

Freddie Mac Comes Under Fire

At House Commerce Hearing

Dawn Kopecki - Dow Jones Newswires

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WASHINGTON, DC -- Lawmakers questioned whether Freddie Mac's (FRE) accounting misdeeds qualify as actual securities fraud, and the company's federal regulator called for mandatory debt and mortgage-backed securities disclosures as Freddie Chief Financial Officer Martin Baumann came under fire at a House hearing Wednesday.

"Using the language that Mr. Baumann used, when I consult securities lawyers, they tell me that is code for securities fraud," said Rep. Cliff Stearns, R-Fla., who chaired the hearing before the House Commerce Subcommittee on Consumer Protection.

Baumann said former Freddie Mac executives misapplied certain accounting rules and policies "with a view" to pushing extraordinary earnings growth into prior years to make earnings appear less volatile.

The company's primary regulator, the Office of Federal Housing Enterprise Oversight, fined Freddie \$125 million and is seeking other remedial actions. It also settled charges of safety and soundness violations with former Chief Operating Officer David Glenn, who paid a \$125,000 fine. OFHEO is seeking millions more from Freddie's former chief executive and chief financial officers, all of whom were ousted last June.

"OFHEO has more work to do," Stearns said, adding "I think the SEC should look at this." The SEC and Justice Department are conducting their own separate investigations into what led to Freddie's widespread accounting problems. While a reaudit of the company's books resulted in a \$5 billion increase in net earnings, OFHEO said the company's accounting manipulation and lack of internal controls posed a threat to its overall financial stability.

OFHEO Director Armando Falcon told lawmakers that Congress should additionally consider repealing laws that exempt Freddie and fellow government-sponsored enterprise, or GSE, Fannie Mae (FNM) from the 1933 and 1934 Securities Exchange Act, which require certain financial disclosures.

The companies have both agreed to voluntarily adhere to the 1934 law, which requires publicly traded firms to register their common stock with the SEC. Fannie did that in March, but Freddie's restatement will delay that process until at least 2005, Baumann said. In addition, both companies have fought efforts to force them to also pay fees and register their debt and MBS with the SEC, which they say would impede consumers' abilities to lock in mortgage rates and increase costs.

"It became very clear to us in the course of this (Freddie) investigation that the current system of voluntary disclosure is not working," OFHEO Director Armando Falcon said. He told reporters after the hearing that if Congress doesn't repeal those disclosure exemptions, the agency plans to adopt regulations that require comparable disclosures, but not necessarily the fees.

"What's important here is a mandatory system of disclosure," he said.

OFHEO Director Falcon said the agency will announce before the end of this week plans to also impose an extra charge against Freddie's minimum capital until it brings its financial statements current and implements all of OFHEO's remedial requirements. OFHEO can require either company to hold an extra 30% in minimum capital to offset unforeseen operational risk. He indicated at a separate hearing last week that the surcharge could be that high, but declined to elaborate on the matter when asked Wednesday.

Falcon also said the cash-strapped agency just received additional money from Congress to hire a firm with forensic accountants to conduct a similar probe at Fannie Mae, which he hopes

to select next week.

While Falcon has said in the past that he doesn't suspect similar conduct to have occurred at Fannie Mae, he wouldn't rule out that possibility when pressed on the issue.

"Are you saying here today that there are no problems in the accounting, no deviation from (generally accepted accounting) standards at that corporation?" Stearns asked.

"I'm not prepared to say that at this time," Falcon said.

The agency has weathered its share of criticism for missing Freddie's problems. But lawmakers commended Falcon for his aggressive pursuit of remedial actions against the company and former executives.

"We were not equipped to detect this kind of accounting misconduct," Falcon said, adding that he now has the funds to create an office within OFHEO dedicated to accounting oversight.

Democratic Rep. Edward Markey of Massachusetts, who is the cosponsor of a bipartisan bill repealing Fannie and Freddie's disclosure exemptions, criticized the company for failing to register with the SEC.

"You understand, Mr. Baumann, that no one trusts Freddie Mac...There's no question that over the years Freddie has been lying about full compliance," Markey said in a terse exchange with Baumann.

Fannie and Freddie often touted their public disclosure policies as meeting or exceeding what is required by SEC registrants before Freddie admitted that some executives concealed certain transactions from the public.

To emphasize the point, Markey submitted into the Congressional Record old press statements from Freddie Mac that described its financial statements as the "vanguard of disclosure."

Markey also pressed Baumann to turn over a draft financial statement it submitted to the SEC last November - before the company decided to postpone its 2002 earnings statement. Although Baumann said the company never received a request for that data, Markey said his office has repeatedly requested it from Freddie Mac since June.

Markey pressed Baumann for an immediate answer when the executive said Freddie's attorneys would contact his office about it.

"No. I'm asking you Mr. Baumann, you're in charge here. I'm not talking your lawyers talking to my lawyers. I'm asking you, are you going to provide these documents or are you going to continue to play this hide-and-seek game?" Markey asked. Baumann promised to follow up with Markey personally.

In addition, Democratic Rep. Jan **Schakowsky** of Illinois pressed Falcon to release a study OFHEO conducted of executive compensation at Fannie Mae and Freddie Mac. The SEC requires companies to publicize compensation and benefits data for the top five highest-paid executives. But Falcon said OFHEO's report included information on about 20 of Fannie and Freddie's top executives and could be deemed proprietary.

OFHEO provided that data to the House Financial Services Committee which has refused to release that information to the public. Former Clinton prosecutor Kenneth Starr is reportedly working for Fannie to block the release of that data.

"I still think full disclosure is in order," **Schakowsky** said.