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Committee on Oversight and Government Reform

Darrell Issa (CA-49), Chairman

GOVERNMENT-SPONSORED MOGULS: EXECUTIVE COMPENSATION AT FANNIE MAE AND FREDDIE MAC

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I. EXECUTIVE SUMMARY

Congress established Fannie Mae in 1934 to increase liquidity in the national mortgage market.[1] Initially created as a government agency, Fannie Mae was privatized and designated as a "government-sponsored enterprise" (GSE) in 1968.[2] Fannie's congressionally-chartered competitor, Freddie Mac, followed in 1970, and with the implicit backing of the United States government, the two GSEs began to dominate the secondary mortgage market.[3] Starting with the Clinton Administration, the federal government pressured Fannie and Freddie ("the Enterprises") to lower underwriting standards, particularly down payment requirements, which resulted in higher leverage and decreased equity.[4] Borrowers flocked to these affordable housing initiatives, and home prices began to skyrocket as borrowers took on riskier mortgages, causing an enormous housing bubble.[5]

When the bubble burst in 2007, Fannie and Freddie began to lose billions of dollars of investments in mortgage-backed securities (MBS) guarantees.[6] In September 2008, the Federal Housing Finance Agency (FHFA) took Fannie and Freddie into conservatorship as a result of mounting losses stemming from the financial crisis.[7] The Enterprises became de facto government entities, funded by preferred stock purchase agreements from the Department of the Treasury (Treasury).[8] Today, the Enterprises remain a multi-billion-dollar drag on the federal government's finances. Since they entered conservatorship, Treasury has provided $169 billion to Fannie and Freddie – and the payouts are scheduled to continue with no end in sight.[9] According to recent FHFA projections, by the end of 2014, Treasury assistance to the Enterprises will total $220 billion to $311 billion.[10]

Since the Enterprises have become government-funded entities, lavish payment packages have been doled out to their senior executives, and taxpayers have been footing the bill. In 2009 and 2010, the Enterprises' top six officers were given a total of more than $35 million in compensation.[11] Of that amount, a total of $17 million in compensation was given to the CEOs of the Enterprises.[12] Additional bonus installments for 2010 may still be forthcoming,[13] and the

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[1] H. Comm. on Oversight and Gov't Reform, The Role of Government Affordable Housing Policy in Creating the Global Financial Crisis of 2008, at 2-3 (updated May 2010) (minority staff report) [hereinafter "Committee Report"].
[2] *Id.* at 3.
[3] *Id.* at 3-5.
[4] *Id.* at 5-12.
[5] *Id.* at 12.
[6] Fed. Housing Finance Agency Office of Inspector General, Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs 7 (Mar. 31, 2011) [hereinafter "FHFA OIG Report"].
[7] *Id.*
[8] Fed. Housing Finance Agency, Projections of the Enterprises' Financial Performance (Oct. 2011), *available at* http://www.fhfa.gov/webfiles/22738/GSEProjF.pdf.
[9] *Id.*
[10] *Id.*
[11] FHFA OIG Report, *supra* note 6, at 12.
[12] *Id.*
[13] *See* Josh Boak & Joseph Williams, *Fannie, Freddie Dole Out Big Bonuses*, Politico, Oct. 31, 2011.

two CEOs stand to make a total of $12 million in 2011.[14] In addition, an executive has been awarded a substantial signing bonus – $1.7 million – upon joining the Fannie Mae.[15] As these figures indicate, senior executives at Fannie Mae and Freddie Mac have become the highest compensated workers on the federal payroll – making as much as eight times more than the President of the United States.[16] The executives even make more than their conservator, FHFA Acting Director Edward J. DeMarco.[17]

Such lucrative compensation packages may be appropriate for profitable companies in the private sector, but substantial questions exist whether they are appropriate for entities in taxpayer-funded conservatorship, especially those that are bleeding billions of dollars each quarter. In this context, it is important to remember that taxpayers – not corporate shareholders – are footing the bill for these lavish bonuses.

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[14] *See* Fannie Mae, 2010 Employee Compensation Statement, Michael J. Williams; Freddie Mac, 2010-2011 Performance Management and Compensation Statement, Charles Haldeman Jr., Chief Executive Officer.
[15] *See, e.g.*, Letter from Brian P. McQuaid, Fannie Mae, to Susan R. McFarland (June 14, 2011).
[16] With a base salary of $900,000 and bonus pay of $2.3 million, Freddie Mac CEO Charles Haldeman made $3.2 million in 2009. President Barack Obama makes only $400,000 a year.
[17] *See* Federal Employees, 2010, http://php.app.com/fed_employees10/search.php (search for "Edward DeMarco").

II. INTRODUCTION

In March of 2009, reports surfaced revealed that after receiving a $170 billion taxpayer-funded bailout, AIG executives had been awarded $121 million in bonuses. Speaking from the East Room in the White House, President Obama responded angrily saying, "This is not just a matter of dollars and cents. It's about our fundamental values…" and asked pointedly "how do they justify this outrage to the taxpayers who are keeping the company afloat?"[18]

In the aftermath of the financial crisis, President Obama would frequently reaffirm his commitment to taxpayers and assail Wall Street executives, who while receiving government funding, also received millions in compensation and bonuses. On January 14, 2010, the President declared, "My commitment is to the taxpayer. My commitment is to recover every single dime the American people are owed. And my determination to achieve this goal is only heightened when I see reports of massive profits and obscene bonuses at some of the very firms who owe their continued existence to the American people -- folks who have not been made whole, and who continue to face real hardship in this recession."[19] The President noted that "if these companies are in good enough shape to afford massive bonuses, they are surely in good enough shape to afford paying back every penny to taxpayers."[20] Speaking about Wall Street bankers who accepted billions of dollars in bonuses, President Obama said, "at a time when most of these institutions were teetering on collapse and they are asking for taxpayers to help sustain them…that is the height of irresponsibility. It is shameful."[21]

When the housing bubble burst, Fannie Mae and Freddie Mac were placed into a conservatorship status, establishing themselves as de facto government entities. Since entering this conservatorship status, Fannie and Freddie have received $169 billion from the Treasury Department.[22] By the end of 2014, Fannie and Freddie are expected to have received between $220 billion to $311 billion in assistance from the federal government.[23] Even though Fannie and Freddie have been subsidized by the federal government since the fall of 2008 and still owes taxpayers $141 billion, their top six officers were given a total of more than $35 million in total compensation in 2009 and 2010.[24] It has recently come to light that of that, $12.79 million were bonuses awarded to Fannie and Freddie's top ten executives.[25]

In January of 2010, President Obama declared that, "we cannot go back to business as usual. And when we see reports of firms once again engaging in risky bets to reap quick rewards, when we see a return to compensation practices that seem not to reflect what the country has

[18] Caitlin Taylor, *President Obama Says AIG Bonuses an "Outrage," Violation of "Our Fundamental Values*,*"* ABCNEWS, Mar. 16, 2009.
[19] President Barack Obama, Remarks by the President on the Financial Crisis Responsibility Fee (Jan. 14, 2010).
[20] *Id.*
[21] President Barack Obama, Remarks by the President after Meeting with the Vice President and the Secretary of the Treasury (Jan. 29, 2009).
[22] Fed. Housing Finance Agency, Projections of the Enterprises' Financial Performance (Oct. 2011), *available at* http://www.fhfa.gov/webfiles/22738/GSEProjF.pdf.
[23] *Id.*
[24] FHFA OIG Report, *supra* note 6, at 12.
[25] Boak & Williams, *supra* note 13.

been through, all that looks like business as usual to me."[26] Just two weeks ago, Fannie Mae asked Treasury for an additional $7.8 billion in aid after reporting a third quarter loss of $5.1 billion.[27] Freddie Mac asked for an additional $6 billion after reporting a $4.6 billion in net losses in its third quarter earnings.[28]

Executive pay and bonuses at Freddie and Fannie appear to be just a continuation of the business-as-usual practices that governed them in previous years, even though the entity is now controlled by the federal government. Rather than coming under more oversight and accountability because of its government-owned status, Fannie and Freddie executives are actually benefitting from this unique status and are continuing to profit on the backs of the American taxpayers. The nexus between taxpayer dollars and executive compensation is direct and substantial. There is no sufficient standard in place to evaluate performance criteria. As reported by its Inspector General, oversight of compensation levels at Fannie and Freddie is "limited."[29]

As the Obama Administration openly and forcefully criticized private enterprises for accepting taxpayer assistance while paying executives bonuses, its defense of the bonuses now being paid to executives at Fannie Mae and Freddie Mac – who now report to the Obama Administration – creates the clear appearance of a double standard. Although the Administration's rhetoric on executive compensation for companies who owe money to taxpayers has been tough in the past, the Administration appears to be in no hurry to change the existing dynamic of executives receiving millions in compensation while taxpayers continue to lose billions on the bad decisions of Fannie Mae and Freddie Mac.

III. FANNIE AND FREDDIE EXECS ARE REWARDED FOR MANAGING LOSSES

Government ownership of Fannie and Freddie has easily turned into "the most expensive bailout of the 2008 financial crisis."[30] Since entering conservatorship, the Enterprises have taken $169 billion from the Treasury and still owe taxpayers $141 billion.[31] Every quarter, the total continues to mount as the Enterprises keep posting net losses.[32] Freddie recently asked Treasury for an additional $6 billion after reporting $4.6 billion in net losses in its third quarter earnings,[33] and Fannie requested an additional $7.8 billion in aid after reported a third quarter loss of $5.1 billion.[34] With FHFA's projection that it will cost at least $51 billion more to support the Enterprises through 2014,[35] the overall bill to the American taxpayers will not be cheap.

Yet, despite their sustained losses and their receipt of billions of dollars in taxpayer assistance, executives at the Enterprises continue to receive immense compensation packages.

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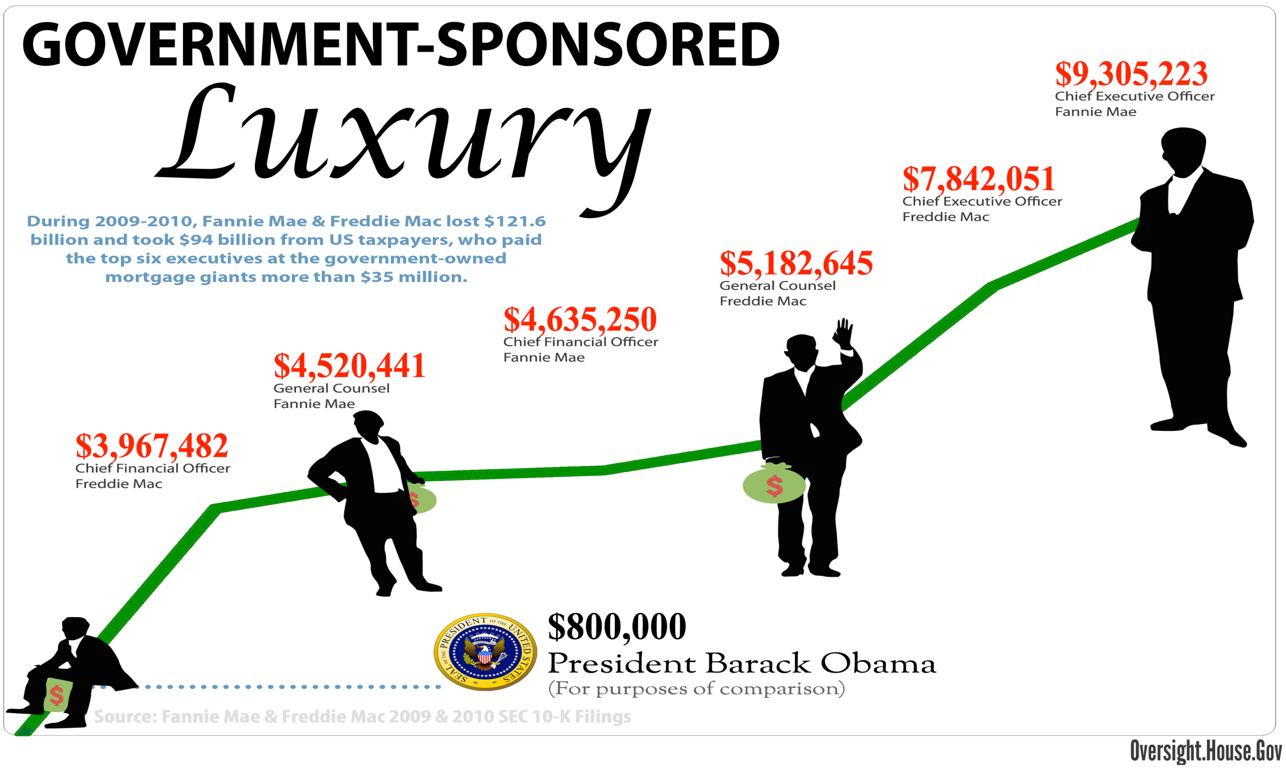
[26] Remarks by the President on the Financial Crisis Responsibility Fee, *supra* note 19.
[27] Margaret Chadbourn, *Fannie Mae Taps $7.8 Billion from Treasury, Loss Widens*, REUTERS (Nov. 8, 2011).
[28] Press Release, Freddie Mac, Freddie Mac Reports Third Quarter 2011 Financial Results (Nov. 3, 2011).
[29] FHFA OIG Report, *supra* note 6, at 18.
[30] Derek Kravitz, *Freddie Mac Reports Q3 Loss, Asks for $6B in Aid*, MSNBC, Nov. 3, 2011.
[31] Nick Timiraos, *Fannie, Freddie Bailout Costs Revised Lower*, WALL ST. J., Oct. 28, 2011.
[32] *See* Chadbourn, *supra* note 27.
[33] Press Release, Freddie Mac, Freddie Mac Reports Third Quarter 2011 Financial Results, Nov. 3, 2011.
[34] Chadbourn, *supra* note 32.
[35] Timiraos, *supra* note 31.

As summarized by Representative Patrick McHenry, Chairman of the Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Companies: "Fannie and Freddie executives are being paid millions to manage losses."[36] The total approved compensation for the top six executives at Fannie and Freddie for 2009 and 2010 totaled more than $35.4 million.[37] The Enterprises' two CEOs received approximately $17 million.[38] In 2010, Ed Haldeman, Freddie Mac's CEO, received a base salary of $900,000, and took home an additional $2.3 million in bonus pay.[39] Haldeman stands to make as much as $6 million in 2011.[40] Meanwhile, Michael Williams, Fannie Mae's CEO, took home $900,000 in base pay in 2010, along with an additional $2.37 million in performance bonuses.[41] Williams also may take home as much as $6 million in 2011.[42] One Fannie Mae executive, Susan McFarland, received a $1.7 million signing bonus upon joining Fannie in June 2009.[43] In contrast, FHFA Acting Director Edward J. DeMarco– the Enterprises' conservator – earns only $239,555 a year.[44]

The chart below summarizes the compensation for the top six executives at Fannie Mae and Freddie Mac in 2009 and 2010, the first two years after they were placed in conservatorship:



[36] Boak & Williams, *supra* note 13 (quote of Rep. Patrick McHenry).
[37] FHFA OIG Report, *supra* note 6, at 12.
[38] *Id.*
[39] Boak & Williams, *supra* note 13.
[40] Freddie Mac, 2010-2011 Performance Management and Compensation Statement, Charles Haldeman Jr., Chief Executive Officer.
[41] *Id.*
[42] Fannie Mae, 2010 Employee Compensation Statement, Michael J. Williams.
[43] *See, e.g.*, Letter from Brian P. McQuaid, Fannie Mae, to Susan R. McFarland (June 14, 2011).
[44] Federal Employees, 2010, http://php.app.com/fed_employees10/search.php (search for "Edward DeMarco").

Although these bonuses are 40 percent below pre-conservatorship levels, the bonuses are, in the words of FHFA Acting Director Edward DeMarco, still "a considerable amount of money."[45] DeMarco has stated that the principal goal of these compensation structures is to create a system that provides the Enterprises' executives with salaries that are sufficient to achieve the goals of the conservatorship, align executive decision-making with the long-term financial prospects of the Enterprises, and minimize costs to taxpayers.[46] However, because DeMarco's assertion lacks independent verification,[47] taxpayers are left uncertain whether these high executive pay rates are truly necessary to retain talented individuals in these positions.

Astronomical compensation packages at Fannie and Freddie are nothing new. Executive pay at the Enterprises has been the subject of considerable controversy for years, even before they were placed into conservatorship. The following examples of compensation packages were given to previous Fannie and Freddie CEOs:

- James Johnson (Fannie Mae CEO, 1991-98) earned roughly $100 million in pay over his time at the company.[48]

- Franklin Raines (Fannie Mae CEO, 1999-05) earned more than $90 million from 1998 to 2003.[49] Further, the Office of Federal Housing Enterprise Oversight (OFHEO) revealed in 2006 that some Fannie senior executives (including Raines and Johnson) manipulated accounting to bolster their pay from 1998 to 2004.[50]

- Daniel Mudd (Fannie Mae CEO, 2005-08) earned $12.2 million in base pay and bonuses while heading Fannie.[51]

- Leland C. Brendsel (Freddie Mac CEO 1987-03) took home more than $28.4 million from 1993 to 2003.[52]

- Richard Syron (Freddie Mac CEO, 2003-08) earned more than $38 million in compensation while CEO.[53] Syron collected $19.8 million of this pay in 2007 alone, the year before the Enterprise went into conservatorship.[54]

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[45] *"Compensation in the Financial Industry – Government Perspectives": Hearing before the H. Comm. on Financial Services*, 111th Cong. (Feb. 25, 2010) (testimony of Edward DeMarco, Acting Director, Federal Housing Finance Agency).
[46] *Id.* (testimony of Edward DeMarco, Acting Director, Federal Housing Finance Agency).
[47] FHFA OIG Report, *supra* note 6, at 13-15.
[48] Gretchen Morgenson & Joshua Rosner, Reckless Endangerment 30 (2011).
[49] *Id.*
[50] *Report: Fannie Mae Manipulated Accounting*, ASSOC. PRESS, May 23, 2006.
[51] Boak & Williams, *supra* note 13.
[52] Eric Dash, *Few Stand to Gain on This Bailout, and Many Lose*, N.Y. TIMES, Sept. 7, 2008.
[53] Charles Duhigg, *At Freddie Mac, Chief Discarded Warning Signs*, N.Y. TIMES, Aug. 5, 2008.
[54] Boak & Williams, *supra* note 13.

These executives benefited from the Enterprises' unique status in the American financial sector. As government-sponsored enterprises, Fannie and Freddie functioned with certain implicit guarantees from the federal government. These guarantees resulted in large profits for the Enterprises, which they spent on large compensation packages for their executives.[55] Today, Fannie's and Freddie's executives continue to profit on the backs of American taxpayers. Now, however, the nexus between taxpayer dollars and Enterprise executive compensation is direct and substantial. As the Enterprises operate in a taxpayer-funded conservatorship, they must be cognizant that the bonuses they award to their executives come straight from the pockets of the American people.

IV. FANNIE AND FREDDIE EXECS BENEFIT FROM QUESTIONABLE METRICS AND PERVERSE INCENTIVES

Post-conservatorship compensation packages were adopted for executive officers at Fannie Mae and Freddie Mac in December 2009.[56] According to FHFA Acting Director Edward DeMarco, these new programs were necessary to attract and retain the kind of individuals who could carry out the goals of the conservatorship while minimizing loses to taxpayers.[57] In a press release dated December 24, 2009, FHFA provided details for the new executive compensation packages.[58] Because there is essentially no value in Enterprise stock, executive salary at the Enterprises is entirely cash-based and it consists of three elements: base salary, deferred salary and long-term incentive awards (LTIs).[59] Base salary is fixed, tied to seniority and paid annually.[60] Deferred Base Salary consists of a fixed portion and a performance-based portion, with deferment for up to 15 months.[61] LTIs, which can also be deferred for up to 15 months, are strictly performance-based.[62]

Along with these changes in pay, FHFA officials claim to have reined in so-called "golden parachutes" and instituted certain "clawback" provisions to retain salary in the event of misconduct or scandals.[63] Though overall compensation is down 40 percent from pre-conservatorship and FHFA has taken some steps to address executive pay, small-scale changes like these are insufficient to stem taxpayer-funded losses at Fannie and Freddie. Indeed, as FHFA's Office of Inspector General ("FHFA-OIG") concluded, the structure of executive compensation at the Enterprises "will likely continue to generate significant controversy."[64]

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55 Committee Report, *supra* note 1, at 14.
56 *See, e.g.*, Fed. Nat'l Mortgage Assoc. Form 8-K, at 2 (2009) (filed December 24, 2009).
57 "*Compensation in the Financial Industry- Government Perspectives*": Hearing before the H. Comm. on Financial Services, 111th Cong. (Feb. 25, 2010) (testimony of Edward DeMarco, Acting Director, Federal Housing Finance Agency).
58 Press Release, Fed. Housing Finance Agency, Fannie Mae, Freddie Mac Executive Compensation Significantly Reduced from Pre-Conservatorship Levels (Dec. 24, 2009).
59 *Id.*
60 FHFA OIG Report, *supra* note 6, at 10.
61 *Id.*
62 *Id.*
63 *Id.* 11.
64 FHFA OIG Report, *supra* note 6, at 21.

Bonuses for Fannie and Freddie Execs Are Based on Questionable Performance Goals

A key objective of the Enterprises' compensation programs "is to tie pay to performance."[65] Half of an executive's deferred pay depends on achievement of corporate goals and his or her LTI award is based entirely on performance of corporate and individual goals.[66] Fannie's 2009 corporate goals were to provide liquidity to the mortgage markets while protecting taxpayers and managing enterprise risk.[67] However, from what little has come to light about the metrics used to measure the achievement of broad goals like these, there is reason to believe that taxpayer money is being spent imprudently.

For instance, a portion of executive performance-based compensation at Fannie and Freddie is tied to hitting targets for the Home Affordable Modification Program (HAMP), a program established by the Obama Administration to help underwater borrowers avoid foreclosure through mortgage modification that has been called a "failure" by the Special Inspector General for the Troubled Asset Relief Program.[68] As the Committee previously found and highlighted, HAMP is plagued with structural problems, has dramatically fallen short of its goal to help 3-4 million distressed homeowners,[69] and has actually harmed homeowners in the process.[70] Taxpayers are paying millions to reward corporate compliance with this failed program: achievement of HAMP and related mortgage modification goals go into determining a significant share – 35 percent – of deferred bonus salary and, to a lesser extent, long-term incentives for Fannie and Freddie executives.[71]

Fannie and Freddie Execs Play a Role in Determining their Own Salaries

When FHFA established the Enterprises' overall executive compensation packages in 2009, it did not act alone. FHFA consulted with the Treasury Special Master for TARP Executive Compensation, Kenneth R. Feinberg, and outside compensation consultants hired by the Enterprises and FHFA.[72] Additionally, senior executives from the Enterprises themselves were closely involved in the decision-making process.[73]

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[65] Fed. Nat'l Mortgage Assoc., Form 10-K, at 208 (2010)
[66] *Id.*
[67] Fed. Nat'l Mortgage Assoc., Form 10-K, at 212-14 (2009).
[68] Office of the Special Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress 10-11 (Jan. 26, 2011).
[69] The most recent information available from Treasury indicates that HAMP has only made 720,612 permanent modifications so far and a total of 902,565 additional modifications have actually been canceled to date. Fannie Mae, Making Home Affordable Program Performance Report through September 2011 (Nov. 2011).
[70] *See* H. Comm. on Oversight and Gov't Reform, Treasury Department's Mortgage Modification Programs: A Failure Prolonging the Economic Crisis (Feb. 25, 2010) (minority staff report).
[71] Josh Boak & Joseph Williams, *Fannie, Freddie Dole out Big Bonuses*, POLITICO, Oct. 31, 2011.
[72] FHFA OIG report, *supra* note 6, at 8.
[73] Fed. Nat'l Mortgage Assoc., Form 10-K, at 209 (2009) ("Our senior management, Compensation Committee and Board of Directors worked closely with FHFA in developing our 2009 executive compensation structure and total compensation target amounts for the named executives.").

It remains unclear what role executives at the Enterprises have played in determining their annual pay since, but their influence on the pay packages in the first place raises questions about the process by which executive compensation is set at the Enterprises. These annual targeted compensation processes will remain in place indefinitely, unless they are modified by FHFA. However, FHFA has shown no willingness to take action to change them.

Bonuses Are Based on Comparisons with Compensation at Profitable Private Companies, Not Comparable Government Entities

The Enterprises paid outside compensation consultants $655,000 in 2008 and $560,000 in 2009 to determine their own pay structure.[74] To arrive at salary levels, the consultants assisted the Enterprises in identifying compensation at "comparable" firms.[75] However, instead of looking to truly similar institutions like Ginnie Mae, FHFA, or the Federal Housing Administration (FHA), the institutions that the consultants identified – large banks and insurance companies like Bank of NY Mellon Co., MetLife, Inc. and Capital One Financial Co. – were anything but comparable to Fannie and Freddie.[76] If these private sector institutions were not profitable by themselves, as is presently the case with the Enterprises, instead of being handsomely rewarded with bonuses, their executives would likely be fired.

As established by the Federal Housing Enterprises Financial Safety and Soundness Act (the GSE Act), pay for Fannie and Freddie executives is modeled after executive compensation at "reasonable and comparable" businesses.[77] Yet, the GSE Act was written when the two Enterprises were not fully government-owned. The circumstances have changed. Pre-conservatorship pay packages may not be appropriate for the Enterprises' post-conservatorship reality. Fannie and Freddie are now for all intents and purposes government-funded entities, and their executives are paid from the government coffers, not corporate profits.

Conservatorship Status Assists Fannie and Freddie Execs in Meeting Performance-based Criteria

To the extent that executive compensation is based on the Enterprises' abilities to achieve certain defined objectives, their conservatorship status actually assists them in meeting performance-based criteria. For example, in 2009, the Federal Reserve purchased $1.25 trillion in the Enterprises' mortgage-backed securities (MBS).[78] That same year, Fannie Mae executive compensation was based partially on whether Fannie could issue 37.5 percent of all new MBS issuances. Fannie exceeded its goal, issuing 47 percent of all new MBS issuances. It is likely that Fannie could not have met this objective without the Federal Reserve's purchase.[79]

An open question remains whether Fannie and Freddie executives profit from the Enterprises' conservatorship status. To date, FHFA has not developed a metric to determine

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[74] *Id.*
[75] FHFA OIG Report, *supra* note 6, at 8-9.
[76] For a full list, see Fed. Nat'l Mortgage Assoc., Form 10 K, at 211 (2009).
[77] Federal Housing Enterprises Financial Safety and Soundness Act, Pub. L. 102-550 § 4518, 106 Stat. 3941 (1992).
[78] FHFA OIG Report, *supra* note 6, at 14.
[79] *Id.*

"whether discounts to the executives' compensation should be applied as appropriate to compensate for executive performance data that may be overstated because of federal assistance."[80] The longer it takes FHFA to act, the less confidence taxpayers will have in Enterprise executive compensation.

V. FHFA'S REGULATORY FAILURE ON ENTERPRISE EXECUTIVE COMPENSATION

Congress created the Federal Housing Finance Agency in July 2008 with the express purpose of actively regulating Fannie and Freddie.[81] By all measures, FHFA has fallen short with respect to its examination and oversight of executive compensation at the Enterprises. In a report issued in March 2011, the FHFA Office of Inspector General ("FHFA-OIG") criticized the agency's supervision of executive compensation calculations at Fannie and Freddie.[82] The report documented inadequacies in FHFA's review and verification of Enterprise compensation levels, as well as a lack of transparency in the process.[83]

FHFA-OIG found that FHFA is not adequately prepared to determine whether compensation packages are reasonable and sufficient to attract and retain talented executives.[84] According to FHFA-OIG, FHFA has not sufficiently articulated what differences exist between the Enterprises and other federal housing entities that explain why executives at the Enterprises deserve substantially more compensation.[85] FHFA-OIG did not take a position on what Enterprise compensation levels should be. Instead it stated that "FHFA should formally review the current situation to account for the disparate levels of compensation and render this issue transparent."[86] In addition, FHFA-OIG claimed that FHFA has not assessed how the Enterprises' status in conservatorship affects their ability to meet performance goals,[87] and that it has no objective metrics by which to determine how the Enterprises' compensation levels affect the retention of key personnel.[88] These findings are unacceptable given the critical role that FHFA plays in safeguarding billions of taxpayer dollars.

FHFA Oversight Lacks "Key Controls"

FHFA-OIG found that FHFA's executive compensation "oversight processes lack a number of key controls necessary to ensure their effectiveness."[89] The report pointed to three main deficiencies. First, FHFA-OIG found that FHFA has no standard evaluation criteria with which to review the Enterprises' proposed goals or measured performance of these goals. This type of "control tool" is "an integral part of an entity's planning, implementing, reviewing, and

[80] *Id.*
[81] *See* Housing and Economic Recovery Act of 2008, Pub. L. 110-289 § 1101, 122 Stat. 2654, 2661 (2008)
[82] *See* FHFA OIG Report, *supra* note 6.
[83] *Id.* at 13-20.
[84] *Id.* at 13-15
[85] *Id.* at 13-14.
[86] *Id.* at 14.
[87] *Id.*
[88] *Id.* at 15.
[89] *Id.*

accountability for stewardship of government resources and achieving effective results."[90] Yet, FHFA defers to the Enterprises' own subjective metrics to set their goals and rate their performance. Before each calendar year, the Enterprises submit proposed corporate goals for review by FHFA. FHFA reviews these goals on an Enterprise-wide basis, but allows the Enterprises to decide which executives are responsible for implementing which goals. FHFA also allows the Enterprises to decide the total compensation for each executive.[91] At the end of each calendar year, the Enterprises submit to FHFA self-assessments on how they performed against the corporate goals. FHFA reviews these self-assessments on an Enterprise-wide level only, not reviewing whether each executive met his or her individual goals.[92] According to FHFA-OIG, these deficiencies "render[] FHFA unable to demonstrate that its oversight of Enterprise executive compensation is effective, consistent, and reliable."[93]

Second, FHFA-OIG found that FHFA's review of Enterprise-recommended compensation levels is narrow and unverified. In the words of an FHFA official, FHFA's review of individual executive compensation levels is "limited."[94] FHFA delegates to the Enterprises the responsibility for setting executive compensation for each executive, and adopts the recommendations unless there is obvious reason not to. According to the report, FHFA only rejects an individual compensation figure if it is an "aberration" or an "outlier" in relation to figures from comparable financial firms.[95] FHFA does not independently verify or test the appropriateness of the compensation levels, contrary to accepted auditing procedures. FHFA does not verify the executive's performance rating, recalculate the proposed compensation level, or determine whether the decision was in line with established procedures.[96] This "lack of testing and verification does not provide a reasonable basis for outside observers, such as FHFA-OIG, Congress, or taxpayers, to be assured that the Enterprises are, in fact, making individual compensation decisions consistent with policies and procedures."[97]

Finally, FHFA-OIG found that FHFA has no established documentation or record-keeping procedures for executive compensation decisions. Documents related to executive compensation are not stored on a consistent basis and are not readily available for review. Some documents are physically stored in FHFA employee offices while awaiting electronic filing, and some are electronically stored on FHFA email.[98]

FHFA Oversight Lacks Transparency

FHFA-OIG also concluded that FHFA's review of executive compensation levels is not sufficiently transparent to shareholders and the public.[99] FHFA-OIG recommended that FHFA conduct formal, written analyses of executive compensation at the Enterprises, comparable

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[90] U.S. Gen. Accounting Office, Standards for Internal Control in the Federal Government 13 (Nov. 1999).
[91] FHFA OIG Report, *supra* note 6, at 16.
[92] *Id.* at 17.
[93] *Id.* at 17
[94] *Id.* at 18.
[95] *Id.*
[96] *Id.*
[97] *Id.*
[98] *Id.* at 19.
[99] *Id.* at 19-20.

financial firms, and government entities. It recommended that FHFA publish the results and its review of the Enterprises' performance measures to "provide assurances that [executive] compensation is reasonable and justified."[100] FHFA-OIG also recommended that FHFA improve its website to include user-friendly information on Enterprise performance goals and compensation levels. FHFA-OIG suggested that the information include SEC filings, trend data, and analyses to ensure that the executive compensation levels are reasonable and earned.[101]

FHFA Is Not Serious about its Oversight of Enterprise Executive Compensation

Although FHFA acknowledged that some improvements could be made, it disagreed in part with each of the FHFA-OIG's recommendations.[102] FHFA discounted an OIG suggestion for FHFA to clearly explain why Enterprise officers make more than other government housing officials, stating FHFA does "not believe that government pay levels are useful benchmarks for evaluating Enterprise pay."[103] FHFA also rejected an OIG recommendation to more closely supervise individual compensation levels, instead deferring "to the Board of Directors and senior management that we have hired to do this as a normal part of their jobs."[104] FHFA dismissed OIG calls for increased transparency of executive compensation, stating that while it agreed in principle, it "believe[s] that current SEC disclosures provide excellent information about executive pay at the Enterprises."[105] In summary, where Congress intended FHFA to be a zealous conservator of taxpayer money, the agency has become essentially a rubber stamp for executive compensation at Fannie and Freddie.

The deficiencies noted in the FHFA-OIG report are emblematic of FHFA's culture of inadequate supervision of Fannie and Freddie. In just the last few months alone, FHFA-OIG has highlighted delinquencies relating to FHFA's supervision of Fannie's Retained Attorney Networks (RAN),[106] Freddie's loan-review process,[107] and Fannie's operational risk management program.[108] As Fannie and Freddie losses continue to pile up, American taxpayers deserve an aggressive regulator of the Enterprises. The reports of the FHFA-OIG indicate that, at present, the jury is still out on whether FHFA can fulfill that role.

VI. A DOUBLE STANDARD ON EXECUTIVE COMPENSATION

For all its rhetoric on housing policy, the White House has demonstrated absentee leadership over Fannie and Freddie executive compensation. The Administration has selectively criticized executive compensation in the private sector but has not similarly criticized executive

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[100] *Id.* at 20.
[101] *Id.*
[102] FHFA IG Report, *supra* note 6, at app. B.
[103] *Id.* at 2
[104] *Id.* at 3.
[105] *Id.* at 3-4.
[106] Fed. Housing Finance Agency Office of Inspector General, FHFA's Oversight of Fannie Mae's Default-Related Legal Services (Sept. 30, 2011).
[107] Fed. Housing Finance Agency Office of Inspector General, Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America (Sept. 27, 2011).
[108] Fed. Housing Finance Agency Office of Inspector General, Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk (Sept. 23, 2011).

compensation at the Enterprises. In 2009, President Obama called Wall Street bankers "fat cats," saying that bankers "are drawing down $10, $20 million bonuses after America went through the worst economic year that it's gone through in – in decades, and you guys caused the problem."[109] That same year, however, the White House declined to comment when Fannie and Freddie employees received a total of $210 million in bonuses.[110] In January 2010, President Obama again criticized executive compensation at Wall Street firms as "massive profits and obscene bonuses at some of the very firms who owe their continued existence to the American people."[111] Yet, the White House has remained "largely silent" on the bonuses given to executives at Fannie and Freddie.[112] White House Press Secretary Jay Carney dismissed any Administration concern over the compensation, saying "These entities are independent and therefore they are independent decisions. The White House is not involved, and nor should it be."[113]

The Administration's indifference to Enterprise executive compensation is striking given how forcefully the President decried similar compensation packages at private entities. It leaves the impression that the White House is disengaged from addressing the deficiencies of Fannie and Freddie. At a time when strong leadership of the Fannie and Freddie is sorely needed, the Administration has come up short. As the Enterprises continue to lose taxpayer money and the White House continues to dither, American taxpayers will continue to pay the price.

VII. CONCLUSION

As Fannie and Freddie enter year three of their conservatorship, little progress has been made to wind them down. The Enterprises continue to lose billions of dollars and continue to milk the American taxpayers for more and more financial support. Meanwhile, executives at Fannie and Freddie, influenced by perverse incentives and rewarded by questionable performance criteria, continue to receive enormous compensation packages. To make matters worse, the Enterprises' conservator, FHFA, has shown little initiative to address these run-away executive compensation rates, and President Obama tacitly endorses them by turning a blind eye. This lack of oversight over executive compensation from the FHFA and the Administration reinforces why it is imperative for Congress to wean Fannie and Freddie off the government payrolls for good. Even FHFA, the Enterprises' conservator, agrees that the controversy over executive compensation packages at Fannie and Freddie illustrates the need to "provide a clear path forward to end the conservatorships and reduce the taxpayer exposure to the mortgage market."[114] Three years and hundreds of billions of dollars later, the time has come to cut off these government-sponsored moguls.

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[109] Elizabeth Williamson, *Obama Slams 'Fat Cat' Bankers*, WALL ST. J., Dec. 14, 2009.
[110] Charles Duhigg, *Big Bonuses at Fannie and Freddie Draw Fire*, N.Y. TIMES, Apr. 3, 2009.
[111] *White House Bonus Hypocrisy*, Inv. Bus. Daily, Nov. 2, 2011.
[112] Boak & Williams, *supra* note 13.
[113] *White House Bonus Hypocrisy*, *supra* note 111.
[114] *See* Letter from Edward J. DeMarco, Acting Director, Fed. Housing Finance Agency, to United States Senators (Nov. 10, 2011).