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COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
The Role of Fannie Mae and Freddie Mac in the Financial Crisis
December 9, 2008

Today we are holding the Committee's sixth hearing on the financial crisis. To date, we have examined the bankruptcy of Lehman Brothers, the fall of AIG, and the role of credit rating agencies. We held a hearing with federal regulators and one with the nation's most successful hedge fund managers.

Today's hearing will focus on the collapse of two government sponsored mortgage financing enterprises: Fannie Mae and Freddie Mac.

On September 7, the Treasury Department took control over Fannie and Freddie. The companies have now been given access to $200 billion in capital from the federal government. Our job today is to examine why Fannie and Freddie failed.

As part of our investigation, the Committee obtained nearly 400,000 documents from Fannie Mae and Freddie Mac. These documents show that the companies made irresponsible investments that are now costing federal taxpayers billions of dollars.

One key document is a confidential presentation from the files of Fannie Mae CEO Daniel Mudd. According to this document, the company faced a "strategic crossroads" in June 2005. The document states:

> We face two stark choices: (1) Stay the course; or (2) Meet the market where the market is.

"Staying the course" meant focusing predominantly on more secure, prime and fixed-rate mortgages. The presentation explained that this option would "maintain our strong credit discipline" and "protect the quality of our book."

But according to the confidential presentation, the real "revenue opportunity" was in buying subprime and other alternative mortgages. To pursue this course, the company would have to "accept higher risk and higher volatility of earnings."

This presentation recognized that homes were "being utilized ... like an ATM." It acknowledged that investing in subprime and alternative mortgages would mean "higher credit losses" and "increased exposure to unknown risks." But the lure of additional profits proved to be too great.

The documents make clear that Fannie Mae and Freddie Mac knew what they were doing. Their own risk managers raised warning after warning about the dangers of investing heavily in the subprime and alternative mortgage market. But these warnings were ignored.

In 2004, Freddie Mac's chief risk officer sent an e-mail to CEO Richard Syron urging Freddie Mac to stop purchasing loans with no income or asset requirements "as soon as practicable." The risk officer warned that mortgage lenders were targeting "borrowers who would have trouble qualifying for a mortgage if their financial position were adequately disclosed" and that the "potential for the perception and the reality of predatory lending with this product is great."

But Mr. Syron did not adopt the chief risk officer's recommendation. Instead, the company fired him.

A year later, on November 10, 2005, a top Fannie Mae official warned: "our conclusion has consistently been that the layering of risk in many of these private-label securities has not adequately been reflected in their pricing."

On October 28, 2006, Fannie's chief risk officer sent an e-mail to company CEO Daniel Mudd warning about a "serious problem" at the company. He wrote: "There is a pattern emerging of inadequate regard for the control process."

In another e-mail on July 16, 2007, the same risk officer wrote to Mr. Mudd again, this time complaining that the board of directors had been told falsely that the "we have the will and the money to change our culture and support taking more credit risk." The risk officer wrote:

> I have been saying that we are not even close to having proper control processes for credit, market, and operational risk. I get a 16 percent budget cut. Do I look so stupid?

But these warnings were routinely disregarded. In one 2007 presentation, the management of Fannie Mae told the board:

> We want to go down the credit spectrum. ... Subprime spreads have widened dramatically to their widest level in years. We do not feel there is much risk going down to AA and A. ... We don't expect to take losses at AA and A level. Eventually, we want to go to BBB. ... We want to move quickly while the opportunity is still there.

Taking these risks proved tremendously lucrative for the Fannie and Freddie CEOs. They made over $30 million between 2003 and 2007. But their irresponsible decisions are now costing the taxpayers billions of dollars.

At an earlier hearing, the minority released a report that called Fannie and Freddie "the central cancer of the mortgage market, which has now metastasized into the current financial crisis." The next day, John McCain made a similar statement during a presidential debate in Nashville, stating that "Fannie and Freddie were the catalysts, the match that started this forest fire."

The documents do not support these assertions. The CEOs of Fannie and Freddie made reckless bets that led to the downfall of their companies. Their actions could cost taxpayers hundreds of billions of dollars. But it is a myth to say they were the originators of the subprime crisis. Fundamentally, they were following the market, not leading it.

It is also a myth to blame the nation's affordable housing goals. The bulk of Fannie and Freddie's credit losses — nearly $12 billion so far this year — are the result of their purchases of Alt-A loans and securities. Because many of these risky loans lack full documentation of income, they did not help the companies meet their affordable housing goals.

At today's hearing, we will have the opportunity to question four former CEOs of Fannie Mae and Freddie Mac, and I thank them for their cooperation. I also thank the companies themselves for cooperating with the Committee's investigation.

But I especially want to thank and congratulate the members of the Committee for their work this Congress. This will be the last full Committee hearing we will hold this year. And it will be the last Oversight Committee hearing that I will chair.

It has been a tremendous honor to chair this Committee. We began our oversight efforts in February 2007 with four days of back-to-back hearings on waste, fraud, and abuse in federal spending. We investigated the missing $8 billion in cash handed out in Iraq ... the actions of Blackwater's private security guards ... the politicization of federal science ... high drug prices ... and CEO pay. We took testimony from Valerie Plame and Condoleezza Rice; Kevin Tillman and Donald Rumsfeld; Roger Clemens and Brian McNamee; and dozens of corporate and government leaders.

And our actions were the catalyst for legislative changes that will save the taxpayers billions of dollars.

It has been a busy schedule, but the one constant has been the dedication and commitment of the members of the Committee. Oversight is not easy. To have an impact, you have to work hard and know your facts. And that is what you have done in hearing after hearing.

I will always be proud of the work that this Committee has done — and even prouder of the members with whom I have had the great good fortune to serve.

I know you will do great things next year under the leadership of your new chairman and your new ranking member. But I want you to know that I will miss being here and that it has been a tremendous privilege to serve with you.