws and was, at that point, a requirement under applicable State law.

So the determination was made at that point, and that is not, at this point, a determination to be revisited.

Chairman NEUGEBAUER. We keep talking about Fannie Mae's bylaws. I want to read you something that is also from Fannie Mae's bylaws. For example, it states that the indemnification will not be provided when the officer or director breaches his duty of loyalty to the corporation, acts, or fails to act in good faith, and engages in intentional misconduct.

I know that you have read the OFHEO report, and this is a copy of the report. All of these tabs represent areas where the three individuals that you are continuing to pay legal fees on acted in ways that were not in the best interest of the corporation and, to me, violated the very bylaws of this corporation.

And so, for the determination to find that is not burdensome, and that, in fact, these contracts should be honored, is a little puzzling to me, and I think it is a little puzzling to the American taxpayers, because they are continuing to pay fairly substantial legal fees for these three individuals who, according to this report, weren't doing things that were to the benefit of the corporation and, ultimately, the taxpayers had to come in to the tune of—right now of about $150 billion.

And that total could go up. So I am still trying to figure out how you felt like that was in the best interest of the corporation.

Mr. DEMARCO. Mr. Chairman, that is a fair question. And I think that my written statement, which goes into some detail in defining indemnification, defining the grounds under which indemnification would be denied, may be helpful here. But let me try to summarize, and then if counsel wants to supplement, that may be helpful as well.

But essentially, indemnification is something that actually takes place at the conclusion of a judicial or administrative activity. There are two areas in which the actions of these former executives

have come under review. The first is there was an administrative notice of charges that was filed by FHFA's predecessor agency, OFHEO, based upon the findings in the report that you referenced.

That notice of charges was made in December of 2006 and ultimately resulted in a settlement in April of 2008, a settlement with the three former executives that resulted in payments by those executives but did not result in any finding or admission of the breaches that would violate—that would meet the standards in the bylaws to avoid indemnification.

The litigation that is ongoing today, the multi-district litigation that is the subject of such attention here, is in fact to determine the behavior and activities of these former officers and whether they did breach. So the finding that would be the predicate for denying indemnification has not taken place yet because we are, in fact, in the midst of such litigation.

Therefore, what is going on right now is an advancement of legal fees, and that is very much required by contract and by law, and the advancement of legal fees will continue until the conclusion of this judicial action when there is finality to that based upon what the outcome or findings of that may be.

There would then be a determination as to whether indemnification of these officers would be provided or whether there are grounds to seek repayment of the advancement of those fees. But that cannot take place while this is in process. It is something that takes place at the end of the legal process.

Chairman NEUGEBAUER. I would also say, though, that you could have denied advancement, or if you weren't going to repudiate the indemnification, you had the ability to say to these individuals, "You know what? We have a little problem here. We are broke, and we are not advancing additional monies for these fees." Obviously, I think that brings some incentive for those individuals not to keep burning taxpayers' money.

Mr. DEMARCO. Mr. Chairman, I certainly understand the issue and the concern that you are raising there. I would simply say that the determination at FHFA was that to cease advancing those legal fees would have resulted in suits against us, and operating with the responsibility as conservator, we determined that, looking at the legal case law here and the facts and circumstances and what governed in terms of contract law and other applicable law, what needed to be done was to continue advancing those fees.

That is the determination that was made at the time the conservatorship was established. FHFA did affirm that for the company, and so we continue to operate with that affirmation in place.

Chairman NEUGEBAUER. My time has expired.

Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. DeMarco, basically you made a determination as to who makes the decision as to who breached these fiduciary responsibilities, and obviously you made a determination—correct me if I am wrong—that would require a final court decision as to whether they breached their responsibilities. Is that a fair summary?

Mr. DEMARCO. I did not make that determination, Mr. Capuano. I believe that determination is effectively what is required by statute and governing law here.

Mr. CAPUANO. So that is—but still—
Mr. DEMARCO. But—interpretation of that, yes—
Mr. CAPUANO. —somebody had to interpret the law.
Mr. DEMARCO. —it is our interpretation.
Mr. CAPUANO. I don't mean to be disrespectful. I am a lawyer. Without differences of opinion as to what laws mean, you wouldn't need lawyers. So somebody had to make a determination that is what the law meant, and I understand that. And I would respectfully suggest that, going forward, we make a determination as to where we are going to draw the line.

And I would argue that I understand the legal arguments that you probably would have gotten sued. I agree, you would have. You may have won. You may have lost. You still should have taken the hit, done the right thing, taken the hit, and if you lose it going forward, you lose it going forward. Having done the right thing, you wouldn't be here today. We would be saying, "Good job. Keep it up."

As opposed to that, you made a decision to take the conservative view, to allow them to keep going, and now you are here today, and we are going to beat you up a little bit today and probably a little bit more, going forward. And in my opinion, in defending the taxpayer's money, I think on occasion you have to take a little bit of a reach as to who makes those determinations.

I would also ask, is this agreement—and as I understand it, it is, but I want to hear it from you and from Mr. Williams—is the current agreement, and even the one that was in place then, I agree that directors and officers liability insurance is an important aspect. I buy the concept. There are many ways to do that. Do you believe that the past and current agreements on directors and officer liability is within the standard of normal operating business procedures today?

Mr. DEMARCO. I do.
Mr. CAPUANO. Mr. Williams, do you?
Mr. WILLIAMS. Yes, I do.
Mr. CAPUANO. Okay. I—again, I would like to pursue that a little bit more at a later time with maybe some outside experts. But at the moment, I accept your decision.

At the same time, the definition of the term "reasonable"—has anyone questioned the term "reasonable amounts of money that have been paid out?" I understand you have an outside agency doing it. Has anyone questioned that, either inside Fannie or inside FHFA or any of the plaintiffs? Has anyone said we disagree with this vendor's determination that these charges of X gazillion dollars are reasonable?

Mr. DEMARCO. Sorry. I am not aware of particular claims being made that the legal fees that have been incurred are unreasonable as based on an industry standard. I am simply not aware of that.
Mr. CAPUANO. Mr. Williams, are you aware of anything?
Mr. WILLIAMS. Congressman, I am not aware.
Mr. CAPUANO. Okay. I guess for me, the question is also I understand—yes, go ahead, Mr. Pollard. Sorry.
Mr. POLLARD. In our oversight capacity, we have a—to make all efforts to observe the reasonable—
Mr. CAPUANO. Yes. I think your microphone is not on.

Mr. POLLARD. I apologize. I would say that our oversight capacity from the office of general counsel and the agency, we have spoken with both companies on an ongoing basis, reminding them of the need to keep fees down across-the-board, not just for individuals here, but the general legal expenses.

And I believe they have undertaken to do the best they can in this market to try and keep fees down and to hold fees in line. Their fees are very much going to be judged, in fact, by their legal advisory firm by looking at what other firms do. In other words, what do other courts—

Mr. CAPUANO. I understand that. So that is always the problem with the term "reasonable" is that people read it differently. For me, $160 million worth of legal fees, it certainly sounds unreasonable. Again, I understand people can disagree. But I am also interested in going forward. Is there anything in these provisions? And if not, can you put them in? Would you consider putting them in?

For the sake of discussion in this case, clearly OFHEO should not have accepted this deal the way it was written. Somebody should have sat up and screamed that they were not going to take the deal because it means we now have to pay these outrageous legal fees. Okay, it was done.

Going forward, at the very least, and hopefully today, and hopefully if not soon, let us assume this happens again tomorrow, and you, Mr. DeMarco, make a determination that somebody else has breached their responsibility. Why shouldn't we then, continuing with the typical rules of directors, not just liability, say, Okay, from this day forward, we will either put these payments in some kind of a contingency fee, or we will put a lien on something, or we will have some other surety to guarantee that we will be able to get these fees back, since an initial determination has already been made by a neutral body that you have violated some standard?

Understanding fully well that determination won't be final until it is final, but in the meantime, right now, as we sit here, let us be serious. We are never going to get this money back, at least I don't think any reasonable person thinks we will. And that is the problem. I understand paying it up front. I understand having liability coverage. I get all that.

But what I don't get is why we leave ourselves totally naked to someone who on at least one level, understanding it is not final, has already been determined to have breached their fiduciary responsibilities, and yet we are still going to pay through the nose forever and ever with no real hope of recouping that money. Is there anything we can do going forward, either in this case or in future cases, to say, if this happens again, at the very least, we will have a lien, we will have sureties, we will have something else on the side that we can recoup this money when the time comes?

Mr. DEMARCO. I am sorry, I am not aware of what—I don't have that particular recommendation or answer to that question. I would observe that the matter that you are asking is far broader than two companies in conservatorship. This strikes me as a general matter of both corporate practice and existing law that governs these matters. There is a great deal of case history, as I have been told about these things. So to your question of what could be done, it is a much broader question here—

Mr. CAPUANO. But these case histories are not based on taxpayer dollars doing this. These case histories are on shareholders' dollars doing it, not taxpayer dollars. This is a unique and different situation that I would suggest we consider going forward, at the very least, having unique and different approach.

Mr. DEMARCO. Right. I would certainly agree with that, sir. There is no precedent for 2½ years of conservatorship for major financial institutions like this in conservatorships that are likely to continue for a number of years further until this is ultimately resolved. There has been nothing like this before, sir, and it does pose unique and new questions for us.

Chairman NEUGEBAUER. I thank the gentleman.

And now the vice chairman of the committee, Mr. Fitzpatrick.

Mr. FITZPATRICK. Thank you, Mr. Chairman, for calling this hearing.

This question is for Mr. DeMarco and Mr. Williams, sort of following up on Mr. Capuano's comments that Fannie Mae and Freddie Mac have never really been private entities, fully private. So when a member of our panel questions the appropriateness or reasonableness of paying for the legal defense of former Fannie officers or directors, we just ask that you keep that in mind.

Before the conservatorship, Fannie enjoyed privileges that other private firms were denied. It did not have to pay State taxes, and it didn't have to pay local taxes. Until 2006, they did not have to register the securities with the SEC. They had a line of credit with the Treasury.

Above all, they had a lower cost of funding than any other private entity would have because they were beneficiaries of an implied government guarantee. Notwithstanding this, they are advantages that still resulted in paying for the GSE's shareholders as a result of accounting scandals, and now paying for the taxpayers as a result of the conservatorship status.

The accounting scandals resulted in fines, decreases in market capitalization, expensive internal corrective actions, and declines in share prices which cumulatively blocked the safety and soundness of these institutions. $400 million in fines were paid to the SEC and OFHEO in 2006. Earnings restatements totaling $11 billion were made for both firms.

In 2006, Acting Director of OFHEO Jim Lockhart said this about the cost of Fannie's earning manipulation executed by Fannie senior management. This is his quote: "Fannie Mae's executives were precisely managing earnings to the 100th of a penny to maximize their bonuses while neglecting investments in systems, internal controls, and risk management."

And he went on to say, "The combination of earnings manipulation, mismanagement and unconstrained growth resulted in an estimated $10.6 billion in losses, well over $1 billion in expenses to fix the problems, and ill-begotten bonuses in the hundreds of millions of dollars."

The conservatorship has brought cost to the taxpayers for the GSEs misdeeds. To date, the Fannie Mae and Freddie Mac bailout total stands at about $153 billion, making the GSE conservatorship by far the costliest of all the taxpayer bailouts carried out over the past 3 years. The cost of the bailout could still go higher. On Sep-

tember 15, 2010, in testimony before this committee, Mr. DeMarco stated severe stress scenarios. The Treasury draws for the GSEs could come in, I think you said, at about—or perhaps just under $400 billion.

That brings us to the question before us today of legal fees for Franklin Raines, Tim Howard, Leanne Spencer and the others at Fannie Mae who have been responsible for the massive losses to shareholders and now taxpayers. And so I ask the two of you, in this context, is it reasonable to advance legal fees for individuals who have been found by both OFHEO and the SEC to have manipulated earnings for their own private benefit? Is that reasonable to ask the taxpayers?

Mr. DEMARCO. Congressman, I believe the answer is we have an obligation to advance these legal fees. And at this point, I think it may be best to ask my counsel to provide a little bit more of the legal context as to why we have that view.

Mr. POLLARD. Congressman, OFHEO put in place regulations requiring the Enterprises to select a State law under which to operate. Fannie Mae operates under Delaware law. If you go into Federal court, Delaware law will be the subject that will be raised in any action.

In looking at the requirements of that law and the court decisions under it, there is indemnification, which comes at the end, and there is advancement of legal fees. Even if a company sues its own employees for breaches of fiduciary duties, they are entitled to advancement of legal fees until the final determination. I am just trying to give you, at the extreme end of this.

So I think, just in looking at the law and what we have had to advise from the office of general counsel to the senior management of our agency is that the obligation that we are looking to, under Delaware law, is to advance fees. That does not mean at the end of the day, when a decision is made on indemnification, if someone determines the findings by the agency are its findings, here is what we found, but for someone to sue—and I might note some of the court cases preceded actions by our agency even—that requires the determination by a court or another adjudicative body that you have, in fact, breached these fiduciary duties. And that is what I think the Director has been trying to say.

So the short answer is, under all the law that I have seen and read in Delaware and other States, looking at State law in this matter, is that advancement of legal fees is considered mandatory. The Supreme Court of the United States—excuse me, the Second Circuit of the United States has said that, where the Justice Department was looking to interfere with advancement of legal fees, this would be considered unconstitutional. This was in a criminal case, and I want to be clear, that is a different matter.

But clearly, the courts have been uniform that it is the very charge of the breach of the fiduciary duty, because it is so serious, that is the one that would permit, and even require, advancement of legal fees because you are the most at-risk in that situation. So I think that is the foundational law.

The chairman and the ranking member asked about why don't you step in. All the court cases that I have looked at in cases of advancement of legal fees have gone against the private sector

firm, and even the government, where the government was trying to stop advancement of fees.

So I think that is sort of the foundational basis in which we operate, and I think the ranking member's question about what can we do, and I think the Director's answer about that, a large question is there. So I hope that is helpful in terms—

Mr. FITZPATRICK. So the court cases were construing mostly private corporation?

Mr. POLLARD. They are private corporations, companies, but I even have one case of a company under the RTC that was in receivership. And the court ordered the advancement of legal fees to the officers of that firm when they were being sued by the company.

Mr. FITZPATRICK. But none of those cases are construing a law with respect to government-sponsored enterprises?

Mr. POLLARD. No, sir.

Mr. FITZPATRICK. So this would be a case of first impressions?

Mr. POLLARD. It would be a case of—yes, sir.

Mr. FITZPATRICK. And they are construing the law of indemnification on the corporate side, correct?

Mr. POLLARD. In advancement of fees, yes.

Mr. FITZPATRICK. And are you relying on sort of the corporate law of indemnification, as you understand it, as well as the contracts of these individual employees?

Mr. POLLARD. Yes, that, but also our own regulation, which says select a State law, our own regulation which says you can indemnify your employees with appropriate safeguards. By the way, I think the word "reasonableness" from our perspective, is that it has to be done appropriately and it needs to be reasonable.

Chairman NEUGEBAUER. I thank the gentleman for his questions.

And I now yield to the other gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

And I want to thank the witnesses for helping the committee with its work.

I have been reading through some of the descriptions of the court case against Fannie Mae and its officers by a couple of pension funds in Ohio. And I have to admit, while I understand the principle of indemnification in order to get officers to serve, this case has been going on for 6 years, and that is far longer than any average case under these circumstances.

I understand this is a big case, but I am also reading that, even at the most mundane and procedural conferences, that Fannie Mae and the officers are bringing in 35 to 40 lawyers and paralegals while the plaintiffs are coming in with 2 or 3, that they are bringing in 25 expert witnesses when the plaintiffs are bringing in one or two. And in many cases, the judge has pointed out that they are driving up the cost of this litigation.

So I am interested in indemnifying the taxpayer, because we are bleeding here. This is 6 years and counting, and these are staggering numbers that we are seeing here.

I understand the principle. You have to have indemnification to an extent in order for people to be willing to serve in these positions, but indemnification is an insurable risk. Now, I don't know who made the decisions, but we should have an insurance policy

to provide a fixed amount of resources for a person to fight these claims against them. We shouldn't be having to reach into the taxpayers' pocket every time there is another hearing or a deposition or any other legal proceeding where we need counsel.

And it bothers me greatly that this is an insurable risk. Corporations, every one of them, all across America, get a policy to indemnify their officers. And here we are, Fannie Mae? That is what you would call a target-rich environment, where I am sure you have probably hundreds, if not thousands of folks, suing Fannie Mae for their either nonfeasance or malfeasance during this whole crisis. And it just bothers me to no end that we are not—we are worried about indemnifying these officers to the tune of $137 million and counting. They have already paid a $400 million fine, and nobody is watching out for the taxpayer, in my opinion.

Does anybody want to take a shot at this? Why did we not—is somebody managing this litigation from your standpoint, where they are saying, "No, you shouldn't really have 40 attorneys here? You shouldn't have 30 paralegals. You shouldn't have 25 expert witnesses." Someone to manage—believe me, if this was coming out of their pocket, they would not be handling this this way.

Mr. DEMARCO. Right. Congressman Lynch, there are observations and questions. I believe that Mr. DeWine, who is in the next panel, has raised, in his prepared statement, a situation which, as you describe, there were numerous attorneys present at a particular deposition. I have been told that the presiding judge said something about that at that time, and that has not been repeated. More generally, of course, the judge is the presiding officer in the litigation, and excesses and delays that are taking place on either side are the responsibility of the judge to address.

And finally, with respect to this litigation—and it is in litigation, so I need to be careful about what I can say, but one might ask the other side, the plaintiff in this case is continuing to pursue the litigation in light of the conservatorship. At this point, the plaintiffs are effectively suing for funds that ultimately could come from the U.S. taxpayer.

So the defense that is being put up here is defense against a suit that, if successful, would presumably result in a claim against Fannie Mae, Fannie Mae in conservatorship being backed by the taxpayer, so there are some questions here about—I agree about the situation that we are in. But what we are trying to do is to respect everyone's legal rights, and the judicial process in this matter is with the judge.

And the other thing I would say that I think may be helpful here is I intend to file my written statement for this hearing with the court so that the court is aware of the concern of this body and the discussion that we had here today.

Mr. LYNCH. Thank you.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. Thank you.

We have been joined by Mr. Garrett, who is the chairman of the Capital Markets Subcommittee, and I would ask unanimous consent to allow him to be a part of our—on the dais today and ask questions if he chooses, without objection.

Next, to the gentleman from Florida, Mr. Posey.

Mr. POSEY. Thank you, Mr. Chairman.

I guess you have read Mr. Devine's statement—is it Devine—DeWine—have you all read that?

Mr. DEMARCO. Yes, sir.

Mr. WILLIAMS. Yes, we have.

Mr. POSEY. I was struck somewhat by the fact that 13 lawyers appeared at the April 2010 hearing, the deposition, to represent the accused, so to speak, here. And I was wondering, what if they had brought 50? Would that be okay? They brought 13 for 5 defendants. What if they had brought 50? Would that have been okay?

Mr. MAYOPOULOS. Congressman, perhaps I could address this issue, because I think there is—the statement in Mr. DeWine's—sorry, Attorney General DeWine's statement that there were 13 attorneys present for the defendants at Mr. Raines' deposition is not entirely accurate.

As you know, Mr. Raines and Mr. Howard and Ms. Spencer are all defending lawsuits alleging significant liability, and they are all entitled to have their own separate representation. But at most depositions, one attorney for each defendant appears. For particularly important depositions, such as the deposition of Mr. Raines, it may be appropriate to have more than one.

But for this particular deposition, it lasted for 2 days. Fannie Mae advanced the legal fees for a total of six attorneys, two for Mr. Raines, two for Mr. Howard, and one for Ms. Spencer, and one for Mr. Mudd, who, while not a party directly to this lawsuit, is a party to other lawsuits for which discovery is being conducted at the same time.

And Fannie Mae itself was represented by two attorneys, one of whom became ill during the first day and was replaced by a different person. In fact, Ms. Spencer sought advancement for two attorneys, and we declined that.

So the suggestion that we paid for 13 attorneys to attend this deposition is just not accurate. I don't think Attorney General DeWine would know that. He may know how many people actually showed up, but he doesn't know how many actually got paid. And we know how many got paid, and 13 did not get paid.

Mr. POSEY. Mr. Chairman—how many got paid that day?

Mr. MAYOPOULOS. The number who got paid was a total of seven for the individuals—two for Mr. Raines, two for Mr. Howard, one for Ms. Spencer—I am sorry, that is five—and two for Fannie Mae, one of whom became ill during the course of the deposition. So in effect, six or seven if you count the one who fell ill.

Mr. POSEY. Okay. And we will continue to advance—pay legal fees until there is some adjudication of their guilt. Is that correct?

Mr. MAYOPOULOS. That is correct.

Mr. POSEY. And there is no limit on the future, correct?

Mr. MAYOPOULOS. All the parties, I think, are trying to bring this matter to a close. In terms of how long the case is going to last, I will say that there have been over 120 depositions in the case. A hundred of those were noticed by the plaintiffs, not by the defendants, but by the plaintiffs. The plaintiffs took 100 depositions. So of course, the defendants must show up to appear at those depositions and to examine those witnesses.

So this case has gone on for 6 years, but it is the plaintiffs who have alleged 1,500 pages of accusations; between their complaint, the Paul Weiss report, and the OFHEO report, there are 1,500 pages of allegations. They have done very little to try to winnow the case down.

And frankly, the plaintiffs are the parties who added the three defendants we are talking about. The plaintiffs are not going to collect $9 billion from Mr. Raines, Mr. Howard, and Ms. Spencer. I don't know them, but I doubt that they have $9 billion. It is unclear to me why the Attorney General of Ohio has even named those parties as defendants since the only entity that could actually pay the $9 billion that the Attorney General says he is seeking would be Fannie Mae, and, in effect, not even Fannie Mae, but the U.S. Treasury.

Mr. POSEY. Just a quick response. I would probably fault the agency more than the plaintiffs if they have 1,500 pages worth of allegations. I don't think that is the plaintiff's fault. I think, in all likelihood, there is something that the defendants did wrong that resulted in them coming up with 1,500 pages in accusations.

Mr. DEMARCO. If I may, Mr. Posey, this matter is in litigation. There is a presiding judge. And whether people were right or wrong is something that will be determined through the judicial process, respecting the rights of all those involved. These are very difficult matters, and I appreciate the concern about the legal expenses, but there are various rights here. And I think we are all striving to respect them.

Mr. POSEY. We are trying to respect the taxpayers, too, obviously, and that is who gets left out of the equation, usually. What steps are you taking to protect the assets of the people who are accused of wrongdoing? In the event they are found guilty of wrongdoing, what steps are you taking to get the greatest amount of reimbursement possible?

Mr. POLLARD. We have no authority to freeze any of their assets or to limit that. What I would say is, in the indemnification agreements that they signed, they have to agree to restore any funds given to them if an adverse decision is made. That would mean all of their assets are at risk. In terms of controlling or limiting those assets before such determination, we do not have the authority to do that.

Mr. POSEY. But you have a plan? With the indemnification agreement, you have a course of action that you would take?

Mr. POLLARD. Yes. In order to be advanced fees, they sign an agreement that, if they are found to have violated those fiduciary duties, they will repay the funds. And if they refuse to do that, you can go after them to the maximum of all their assets.

Mr. POSEY. And it would appear that they probably don't have the assets to do that. Is that what you are telling me? Did I read that between the lines earlier?

Mr. POLLARD. I personally don't know the size of their assets and what the final fees would be, so I don't know.

Mr. POSEY. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. I am glad that I attended this hearing just to hear a Republican say

that, if a plaintiff brought a civil lawsuit against the defendant, the defendant must have done something wrong.

Mr. DeMarco, I have been greatly interested in how Fannie and Freddie—how FHFA handles the litigation that may very well affect—will undoubtedly affect taxpayers' ultimate expense for the conservatorship of Fannie and Freddie.

But my questions today are about another topic that will affect taxpayer exposure as much or more, and that is the manner in which mortgages within Fannie and Freddie's control are being handled, the way they are being modified or not modified, proceeding to foreclosure or not. What I have heard from those who are working directly with homeowners facing foreclosure is that Fannie and Freddie are more infuriating to deal with than the private label securitizers, or the servicers for PLS mortgages.

And it is hideously expensive to foreclose. There are obviously many occasions when it clearly would be much wiser to enter into a sensible modification. It appears, from our history, that we have done it successfully in the past. That is what the Homeowners Loan Corporation did during the New Deal, and 20 years later when the program wrapped up, it had made a slight profit and probably saved the middle class.

The former Mac statute provides, by statute, for loss mitigation procedures, for who qualifies for modification, when, and what the modification will be. Those who work in this area say they understand there is a standing order from Fannie and Freddie not to reduce principal. And it is almost impossible to get any kind of information about Fannie and Freddie's loss mitigation practices.

Is there such a standing order? What are the criteria, and why do we know so little about it?

Mr. DEMARCO. Thank you, Congressman. There are a number of questions in there, so let me see if I can work my way through them.

First of all, FHFA is required to file a monthly report to this committee, and so I will make sure that this gets directly to your office. We report monthly on the activities of Fannie Mae and Freddie Mac with regard to foreclosure prevention. This is a requirement of law. It is our Federal property manager's report.

And I would like to share with you a few sort of general numbers to demonstrate that, in fact, Fannie Mae and Freddie Mac are vigorously working on loss mitigation activities. That is the top priority that FHFA has as conservator of the Enterprises, is to see that the delinquent mortgages that they own or guaranty are resolved at the least cost method to the conservatorship, and with all appropriate attempts to avoid foreclosure both for the good of the company and for the borrower.

Let me say that, for calendar year 2010, combined, the two companies completed close to 600,000 loan modifications, and yet their total foreclosure prevention actions, meaning a range of home retention plans like loan modifications, repayment plans, forbearance, as well as foreclosure alternatives, such as short sales and deeds in lieu amounted to about 950,000 finished transactions. That is just for last year.

Since the establishment of the conservatorship, there have been close to 1.5 million loans that have either been modified, have had

some other home retention action taken, or have gone through a short sale or deed in lieu in order to avoid foreclosure. That is nearly 1.5 million loans in about 2½ years on a book of business of about 30 million loans.

So I would say that FHFA and Fannie Mae and Freddie Mac have been aggressive and have been leaders in the marketplace with respect to helping loan servicers to undertake appropriate and rigorous loss mitigation activities. This is essential for what we are trying to do as conservator, and I view this as essential to our responsibility to mitigate losses for the very reason, Congressman, that you said, is that where it is achievable to do a loan modification or some other sort of foreclosure alternative, that is generally going to be less costly to the enterprises than to go through foreclosure.

You asked about principal forgiveness, and there has been very little or no principal forgiveness activity as—to date as part of loss mitigation because the focus has been on loan modifications and these other activities, and because we have not determined or have found a particular principal forgiveness approach that, in our judgment, would result in a lower cost outcome or higher rate of success than the alternatives that we are pursuing.

What we are pursuing right now with respect to the range of modification and foreclosure prevention actions requires a great deal of interaction with mortgage servicers, and it is complex enough, and we are working very, very hard to make this work. And as I say, close to 1.5 million completed transactions since the establishment of the conservatorships.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Renacci?

Mr. RENACCI. Thank you, Mr. Chairman.

And thank you, gentlemen, for being here. I have two questions. First, I am going to go back to indemnification, just a simple question.

With the indemnifications that these gentlemen signed, was that a standard practice for all employees when they were hired? And then the next question would be, was this indemnification changed at any time during their employment?

Mr. DEMARCO. It was standard as part of our regulation. I will have my counsel provide further detail.

Mr. POLLARD. The bylaws of the corporation address this, and the individuals had contracts. Ms. Spencer did not have a contract but agreed to an indemnification repayment contract, which was a standard contract in 2004, so this dates back to that time. They have not been modified.

Mr. MAYOPOULOS. That is correct. All officers and directors receive indemnification and advancement contracts currently, and that has been the practice since 2004.

Mr. RENACCI. Thank you. Next question, we are going to go back to reasonableness, because, quite frankly, reasonableness is in the eyes of the payer. And my biggest concern is, going forward—and it is really I am looking, going forward, is how we make sure we mitigate and minimize taxpayers' expense.

If Mr. Raines was here today, I would really ask him if he would be willing to voluntarily pay his legal fees, going forward, because

then we would really determine what reasonableness was or wasn't. But since he is not here, I am going to ask the question of you. And I know you have talked about a panel outside of your organization as to—the panel is who you look to for reasonableness.

But the question is reasonableness, again, is in the eyes of the beholder, the eyes of the payer. So my question to you is, what are the guidelines that this panel was looking at when it comes to reasonableness? Quite frankly, as a business owner for the last 28 years, I pretty well have determined what unreasonableness is in a courtroom when you see 10, 12, 14 attorneys on the other side. So is there reasonableness standards that were given, or are you relying 100 percent on what this panel says?

And I would ask this next question as a follow up. As the director of the organization, you could also determine reasonableness and overrule their opinion. I would ask that question, too.

Mr. DEMARCO. Yes, sir. So I will begin, but others may want to contribute.

As you noted, the first line of defense here, the first test of reasonableness, the first level of review is the outside firm retained by Fannie Mae with expertise in this area to review line-by-line the submissions that are made for advancement fees.

The next line of review is the Fannie Mae legal department itself overseeing the activities and the expenses that are involved.

The next line of review is FHFA's legal department that is monitoring this activity and is doing so with the benefit of our own outside counsel, who is aware of the ongoing major litigation activities. So those are the various reviews that are in place.

But I will say, in fairness to this hearing—and I think that this hearing that the chairman is bringing is raising important questions, and I respect that. And I will say that FHFA is committed to redoubling its efforts of review here even though I am not aware of any evidence that there have been unreasonable payments made. There are reasonable questions being asked, and we will take additional steps to monitor this.

And as I have already said in response to a question from a previous member, I intend to file with the judge in the particular case my testimony so that he is aware of the concerns that have been raised here.

Mr. WILLIAMS. Yes. Congressman, we take this very seriously, our responsibility to manage the expenses of the company, and including the legal fees. I would like to actually ask Mr. Mayopoulos to walk through the process and what the expectations are as it relates to these expenses.

Mr. MAYOPOULOS. Congressman, we retain a company called Legal Cost Control, which is, frankly, the leader in this space. It is really one of the most respected invoice and audit firms in the country, with over 20 years of experience. They were selected by the bankruptcy court in some of the largest matters in history, including Enron, WorldCom and Adelphia to review the legal fee applications of lawyers in those cases.

They analyze over $60 million in monthly billings for corporations such as Microsoft and Pfizer and Walmart, and so they are very experienced at this. They have a set of guidelines that they have developed with us that are 13 pages long and quite detailed.

They distribute those to all the law firms involved, require them to acknowledge that they have received them and read them and that they will abide by them. And then they review each one of these invoices line-by-line and raise questions where they think that the fees are not appropriate, that it is in line with what similar lawyers charge for similar matters.

I think in the context of this matter, the question of reasonableness doesn't mean that we always end up with a small number, okay? We clearly are spending quite large amounts of money on this matter. But this is a case that involves billions of dollars of potential liability, billions of dollars. And I have been doing this kind of work myself for 25 years now in my career.

And when you look at what it costs to defend a case, such as a WorldCom or an Enron or an Adelphia, or this matter, the amounts of money we are talking about are comparable in terms of what you see. These are enormously expensive, time-consuming matters with very complex legal issues. The lawyers who get paid get paid a lot of money for their skills and experience and expertise in these matters.

And so I don't mean to suggest by saying that—while we think that the fees that have been paid are reasonable—we are happy to pay them. We clearly would prefer not to—but they are consistent with what lawyers who do this kind of work in this kind of matter get paid. And that is really the test that Legal Cost Control is applying as it goes through this process.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. DeMarco, you had, I think, pretty clearly outlined the difficulties you have in defending what could be taxpayer payout if you lose it. But you also indicated by that, raised a question to me that you may have significantly different interest in this lawsuit as a defendant than do these three individuals, or other individuals that are involved.

Have you attempted to split out the cases and to say, look, we will defend our stuff and take the hit, but these three guys, their interests are different than the interests of you and your agency. Have you attempted to split up the case?

Mr. DEMARCO. Mr. Capuano, as FHFA, we are not a defendant in this case. As conservator, we stand in the shoes of the Boards of Directors and senior management of the firm as conservator. So there is no separation there with regard to we are here and someone else is over there. The suit is against the firm and the activities of the firm. One of the counsels here may be able to better explain it than I can, but that is the situation. I don't believe—

Mr. CAPUANO. It certainly strikes me that, in theory, if these individuals acted badly, the company is a victim as much as anybody else. And therefore, the interest of the defendants may not be the same, and I would argue that the interest at one table should at least overlap significantly, and it strikes me just on the face of it that it may not.

Mr. Mayopoulos, or Mr. Pollard, I would like to hear from you on this.

Mr. MAYOPOULOS. I think one of the challenges, Congressman, is that while there are some potentially different interests here, the fact is that, if these individuals did things that violated the law, the company is liable for that whether the company was a victim or not. That is just the nature of corporate liability.

But there are potential differences in the defenses here. Fannie Mae did acknowledge that its accounting was not correct and it restated its accounting. But the individuals have never admitted to any improprieties whatsoever. They didn't do that in the OFHEO special examination, and they didn't make any admission in connection with the SEC matter. In fact—

Mr. CAPUANO. So you don't think it is possible to split it out?

Mr. MAYOPOULOS. I don't think—the case that has been brought has been framed by the plaintiffs. The plaintiffs chose to sue all these defendants together, and that is what we have been dealing with.

Mr. CAPUANO. I get it. So you don't think it is worth trying to split it?

Mr. MAYOPOULOS. I think it is because there are differences of interest that all these individual defendants are entitled to their own legal defense, but I don't think that we on the defense side can actually split the case up in any way that will be productive.

Mr. CAPUANO. Mr. Pollard, do you agree with that? Okay.

Have any of you asked the court if there are any actions you might be able to take, going forward, relative to securing your potential liability from these individuals, going to them and saying to the court, look—actually, Mr. DeMarco, you say you are going to submit something to the court. I would ask you to submit this hearing to the court and tell them that we are concerned about getting this money back if and when this case is finally determined.

I get that. Maybe they could find a way to allow some sort of lien or some sort of surety or some other such activity again that may never be paid. If they are found innocent and not a problem, we get it. But if they are, I am also concerned with getting our money back, and maybe the court could help you find a way to secure that future ability. Do you think that is a reasonable approach?

Mr. DEMARCO. Mr. Capuano, I have already committed that I will file with the court my statement and that the court will be made aware of this proceeding here. But in terms of the particulars, because this is a matter in litigation, it is with the judge, I am not feeling comfortable with sort of further expanding in the line of—

Mr. CAPUANO. All I am asking you to do is to ask the court if they can help.

Mr. DEMARCO. Yes, sir.

Mr. CAPUANO. That is all I am asking.

Mr. DEMARCO. And I have said that we would bring this to the court's attention, yes.

Mr. CAPUANO. So you will ask them, in a positive manner, if you can help you find a way to do that?

Mr. DEMARCO. Yes, sir.

Mr. CAPUANO. Mr. Williams, Mr. Mayopoulos?

Mr. MAYOPOULOS. Congressman, I would note that the indemnification contract has a specific provision in it that no surety or

collateral will be required of a party receiving advancement of legal fees. So to do what you are suggesting, while I understand why you are suggesting it, seems to have been anticipated in the contract, and—

Mr. CAPUANO. I respect that, but—I don't mean to be disrespectful. Isn't that what courts are, to determine what the contract actually says? All you have to do is ask. Let them say no. You might be right, but you might be wrong.

Mr. MAYOPOULOS. Yes, that is what courts are for, is to determine where there are differences. With respect, having looked at this issue, I believe, sir, that this one is pretty clear.

Mr. CAPUANO. I respect that, but I guess what I am trying to say is you guys don't seem to get it. The difference between this and everything else that has ever happened, this is taxpayer dollars. This is not Enron. This is not WorldCom. We are not shareholders. We are taxpayers. And all I am trying to do is—yes, it is unique. Yes, it is unusual.

What I am asking you to do is get a little aggressive on behalf of taxpayers even if you lose. There is no dishonor in losing if you are doing the right thing. But to sit there and presume that you cannot even try to do the right thing because you think the answer might be no, that is not an acceptable answer, not to me, it is not.

Make the fight. If you lose, fine. But what if you are wrong and you win, and you get a judge who says, "You know something? This is a little unusual." Take the shot. Taxpayers deserve it.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Grimm?

Mr. GRIMM. Thank you, Mr. Chairman.

Obviously, there is a lot of passion in the room, and that is for good reason. Everyone here is frustrated, and I think you are frustrated as well, because the answer to almost every question is, we have to play the hand that we are now dealt. So rather than beat a dead horse, I am going to see—looking for the future, is there a way that we don't get dealt this hand again.

So I have two questions for you. First of all, one of the reasons why I believe we are in this boat that the taxpayers, quite frankly, are paying for is because the individuals who are spending this much money on defense have entered into a settlement whereby they had no admission of guilt. So the first question is, could we have avoided that by not entering into that settlement?

And second, who made the decision to go with conservatorship as opposed to a receivership? And can you explain what boat we would be in now had we been in a receivership and not a conservatorship?

Mr. DEMARCO. With respect to your first question, Congressman, the determination to reach a settlement agreement with the three former officers was something that was—a decision that was made by the then-director of OFHEO. It was done based upon the facts and circumstances in which he was operating at this time. And that was not my decision, but I believe he had solid grounds for his determination at that point, but that was done at that time.

With respect to the decision of conservatorship versus receivership, I believe that that has been described at some length by the participants who were involved in that decision at the time. That

would be principally Secretary Paulson and FHFA Director Lockhart about the determination of what form of intervention the government would take with Fannie Mae and Freddie Mac being—removing from the market and having their access to the capital markets rapidly being withdrawn.

The issues there are far broader than the immediate matter that we are talking about here today regarding certain litigation. And the determination was that it was necessary for—the goal was appropriate to provide government support in using the vehicle of conservatorship because there were grounds to appoint a conservator, and there was a public policy goal of assuring that the country maintained a functioning secondary mortgage market right at the point that the whole U.S. financial system was teetering on the brink.

And so that was a determination made at that time. I believe it was the right one, and it was done for reasons that are far broader and have far more—more far-reaching implications than the particular matters of litigation that we are discussing today, sir.

Mr. GRIMM. Understood. But it still leaves—one of the problems that we have here is that, overall, this is the exact reason why the general public doesn't trust the government and doesn't believe that we ever have their interest at heart.

What we have here are three individuals that we know have abdicated their fiduciary responsibilities, at a minimum, and in doing so caused a tremendous amount of harm to the markets and to the taxpayers. And because they were able to enter into a settlement where they didn't have to admit any guilt, the taxpayer bears the second burden.

That frustration is overwhelming, and I have to believe there is a better way. And there has to be a mechanism that, when we look at these types of settlements, and when we decide whether—and I understand it is a very complicated issue between conservatorship versus receivership. I understand that. But when you break it all down and get past all the legal jargon, I have to believe there is a better way than leaving the taxpayers constantly holding the bag.

So I leave you with the thought that, when we are entering into settlements, in this very unique situation where there is almost unlimited liability for the taxpayers, that has to be part of the decisions process when entering into these settlements.

Thank you.

Chairman NEUGEBAUER. The gentleman from Texas, Mr. Canseco.

Mr. CANSECO. Thank you, Mr. Chairman.

Let me, first of all, ask you this question. Prudence would dictate that if you, indeed, represent Fannie and Freddie and making sure that the mortgage market continues to function when you took on the conservatorship, that you really represented the American people. Yet it seems to me that your act in extending this indemnity, that you were no longer representing the American people, that you were representing the defendants in this particular case.

Wouldn't it have been more prudent to allow the defendants to sue the conservatorship for indemnity than to go ahead and honor the indemnity agreement that was in place?

Mr. DEMARCO. Thank you, Congressman. I am going to ask my counsel to respond to that question.

Mr. POLLARD. Congressman, the difficult decision that you have posited is one of a lawyer looking at the situation at hand, which is someone being indemnified, and what would happen if, in fact, we had repudiated the contract. What would happen in that situation, my best estimation as a lawyer advising the agency, was that the defendants would sue us. Our repudiation of contract is specifically authorized and in HERA in 2008 to authorize them—anyone to challenge that. Therefore, they could sue us, as provided by the statute, for which they would be advanced legal fees.

The predominant court cases that I have looked at is that, at a time when they were being advanced fees, when there was no final action, that they would in fact have a chance, and a very strong chance—understanding what Mr. Capuano has asked us about taking that chance—that they had a very strong chance of prevailing and that we could be in extended litigation on this matter with a set under Delaware law that is very, very strong.

And let me make this point. I think the question—

Mr. CANSECO. Understood, but—

Mr. POLLARD. —I am just trying to say, advancement of legal fees is actually accorded even greater strength at times than indemnification. That is really the challenge.

Mr. DEMARCO. But there is an important other concept here if I may, Congressman, and maybe secondary, but it is nonetheless critical, and I would call the subcommittee's attention to it, which is that when we place these companies in conservatorship and we place the American taxpayer support behind the operations of Fannie Mae and Freddie Mac in conservatorship, that support is backing $5.5 trillion worth of securities that are trading in global financial markets.

We need, in the conservatorships, there to be talented, capable professionals who continue to operate the day-to-day operations of these companies, and we needed to replace a number of senior officers and the entire Boards of Directors of both companies.

If FHFA was to take an action that would have called into question the reliability of the government's affirmation of indemnification to these folks because it saves—and we are going to back out from it, we would not have been able to attract and retain the talent that we brought in post-conservatorship, as well as the existing managers and staff that were there to do their important job.

These individuals are subject to lawsuits today. They are subject to a wide array of government investigations. And it is incumbent on us to provide the standard protections of indemnification and advancement of legal fees that are available.

Mr. CANSECO. I appreciate your comments on that, but my time is a little limited here. And my comment on that is you would have had an opportunity to at least question the size of the legal fees and the quantity of the legal fees and at least put into issue the fact that you were doing it under protest because, after all, your main client is the taxpayers of this country and not the people that you are indemnifying.

Now let me go off into something else, if I may. Mr. Williams and Mr. DeMarco, in the timeline leading up to the May 23, 2004, sign-

ing of the comprehensive indemnification agreements with Franklin Raines and Tim Howard and Leanne Spencer and Fannie Mae, on the 17th of July of 2003, the Director of OFHEO, Armando Falcon, announced that OFHEO would conduct a special accounting review of Fannie Mae in testimony before the Senate Banking Committee. By January of 2004, press reports and market analysis began to call into question Fannie Mae's accounting practices.

The indemnification agreements were then signed on May 23rd of 2004, less than 4 months before the release of OFHEO's first report on Fannie's noncompliance with accounting rules. The September 17, 2004, report of findings, the date of the special examination of Fannie Mae, stated that Fannie's management culture made noncompliance with accounting rules possible—"The problems relating to these accounting areas differ in their specifics, but they have emerged from a culture and environment that made these problems possible. Characteristics of this culture included"—and it goes on.

These facts call into question the timing of the signing of the comprehensive indemnification agreements. To the best of your knowledge, did Fannie Mae executives request new indemnification agreements because they feared their accounting misdeeds would soon be exposed by OFHEO investigation? Do you know that? Do you have an answer to that?

Mr. WILLIAMS. Congressman, yes, let me answer that. The Board of Directors at the time had undertaken a review of the indemnification agreements and had decided to re-issue a standard agreement for all officers. Mr. Raines, Mr. Howard and Ms. Spencer already had indemnification agreements in place, Mr. Howard's from 1987, Mr. Raines' from 1991, and Ms. Spencer from 1993.

Mr. CANSECO. So all you did was just renew them in this short period of time?

Mr. WILLIAMS. The Board of Directors—I was not on the Board at the time, but the Board of Directors wanted to re-issue standard indemnification agreements. They have been custom or unique to each individual in one standard agreement.

Mr. CANSECO. And it just seems odd that these new indemnification agreements were signed less than 4 months before the regulator issued a report blaming senior management for mismanaging earnings statements, given the questions about the motivation of Raines et al. to seek new indemnification agreements. Do you still believe that it is appropriate to advance fees for these individuals, given their egregious conduct?

Mr. WILLIAMS. Congressman, the agreements have been in place since 2004, and as both Mr. DeMarco and I have said, we have to advance the fees under the agreements.

Mr. CANSECO. Thank you, sir. My time has expired.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Garrett?

Mr. GARRETT. And I thank you.

I guess I will go to Mr. Williams, and I am going to go down a totally different road, although it is tangentially related. It is related to the issue of what we have heard before with regard to legal fees and the payments and the like. It goes to the issue of when Fannie purchases loans originated in names of persons other than

a seller, and specifically taking a look at the situation with various credit unions, specifically Picatinny Federal Credit Union.

And if you are familiar with this situation, this is where there is legal action pending, where Picatinny Federal Credit Union has 52 loans with a total outstanding balance of around $13 million that were sold to Fannie without Picatinny's knowledge or authorization. To date, my understanding is Fannie has not offered Picatinny more than basically in the settlement discussions, 23 cents on a dollar in settlement, and even that offer, I understand, had a number of conditions attached to it.

So, I have a couple of questions here on this. First, is that a meaningful settlement, from your perspective? And second, can you tell me how much it is costing—or we should say us, or Fannie—what it is costing to continue with the settlement negotiations, the investigation, and defending the claims brought by them and the other credit unions in this matter? Let me just stop there and go on.

Mr. WILLIAMS. Thank you, Congressman. As you know, this was a fraud that was brought upon both Fannie Mae and the credit unions, and I would like to ask Mr. Mayopoulos to discuss the nature of the settlement.

Mr. GARRETT. Sure.

Mr. MAYOPOULOS. Congressman, as Mr. Williams has indicated, this is a fraud that was perpetrated on both the credit unions and on Fannie Mae. And basically, the question in the litigation is, who bears that loss? Is it the credit union that originally bought the mortgages and sold them to Fannie Mae or is it Fannie Mae?

There are—my recollection, I don't remember precisely—my recollection is there are about two dozen credit unions who had a similar set of issues, all victims of the same fraud. And we have reached settlements with the vast majority of them. There are a handful, including Picatinny, with whom we have not reached settlements. We have sought to do that. And the terms on which we have sought to reach a settlement with Picatinny are essentially the same as they are with the other credit unions, and the vast majority of the credit unions have accepted that settlement.

Mr. GARRETT. Do you have an answer, though—I appreciate that. Do you have numbers at your fingertips with regard to what it is actually costing us with regard to defending the claim, all the investigations and all that that goes on, at least with regard to this credit union—or all the credit unions out there?

Mr. MAYOPOULOS. I am sorry, Congressman, I don't have those numbers at my fingertips. We can—

Mr. GARRETT. You can provide that?

Mr. MAYOPOULOS. —work—we can get those for you.

Mr. GARRETT. That would be great. And also, along the same lines, I used to be with law firms, and I always thought that small ones were better than the big guys. I know we were certainly cheaper than the big guys. The Picatinny has hired one of those smaller ones, and I think it is connected with—I should say that. Fannie Mae has retained, I guess, Latham & Watkins, I guess one of the bigger guys in the entire country. Can you also—you probably don't have it at your fingertips—just provide us also at the

same time what that is costing us, the rates and the billing and proceedings on that?

What we are dealing with—and I appreciate you both making the same comment. You started out with your comment that this is basically a fraud not just on the GSEs, on Fannie, this is also a fraud that was against credit unions as well, Picatinny, right? Yes, I appreciate that, because basically what you have here is when—I could basically come to Fannie and say I want to sell some loans to them, and Fannie buys them, and the owner of them doesn't know a thing about it. That is really what we are talking about here, correct, and that is where the fraud is engaged?

Mr. MAYOPOULOS. Yes. My understanding of the fraud here was that the person who sold these loans from credit unions to Fannie Mae appeared to have authority to do that, and the law firm on the side of the credit unions now say that no, that person didn't have the authority. So the question is, who bears that risk?

Mr. GARRETT. Right. And so, because I only have 45 seconds left, what is done, as far as from Fannie's perspective, in order to see whether that individual maybe in that situation, that hypothetical, had the authority to do it? You notify the borrowers at some point in time that Fannie holds these loans at this point in time, right? So do you also notify the—would you have also notified the seller, which case would it be the credit unions at the same time? So what steps are taken to make sure that they are really the rightful owners, and do you notify them when they are secured at the same time?

Mr. MAYOPOULOS. We don't typically notify sellers of loans that they have sold loans to us. They—in this case, the person in question actually appeared to have apparent authority to do that, and in fact, if I recall the facts correctly, had in fact been authorized to sell some loans on behalf of Picatinny.

So this is a person that Picatinny brought to the situation, gave authority to to sell at least some loans, and then apparently this person sold loans beyond what he had authority to sell.

Mr. GARRETT. And one last question, in the hearing, it is said that—it was understood that you continue to purchase loans from sellers who the principal owners are subject to criminal indictment or mortgage fraud, until the fraud has been judicially determined or discovered to have been committed upon Fannie Mae. Basically, you will, or have, continued to purchase loans from people even though they are indicted and there are fraud allegations against them, even until that is actually adjudicated in the court. Is that correct?

Mr. MAYOPOULOS. I am sorry. I am not familiar with that, Congressman.

Mr. GARRETT. Okay. Then that will be one of the other points you can get back to me on.

Thank you very much. I appreciate the indulgence of the Chair.

Chairman NEUGEBAUER. I thank the gentleman.

That concludes the questions for our first panel. I think you can tell by the questions that these members have asked that we are very concerned about this process and that when you look at some of the authority of the conservatorship, it in some ways emulates some of the same authority that FDIC has in certain actions.

And I think that the question here, while Mr. DeMarco was not the original conservator, that many of us are concerned that some decisions were made in the front end of that conservatorship that, quite honestly, weren't in the best interest of the taxpayers.

And while I think it is noble of you to defend these indemnification agreements, I believe that there is compelling evidence there that it is a little fishy. I think that we had to redo new contracts in 2004, but I think the other thing is that, when you look at the reports, that what these folks—what the entities agreed to in a $400 million fine is no small admission of wrongdoing.

And so we hope that, moving forward, you will look for ways to minimize additional exposure for the taxpayers. We hope that you will review this issue, go back and look at some of the corporate minutes and make sure that these agreements are on solid ground and that, if there are things that we can do, then we would like to look at that action.

I think the other question that was brought up, and that is was this the right structure, should this have been receivership rather than conservatorship, because obviously I think what Congress has in mind when we think about conservatorship, I think it is about conserving the taxpayers' investment in these entities.

Anyway, I thank the panel, and this panel is now excused.

We will call up the second panel. I am going to yield to the gentleman from Ohio, Mr. Renacci, to introduce our second panel. Thank you.

Mr. RENACCI. Thank you, Mr. Chairman.

It is my pleasure to introduce to the subcommittee the attorney general of the great State of Ohio, Mike DeWine. Mr. DeWine is a native Ohioan, a former prosecutor, a four-term member of this chamber, and a two-term United States Senator. Mike has dedicated his entire career in public service to speaking out for the most vulnerable in our society, from children to the elderly to the unborn.

He and his bride of over 43 years, Fran, are the parents of 8 and the grandparents of 13, with the 14th due any day. I have had the pleasure of knowing Mike DeWine for some time now, and I know that nothing is more important to him than family. It is because of his love of family and community that, when he took the office last month to become Ohio's 50th attorney general, he swore that he would do everything in his power to seek truth and justice and to protect Ohio's families.

I am pleased to introduce my friend, Mike DeWine.

Chairman NEUGEBAUER. Thank you. Welcome.

STATEMENT OF THE HONORABLE MIKE DeWINE, ATTORNEY GENERAL OF OHIO

Mr. DEWINE. I am delighted to be here, and I thank you and the committee for inviting me. I must tell you, after having spent 20 years on your side of the dais, this is a different experience for me. But I appreciate the opportunity to be here.

And Mr. Renacci, thank you, Congressman. We are proud that you are from Ohio, and thank you for that kind introduction.

Mr. Chairman, members of the committee, I am here today because I represent the lead plaintiffs, the Ohio Public Employees Re-

tirement System and the State Teachers Retirement System in a securities fraud class-action filed over 6 years ago against Fannie Mae, against its former three most senior officers, and against its auditor. This class-action also includes nearly 29 million other defrauded investors from each of the 50 States.

The defense engaged in a massive accounting fraud against the class to the tune of nearly $9 billion. Our case originally was filed in November 2004, and continues to this day unresolved. What is worse is that Fannie Mae and its former executives, whom Fannie Mae is indemnifying, have been using taxpayers' dollars to pay for their defense. It is wrong, and Mr. Chairman, it is unconscionable. And I urge the committee and Congress to bring this absurdity to an end.

We already know that Fannie Mae cooked its books. We already know that it smoothed its earnings. We already know that it violated 30 Generally Accepted Accounting Principles. And yet Fannie Mae continues to deny liability, dragging out the current litigation billable hour by billable hour by billable hour and bleeding Americans so far, by Fannie Mae's own admission, of at least $132 million for its legal fees alone. And according to your calculations, Mr. Chairman, the total cost to taxpayers is much higher.

But Mr. Chairman, I am not here today to use this hearing as a forum to try to reach a settlement. We are, in fact, quite anxious for this case to go to trial, and we are ready for that to happen. But Fannie Mae is doing everything in its power to stall. It is really easy to impede the resolution of a lawsuit when you have a bottomless coffer of taxpayers' dollars to pay your legion of lawyers to engage in delaying tactic after delaying tactic.

U.S. District Judge Richard Leon, who is the judge in this case, has done everything in his power to move this case forward. In fact, I have on this piece of paper several quotes from the judge indicating his displeasure with Fannie Mae's tactics. And those quotes are, Mr. Chairman, members of the committee, in my written testimony that I have submitted for the record.

To keep things moving, the judge holds regular conferences to check on the status of the litigation. Where we on our side typically bring 2 or 3 lawyers, the Fannie Mae defense, however, even just for short, routine conferences where really nothing of great substance is discussed, typically—typically—bring 35 to 40 attorneys and paralegals, costing taxpayers over $600 per hour for some of these lawyers.

At former Fannie Mae CEO Franklin Raines' April 2010 fact deposition, we were the only party asking questions, and yet the Fannie Mae defendants brought 13 lawyers—and we counted them, Mr. Chairman. We counted them—none of whom asked a single question, not a single question. They just sat there and billed the taxpayers for their hours.

We are now conducting, at this stage of the case, expert depositions where the bill to taxpayers continues to mount. As the lead plaintiffs, we have the burden of proof, and therefore we have designated eight experts on our side. Defendant KPMG has designated five experts. Fannie Mae defendants, however, have designated 25 experts. And Mr. Chairman, members of the committee, these ex-

perts are not cheap. According to documents filed with the court, their billable hours are between $600 to $1,500 per hour.

Franklin Raines has 9 experts just for himself, including 4 to say essentially that he fulfilled his job as CEO by properly relying on others to tell him what to do, and 2 experts to say that his $91 million in compensation over 5 years was in fact, justified.

Now I fully understand an argument could be made, Mr. Chairman, and members of the committee that Fannie Mae has to defend itself and its former senior officers. But the amount they are spending, at the expense of U.S. taxpayers, is ridiculous. And you would think, Mr. Chairman, that a former CEO who made over $91 million just might—just might—be able to afford his own lawyer.

Mr. Chairman and members of the committee, Ohio families have been wronged. American families are being wronged, and it is time to just stop this. If I could just add one more thing, Mr. Chairman, and I know the light is on, the comment was made in the previous panel about 1,500 pages that we have filed. I do not apologize for filing 1,500 pages on behalf of 30 million victims in this country. The 1,500 pages represent not things that we did, not things that the victims did, but things that these defendants did.

Let me conclude with a quote from Judge Leon, which tells you what he thinks about this case and the gravity of this case when you look at whether 1,500 page is excessive: "This is a case of monumental proportions. Indeed, it is a case unique in the annals of American industry and history and business at the highest levels. It has been regarded and referred to as the largest accounting fraud case in the history of the United States."

I thank the Chair.

[The prepared statement of Attorney General DeWine can be found on page 44 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

One of the things that appears to me is that the longer this goes on, obviously the longer the benefit to these three individuals, that there is not a lot of incentive out there as long as you can lawyer up and have all of these hearings and these depositions, and then you give Freddie and Fannie, and actually you give the taxpayers the bill for it. Is that your observation of what is going on here, is that this is really about, if we just keep churning here, that—

Mr. DEWINE. Mr. Chairman, we want this case to be over. We want to be compensated. Thirty million victims want to be compensated. What these defendants are doing is lawyering us to death. They are showing up with dozens of lawyers. They are drawing this out, and I think Judge Leon said it best, if I could quote. He commented on the huge expense incurred by having so many defense lawyers, saying at a June 25, 2009, hearing that, "The lawyers are doing pretty well. I am not so sure the taxpayers are doing pretty well, but the lawyers are doing pretty well in this deal."

Chairman NEUGEBAUER. Yes, I think the judge makes a good point there. I think the lawyers are doing well indeed, looking at these numbers.

And so, what could be done to begin a process to manage these fees and make—if they are going to continue this process, what are things that we could require or request that the conservator do to lower the cost of this process?

Mr. DEWINE. Mr. Chairman and members of the committee, I think that is an excellent question. I know on this—I am on this side and you are on that side. Ultimately, you are the ones who have to make this determination.

But just since you asked, just maybe a comment, FHFA has a responsibility, it seems to me, to the taxpayers of this country. They have an obligation to conserve assets. They have an obligation to be concerned about what tax dollars are going out.

Even if you concede—and I don't concede this—that there is an obligation to indemnify Franklin Raines, Mr. Raines, who made $91 million, and even if we don't think he has the money to handle this, and we have to put that money up out front, it still seems that there are ways that FHFA could control this. How many lawyers do you really need? How many expert witnesses do you really need?

Now, it is not Judge Leon's job to tell the defense that they cannot bring more lawyers to the table. The scene, if I could describe the scene as an amazing scene, you have in Judge Leon's courtroom at these fairly routine hearings, pretrial conferences, you have a couple of lawyers for each who are sitting at the table, and then you can have a whole room full of the rest of the lawyers who are out there for the defense, all on billable hours, all not doing anything maybe but charging for thinking.

So FHFA has an obligation, it seems to me, to bring some reasonableness to this, some common sense to this, cut down on the number of lawyers, control the number of expert witnesses. Even if we believe that all these defendants are entitled to lawyers, somebody might be entitled to a lawyer, and I guess they can have as many lawyers as they want, but they are not entitled to have someone else pay for it.

Chairman NEUGEBAUER. So have you all requested the trial date?

Mr. DEWINE. We don't have a trial date. Judge—

Chairman NEUGEBAUER. But have you requested—have you—

Mr. DEWINE. We want to move forward on this as quickly as we can. We are now in the second phase of the depositions. We are in the depositions for the expert witnesses. And again, if I could explain, the problem is, when the other side comes up with 25 expert witnesses—and Judge Leon described it pretty well about these expert witnesses. Let me read what he said about these expert witnesses, because having 25 expert witnesses who have to be deposed over a period of time slows the process of the case.

At a June 14, 2010, hearing, Judge Leon said there is absolutely no way that so many experts will ultimately testify—actually testify—at court, admonishing Fannie Mae defendants, "So you don't need to have five experts say the same damned thing. If one good one says it the right way, from your perspective, that is going to be more than enough. You don't need five to say it. It is not a me-too operation. So bear that in mind. Bear that in mind." The costs are just staggering.

Chairman NEUGEBAUER. Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, I don't really have any questions for the attorney general. I get exactly what you are saying. You have been very

clear. I don't disagree with what your parameters are. I am not exactly sure what we can do about it. I understand what you are saying, and that is why to some extent, as one of my colleagues said earlier, we are trying to play the cards we are dealt as of today and trying to move forward.

But I appreciate the points you raised. I agree with pretty much everything you have said. I am not exactly sure how we could accomplish what we want to accomplish, and I would be happy to hear later on at another time maybe some other ideas on how we might be able to do it.

At the same time, I also want to thank you for pursuing this matter as vigorously as you have, and wish you the best of luck as you go forward, because it will be important to get this thing settled, and it will be important to get these things answered and to get this issue behind us so that we can address the other issues related to Fannie Mae and Freddie Mac. Thank you.

Mr. DEWINE. Thank you very much, Congressman.

Chairman NEUGEBAUER. Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Mr. Chairman.

Attorney General DeWine, thank you for your time. I know that all of us here appreciate the fact that you are working hard to protect your constituents, the taxpayers of Ohio.

In the previous panel, Mr. Renacci of Ohio asked a great question to the witnesses. It had to do with the reasonableness of the attorney's fees. And the underlying assumption of his question was that reasonableness many times is in the eye of the beholder, as he said, or really the capacity of the payer to pay. And I guess my question is, if the Fannie Mae defendants, perhaps using Mr. Franklin Raines as an example, if they had to pay even a portion of the attorneys and the attorney's fees that were being paid on his behalf, do you think it would have had an impact on the number of attorneys who filled the courtroom the day that you described?

Mr. DEWINE. Congressman, thank you for the question. Mr. Raines does, we assume, have a lot of resources, and I suppose if he wanted to fill the courtroom full of lawyers to be concerned and pay a lot of people to be thinking at the same time about his problem, he could do that. I am not sure any reasonable person would do that. I am not sure any defendant who has to reach into his own pocket, frankly, no matter how much money he or she might have, would have duplitive lawyers there at a fairly routine matter.

Congressman, it is one thing to go to trial and make sure you have enough lawyers there because you are going at it, and hard at it. It is something else, it seems to me, for a routine conference with the judge where there aren't huge matters to be thought out or be worried about. So I think the answer clearly is obvious, and that is no person in their right mind shows up with that many lawyers if they are paying for it themselves.

Mr. FITZPATRICK. And so, in this particular case, in your case, in the litigations that have been brought in Ohio, the taxpayers of Ohio are paying legal fees on both sides, I assume.

Mr. DEWINE. That is right, and I think we don't want to forget the fact that each one of you represents some of these victims. We have 50 States that are represented, 30 million pensioners. These are mostly pension. It is interesting. Fannie Mae—I asked our law-

yers who are working on this, why in the world are there so many pensioners? Why in the world so many pension systems? And the answer was, Fannie Mae marketed this as—and went for these pension systems and said, look, this is a very, very conservative investment.

So you have pensioners, 30 million of them, who through their representatives relied on this misrepresentation, first of all that it was a conservative investment, and second, they relied on the fact that they were getting facts about the condition of Fannie Mae. And that is one thing that is so ironic about this whole discussion in the previous panel, Mr. Chairman. There is no dispute about the facts. They have not, as I understand it, admitted liability, but we have had two regulators who have looked at this who have come to the same conclusion.

Fannie Mae settled with both of them, and in one even said we will not dispute in any way—we won't admit anything, but we will not dispute the factual determinations that we are agreeing to. So there is no dispute about what really happened here or that these are bad actors who did bad things.

Mr. FITZPATRICK. Thank you, Attorney General DeWine.

I yield back.

Chairman NEUGEBAUER. Thank you.

Mr. Renacci?

Mr. RENACCI. Thank you, Mr. Chairman.

Mr. DeWine, you are representing 30 million pensioners in your case here. Can you tell me what your costs are approximately?

Mr. DEWINE. This case—and I am, by the way, Congressman, the fourth attorney general in Ohio to handle this case, or to oversee this case. We remained as the lead plaintiff because we had more pensioners. We had more at stake. Our costs are on a contingent basis. So if we win, the lawyers who are representing us, who my predecessors retained, they will get a certain percentage based on a contract.

But what is so aggravating is that, each day that goes on, we have a pension system in Ohio and pension systems in other States that are out this money. And you know, Congressman, the problems we are having, or the challenges we are having with the change in the market in the last few years, the down market with our pension system in the State of Ohio, and you know what that means. And we can only assume that most States who invested in Fannie Mae have a similar problem.

So this is not like the days when everything was going up and you could have a loss like this, and it would maybe not be good, but it wouldn't be as devastating. This is very tough for Ohio. It is tough for our pension system and the people who rely on it, the teachers, the firemen, and other public employees.

Mr. RENACCI. Sure. What I was trying to get to was your actual costs in comparison to the number of people you are representing.

Mr. DEWINE. I think a good way to look at it is, when we show up with 2 and they show up with 15, I think that is a pretty good indication. We try to do things in a reasonable way, and you do what you have to do in litigation. This is important litigation. No one thinks that you should not have lawyers. No one thinks that you shouldn't have two, whatever it takes.

But there comes a point, anybody who has tried civil litigation, as I know members of this committee have, that you just reach the point of absurdity, and we have reached that point today.

Mr. RENACCI. Sure. All right. Again, I would assume that your cost per person is a lot less than the cost—

Mr. DEWINE. It is going to be a lot less, much, much, much less. It is going to be a fraction of what their cost is. It simply has to be just based on numbers. And that is not even getting into the question of how much they are paid per hour. It is just a number of how many there are.

The same way with the expert witnesses. We are now—we bled so much. Taxpayers are bled. What this hearing—it seems to me, at least what my testimony, Mr. Chairman, at least in part is about is stop the bleeding.

We are headed into an era, or a period of time where we are going to have a lot more bleeding with 25 expert witnesses that Judge Leon has already said he is not going to let 25 in, but he is not going to stop people from taking depositions and not stop them from putting 4 of these people as potential witnesses. And each one is getting paid, according to documents filed with the court, $600 to $1,500 an hour.

So the lawyers are getting a lot, but these experts are getting a lot more.

Mr. RENACCI. Thank you. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Canseco?

Mr. CANSECO. Thank you, Mr. Chairman.

And thank you, Attorney General DeWine, for being here today, and thank you for taking a leadership role in representing the people of Ohio and also the people of the United States in this very important issue.

Let me ask you a technical question, because I am just appalled at this very outrageous and egregious amount of attorneys' fees. I have been a lawyer for 35 years and never in my life, not even in the tobacco cases, have I seen legal fees amount to such amounts.

Is there any way that you can challenge the necessity for so many witnesses, so many expert witnesses, so many attorneys coming in and limit the number of attorneys who go in there, and also find standing to challenge the fees that are being charged?

Mr. DEWINE. Congressman, I think that is certainly a good question. I guess my answer would be that is not something that normally counsel for one side does. I think that only goes back to FHFA, their oversight responsibility. I think they have some obligation, even if they believe that indemnification is correct, even if they believe there is no choice in this matter, which I disagree with, they have responsibility to taxpayers to limit this.

And to put it back on the judge and to say that, as the previous panel did and to say this is something, "Well, gee, Judge Leon should do this," he has commented on it. He has made a point about it. He said that he is not going to let, for example, that many expert witnesses testify in court because he is—this is a case that will go on for a long, long time, and he has every obligation to try to make it an efficient use of time.

But as far as a judge looking up or us looking up and trying to stop them from bringing in a whole bunch of lawyers, I don't think—I don't know what your experience has been, but at least in my experience in a practice, that is just normally not done.

I am doing today what I think I need to do, and that is talk about this issue, raise this issue, and say at least, in my opinion, FHFA has an obligation. They have an obligation to do something about this.

Mr. CANSECO. Thank you.

Mr. DEWINE. Thank you.

Chairman NEUGEBAUER. Thank you, Congressman.

Mr. CANSECO. I yield back my time.

Chairman NEUGEBAUER. Attorney General DeWine, thank you very much for coming today and for your testimony.

The Chair notes that some members may have additional questions for today's witnesses, 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.

If there is no other business before the committee, we are adjourned.

[Whereupon, at 4:24 p.m., the hearing was adjourned.]

A P P E N D I X

February 15, 2011

Rep. Francisco Canseco (TX-23) - Opening Statement for hearing "An Analysis of the Post-Conservatorship Legal Expenses of Fannie Mae and Freddie Mac" – Oversight & Investigations Subcommittee – February 15, 2011

Thank you, Chairman Neugebauer for holding this hearing. Two months from today is the filing deadline for federal income taxes. As our fellow citizens submit their return on that day, there's that moment of hesitation when they wonder what it's all going towards. It's a legitimate question and one that members of Congress need to take very seriously as we find ourselves in a period of record deficits and debt. Last year, according to the Tax Foundation, Americans worked from January 1st to April 9th in order to be able to pay their federal, state, and local taxes. It's only natural for them to wonder what they're getting when the government spends their money.

Today, I look forward to hearing from our panel about the legal costs incurred by Fannie Mae and Freddie Mac since they became the full responsibility of the taxpayer two and a half years ago. The amount of money we're talking about here today may seem small relative to the federal budget or to the bailout cost of Fannie and Freddie's business operations. But the source of these legal costs is a shining example of why so many of our fellow citizens are frustrated that the taxes they pay sometimes go towards things that seem to be outside the legitimate functions of government.

I hope to hear from our panel today an explanation for *why* these legal costs were passed on to the taxpayer, *how* exactly these legal fees were incurred and whether they were appropriate given the conservatorship of the GSE's, and *when* the taxpayers will be asked to stop covering these payments.

Thank you and I look forward to hearing from each of you.

Statement of

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Before the
Committee on Financial Services
Subcommittee on Oversight and Investigations
U.S. House of Representatives

"An Analysis Post-Conservatorship Legal Expenses of Fannie Mae and Freddie Mac"

February 15, 2011

Statement of Edward J. DeMarco, Acting Director
Federal Housing Finance Agency

Before the Committee on Financial Services,
Subcommittee on Oversight and Investigations,
U.S. House of Representatives
"An Analysis Post-Conservatorship Legal Expenses of Fannie Mae and Freddie Mac"

February 15, 2011

Chairman Neugebauer, Ranking Member Capuano and members of the Subcommittee, today I will address matters relating to legal expenses of Fannie Mae and Freddie Mac and advancement of legal fees for certain former officers.

The Federal Housing Finance Agency (FHFA) has not altered its view regarding indemnification post-conservatorship as a prerequisite for attracting and retaining skilled officers and directors. Indemnification properly administered is in the best interest of the regulated entity and therefore fits within FHFA's goal of preserving and conserving assets. At the same time, properly structured indemnification includes limitations for denying indemnification and repayment of advanced fees in certain circumstances. Overturning existing contracts or policies would be a determination with potential adverse consequences and would be inconsistent with standard business practice.

My testimony covers the policy and legal views of the FHFA regarding advancement of legal fees to former Enterprise officers and the management of legal expenses by the Enterprises operating in conservatorship.

Background on Indemnification and Advancement of Legal Fees

Indemnification refers to a final determination that a corporate officer or director is due funds for their payment of defense costs, judgments and settlements in public or government lawsuits, whether civil or criminal. Boards of Directors generally put in place such plans under state laws through their corporate bylaws and the administration of fee advancement is left to management.

Advancement of funds for legal fees and costs is the contingent payment of funds by a company on behalf of a covered officer or director and may occur throughout the course of a matter, including appeals. Payment is tied to "reasonable" incurred expenses. As a condition precedent to advancement, the party for whom funds are provided agrees to repay those funds to the company in the event it is later determined that indemnification does not apply to the matter.

The Board of Directors approves indemnification in an individual case when a lawsuit or administrative proceeding is concluded and there is final action. At such time, either the individual is indemnified and the contingency on advanced funds is removed or the individual is not indemnified and the funds must be repaid. Bylaws of corporations provide the circumstances under which funds must be repaid, but repayment occurs at the end of proceedings, not during them.

Courts have upheld the advancement of fees as proper, even in criminal cases. The most important recent decision involving advancement of fees came in *United States v. Stein* in the Southern District of New York in 2006. Here the court ruled that a Justice Department effort that would limit advancement of legal fees would run afoul of constitutional protections, even as the court recognized that such legal fees incurred by defendants may be substantial. Many times corporations have sought to cut off fees; they have been rebuked in the courts. Even where questions arise as to the issue of meeting fiduciary responsibilities, the obligation to advance fees remains.

FHFA supports, as did its predecessor, the Office of Federal Housing Enterprise Oversight (OFHEO), indemnification of officers and directors in line with general corporate principles that seek to protect officers, directors and other employees when acting within the scope of their authority for a corporation. Such indemnification greatly assists in a corporation's ability to attract and retain corporate personnel by protecting them from lawsuits. This determination was made as part of OFHEO's corporate governance rule in 2002. That rule directs the Enterprises to undertake their corporate governance by adopting the law of the state in which their principal place of business exists, Delaware corporate law or the Revised Model Business Corporation Act. The regulation specifically authorized indemnification under appropriate rules. That rule, which serves as the explanation of FHFA's authority and views on indemnification, remains unchanged to this day.

The Housing and Economic Recovery Act of 2008 (HERA), which created FHFA, provided clearer authority for the agency, based on concepts contained in the Federal Deposit Insurance Act. It made no major change in the fundamental concept of permitting indemnification or the advancement of legal fees, but rather provided greater expression of the criteria surrounding such indemnification and fee advancement.

At the time of the conservatorship, FHFA announced that it intended for the Enterprises to operate as going concerns with new CEOs and Boards of Directors and that they were to continue normal business operations in support of the mortgage markets. This included the need to attract and retain skilled professionals. These officers and directors, therefore, could be sued just as before conservatorship, thus the need for retaining indemnification.

The determination by FHFA not to interfere with indemnification and advancement of legal fees for former Fannie Mae executives was based on Fannie Mae's corporate by-laws, governing Delaware state law, the provisions of statute governing FHFA's oversight of Fannie Mae and court cases addressing such an action.

Background to Regulatory Reviews and Litigation

In 2003, FHFA's predecessor agency OFHEO addressed serious problems relating to an accounting restatement that was underway at Freddie Mac. In an abundance of caution, OFHEO began its special examination of Fannie Mae which led to a restatement at the firm. Freddie Mac and Fannie Mae both reached settlements with OFHEO and the Securities and Exchange Commission (SEC) to address accounting problems and internal control matters uncovered in the course of the OFHEO reviews.

In September 2004, OFHEO issued a preliminary report regarding Fannie Mae. At that time, several cases were brought against the Fannie Mae involving securities law violations. These cases were consolidated into a multi-district litigation (MDL) in the District of Columbia. Former Fannie Mae CEO Franklin Raines, former CFO Timothy Howard and former Controller Leanne Spencer also were defendants in this litigation. Over time, the defendants brought OFHEO into the case, issuing a number of document subpoenas calling for the production of a wide assortment of OFHEO records and other information and by issuing subpoenas for the testimony of agency personnel.

OFHEO issued a final report in May 2006 highlighting problems with the culture at Fannie Mae, with the internal controls at the institution and with an overemphasis on meeting profit targets; the report detailed needed reforms. When the report was released, Fannie Mae agreed to a settlement with OFHEO and the SEC, paid a $400 million penalty and began a program to implement corrective actions. The majority of the penalty amount went to an investor's fund that exists under the securities laws.

In December 2006, OFHEO issued an administrative Notice of Charges against Mr. Raines, Mr. Howard and Ms. Spencer, charging the former officers with a variety of violations of OFHEO's statute. The process was governed by OFHEO authorities and under its rules of procedures. In April 2008, with the uncertainty about securing a resolution that would bear a return commensurate with the effort, OFHEO determined to settle with the three former officers. While they did not admit to offenses that would have cost them their indemnification, they did waive certain claims and certain stock options.

Also, the SEC and other government reviews began to look into the events at Fannie Mae after publication of the OFHEO report. Other reviews were begun after the imposition of the conservatorship and as part of the government's consideration of the causes of the financial crisis.

Potential Denial of Indemnification— Pre- and Post-Conservatorship

Indemnification can be denied for two reasons. In an administrative hearing, if the level of violation is determined to reach a level provided for in statute to deny indemnification or if a finding in an administrative action or in a judicial proceeding rises to the level that would violate the company's bylaws and the company denies indemnification. Second, indemnification in conservatorship could be terminated for the reasons set forth above as part of an administrative or judicial proceeding or, additionally, as part of the FHFA's conservatorship authority to repudiate contracts. It was the judgment of OFHEO and FHFA that neither action was practicable under our statute or under state laws under which the Enterprises operate.

In 2008 HERA enhanced FHFA's enforcement authorities. The language of HERA follows, almost identically, the provisions of the Federal Deposit Insurance Act on indemnification at 12 USC 1828 (k) and addressed by FDIC in its rule at 12 CFR 359. The FDIC statute and the rule provide for indemnification and advancement of fees and provide what terms would disqualify individuals from indemnification. Under HERA, FHFA's authority is limited to denying indemnification in certain agency administrative actions; it does not apply to regulatory investigations of other agencies or judicial proceedings.

Even if action were employed - under separate language on conservatorship relating to terminating contracts - HERA provides for a party's right to challenge in court for damages caused by such action. The result, therefore, would likely be more legal expenses and recovery by the parties of any denied advances. Such an outcome would be a direct cost to the taxpayers.

FHFA believed that continued advancement of funds was in line with the conservatorship and that actions to interfere would be counterproductive due to the ability of individuals denied to sue the agency for such actions. Also, such action would raise secondary issues relating to other employees and their view of the validity of indemnification of their legal expenses and their willingness to continue their employment.

At the time the Enterprises were placed into conservatorship, it was important to avoid losing personnel who could help reduce the costs to the taxpayer from their large portfolios and business activities and who could be distracted by an absence or potential absence of indemnification. Adding new employees to the staffs of the Enterprises would not be possible without indemnification. As FHFA Director Lockhart noted at the time of the conservatorships, "...Monday morning the businesses will open as normal...[and] it is very important to work with the current management teams and employees to encourage them to stay and continue to make important improvements to the Enterprise." Treasury Secretary Paulson added, "...we hope and expect that the vast majority of key professionals will remain in their jobs." [September 7, 2008 statements.] Finally, FHFA is seeking to recover billions of dollars due the Enterprises from their counterparties; altering indemnification could adversely affect the very Enterprise personnel vested with doing the work necessary to substantiate and advance such claims.

Background on Legal Expenses

Even in ordinary times, the Enterprises are large corporations and incur significant legal expenses. Clearly, in conservatorship their legal expenses continue and the mortgage market crisis has led them to expend funds for legal matters that relate both to the advancement of fees for current and former officers in litigation and regulatory matters as described above. The Enterprises must also respond to lawsuits by homeowners, investigations by government agencies and expenses relating to securing recovery of damages from their counterparties. In all of these activities, the legal issues are very complex and litigation involves significant expenses associated with extensive discovery, expert witnesses and other costs involved in judicial proceedings. Further, the defense of lawsuits may occur in multiple jurisdictions.

For its part, FHFA has reminded the Enterprises operating in conservatorship that they need to manage legal expenses effectively and where possible seek to reduce such expenses as they operate with the support of the federal government.

Thank you.

FULL TESTIMONY
OHIO ATTORNEY GENERAL MIKE DEWINE
"An Analysis of the Post-Conservatorship Legal Expenses of
Fannie Mae and Freddie Mac"
HOUSE SUBCOMMITTEE HEARING ON
OVERSIGHT AND INVESTIGATIONS
WASHINGTON, DC
FEBRUARY 15, 2011

Good afternoon Chairman Neugebauer, Ranking Member Capuano, and Members of the Committee. Thank you for inviting me to testify before you today.

I have to be honest -- I'm not used to being on this side of the dais. I used to be the guy who got to ask all the really tough questions. Now I'm the guy who has to answer them! I guess that's some sort of Congressional payback!

In all seriousness, though, while I consider it an honor to testify before you today -- more importantly, I consider it my responsibility.

I am here today on behalf of the Lead Plaintiffs -- the Ohio Public Employees Retirement System (PERS) and the State Teachers Retirement System of Ohio (STRS), who represent over one million Ohio public employees and teachers -- and nearly 29 million other defrauded investors and pensioners throughout the 50 states in a securities fraud class action filed against Fannie Mae; its three former most senior officers, Franklin Raines, Tim Howard, and Leanne Spencer; and its auditor, KPMG.

The Defendants engaged in a massive accounting fraud against the class to the tune of nearly $9 billion. Our case, which we originally filed over six years ago in November 2004, continues unresolved. What has happened prior to and since the federal government seized control of Fannie Mae nearly two and a half years ago is both outrageous and egregious. Simply put, Fannie Mae and its former executives, whom Fannie Mae has indemnified, have been using U.S. taxpayer dollars to pay their highly compensated cadre of lawyers to over-lawyer their indefensible actions.

The point of this hearing is not for me to retread Fannie Mae's past transgressions or the transgressions of its executives and its accounting firm -- because, bluntly, the liability is clear. Rather, I am here today because what Fannie Mae currently is doing to U.S. taxpayers is wrong.

It is unconscionable.

And, I urge the Committee and Congress to bring it to an end.

Fannie Mae and its former senior officers have done considerable wrong and caused great harm to a great many. But that's nothing new. We already know that Fannie Mae cooked its books, smoothed its earnings (overstating them by $10.3 billion), and violated 30 generally accepted accounting principles -- nearly every major accounting rule applicable to it. Fannie Mae

admitted as much in May 2006, when it paid the Securities and Exchange Commission (SEC) a $350 million civil money penalty and paid the Office of Federal Housing Enterprise Oversight (OFHEO) a $50 million civil money penalty to settle the same fraud allegations as the ones in our current complaint! Not only that, Fannie Mae agreed in the SEC consent order to "not take any action or to make or permit to be made any public statement denying, directly or indirectly, any allegation in the Complaint or creating the impression the Complaint is without factual basis."

Yet, Fannie Mae continues to deny liability, dragging out the current litigation -- billable hour by billable hour -- and bleeding Americans so far, by Fannie Mae's own admission, of at least $132 million for its legal fees. And, by your account, Mr. Chairman, the total cost incurred by Freddie Mac and Fannie Mae, to date, with respect to the fraud exceeds $400 million post-conservatorship.

Candidly, I am both perplexed and frustrated at the way this lawsuit has been handled. Fannie Mae and the executives it is indemnifying are lawyering this case to death and delaying justice for those whom they defrauded in the first place over six years ago, while simultaneously, swindling every U.S. taxpayer.

We have made good faith efforts to move the case toward resolution. We just want justice. But these efforts, at every turn, have been ignored, with no meaningful conclusion in sight.

And let me just say this flat out -- I am not here today to use this hearing as a forum to reach a settlement. We are, in fact, prepared to go to trial. But the problem is that Fannie Mae, whom OFHEO (at one time headed by Edward DeMarco) described as having an "arrogant and unethical corporate culture," is doing everything in its power to delay and stall, all while racking up astronomical legal costs and sticking America's taxpayers with the bill.

It's really easy to holdup the resolution of a lawsuit, when you've got a seemingly bottomless coffer of U.S. taxpayer dollars from which to pay your legion of lawyers to engage in wasteful delay tactics. For the public and private pensioners whom Fannie Mae and its officers defrauded, it's as if they are up against the richest guy in the world and he just doesn't care how much it's going to cost to keep this thing going. If, what Supreme Court Justice David Brewer once said is true -- that "America is the paradise of lawyers" -- then counsel for Fannie Mae, Raines, Howard, and Spencer have found Shangri-La!

I would like to take a moment to share with the Committee some examples of the circus that this lawsuit has become and to provide a glimpse into the absurdity of the actions of Fannie Mae, Raines, Howard, and Spencer.

U.S. District Judge for the District of Columbia, the Honorable Richard J. Leon, is the judge in our case. He has tried diligently to keep the case moving forward. He holds regular conferences to check on the status of the litigation. We, as the Lead Plaintiffs -- representing millions of U.S. pensioners -- typically bring three attorneys to these conferences, including our local counsel. The Fannie Mae Defendants, however -- even just for short routine conferences, where nothing substantive is to be discussed -- typically bring 35 to 40 attorneys and paralegals, costing

taxpayers over $600 per hour for some of these lawyers. Judge Leon commented on the huge expense incurred by having so many defense attorneys, saying at a June 25, 2009, hearing that "...the lawyers are doing pretty well.... I am not so sure the taxpayers are doing pretty well, but the lawyers are doing pretty well in this deal."

At the 123 fact depositions taken in the case, on average, we brought two lawyers because we were usually the party asking the questions. Fannie Mae Defendants brought 13, many of whom never asked any questions. For example, at Mr. Raines' deposition held in April 2010, it lasted 12 hours, covering two days. The Plaintiffs were the only party asking questions; yet the Fannie Mae Defendants brought 13 lawyers:

- Five for Raines;
- Three for Fannie Mae;
- Two for Howard;
- Two for Spencer; and
- One for Daniel Mudd -- a former Fannie Mae employee, who isn't even a defendant in the case.

None of these 13 lawyers asked a single question at this particular deposition -- not a single question, Mr. Chairman. They just sat there and billed the taxpayers for their hours.

We are now in the expert deposition phase of the case, and if the current practice continues, you can expect the Fannie Mae Defendants to rack up a very sizeable bill. For expert witnesses, we, who as the Lead Plaintiffs have the burden of proof, have designated eight experts. Defendant KPMG has designated five experts. Fannie Mae Defendants, however, have 25 experts, costing taxpayers an astounding $600 to $1500 an hour! Franklin Raines has nine experts just for himself, including four to say essentially that he fulfilled his job as CEO by properly relying on others and two to say that his $91 million in compensation over five years was justified.

At a June 14, 2010 hearing, Judge Leon said there is absolutely no way that so many experts will testify at trial, admonishing Fannie Mae Defendants: "So you don't need to have five experts say the same damn thing. If one good one says it the right way from your perspective, that's going to be more than enough. You don't need five to say it. It is not a 'me too' operation. So bear that in mind. The costs are just staggering."

Mr. Chairman and Members of the Committee, candidly, securities cases don't normally take this long to resolve. Our case has been on-going for over six years. Typically, 98% of all securities cases reach a conclusion in far less time -- and with far less cost. Even the similar June 2003 securities fraud class action case against Freddie Mac, relating to its 2003 financial restatement, was resolved in a little under three years.

The bottom line, as Judge Leon put it, is this: "....the more this litigation is protracted and prolonged, the greater the risk that when it is all said and done, the pensioners and the shareholders will not have as much or will have markedly less and the taxpayers will be out millions and millions and tens and tens of millions of dollars for legal fees that can't be recouped in effect because they are gone...."

While the two Ohio pension funds are the Lead Plaintiffs, the class they represent in the case includes investors from all 50 states, including at least 67 entities from your home state of Texas, Mr. Chairman -- ranging from the Priest Retirement and Disability Fund, Teachers Retirement System of Texas, Police Officers Pension System of the City of Houston, and the Texas State Association of Firefighters. And, Congressman Capuano, the class includes at least 12 entities from your home state of Massachusetts, including the Massachusetts State Teachers Fund.

There's no question. Fannie Mae and its former executives harmed American pensioners and public service workers, including teachers, police officers, and firefighters. And, Fannie Mae and its former executives harmed nearly every major corporation in America, such as General Electric, IBM, Coca Cola, and General Motors, as their pension funds had also invested in the Enterprise.

Judge Leon described this case best when he said, "This is a case of monumental proportions. Indeed, it's a case unique in the annals of American industry and business at the highest levels. It has been regarded and referred to as the largest accounting fraud case in the history of the United States."

Members of the Committee, this is bigger than Enron. It is bigger than Worldcom. It has turned into a feeding frenzy on the part of Fannie Mae and its former officers. The evidence of liability is overwhelming, and it is time to rein them in.

Realistically, there are ways for Fannie Mae and its former officers to put up a defense without being so wasteful. I fully understand an argument can be made that Fannie Mae has to defend itself and its former senior officers, but the amount they are spending -- at the expense of U.S. taxpayers -- is, in a word, ridiculous. And, you would think -- a former CEO, who made over $91 million -- might be able to afford his own lawyer.

I thank the Chairman, Ranking Member, and Committee Members for shedding light on the flagrant activities that are taking place. I am, of course, not here to tell you how to proceed and how to conduct your oversight investigation. However, I believe that as you ask more questions and dive more deeply into the facts, you will uncover even more of the Fannie Mae Defendants' needless and wasteful spending of our tax dollars.

When I took the oath of office last month to become Ohio's 50th Attorney General, I swore that I would seek truth, that I would seek justice, and that I would do all I can in my power to protect Ohio families.

And that is precisely why I am here today.

Ohioans have been wronged. Americans are being wronged. And now it is time for someone to stand up and just say stop!

Thank you.

Testimony of Michael J. Williams
President and Chief Executive Officer
Fannie Mae
U.S. House of Representatives Committee on Financial Services
Subcommittee on Oversight and Investigations
"Analysis of the Post-Conservatorship Legal Expenses of Fannie Mae and Freddie Mac"
February 15, 2011

Chairman Neugebauer, Ranking Member Capuano, Members of the Committee, good afternoon. My name is Mike Williams. I am President and Chief Executive Officer of Fannie Mae. I was named to that role in April 2009, after the Company had been placed into conservatorship.

Fannie Mae plays a critical role in stabilizing the nation's fragile housing market. Since 2009, Fannie Mae has provided more than $1.2 trillion in mortgage liquidity, helped one million families buy homes and enabled 3.8 million homeowners to refinance. In that time, we have also provided over $30 billion in financing for more than 570,000 units of affordable rental housing.

Fannie Mae has also substantially strengthened its underwriting standards, and set new guidelines for the industry on loan quality. As a result, we are building a profitable new book of business. We are committed to putting a very strong foundation in place for a sustained recovery in housing, which is key to getting the U.S. economy back on track.

The Committee has asked me to discuss Fannie Mae's post-conservatorship legal expenses. As CEO, I am keenly aware of Fannie Mae's responsibility to manage expenses prudently.

Fannie Mae's Legal Expenses
Fannie Mae is currently facing an unprecedented volume of complex legal matters.

For example, various members of the plaintiffs' trial bar are pursuing class action lawsuits against Fannie Mae, including one brought on behalf of the Attorney General of Ohio. Plaintiffs and their lawyers are seeking billions of dollars. Fannie Mae has substantial defenses in these lawsuits and is vigorously defending the Company and the taxpayers from this potential liability.

Fannie Mae has also been the subject of numerous agency and Congressional investigations. In cooperating fully, we have incurred significant expenses collecting, processing, reviewing, storing and producing tens of millions of pages of data and documents.

We also incur legal expenses in the aggressive pursuit of claims against entities that owe Fannie Mae money. To date, we have been successful in recovering sums well in excess of our legal costs.

Fannie Mae's Advancement Obligations
In addition to our own legal expenses, Fannie Mae is obligated to advance certain legal expenses incurred by current and former officers.

This obligation derives from Article 6 of our bylaws, which Fannie Mae's shareholders adopted in 1987. It is also governed by the contracts that Fannie Mae's Board has entered into with each of its officers and directors. Our Conservator affirmed these contracts in 2008. Where they apply, the Company's obligation to advance legal expenses is always mandatory. If Fannie Mae were to refuse to honor this obligation, we would undoubtedly be sued and likely be subject to additional costs.

Corporations throughout America make provisions similar to ours in order to attract and retain strong and experienced officers and directors.

Since 2009, Fannie Mae has put in place a new Board of Directors and senior executive team. It would not have been possible for the Company to recruit and retain these professionals without offering advancement protections and applying them consistently.

Managing Advancement of Legal Expenses
Since 2005, Fannie Mae's General Counsel has used the services of a third party vendor to review all legal bills for individuals entitled to advancement. Currently, we use a legal invoice audit firm that has provided services for some of the largest corporations in America and various government entities. The vendor negotiates billing rates and determines the reasonableness and necessity of all charges.

In closing, we take seriously our responsibility to manage effectively the resources we have been provided.

I am joined today by our General Counsel Timothy Mayopoulos. He and I look forward to answering your questions.

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