



**Office of Federal Housing Enterprise Oversight
(OFHEO)**

NEWS RELEASE

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**Statement of the Honorable Armando Falcon, Jr.
Before the Committee on Banking, Housing and Urban Affairs,
United States Senate, July 17, 2003**

Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, I appreciate the opportunity to appear before you. My testimony today will focus on the Freddie Mac restatement process, OFHEO's role as a safety and soundness regulator, more specifically, the Agency's approach to examining accounting practices and financial controls at the Enterprises, and a status report on the related issues of Executive Compensation and Corporate Governance. In addition, I have attached some legislative recommendations for the Committee's consideration to enhance OFHEO's role as safety and soundness regulator.

Introduction

On January 22, 2003, Freddie Mac announced that it would reaudit and restate its financial statements for 2000 and 2001. The company also announced that its external auditor would delay certification of Freddie's year-end 2002 financial statements. Five months later, on June 7, the Board removed the company's top three officers. OFHEO, the SEC and a U.S. Attorney all have ongoing investigations of the company and its accounting practices. These extraordinary actions reflect the culmination of developments over several years. Given our ongoing investigation, I ask for the Committee's understanding if I am restrained in my testimony, as facts are still being verified and circumstances evaluated. I will begin by describing the major developments in chronological order.

Lead -Up to FAS 133 Preparation and Implementation -- 1999

First, the sequence of events begins with the preparation, in 1999, for implementation of Financial Accounting Standards Board (FASB) Statement No. 133 – Accounting for Derivative Instruments and Hedging Activities (FAS 133). FAS 133 is not the only accounting standard involved in this matter, but it plays the most important role. FAS 133 establishes accounting and reporting standards

for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities.

FAS 133 requires an entity to recognize all derivatives as either assets or liabilities in the financial statements and reflect those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as: a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment; b) a hedge of the exposure to variable cash flows of a forecasted transaction; or c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation.

Under FAS 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk.

I would now like to turn to OFHEO's examination strategy to cover FAS 133 preparation at the Enterprises in 1999. The routine 1999 examination work was conducted at the same time OFHEO's examiners were expending considerable efforts to ensure that both Enterprises were prepared for, and all essential systems across the two companies would be fully compliant with Y2K goals. Because of the critical nature of Y2K readiness, examiners conducted extensive testing and validation of systems preparedness. Against this backdrop, the FAS 133 examination strategy required the examination team to maintain expertise and working knowledge of the accounting standard and its potential effects on each Enterprise; evaluate and assess the Enterprises' timelines for implementation; evaluate the strategy each Enterprise was pursuing for its implementation of the accounting pronouncement, and analyze the effects of FAS 133 on financial statements. In addition, our examiners would continue to evaluate the external accountant's position on the accounting policy guidance associated with implementing FAS 133; assess the systems enhancements to conduct hedging and financial reporting under FAS 133; and evaluate and monitor implementation readiness and event management, including contingency preparations for the transition.

In the second half of the year, FASB unexpectedly delayed the implementation date of FAS 133, from January 1, 2000 to January 1, 2001, so that companies could focus their attention on Y2K.

Transition Period to FAS 133 Readiness – 2000

In 2000, OFHEO's examiners assessed the development and implementation of Enterprise plans with respect to several new significant accounting standards, including FAS 133. At the same time, they reviewed the effectiveness of Y2K efforts and the effects on the financial safety and soundness of a 20 percent decline in the volume of originations; an increase in the proportion of Enterprise purchases of single-family mortgages evaluated through automated underwriting systems; and the increased use of sophisticated technology for risk management across the companies.

In evaluating preparations for the implementation of FAS 133, examiners were actively evaluating: Systems preparation, implementation strategies, impact analysis, documentation specifications, portfolio management strategies and the approvals from management, the Board and the internal and independent external accountants involving FAS 133 implementation. We recognized the substantial progress that had been made on the preparations and the considerable analysis that had been performed. Further, we noted the additional efforts that were underway to deal with the remaining systems and documentation challenges associated with implementing and operating with FAS 133.

In late 2000, the Audit Committee approved the Financial Reporting Controls Improvement Plan (FRCIP). The FRCIP was designed to address issues affecting financial accounting and financial reporting that had been identified by the company, its independent auditors and OFHEO. The goal of the FRCIP was to achieve the same level of controls in the financial accounting and financial reporting area that were present across the other areas of the company and in the operating business units.

OFHEO's examiners evaluated the FRCIP and Freddie Mac's progress in completing the FRCIP in a number of ways. In 2000, examiners evaluated and communicated with management about the FRCIP itself, ensuring if it was reasonably designed to address the root causes of the identified weaknesses. Also, in 2000, examiners assessed the design of the tools both management and the Board's Audit Committee intended to use to measure and report progress in implementing the FRCIP. On a regular basis, examiners were assessing the progress toward completion of the FRCIP and communicating our assessments to the company.

In the fourth quarter of 2000 and the first quarter of 2001, Freddie Mac entered into several transactions to minimize the impact of FAS 133. PwC later identified these FAS 133 transition transactions as accounting issues needing correction before the 2002 financial statements could be certified.

Implementation of FAS 133 – First Quarter 2001

In 2001, OFHEO's examiners continued their ongoing evaluation of the implementation of FAS 133 and its impact on the Enterprise, with respect to business activities, risk management strategies and portfolio management. Among the variety of features our examiners were reviewing, were the operational aspects associated with FAS 133 and the company's quarterly closing practices. When reviewing the quarterly closings, we noted the sign-offs and notations of the company's auditors. Our review found no reservations or qualifications associated with Arthur Andersen's certification of the quarterly and year-end 2001 financial statements and the conformance of those financial statements and disclosures with GAAP.

FAS 133 was implemented in first quarter 2001. Arthur Andersen certified each quarter's financial statements under the new FAS 133 pronouncement as GAAP compliant. At this same time, extensive interpretations continued to be produced on FAS 133 by Financial Accounting Standards Board (FASB).

While OFHEO was conducting its FAS 133-related examination activities, we were also dedicating examiners to assess the impact of record levels of originations, new corporate governance standards and record volumes of purchases and securitization on both Enterprises' safety and soundness. OFHEO examiners were also evaluating the timeliness and effectiveness of the Enterprises' actions to meet the final Risk-Based Capital Rule.

Need to Strengthen Expertise and Controls -- 2001

After preparing for FAS 133, the actual implementation of this accounting standard further highlighted aspects of Freddie Mac's financial accounting and financial reporting areas that needed strengthening. It became more apparent to OFHEO and Freddie Mac that, while the overall control structure for the company was strong, in the financial accounting and financial reporting area there was an apparent need to strengthen expertise and reduce the reliance on manual systems. Strengthening expertise and reducing the reliance on manual systems were important aspects of the FRCIP introduced in 2000, and examiners continued in 2001 to evaluate the progress against this remediation plan. We continued to press management to ensure progress continued in implementing the FRCIP and maintaining the plan's implementation remained an important corporate priority.

OFHEO felt the control environment at that point in financial accounting and financial reporting was stable, but in need of strengthening. The FRCIP was designed to address the identified weaknesses and to strengthen the control environment in the financial control and financial reporting area to a level consistent with the control environments across the other parts of Freddie Mac. While there were weaknesses in the financial accounting and financial reporting

area, the manual processes did mitigate those control weaknesses in the operating process and resulted in Freddie Mac's ability to produce reliable financial records. Upon completion of the work to re-engineer the financial accounting and financial reporting process, there would be a more timely, efficient and streamlined process that would not depend upon manual systems to ensure the reliability of financial information.

In context, Freddie Mac maintained effective internal controls in its various business areas. The area covered by FRCIP was the financial accounting and financial reporting area, which represents a subset within the larger finance area, and an even smaller subset within the overall company.

OFHEO's examiners continued in 2001 to evaluate progress on the FRCIP at least quarterly by, for example, analyzing and testing the quarterly progress reports to the Audit Committee, Internal Audit, senior management and Arthur Andersen, and evaluating the events reached or expected, major milestones, schedule overruns and the level of completion of each project. Examiners concluded that by mid-2001 approximately one-third of the FRCIP had been completed. As a result of a national search, Freddie Mac brought in a new Senior Vice President – Corporate Controller, charged with responsibility for the accounting and control function. This key milestone was achieved in October 2001, and by year-end 2001 Freddie Mac completed Phase I of the FRCIP, which included reconciliations, and deployment of integrated and automated cash management, bank account and transactional reconciliations and billings/receivables functionalities. In 2002, OFHEO's examiners continued their ongoing assessments of progress under the FRCIP, and determined that the new accountability model and Operation Risk Management Unit, when implemented, would strengthen Freddie Mac's financial accounting and reporting processes.

Also during this period, OFHEO was planning enhancements for its examination activities. In 2000, I had meetings with OFHEO's Chief Examiner, and we outlined plans for strengthening OFHEO's examination program. Among our discussions was an idea to create an examination team dedicated to accounting matters. In January 2001, the Chief Examiner delivered a plan designed to enhance OFHEO's examination program. A cornerstone of that plan was to more than double the size of the examination staff, adding depth and additional specialized skill sets to deal with complex issues associated involving the supervision of the Enterprises.

The plan to strengthen OFHEO's examination program included the formation of a group for specialized examination activities, including a team of accountants. After receiving this plan in January 2001, I began advocating within the Administration and with Congress the importance of OFHEO obtaining the resources to begin implementing this plan and enhancing our examination program. In the second half of 2002, we were able to start adding to our team of

accountants with skilled technicians who would be dedicated to accounting matters at the Enterprises.

New Outside Auditor -- 2001

Late in 2001, Arthur Andersen was under public scrutiny because of its role as the audit firm of record in certain high-profile federal investigations and bankruptcy filings. Given these developments in late 2001 with Arthur Andersen, Freddie Mac's Board of Directors and executive management deliberated whether they should keep that firm or select a new, independent accounting firm. Freddie Mac solicited OFHEO's views concerning the retention of Arthur Andersen. OFHEO opined that given the circumstances, retention of the firm created a higher-risk situation for Freddie Mac.

The Audit Committee decided to change independent accountants and interviewed two potential firms in the first quarter of 2002. The Committee decided to switch to PwC for Freddie Mac's independent public accountants for the year ending December 31, 2002. Freddie Mac made a public announcement of this decision on March 6, 2002.

The audit opinions of Arthur Andersen on the consolidated financial statements of Freddie Mac for the fiscal years ending December 31, 2000 and 2001 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles. In separate management letters, Arthur Andersen shared its concern with senior management on a number of items that had also been independently noted by OFHEO.

Engagement of PwC -- 2002

OFHEO evaluated and tracked changes being made through its routine examination activities in 2002 regarding the engagement of PwC and the work of the Audit Committee. PwC began its audit engagement immediately after being selected by the Audit Committee. OFHEO examiners had an introductory meeting with PwC managers for the Freddie Mac audit on March 5, 2002. PwC was ratified as the independent public accountant at Freddie Mac's May 2, 2002 annual shareholders meeting.

In the course of its audit, PwC initiated a process of identifying various accounting policies and accounting issues to discuss with Freddie Mac's management. Both Freddie Mac management and PwC conveyed the nature of these discussions to the Audit Committee. In the normal course of business, PwC met with the Audit Committee in executive session on these matters.

Additional Expertise Added at Freddie Mac -- 2002

Consistent with OFHEO's concerns, some important staffing decisions in the finance area were announced at Freddie Mac during 2002, adding necessary expertise. In June, a new Senior Vice President for Operational Risk Oversight was hired. On June 18, the Board announced the creation of a new senior level executive position and national search, for an Executive Vice President of Finance, consistent with the goals outlined in the FRCIP. The newly created position would be responsible for the overall finance, accounting, corporate planning, tax, shareholder relations, and market risk and operating risk oversight functions of the company. The CFO and the Corporate Controller would continue in their respective roles and they would report to the new Executive Vice President – when hired. Until the new position was filled, the Corporate Controller had a direct administrative reporting line to the COO and a direct communication line with the Audit Committee, similar to the CFO's reporting line. The current EVP and CFO – Mr. Vaughn Clarke - no longer had the Corporate Controller reporting through him, and notified the company of his intentions to leave Freddie Mac. On March 19, 2003, Freddie Mac announced that Mr. Martin Baumann had filled the newly created EVP of Finance position.

ALLL Accounting Matter Identified -- 2002

OFHEO was actively involved in the discussions that were taking place between PwC and Freddie Mac regarding the Allowance for Loan and Lease Losses (ALLL). The ALLL was identified in July 2002 by PwC as a critical accounting matter that needed to be resolved as they worked toward certifying Freddie Mac's financial statements.

A special Audit Committee meeting was held on July 16, 2002 where PwC raised the ALLL issue for Freddie Mac – it was too conservative in its loss estimates and coverage per PwC's determination under GAAP. PwC said this matter on the ALLL needed to be resolved before Freddie Mac's release of second quarter financial statements on July 23, 2002.

OFHEO and Freddie Mac representatives met on July 22, 2002 to gather information about the final size of the adjustments being made to Freddie Mac's financial statements. The adjustment was a \$246 million reduction in the ALLL. On the same day, the Audit Committee had a special meeting to review the final analysis and approve the adjustment for release to the public in the July 23, 2002 release of financial statements.

Accounting policies and issues continued to be worked on by PwC, management and the Board throughout 2002. Progress appeared on track for the certification of fiscal year 2002 financial statements. As of fourth quarter 2002, the ALLL was the only accounting issue that had risen to the level of PwC expressing reservations to the Audit Committee relating to that firm's ability to certify Freddie Mac's statements and that had been resolved in July 2002.

OFHEO continued to evaluate and monitor the status of the accounting policies under discussion between PwC and Freddie Mac during 2002, as well as the actions and decision-making by the Audit Committee. Examiners continued in 2002 to evaluate progress on the FRCIP at least quarterly. This included examiners testing selected work products and evaluating project management and reporting.

Unresolved Accounting Matters under FAS 133 -- 2003

PwC came to the Freddie Mac Board in mid-January 2003 and informed the Audit Committee they would be meeting with representatives from PwC's national office about unresolved accounting policy matters, related to FAS 133 implementation. On Monday, January 20, 2003, PwC notified the Audit Committee that they were uncomfortable with certain accounting treatments applied during the FAS 133 transition. Furthermore, until its concerns were resolved, it would not be able to certify the company's 2002 fiscal financial statements using the accounting policies from prior periods, even though the policies had been approved by Arthur Andersen as GAAP compliant. OFHEO was made aware of these developments on that day and met with Freddie Mac officials the following day.

The nature of the major accounting issues identified through the restatement process include:

1. The erroneous accounting treatment of the company's Securities Sales and Trading Group (SS&TG) as a third-party broker dealer;
2. Inadequate documentation and testing of certain derivative instruments and their valuations accounted for as hedge instruments for accounting purposes;
3. The erroneous transfer of mortgage securities out of the "held-to-maturity" and trading accounts;
4. The treatment of mortgage sales transactions as financings;
5. Accounting for certain cash transactions used to manage interest rate risk as if they were derivatives; and
6. Omitting the recognition of the guarantee fee and credit obligations embedded within sold PCs. These transactions are the subject of our investigation, and I will have more to say about them in my final report.

Because Arthur Andersen was no longer an operating firm at this point, PwC could not undertake a normal transition pursuant to the American Institute of Certified Public Accountants (AICPA) guidance for successor/predecessor accountants. Instead, PwC would have to undertake additional substantive

testing. The Board of Directors determined that PwC should conduct a reaudit of the prior period financial statements.

OFHEO, PwC, and the Audit Committee evaluated the nature of the accounting issues. Among the factors considered was the cumulative effect of the adjustments flowing from the change in accounting treatments. The net cumulative effect of the new accounting treatments was an increase to income in prior periods, thus increasing the amount of capital on a cumulative basis. This would also result in considerable volatility in those prior periods. Further, OFHEO, PwC, and the Audit Committee considered the effects from the accounting policy changes for any potential effect on the fair value statements of Freddie Mac. All concluded there was no meaningful impact on the fair value statements, which meant the underlying economics for Freddie Mac's risk positions were materially unaffected by the timing changes in recognizing income for the GAAP statements being restated.

Examiners were on-site at Freddie Mac gathering more information about the issues and the action plan that were being formed to address the reaudit. Freddie Mac announced the reaudit and the delay in 2002 certified financial statements on January 22, 2003.

Based upon the reaudit of prior periods, Freddie Mac said it would be restating 2000 and 2001 annual results and quarterly financial results for 2001. Along with delays in issuing certified 2002 financial results and prior period restatements, there would be delays in issuing certified quarterly financial statements for the first and second quarter of 2003. The timeline was to have the restatements done in approximately six months.

The restatement process has involved the reevaluation of over 100 accounting policies, which resulted in the identification of approximately 20 major issues that will affect the financial statements.

These accounting changes will result in about half of the company's derivatives being marked to market through current period earnings as opposed to being deferred and recorded into earnings over time. In addition, all mortgage securities will be marked to market either through OCI or current period earnings. In addition, previously off-balance sheet guarantee fees and obligations relating to approximately one-half of the guarantee business will now be recorded on balance sheet at fair value, with changes reported in current period earnings. These changes will most likely result in increased volatility and decreased future earnings.

Heightened Focus -- January 2003 to Present

In mid-January 2003, it was clear that a forensic review of selected accounting issues raised by PwC would be appropriate. The law firm of Baker Botts was

retained by the Audit Committee to perform diagnostic and forensic work associated with the restatement process. The scope of Baker Botts' engagement is to conduct a review of the facts and circumstances surrounding certain transactions and other matters related to the restatement process. OFHEO's plans were to monitor and consider the work of Baker Botts, while concentrating the Agency's efforts on the re-audit and restatement process. When the restatement process neared its completion, OFHEO would consider the progress and adequacy of the counsel's review and determine whether the Agency would need to undertake its own forensic review.

At this point, OFHEO focused on its mission -- safety and soundness -- and emphasized to Freddie Mac the importance of properly concluding the reaudit and publishing certified financial statements. In addition, OFHEO concurred with the Board's decision to engage outside counsel for forensic and related work.

OFHEO's accounting team began continuous surveillance of the restatement process on January 22, 2003, focusing on: The accounting issues surrounding the transactions that triggered the reaudit; the accounting policies/issues under consideration – being changed or affirmed; the organization and staffing of the project; the analysis of the cumulative effect of the restatement process; the preparation of adjustments; the methodology for establishing value estimates; the process for running ledgers and analyzing results; the quality control process; the plan for rolling out the revised financial statements; and the status of controls being embedded into the new processes as they are being built. In addition to the ongoing work of the accounting team, there were periodic updates and evaluations on the restatement process from January on.

February - In February, OFHEO continued its close evaluation of the restatement process. Specifically, OFHEO's accounting team scrutinized the organizational structure of the effort, the plan of action, and the resources and the timeline associated with the work on the restatement process.

March - OFHEO met with the Board and its Audit Committee on March 6. In that meeting, there was considerable discussion relating to the restatement process, the reaudit, and OFHEO's posture toward completing the restatement process. Also in March, as noted earlier, Freddie Mac announced the hiring of Mr. Baumann as Executive Vice President for Finance. Mr. Baumann was given full responsibility for the restatement process by the Board of Directors and for formulating a plan of action for the post-restatement environment. Mr. Baumann is reporting directly to the Board of Directors until the restatement process is completed.

OFHEO remained engaged during the period the Board considered a delay in the release of first quarter financial results to coincide with the restated financials for prior periods. On March 25, Freddie Mac announced the restatement process remained on track. The company's expectation was still to have the restatement

concluded as soon after the close of second quarter 2003 as practical – expecting to restate financials by mid-July 2003. Freddie Mac also notified the market they would not be releasing first quarter financials, rather, they would provide operating statistics and risk measures. The decision to delay first quarter financials was to provide those 2003 results consistent with the basis upon which the restated financials will be presented. In the March 25th release, Freddie Mac also identified additional accounting issues.

April - In April, Freddie Mac was moving toward the final stages of a complete review and affirmation of all the accounting policies. OFHEO continued to evaluate the work being conducted and the progress against the established timeline. Some additional accounting items were adding to the complexity of the task. Freddie Mac brought in third-party vendors to expedite the process after PwC approved the use of such vendors. On April 29th, PwC informed the Audit Committee that they might not be able to accept the representations of top management.

May - In May, OFHEO observed slippage in the restatement process against established time frames. PwC and Freddie Mac had more than 500 people working on the process six days a week and this work had been continuous since January 2003. They were beginning to complete some of the adjustments. There was considerable work that needed to be done between production of statements and producing the tables and disclosure to accompany those statements. On May 8th, PwC informed Senior Board members and counsel that PwC would not accept the representations of Vaughn Clarke and David Glenn.

On May 13, the Board's Governance Committee at its weekly meeting approved the Finance Function Governance Plan (FFGP) presented by Mr. Baumann. This plan, superceding the FRCIP, addressed the considerable work that has been done to re-engineer the process and enhance the controls for financial accounting and financial reporting. This plan, some of which will take almost two years to complete, is intended to build a finance environment incorporating a high level of professional standards and compliance that delivers comprehensive and understandable financial information. The objectives included addressing findings which had arisen during the restatement process and the work of Baker Botts and PwC.

In late May, OFHEO again observed the challenges against achieving the timeline with the additional accounting issues that were added in April. However, Freddie Mac continued to work toward the mid-July target. There were no new issues since April. Freddie Mac continued to work through all the adjustments and calculated the valuation estimates for prior periods. Some opportunities to strengthen controls noted during the restatement process continue being implemented by Freddie Mac.

On May 27, OFHEO was briefed on the Baker Botts work for the Audit Committee. The briefing covered the scope of the project, the nature of their forensic work and perspective on the status of their findings to-date. In response to a direct question, Baker Botts expressed no concerns regarding the management team of inappropriate or improper management behavior. Subsequent to this meeting, OFHEO learned of very troubling information regarding the conduct and integrity of management in matters related to the restatement process, indicating the Board's counsel had not been fully forthcoming. This lack of candor contributed to my decision on June 7th to initiate an OFHEO investigation.

Events of June 4 through June 7

Mr. Chairman, I will begin a discussion of the key events of June 4-7, that have drawn so much attention. First, I would note that the Freddie Mac Board of Directors was holding a regularly scheduled meeting on Thursday, June 5th and Friday, June 6th.

On Wednesday, June 4th, Mr. David Glenn met with the Board's outside law firm—Baker Botts—and informed them that he had altered parts and had removed pages from a document that had been requested by the firm. That evening, counsel from Baker Botts informed the lead outside Director of Mr. Glenn's admission.

On Thursday, June 5th, Freddie Mac's Board was informed of Mr. Glenn's admissions and determined that actions were required. The morning of June 5th, OFHEO was alerted that the Board would have an urgent communication to discuss with us when the Board's deliberations were concluded. The Board's deliberations continued into Friday, June 6th.

On Friday June 6th, during the day, the Board made decisions on the separation from the firm of Brendsel, Glenn, and Clarke and on the appointment of O'Malley, Parseghian, Petersen and Baumann. The Board communicated to OFHEO immediately its actions regarding the management changes. Later that evening, I was informed about the circumstances surrounding Mr. Glenn. I instructed Board counsel to appear at OFHEO's offices on Saturday, June 7th, to advise us on all the matters surrounding management changes.

On the morning of June 7th, OFHEO senior staff and I met with representatives of Freddie Mac's Board to learn the details of recent events. I would note that much of what was addressed that day was known to OFHEO and had been the subject of the restatement. However, new issues relating to Mr. Glenn and the termination and replacement of senior management were also presented; particularly the lack of confidence in Mr. Glenn expressed a month earlier by PwC. I considered the information regarding Mr. Glenn a clear signal of a breakdown in the integrity of the Freddie Mac's control environment at the

highest levels and sent a letter to the Board that day initiating an OFHEO investigation.

Following this meeting, as occurred after the meeting on May 27, additional matters came to light and, again, reflected a lack of candor that concerned me deeply.

In the June 7 letter, I formalized with the Board certain actions with respect to the restatement process. In addition, I tasked a special investigative team to explore and review accounting practices relevant to the restatement process at Freddie Mac and, in addition, management's progress in implementing an action plan that OFHEO directed the Board to provide for the Agency's formal approval. The investigative team has also undertaken an investigation of employee misconduct. OFHEO is moving expeditiously on this review.

The Role of a Federal Financial Safety and Soundness Regulator

Having discussed our specific regulatory role over the restatement process at Freddie Mac, I would now like to put it in a more general context. First, the role of a financial safety and soundness regulator and second, and more specifically, the Agency's regulatory approach in examining accounting practices and controls.

OFHEO uses a safety and soundness approach in supervising the Enterprises that is analogous to the Federal Reserve System's and the Office of the Comptroller of the Currency's approach to supervising large-and-complex banking organizations. The foundation of these approaches is that the management of these firms should be held responsible for monitoring and managing the institution's exposure to risk. By looking at the firm's risk management procedures and internal controls, the safety and soundness regulator assesses whether the firm's ability to manage risk matches the level of risk it assumes. In addition, the supervisory process also reviews the firm's performance in complying with the company's own internal policies, as well as other prescriptive requirements. In short, safety and soundness supervision is directed toward identifying material problems or emerging problems and seeing they are appropriately corrected before the company's financial solvency is threatened.

During the past decade, financial safety and soundness regulators and OFHEO have endeavored to continuously enhance the examination process to make it more risk-focused and to make greater use of technological innovations. Increasingly, safety and soundness supervision stresses the need for financial firms to implement sound risk management practices for: Active oversight of management by the Board; clearly defined policies, procedures and authority; comprehensive risk measurement and reporting systems; and adequate audits and systems of internal controls.

OFHEO's supervisory activities are designed to assess the Enterprises' risk profiles and require remedies where and when they are appropriate. They encompass evaluations of each Enterprise's asset quality, management of interest rate risk, liquidity management, capital adequacy, and their risk management strategies and risk management practices -- including their internal controls and governance.

Safety and soundness regulators do not attempt to prescribe "regulatory accounting principles" for financial reporting. In fact, when accounting principles were prescribed in the 1980s by financial regulators, many of those standards were criticized after numerous financial institutions failed. Congress subsequently expressed its desire for financial safety and soundness regulators to rely upon established accounting principles (GAAP) for financial reporting standards (Section 121 of FDICIA). In OFHEO's 1992 Act, Congress directed OFHEO to do the same, i.e., to pursue GAAP in their regulatory reporting requirements.

Safety and soundness regulators do not review accounting policies for conformance with GAAP, nor do we certify that a company's financial statements are consistent with GAAP. We expect an independent auditor to certify that a company's financial statements are in conformance with GAAP. We review transactions to ensure that they are consistent with sound risk management. The work of the independent auditor is to conduct its audit and report on the company's annual financial statements. The scope of the independent auditor's engagement must be sufficient to permit the auditing firm to determine and report upon whether the financial statements are presented fairly and in accordance with GAAP.

The internal and external auditors routinely work together in establishing the scope and frequency of audits to be performed. The independent auditor reviews the scope and adequacy of the internal auditing program.

Safety and soundness supervision does not replace an internal audit function for the Enterprises' Boards of Directors. Internal audits are a governance/management control question. That is, the Board of Directors and executive management need to have the internal controls tested and assessed by units without business-line operating responsibilities, such as an internal audit group. Internal audit provides the Board and the CEO, along with other members of senior management, with assurances concerning the effectiveness of controls.

Safety and soundness regulators do not perform forensic work (investigative work on what has occurred) unless a need arises. In fact, safety and soundness regulators frequently cause the Board of Directors to engage forensic professionals to investigate irregularities and share the results of their findings with the regulator. Subsequent to the findings from the forensic work, the regulator holds the Board accountable for ensuring there are appropriate remediation plans and action items to address the issues that are identified.

OFHEO's Approach to Examining Accounting Practices and Controls Over Financial Reporting

The process of examining an Enterprise's accounting practices and related internal controls for financial reporting begins with a thorough study of the strategies and the techniques the Board of Directors has adopted to set the company's course, and to measure and evaluate management's performance in implementing the Board's strategies. This step includes, for example, an evaluation of the Board's committee structure, oversight practices and reporting conventions, and an assessment of the effectiveness of the overall control framework at the Board level. The examination process also includes a "mapping" of the corporate structure management has adopted to facilitate the implementation of the Board's strategies and the achievement of its objectives pertinent to financial reporting. The objective of the mapping process is to establish a roadmap of management's assigned responsibilities, duties, and functions that can then be used to identify key risk points in the internal control framework for financial reporting that warrant targeted evaluation and attention due to their potential impact on financial safety and soundness.

Having established an appropriate understanding of the overall control framework and its risk points by, for example, reviewing relevant policies, procedures, systems, tools, and management reporting, and by interviewing Enterprise management and personnel, examiners then sample selected transactions in order to test whether the framework actually functions as designed and intended. Depending on the nature of the examiners' focus, these sampling activities may include evaluations of the actions of a variety of different participants and their respective roles in the control framework, including management, technical staff, internal auditors, and independent auditors. During the course of their evaluations, examiners apply evaluative standards that reflect the professional standards appropriate for the actions under review, and reach conclusions that address the Enterprises' financial safety and soundness.

OFHEO's approach to examining accounting practices and internal controls for financial reporting should be familiar to the Committee, given that our approach is built on the same well-established concepts that form the core of applicable provisions of the Sarbanes-Oxley Act of 2002 and the SEC's regulations implementing the control-related provisions of that Act. Our examination approach also embraces fundamental precepts found in widely-recognized control frameworks such as the Internal Control—Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (more familiarly known as "COSO"), the Guidance on Assessing Control published by the Canadian Institute of Chartered Accountants, and the Turnbull Report published by the Institute of Chartered Accountants in England & Wales. Moreover, we regularly consider practices adopted by other financial safety and soundness regulators, generally accepted auditing standards, and control-related methodologies and standards propounded by professional

associations such as the Institute of Internal Auditors and the American Institute of Certified Public Accountants, and we enhance our evaluative techniques as necessary to maintain a position on the leading edge of this evolving field of expertise.

The Committee has requested information on OFHEO's role with respect to approving termination agreements for the executive officers of the Enterprises, including involvement in the recent termination agreements of Freddie Mac's executive officers. In addition, you sought information on OFHEO's corporate governance rule. Details on both follow.

Executive Compensation

OFHEO has broad authority to consider executive compensation, both as a specific matter of excessive compensation as well as a factor in the operational integrity of the Enterprises.

OFHEO draws authority from the explicit and implied authorities of its statute, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, PL 102-550, Title XIII; 106 Stat. 3672 (October 28, 1992). At the same time, other OFHEO authorities are delineated in certain sections of the chartering acts for the Enterprises.

Excessive Compensation. OFHEO is directed by statute to prohibit the payment of "excessive compensation" to executive officers; 12 USC 4513(b)(8). The prohibition on excessive compensation is tied to compensation that is "...not reasonable and comparable with compensation for employment in other similar businesses..."; 12 USC 4518(a). At the same time, OFHEO may not set or prescribe or set a specific level or range of compensation for such executives; 12 USC 4518(b).

Termination Benefits. OFHEO has authority to review and provide approval for "termination benefits." This authority is contained in the charter acts of the two Enterprises.

For example, in the Freddie Mac charter (Federal Home Loan Mortgage Corporation Act, 12 USC 1451 et seq.), Section 303(h)(2) provides that the Corporation may not enter into any agreement or contract to provide money or other things of current or potential value in connection with the termination of employment of any executive officer unless the agreement or contract is approved in advance by OFHEO; 12 USC 1452(h)(2). The statute provides for OFHEO to make such determination based on comparability of such agreements with officers at comparable companies. The statute covers contracts entered after the date of enactment, but provides that any "renegotiation, amendment, or change" after such date of enactment to any contract entered into before or after

the date of enactment shall be considered entering into a new agreement or contract that OFHEO should review and provide its opinion.

In regards to Freddie Mac, OFHEO has undertaken certain actions relating to executive compensation. Specifically, I wrote to the Board of Directors on June 7, 2003 indicating it must explain its rationale for any termination packages for the individuals leaving the firm, specifically for Brendsel, Glenn and Clarke. Further, I directed the Board to inform these individuals that their termination packages are subject to OFHEO review and approval and, for any employee discharged for misconduct, that OFHEO could direct indemnification of Freddie Mac for losses incurred.

We have directed Freddie Mac not to transfer funds, stock or options to these three individuals and Freddie Mac is complying. OFHEO is reviewing now the termination packages for Brendsel, Glenn and Clarke.

I want to reiterate what I noted regarding OFHEO's authority in this area. First, we review executive compensation as a stand-alone matter, that is: Is such compensation excessive? And, second, as we proceed with the investigation, we look to the behavior of management and whether it comports with the standards of the corporation, violates any corporate governance rules or otherwise harms or threatens the safety and soundness of the corporation. If so, OFHEO would consider actions that would involve compensation, such as ordering restitution.

Corporate Governance

OFHEO has had in place for some time an active program of review for corporate governance at the Enterprises. Corporate governance is considered a major component of risk management and a fundamental ingredient in the safe and sound operation of the firms. Corporate governance under the examination program is composed of separate programs entitled Board Governance, Management Processes Program, Audit Program and Management Information Program.

While OFHEO has strong statutory support for its corporate governance regime, in 2000, the Agency began a program of building up its regulatory infrastructure, putting in place rules to support its various functions and to strengthen its legal position. This program included a corporate governance rule.

The rule generated a great deal of interest and OFHEO issued a Final Rule on June 2, 2002, effective on August 5, 2002. The rule made clear that corporate governance is a key area of safety and soundness and it directed each of the Enterprises to elect a state law for the purposes of adhering to a body of corporate law. Both have done so. The rule required the companies to have committees and that they meet the highest applicable standards; both have such committees. A quorum of the board is required to transact business and no proxy

voting is allowed; both have such policies. The rule required conflict of interest policies; both have such policies. The rule mandated that the Board meet its responsibilities and described the areas of key concern for Board oversight of senior management. Finally, the rule noted the authority of OFHEO to limit or restrict indemnification of current or former Board members as part of its safety and soundness authority.

OFHEO's examination team has worked with the Enterprises to see that changes that were required have been put in place and that the Enterprises continue to address other requirements, such as changes mandated in the Sarbanes-Oxley Act.

Legislative Enhancements

I would like to submit for the Committee's consideration a series of legislative recommendations to add to OFHEO's broad authorities and to fill in a number of gaps between OFHEO's authorities and those of other financial regulators.

Paramount among these is permanent funding for the Agency. Other financial safety and soundness regulators are funded through assessments on the institutions they regulate; so is OFHEO. Only OFHEO, however, must move through the annual appropriations process. The budget process has had a limiting effect on the Agency's resources and may affect our ability to effectively address regulatory issues on a timely basis.

OFHEO must have more flexibility to respond to important issues, such as Freddie Mac's restatement of income, without stretching thin our ability to continually monitor the significant credit and interest rate risks being managed by the two Enterprises. The amount of resources needed to address the issues surrounding Freddie Mac's restatement is straining our resources. Permanent funding is needed to ensure that OFHEO can continue to effectively regulate the Enterprises. I am pleased that the Administration has endorsed this needed change.

The other recommendation I would like to highlight relates to charter compliance. I believe that the regulatory responsibility for ensuring that the Enterprises remain in compliance with their charters more properly resides with the safety and soundness regulator. Mission regulation would continue to reside in HUD in the form of affordable housing goals and fair lending enforcement.

OFHEO has the authority and responsibility for taking an enforcement action when an Enterprise violates any applicable law or regulation. In fact, under the current scheme, if HUD found that a new program was not permissible, HUD would turn to OFHEO to take any necessary enforcement action. In addition, OFHEO would take appropriate action if we independently determined that an

Enterprise was in clear violation of its charter. OFHEO should have full authority, including in areas of ambiguity, for interpreting and enforcing charter compliance.

Without casting any doubt on HUD's abilities, I simply believe that public policy would be better served if OFHEO, with its active examination and oversight of the Enterprises, had full responsibility for charter compliance.

The draft proposal, attached with a summary, strengthens OFHEO with explicit receivership authority, removal authority, greater facility in hiring examiners, adds criminal penalties for certain violations of law, provides independent litigation authority and addresses certain gaps in OFHEO's enabling statute that have been addressed previously by regulation.

Notes on Recent Events and the OFHEO June 2003 Annual Report to Congress

Turning now to the OFHEO Report to Congress, we reported that Freddie Mac's overall internal control framework, and the management of the internal control framework, are effective. We stated, however, that Freddie Mac's release of audited financial statements was being delayed pending a reaudit of past financial statements, and that Freddie Mac had agreed that certain accounting treatments applied in the past were incorrect. We informed Congress at the time, of our opinion regarding the reaudit. We further advised Congress that Freddie Mac's Board of Directors had undertaken efforts to enhance expertise and controls in the area of financial accounting and operational control, that we had evaluated the Board's and management's plans in that regard, and that we were satisfied that these actions were appropriate steps to address the situation. In my view, these statements clearly indicate that, although the overall framework is effective, OFHEO is ensuring that the Board and management devote serious attention and remedial efforts to the area of financial reporting and related controls. OFHEO's activities in this regard are highlighted in this testimony.

With regard to internal controls, our examination program is consistent with applicable professional standards in that it addresses each Enterprise's overall internal control framework; that is, the framework that includes the following categories: (1) the effectiveness and efficiency of operations; (2) the reliability of financial reporting; (3) compliance with applicable laws and regulations; (4) and safeguarding the assets of the company. Consider that the term "internal control" encompasses five interrelated components—the control environment; risk assessment activities; control activities; information/communication; and monitoring. As you might imagine, companies as complex as Fannie Mae and Freddie Mac develop equally complex internal control frameworks. These frameworks encompass hundreds, perhaps thousands, of separate controls, including approvals, authorizations, verifications, reconciliations, segregation of duties, systems access limitations, and a myriad of others. In short, the integrity of the overall internal control framework is determined by considering the total picture, and when viewed in its entirety, a framework may exceed safety and

soundness standards even though there are observed weaknesses or deficiencies in particular controls.

Examples of the application of this principle include practices adopted under standards established by the American Institute of Certified Public Accountants, and guidance provided by the SEC in recent rules implementing provisions in the Sarbanes-Oxley Act that pertain to assessments of internal controls over financial reporting. Specifically, it is common for an independent auditor to provide an unqualified opinion on management's reports of financial condition even though the auditor is aware of certain "reportable conditions." In the vernacular of the independent auditor, a reportable condition is a significant deficiency in the design or operation of the internal control structure that could adversely affect a company's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The common practice is for the auditor to communicate such deficiencies to management in the form of a management letter, while at the same time allowing its unqualified opinion to stand. As a separate example, under SEC rules, significant deficiencies that do not rise to the level of a material weakness do not preclude management from characterizing its internal controls over financial reporting as "effective." The SEC guidance prohibits management from deeming its controls effective if there are one or more material weaknesses; however, the SEC also observes that a material weakness constitutes a greater deficiency than a significant deficiency. In sum, I believe the standards we have applied in reaching our examination conclusions on internal controls are consistent with those established by both the AICPA and the SEC.

Before I move on, I would like to emphasize a point or two about information flow and the environment that preceded the publication of our Annual Report to Congress. The results and conclusions of the 2002 annual examination were based on the information gathered and evaluated during the course of our work during 2002. That information was supplemented by information obtained by OFHEO during 2003, from early January up to the time of the publication of the Annual Report to Congress. As I discussed earlier, OFHEO has devoted considerable effort and resources to this matter, and our efforts continue to yield new information. One should also consider that the Board of Directors' internal investigation is being conducted during 2003 as well, and that the Board's investigation may yield new information. In addition, the Committee is aware that I initiated OFHEO's own special examination on June 7, little more than one week before the statutory delivery date for the Report to Congress; and it is possible that our special examination could give rise to new findings as well. I raise these facts to emphasize that the date on which the Report was due fell in the midst of a very fluid environment; nevertheless, I believe that the examination results and conclusions expressed in the Report to Congress regarding the overall internal control and framework at Freddie Mac are appropriate. Certainly, we will have more to say about the controls over financial reporting, improper earnings management, and corporate governance practices after the special

examination has concluded. I assure you that I will provide the Committee with a timely notification and description of any substantive changes in our view of the internal control framework and corporate governance practices once I have the benefit of the results under the various investigations currently underway.

Supplemental Appropriations

Finally, I would like to bring to the committee's attention an urgent funding matter. Earlier this week I submitted an FY 2003 supplemental funding request of \$4.5 million to the Senate and House Appropriations Committees.

The requested funds will support two critical objectives: First, the funds will support the ongoing special investigation of Freddie Mac. The investigation is already well underway and is building on information gathered over the course of the restatement process. The requested resources are necessary to obtain contract services for investigative support and forensic accounting experts. Second, OFHEO intends to conduct a special accounting review of Fannie Mae. The special review would independently evaluate the accounting policies at Fannie and examine whether their implementation is resulting in a high level of conformance to GAAP. While I do not have a specific concern about Fannie Mae's accounting practices, such a review would be most prudent under the circumstances.

OFHEO's goal of concluding the investigation of Freddie Mac expeditiously is dependent on receiving these funds as soon as possible. I would like to ask for the Committee's support in obtaining the additional funds.

Conclusion

In summary, Mr. Chairman, is this a serious matter? Yes. Is there a crisis? No. While challenges remain, Freddie Mac remains safe and sound. At the end of our investigation, we will present all the facts, conclusions, and recommendations for the Committee's consideration. Mr. Chairman, thank you for the opportunity to testify. I would be pleased to answer any questions you or Committee Members may have.

OFHEO's Legislative Enhancements (follows this release).

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OFHEO's mission is to promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.

APPENDIX

**Federal Housing Enterprises Financial Safety and Soundness Act
Amendments of 2003**

**Office of Federal Housing Enterprise Oversight
July 17, 2003**

Federal Housing Enterprises Financial Safety and Soundness Act Amendments of 2003

The attached bill and section-by-section summary address improvements to the statute that serves as the chartering document for the Office of Federal Housing Enterprise Oversight.

In brief, the bill would

- enhance OFHEO's current risk based capital regime;
- provide receivership authority;
- conform OFHEO's permanent funding to that of other financial institution regulators;
- make explicit OFHEO's ability to remove and to bar individuals who have engaged in unsafe and unsound conduct at an Enterprise, including institution-affiliated parties;
- clarify OFHEO's ability to measure Enterprise behavior against their chartered mission and to disallow non-conforming activities and provide OFHEO responsibility for reviewing and approving new programs;
- enhance the flexibility and availability of a number of existing enforcement tools, such as cease and desist orders; and,
- improve OFHEO's ability to attract, retain and deploy personnel.

July 17, 2003

1 **Federal Housing Enterprises Financial Safety and Soundness**

2 **Amendments Act of 2003**

3
4 **Section-by-Section Analysis**

5 *Sec. 1. Short title and table of contents.*

6 The short title of this Act is the Federal Housing Enterprises Financial
7 Safety and Soundness Amendments Act of 2003 (the Act).

8 **TITLE 1 – ENHANCEMENT OF SUPERVISION OF THE ENTERPRISES**

9 *Sec. 101. Duties and authorities of director.*

10 Amends Section 1313 of the Housing and Community Development Act of
11 1991 (1992 Act) (12 U.S.C. 4513) by clarifying that the principal duties of the
12 Director are to ensure that the enterprises operate in a safe and sound manner
13 and comply with applicable laws, regulations and their charters; carry out their
14 missions in a safe and sound manner and only through authorized programs; and
15 maintain adequate capital.

16 Clarifies that the Director shall exercise general and incidental supervisory
17 and regulatory authority over the enterprises, in accordance with this title, the
18 Federal National Mortgage Association Charter Act, the Federal Home Loan
19 Mortgage Corporation Act, and any other provisions of law.

20 Transfers authority to approve new programs from the Department of
21 Housing and Urban Development to the Director.

1 Provides for independent litigation authority similar to that of other
2 financial institution regulatory agencies. This provision will provide the Office with
3 authority to defend and to enforce expeditiously its orders and subpoenas.

4 Exempts the Office from the Federal Advisory Committee Act (Pub. L. 92-
5 463, as amended).

6 Amends section 1313 of the 1992 Act to add a section 1313A clarifying
7 that the Director's regulatory and enforcement authority extends to determination
8 of compliance with the enterprises' chartering acts—the Federal National
9 Mortgage Association Charter Act and the Federal Home Loan Mortgage
10 Corporation Act. The Director must promulgate regulations and orders to explain
11 the procedures for determinations that activities are inconsistent with the
12 enterprise charters.

13 *Sec. 102. Accountants, economists, and examiners.*

14 Amends Section 1317 of the 1992 Act by providing the Office the authority
15 to hire accountants, economists, and examiners using the same hiring
16 procedures as apply to positions in the excepted service. This is modeled on
17 authorities provided to other financial regulators, notably the SEC.

18 *Sec. 103. Assessments.*

19 Amends Section 1316 of the 1992 Act (12 U.S.C. 4516) to provide that if
20 at any time amounts available from any assessment for any semiannual period
21 for an assessment are insufficient to cover the expenses of the Office as the
22 result of increased costs of regulation of an enterprise that is not classified as
23 adequately capitalized or as the result of supervisory or enforcement activities

1 involving one of the enterprises, the Director may make an immediate
2 assessment against the affected enterprise to cover the amount of the deficiency
3 for such semiannual period. If, at the end of any semiannual period for which an
4 assessment is made, any amount remains from such assessment, such amount
5 will be deducted from the assessment of the enterprise for the following
6 semiannual period.

7 Provides OFHEO with permanent funding authority.

8 Provides that the assessments collected are not to be construed as
9 government funds or appropriated monies, or subject to apportionment for the
10 purposes of chapter 15 of Title 31, or any other authority.

11 *Sec. 104. Prior approval authority for new programs.*

12 Transfers to the Director from the Secretary of HUD the authority to
13 approve new programs, which ensures review for their safety and soundness in
14 addition to compliance with the Federal National Mortgage Association Charter
15 Act and the Federal Home Loan Mortgage Corporation Act.

16 Provides that the Director must determine whether the enterprise can
17 conduct the new program in a safe and sound manner and whether the new
18 program is in the public interest.

19 Provides conforming amendments to Federal National Mortgage
20 Association Charter Act and the Federal Home Loan Mortgage Corporation Act.

21 *Sec. 105. Conforming loan limits.*

22 Amends Section 302(b)(2) of the Federal National Mortgage Association
23 Charter Act (12 U.S.C. 1717(b)(2)) and Section 305(a)(2) of the Federal National

1 Mortgage Association Charter Act (12 U.S.C. 1454(a)(2)) by providing that
2 conforming loan limitations must comply with such levels established by the
3 Director.

4 Amends Part I of subtitle A of title XIII of the 1992 Act by requiring the
5 Director to establish and maintain a house price index for adjusting the
6 conforming loan limitations of the enterprises. In employing such index, provides
7 the Director with discretion to take into consideration any other index or measure
8 that the Director considers appropriate.

9 *Sec. 106. Risk-based capital test for enterprises.*

10 Amends Section 1361 of the 1992 Act (12 U.S.C. 4611) by authorizing the
11 Director, in defining the risk-based capital test, to make any assumptions that the
12 Director considers appropriate regarding interest rates, home prices, and new
13 business as well as appropriate percentage adjustments to be applied to cover
14 operations risk.

15 *Sec. 107. Minimum and critical capital levels.*

16 Amends section 1362 and 1363 of the 1992 Act (12 U.S.C. 4612 and
17 4613) by providing the Director with the authority to set and adjust minimum and
18 critical capital levels by regulation or order, which levels may not be lower than
19 the level calculated in accordance with the statutory formula.

20 *Sec. 108. Definitions.*

21 Amends Section 1303 of the 1992 Act (12 U.S.C. 4502) by defining the
22 term “enterprise-affiliated party” to mean any director, officer, employee, or
23 controlling stockholder of, or agent for, an enterprise; any shareholder,

1 consultant, joint venture partner, and any other person as determined by the
2 Director (by regulation or case-by-case) who participates in the conduct of the
3 affairs of an enterprise; and any independent contractor (including any attorney,
4 appraiser, or accountant) who knowingly or recklessly participates in (1) any
5 violation of any law or regulation; (2) any breach of fiduciary duty; or (3) any
6 unsafe or unsound practice, which caused or is likely to cause more than a
7 minimal financial loss to, or a significant adverse effect on, the enterprise. This
8 conforms OFHEO authority to those of other financial regulators.

9 Subtitle B—Prompt Corrective Action

10 *Sec. 131. Capital classifications.*

11 Amends Section 1364 of the 1992 Act (12 U.S.C. 4614) by expanding the
12 discretionary reclassification authority in connection with unsafe and unsound
13 conditions or conduct by an adequately capitalized enterprise.

14 Prohibits, with certain exceptions, an enterprise from making a capital
15 distribution if, after making the distribution, the enterprise would not be
16 adequately capitalized.

17 *Sec. 132. Authority over critically undercapitalized enterprises.*

18 Amends Part I of subtitle B of the 1992 Act (12 U.S.C. 4631 *et seq.*) by
19 adding a new section 1369E, which authorizes the Director to appoint a receiver
20 for an enterprise that is classified as critically undercapitalized, upon written
21 notice to the enterprise, the Secretary, the Committee on Financial Services of
22 the House of Representatives, and the Committee on Banking, Housing, and

1 Urban Affairs of the Senate. Provides qualifications and authorities of receivers
2 and judicial review of the decision to appoint a receiver.

3 This section codifies regulatory actions and enhances OFHEO authorities
4 regarding capital classifications.

5 Subtitle C—Enforcement Actions

6 *Sec. 151. Cease-and-desist proceedings.*

7 Amends Subtitle C of the 1992 Act (12 U.S.C. 4631 *et seq.*) by providing
8 that, if in the opinion of the Director, an enterprise or any enterprise-affiliated
9 party is engaging or has engaged, or the Director has reasonable cause to
10 believe that the enterprise or any enterprise-affiliated party is about to engage, in
11 an unsafe or unsound conduct in conducting the business of the enterprise or is
12 violating or has violated, or the Director has reasonable cause to believe that the
13 enterprise or any enterprise-affiliated party is about to violate, a law, rule, or
14 regulation, or any condition imposed in writing by the Director in connection with
15 the granting of any application or other request by the enterprise or any written
16 agreement entered into with the Director, the Director may issue and serve upon
17 the enterprise or such party a notice of charges in respect thereof.

18 Clarifies that the cease-and-desist authority includes, but is not limited to,
19 the same authority to issue an order requiring a party to take affirmative action to
20 correct conditions resulting from violations or conduct or to limit activities of an
21 enterprise or any executive officer or director of an enterprise or any enterprise-
22 affiliated party as appropriate federal banking agencies have to take with respect

1 to insured depository institutions under paragraphs (6) and (7) of section 8(b) of
2 the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(6) and (7)).

3 Enhances enforcement authority by broadening the bases for issuance
4 cease and desist orders.

5 *Sec. 152. Temporary cease-and-desist proceedings.*

6 Amends Section 1372 of the 1992 Act (12 U.S.C. 4632) by expanding the
7 issuance of a temporary cease-and-desist proceeding to enterprise-affiliated
8 parties. Clarifies jurisdiction of judicial proceedings related to enterprise-affiliated
9 parties.

10 Provides for enforcement of the temporary cease-and-desist order by the
11 Director.

12 *Sec. 153. Removal and prohibition authority.*

13 Amends subtitle C of title XIII of the 1992 Act, and makes conforming
14 amendments to the Freddie Mac Corporation Act and the Fannie Mae Charter
15 Act by authorizing the Director to remove or suspend enterprise-affiliated parties
16 from office, or to prohibit such party from further participation in the conduct of
17 the affairs of any enterprise. This makes explicit OFHEO authority in these
18 situations.

19 The Director may exercise this authority if (1) such a party has committed
20 a listed violation, misconduct, or breach; (2) the enterprise or its investors has
21 suffered or will probably suffer financial loss or other harm or the enterprise-
22 affiliated party has received financial gain or other benefit by from the violation,
23 misconduct or breach and (3) the matter involves dishonesty by the party or

1 willful or continuing disregard for the safety or soundness of the affiliated
2 enterprise.

3 Authorizes the Director to notify appropriate federal banking agencies and
4 other federal financial regulatory agencies of an individual's violation of this
5 section.

6 Provides that if the suspension of one or more directors of the board of
7 directors of an enterprise results in less than a quorum of directors not
8 suspended, all powers and functions vested in the board of directors, are to vest
9 in the remaining directors.

10 Authorizes the Director to appoint board members to serve temporarily as
11 board members in the event all of the board members of an enterprise are
12 suspended.

13 Provides for procedural requirements, including notice, hearings, and
14 judicial review.

15 *Sec. 154. Enforcement and jurisdiction.*

16 Amends Section 1375 of the 1992 Act (12 U.S.C. 4635) by providing the
17 Director with the authority to apply directly to the United States District Court for
18 the District of Columbia, or the United States district court within the jurisdiction
19 of which the enterprise-affiliated-party resides or the headquarters of the
20 enterprise is located, for the enforcement of any effective and outstanding notice
21 or order, or request that the Attorney General of the United States bring such an
22 action.

23 *Sec. 155. Civil money penalties.*

1 Amends Section 1376 of the 1992 Act (12 U.S.C. 4636) by expanding the
2 applicability of civil money penalties to enterprise-affiliated-parties and by
3 clarifying that a civil money penalty may be imposed for conduct that the Director
4 determines to be unsafe or unsound.

5 *Sec. 156. Criminal penalty.*

6 Amends Subtitle C of Title XIII of the 1992 Act (12 U.S.C. 4631 et seq.) by
7 subjecting an enterprise-affiliated-party who is subject to an order to a criminal
8 penalty if that enterprise-affiliated-party knowingly participates, directly or
9 indirectly, (including by engaging in an activity specifically prohibited in such an
10 order) in the conduct of the affairs of any enterprise without the prior written
11 approval of the Director.

12 *Sec. 157. Subpoena authority.*

13 Amends Section 1379D, as redesignated in Sec. 153 above, of the 1992
14 Act by deleting the requirement that the Director operates under the direction and
15 control of the attorney general in enforcing subpoenas.

16 *Sec. 158. General supervisory authorities.*

17 Amends Subtitle C of the 1992 Act (12 U.S.C. 4631 et seq.) by inserting a
18 new section 1379E , which provides that the Director is authorized to take
19 enforcement actions under the 1992 Act and other formal and informal
20 enforcement actions, including but not limited to requiring prompt supervisory
21 actions under subtitle B, as the Director deems necessary to enforce the
22 compliance of any enterprise or any enterprise-affiliated party with applicable
23 laws, regulations, rules, or orders.

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Subtitle D—General Provisions

Sec. 171. Conforming and technical amendments.

Provides for conforming and technical amendments to the 1992 Act, Department of Housing and Urban Development Act, Freddie Mac Corporation Act, and the Fannie Mae Charter Act.

Deletes section 1319G of the 1992 Act, which included special provisions that applied only to the first 18 months of OFHEO's existence.

Sec. 172. Term of Director.

Makes the Act consistent with provisions for the Comptroller of the Currency by providing that the Director may be removed upon reasons to be communicated by the President to the Senate; this is interpreted as meaning "for cause." Does not apply to incumbent.

Sec. 173. Effective date.

Provides that the amendments made are to take effect on, and shall apply beginning on, the date of enactment of this Act.

A BILL

To enhance the supervision of the government-sponsored enterprises, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the ‘Federal Housing Enterprises Financial Safety and Soundness Amendments Act of 2003’.

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title and table of contents.

TITLE I—ENHANCEMENT OF SUPERVISION OF THE ENTERPRISES

Subtitle A—Enhancement of Supervision

Sec. 101. Duties and authorities of Director.

Sec. 102. Examiners, economists, and accountants.

Sec. 103. Assessments.

Sec. 104. Prior approval of Director for new programs.

Sec. 105. Conforming loan limits.

Sec. 106. Risk-based capital test for enterprises.

Sec. 107. Minimum and critical capital levels.

Sec. 108. Definitions.

Subtitle B—Prompt Corrective Action

Sec. 131. Capital classifications.

Sec. 132. Authority over critically undercapitalized enterprises.

Subtitle C—Enforcement Actions

Sec. 151. Cease-and-desist proceedings.

Sec. 152. Temporary cease-and-desist proceedings.

Sec. 153. Removal and prohibition authority.

Sec. 154. Enforcement and jurisdiction.

Sec. 155. Civil money penalties.

Sec. 156. Criminal penalty.

Sec. 157. Subpoena authorities.

Sec. 158. General supervisory authorities.

Subtitle D—General Provisions

Sec. 171. Conforming and technical amendments.

Sec. 172. Term of Director.

Sec. 173. Effective date.

TITLE I—ENHANCEMENT OF SUPERVISION OF THE ENTERPRISES

SEC. 101. DUTIES AND AUTHORITIES OF DIRECTOR

(a) IN GENERAL.—Section 1313 of the Housing and Community

Development Act of 1992 (12 U.S.C. 4513) is amended—

(1) by amending subsection (a) to read as follows:

‘SEC. 1313. DUTIES AND AUTHORITIES OF DIRECTOR.

‘(a) DUTIES.—

‘(1) PRINCIPAL DUTIES.—The principal duties of the Director under this title of the 1992 Act shall be to ensure that the enterprises—

‘(A) operate in a safe and sound manner and comply with applicable laws, regulations, including the Federal National Mortgage Association Charter Act, and the Federal Home Loan Mortgage Corporation Act;

‘(B) carry out their missions in a safe and sound manner and only through activities that have been authorized under, and are consistent with the purposes of, the provisions of federal law that charter the enterprises; and

‘(C) maintain adequate capital.

‘(2) OTHER DUTIES.—To the extent consistent with paragraph (1), the duty of the Director shall be to exercise general supervisory and regulatory authority over the enterprises in accordance with this title, the Federal National Mortgage Association Charter Act, the Federal Home Loan Mortgage Corporation Act, and any other provisions of law.

(2) in subsection (b)(1) by inserting ‘, and the Federal National Mortgage Association Charter Act and the Federal Home Loan Mortgage Corporation Act’ after ‘subtitle C’ and before the semicolon;

(3) in subsection (b)(4) by inserting ‘and receivers’ after ‘conservators’;

(4) by inserting new subsection (b)(12) to read as follows:

‘(12) approval of new programs under section 1319I; and;’

(5) by inserting new subsection (b)(13) to read as follows:

‘(b)(13) the exercise of such incidental powers as may be necessary or appropriate to fulfill the duties and authorities set forth in subsection (a) and subsection (b) in the regulation of the enterprises.’

(6) by inserting new subsection (f) to read as follows:

‘(f) EXEMPTIONS.—The Office shall be exempt from the Federal Advisory Committee Act (Pub. L. 92-463, as amended).’

(7) by inserting a new subsection (g) to read as follows:

‘(g) LITIGATION AUTHORITY.—In enforcing any provision of this title, regulations or orders prescribed under this title, or any other law, rule, regulation, or order, or in any other action, suit, or proceeding to which the Director is a party or in which the Director is interested, and in the administration of conservatorships and receiverships, the Director may act in the Director’s own name and through the Director’s own attorneys. Except as otherwise provided, the Director shall be subject to suit (other than suits on claims for money

damages) by any Enterprise or director or officer thereof with respect to any matter under this title or any other applicable law, rule, order or regulation thereunder, in the United States district court for the judicial district in which the Enterprise has its principal place of business, or in the United States District Court for the District of Columbia, and the Director may be served with process in the manner prescribed by the Federal Rules of Civil Procedure.'

- (b) (b) Subtitle A of the Housing and Community Development Act of 1992 (12 U.S.C. 4631 *et seq.*) is amended by inserting after section 1313 (12 U.S.C. 4513) the following new section:

'SEC. 1313A CHARTERING ACT COMPLIANCE.

(a) (a) No Enterprise shall engage in any activity that the Director determines to be inconsistent with its respective chartering act.

(b) (b) The Director, by regulation or order, shall establish procedures and standards to effect compliance with this section as contemplated in section 1313.

SEC. 102 . EXAMINERS, ECONOMISTS, AND ACCOUNTANTS.

(b) ENHANCED AUTHORITY TO HIRE ACCOUNTANTS, ECONOMISTS, AND EXAMINERS.—Section 1317 of the Housing and Community Development Act of 1992 (12 U.S.C. 4517) is amended by adding at the end the following new subsection:

‘(g) APPOINTMENT OF ACCOUNTANTS, ECONOMISTS, AND EXAMINERS.—

‘(1) APPLICABILITY.— This section applies with respect to any position of examiner, accountant, and economist at the Office, with respect to supervision and regulation of the enterprises, that is in the competitive service.

‘(2) APPOINTMENT AUTHORITY.—The Director may appoint candidates to any position described in paragraph

(1)—

‘(A) in accordance with the statutes, rules, and regulations governing appointments in the excepted service; and

‘(B) notwithstanding any statutes, rules, and regulations governing appointments in the competitive service.

SEC. 103 ASSESSMENTS.

Section 1316 of the Housing and Community Development Act of 1992

(12 U.S.C. 4516) is amended—

(1) in subsection (a) by striking ‘, to the extent provided in appropriation Acts,’;

(2) in subsection (c)—

(A) by inserting ‘(1)’ before the first sentence;

(B) by inserting 'for an assessment under subsection (a)(1) that are' after 'The semiannual payments'; and

(C) by inserting after subsection (c)(1) a new subsection (c)(2) as follows:

'(2) If at any time amounts available from any assessment for any semiannual period for an assessment under subsection (a)(1) are insufficient to cover the expenses of the Office as the result of increased costs of regulation of an enterprise that is not classified as adequately capitalized or as the result of supervisory or enforcement activities involving an enterprise, the Director may make an immediate assessment against the enterprise to cover the amount of the deficiency for such semiannual period. If, at the end of any semiannual period for which an assessment is made, any amount remains from such assessment, such amount will be deducted from the assessment of the enterprise for the following semiannual period.'

(3) by striking subsection (e);

(4) in subsection (f), by redesignating subsection (f) as subsection (e) and in the third sentence by striking ', to the extent provided in

appropriation Acts and subsection (e),’ and substituting ‘, without fiscal year limitation,’;

(5) by redesignating subsection (g) as subsection (f);

(6) by inserting a new subsection (g) to read as follows:

‘(g) Notwithstanding any other provision of law, any assessment collected pursuant to this section shall not be construed to be government funds or appropriated monies, or subject to apportionment for the purposes of chapter 15 of title 31, or any other authority, and shall be available for carrying out the responsibilities of the Director, including any necessary administrative and non-administrative expenses of the Director in carrying out the purposes of this title, the Federal National Mortgage Association Charter Act, and the Federal Home Loan Mortgage Corporation Act.’

SEC. 104. PRIOR APPROVAL AUTHORITY FOR NEW PROGRAMS.

(a) (a) Subtitle A, Part 1 of the 1992 Act—Title XIII of the Housing and Community Development Act of 1992 (12. U.S.C. 4501 et. seq.) is amended by inserting the following section—

SEC. 1319I PRIOR APPROVAL AUTHORITY FOR NEW PROGRAMS.—

(a) (a) **AUTHORITY.**—The Director shall require each enterprise to obtain the approval of the Director for any new program of the enterprise before implementing the program.

(b) (b) STANDARD FOR APPROVAL.—

Except as provided in paragraph (2), the Director shall approve any new program of an enterprise for purposes of subsection (a) unless—

(1) (1) for a new program of the Federal National Mortgage Association, the Director determines that the program is not authorized under paragraph (2), (3), (4), (5) or section 302(b) of the Federal National Mortgage Association Charter Act, or under section 304 of such Act;

(2) (2) for a new program of the Federal Home Loan Mortgage Corporation, the Director determines that the program is not authorized under section 305(a)(1), (4), or (5) of the Federal Home Loan Mortgage Corporation Act; or

(3) (3) the Director determines that the new program is not in the public interest.

(c) (c) PROCEDURE FOR APPROVAL.—

(1) (1) SUBMISSION OF REQUEST.—To obtain the approval of the Director for purposes of subsection (a), an enterprise shall submit to the Director a written request for approval of the new program that describes the program in such form as prescribed by order or regulation.

(2) (2) RESPONSE.—The Director shall, no later than the expiration of the 45-day period beginning upon the

submission of a request for approval, approve the request or submit to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate a report explaining the reasons for not approving the request. The Director may extend such period for a single additional 15-day period only if the Director requests additional information from the enterprise.

(3) (3) FAILURE TO RESPOND.— If the Director fails to approve the request or fails to submit a report under paragraph (2) during the period under such paragraph, the request shall be considered to have been approved.

(4) (4) REVIEW OF DISAPPROVAL.—

(A) (A) UNAUTHORIZED NEW PROGRAMS.—If the Director submits a report under paragraph (2) of this subsection disapproving a request for approval on the grounds under subparagraph (A) or (B) of subsection (b), the Director shall provide the enterprise submitting the request with a timely opportunity to review and supplement the administrative record.

(B) (B) NEW PROGRAMS NOT IN PUBLIC INTEREST.—If the Director submits a report under paragraph (2) of this subsection disapproving a request

for approval on the grounds under subsection (b)(1)(C) or (b)(2)(B), the Director shall provide the enterprise submitting the request notice of, and opportunity for, a hearing on the record regarding such disapproval.

(b) Part 2, subtitle A of the 1992 ACT—Title XIII of the Housing and Community Development Act of 1992 (12. U.S.C. 4501 et. seq.) is amended by striking Section 1322 in its entirety.

SEC. 105. CONFORMING LOAN LIMITS.

(a) FANNIE MAE.—Section 302(b)(2) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717(b)(2)) is amended by striking the 7th and subsequent sentences to the end and by inserting the following new sentence:

‘Such limitations shall comply with the conforming loan limitations established by the Director by regulation or order.’.

(b) FREDDIE MAC.—Section 305(a)(2) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1454(a)(2)) is amended by striking the 6th and subsequent sentences to the end and by inserting the following new sentence:

‘Such limitations shall comply with the conforming loan limitations established by the Director by regulation or order.’.

(c) HOUSE PRICE INDEX.—Part I of subtitle A of title XIII of the Housing and Community Development Act of 1992 (as amended by the preceding

provisions of this Act) is amended by inserting the following new section 1319H (12 U.S.C. 4527):

‘SEC. 1319H. HOUSE PRICE INDEX.

‘The Director shall utilize a house price index to adjust the conforming loan limitations of the enterprises. In employing such index, the Director shall take into consideration any other index or measure that the Director considers appropriate.’.

SEC. 106. RISK-BASED CAPITAL TEST FOR ENTERPRISES.

Section 1361 of the Housing and Community Development Act of 1992 (12 U.S.C. 4611) is amended—

(1) in subsection (a)(2)(A), by inserting ‘or change in such other manner as the Director considers appropriate,’ after ‘enterprise’;

(2) in subsection (b)(1), by inserting after the period at the end the following: ‘Notwithstanding subsection (a), the Director may, in the sole discretion of the Director, make any assumptions that the Director considers appropriate regarding interest rates, home prices, and new business.’; and

(3) in subsection (c)(2), by inserting ‘or such other percentage as the Director considers appropriate’ before the period at the end of the subsection.

SEC. 107. MINIMUM AND CRITICAL CAPITAL LEVELS.

(a) MINIMUM CAPITAL LEVEL.—Section 1362 of the Housing and Community Development Act of 1992 (12 U.S.C. 4612) is amended—

(1) by striking subsection (b);

(2) by striking '(a) IN GENERAL.—'; and

(3) in the matter preceding paragraph (1), by inserting before 'the sum of' the following: 'the amount established by the Director, by regulation or order, as such amount may be adjusted from time-to-time by the Director to achieve the purposes of this title, that is not less than'.

(b) CRITICAL CAPITAL LEVEL.—Section 1363 of the Housing and Community Development Act of 1992 (12 U.S.C. 4613) is amended, in the matter preceding paragraph (1), by inserting before 'the sum of' the following: 'the amount established by the Director, by regulation or order, as such amount may be adjusted from time-to-time by the Director to achieve the purposes of this title, that is not less than'.

SEC. 108. DEFINITIONS.

Section 1303 of the Housing and Community Development Act of 1992 (12 U.S.C. 4502) is amended—

(5) by redesignating paragraphs (7) through (14) (as amended by the preceding provisions of this Act) as paragraphs (8) through (15), respectively; and

(6) by inserting after paragraph (6) the following new paragraph:

'(7) ENTERPRISE-AFFILIATED PARTY.—The term

'enterprise-affiliated party' means—

‘(A) any director, officer, employee, or controlling stockholder of, or agent for, an enterprise;

‘(B) any shareholder, consultant, joint venture partner, and any other person as determined by the Director (by regulation, order, or case-by-case) who participates in the conduct of the affairs of an enterprise; and

‘(C) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in—

‘(i) any violation of any law or regulation;

‘(ii) any breach of fiduciary duty; or

‘(iii) any unsafe or unsound conduct,

which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the enterprise.’.

Subtitle B—Prompt Corrective Action

SEC. 131. CAPITAL CLASSIFICATIONS.

Section 1364 of the Housing and Community Development Act of 1992 (12 U.S.C. 4614) is amended—

(1) by striking subsection (a)(3)(A)(i) and redesignating ‘(ii)’ and ‘(iii)’ as ‘(i)’ and ‘(ii)’, respectively;

(2) by striking subsection (b) and inserting the following new subsection:

‘(b) DISCRETIONARY CLASSIFICATION.—

‘(1) GROUNDS FOR RECLASSIFICATION.— The Director may reclassify an enterprise under paragraph (2) if—

‘(A) at any time, the Director determines in writing that an enterprise is engaging in conduct that could result in a rapid depletion of core capital or that the value of the property subject to mortgages held or securitized by the enterprise has decreased significantly;

‘(B) the Director determines that an enterprise is in an unsafe or unsound condition; or

‘(C) pursuant to section 1371(b), the Director determines that an enterprise is engaging in unsafe or unsound conduct.

‘(2) RECLASSIFICATION.—In addition to any other action authorized under this title, including the reclassification of an enterprise for any reason not specified in this subsection, if the Director takes any action described in paragraph (1) the Director may classify an enterprise—

‘(A) as undercapitalized, if the enterprise is otherwise classified as adequately capitalized;

‘(B) as significantly undercapitalized, if the enterprise is otherwise classified as undercapitalized; and

‘(C) as critically undercapitalized, if the enterprise is otherwise classified as significantly undercapitalized.’;

(2) by redesignating subsection (d) as subsection (e); and

(3) by inserting after subsection (c) the following new subsection:

“(d) RESTRICTION ON CAPITAL DISTRIBUTIONS.—

“(1) IN GENERAL.— An enterprise shall make no capital distribution if, after making the distribution, the enterprise would not be adequately capitalized.

“(2) EXCEPTION.— Notwithstanding paragraph (1), the Director may permit an enterprise to repurchase, redeem, retire, or otherwise acquire shares or ownership interests if the repurchase, redemption, retirement, or other acquisition—

“(A) is made in connection with the issuance of additional shares or obligations of the enterprise in at least an equivalent amount; and

“(B) will reduce the financial obligations of the enterprise or otherwise improve the financial condition of the enterprise.

SEC. 132. AUTHORITY OVER CRITICALLY UNDERCAPITALIZED ENTERPRISES.

Part I of subtitle B of title XII of the Housing and Community Development Act of 1992 is amended by inserting the following new section 1369E :

“SEC. 1369E. APPOINTMENT OF RECEIVERS.—

“(a) APPOINTMENT.—

‘(1) AUTHORITY.—Upon a determination that an enterprise is critically undercapitalized and a determination that the enterprise meets such other conditions for taking action pursuant to this subsection as the Director shall by regulation or order establish, the Director may, notwithstanding section 1367(a)(1), appoint a receiver for the enterprise in accordance with this section and in lieu of appointment of a conservator pursuant to section 1367. If the Director takes action pursuant to this subsection, the Director shall appoint the receiver not later than 30 days after providing notice under paragraph (2) of this subsection.

‘(2) NOTICE.—Upon making a determination under paragraph (1) to appoint a receiver for an enterprise, the Director shall provide written notice to the enterprise, the Secretary, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate—‘(A) that a receiver will be appointed for the enterprise;

‘(B) stating the reasons for the appointment of the receiver; and

‘(C) identifying the person or governmental agency that the Director intends to appoint as a receiver.

‘(3) QUALIFICATIONS.— The receiver shall be—

‘(A) the Director or any other governmental agency; or

‘(B) any person that—

‘(i) has no claim against, or financial interest in, the enterprise or other basis for a conflict of interest; and

‘(ii) has the financial and management expertise necessary to carry out the duties under subsection

(c).

‘(b) JUDICIAL REVIEW.—The provisions of section 1369(b) shall apply to the appointment of a receiver pursuant to this section and to the exercise of powers or functions of a receiver to the same extent that such provisions apply to the appointment of a conservator and the exercise of the powers or functions of a conservator.

‘(c) DUTIES.—A receiver appointed pursuant to this section shall be appointed for the purpose, and shall have the duty, of liquidating or otherwise resolving and of winding up the affairs of the enterprise, in accordance with such regulations or orders as the Director may issue, and notwithstanding the second sentences of paragraphs (1) and (2)(B) of section 302(a) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717(a)) and section 303(c)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(c)(2)).

‘(d) REPLACEMENT, POWERS, LIABILITY PROTECTION.—The provisions of subsections (c) and (d) of section 1369, section 1369A, and section 1369B shall apply to a receiver appointed pursuant to this section to the same extent that such provisions apply to a conservator appointed pursuant to this subtitle. In addition to any powers under section 1369A, a receiver appointed pursuant to this section shall have such powers with respect to an enterprise, as the Director may by regulation or order provide, that the Federal Deposit Insurance Corporation has under section 11 of the Federal Deposit Insurance Act (12 U.S.C. 1821), as in effect at that time, with respect to an insured depository institution when acting as a receiver under such section.’

Subtitle C—Enforcement Actions

SEC. 151. CEASE-AND- DESIST-PROCEEDINGS

Subtitle C of the Housing and Community Development Act of 1992 (12 U.S.C. 4631 *et seq.*) is amended—

(1) by striking the title and subsections (a) and (b) of Section 1371

(12 U.S.C. 4631(a) and (b)) and inserting the following:—

‘SEC. 1371. CEASE-AND-DESIST AUTHORITIES.

(a) ISSUANCE FOR UNSAFE OR UNSOUND CONDUCT AND VIOLATIONS OF RULES OR LAWS.—If, in the opinion of the Director, an enterprise or any enterprise-affiliated party is engaging or has engaged, or the Director has

reasonable cause to believe that the enterprise or any enterprise-affiliated party is about to engage, in an unsafe or unsound conduct in conducting the business of the enterprise or is violating or has violated, or the Director has reasonable cause to believe that the enterprise or any enterprise-affiliated party is about to violate, a law, rule, or regulation, or any condition imposed in writing by the Director in connection with the granting of any application or other request by the enterprise or any written agreement entered into with the Director, the Director may issue and serve upon the enterprise or such party a notice of charges in respect thereof. The Director may not enforce compliance with any housing goal established under subpart B of part 2 of subtitle A of this title, with section 1336 or 1337 of this title, with subsection (m) or (n) of section 309 of the Federal National Mortgage Association Charter Act (12 U.S.C. 1723a(m), (n)), or with subsection (e) or (f) of section 307 of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1456(e), (f));

(2) in subsection (c)(2), by striking 'or director' and inserting 'or enterprise-affiliated party'; and

(3) in subsection (d)(7), by inserting at the end –

‘Such authority includes the same authority to issue an order requiring a party to take affirmative action to correct conditions resulting from violations or conduct or to limit activities of an enterprise or any executive officer or director of an enterprise or any enterprise-affiliated party as appropriate federal banking agencies may take with respect to insured depository institutions under paragraphs (6) and (7) of section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(6) and (7)).’

SEC. 152. TEMPORARY CEASE-AND-DESIST PROCEEDINGS.

Section 1372 of the Housing and Community Development Act of 1992 (12 U.S.C. 4632) is amended—

(1) by striking subsection (a) and inserting the following new subsection:

‘(a) GROUND FOR ISSUANCE.—Whenever the Director determines that the violation or threatened violation or the unsafe or unsound conduct specified in the notice of charges served upon the enterprise or any enterprise-affiliated party pursuant to section 1371(a), or the continuation thereof, is likely to cause insolvency or significant dissipation of assets or earnings of the enterprise, or is likely to weaken the condition of the enterprise prior to the completion of the proceedings conducted pursuant to sections 1371 and 1373,

the Director may issue a temporary order requiring the enterprise or such party to cease and desist from any such violation or conduct and to take affirmative action to prevent or remedy such insolvency, dissipation, condition, or prejudice pending completion of such proceedings. Such order may include any requirement authorized under subsection 1371(d).’;

(2) in subsection (b), by striking ‘or director’ and inserting ‘or enterprise-affiliated party’;

(3) in subsection (d), striking ‘or director’ and inserting ‘or enterprise-affiliated party’; and

(4) by striking subsection (e) and inserting the following new subsection:

‘(e) ENFORCEMENT.—In the case of violation or threatened violation of, or failure to obey, a temporary cease-and-desist order issued pursuant to this section, the Director may apply to the United States District Court for the District of Columbia or the United States district court for the district in which the headquarters of the defendant is located or, if the defendant is an individual the district in which the defendant resides for an injunction to enforce such order, and, if the court determines that there has been such violation or threatened

violation or failure to obey, it shall be the duty of the court to issue such injunction.’.

SEC. 153. REMOVAL AND PROHIBITION AUTHORITY.

(a) IN GENERAL.—Subtitle C of title XIII of the Housing and Community Development Act of 1992 is amended—

(1) by redesignating sections 1377 through 1379B (12 U.S.C. 4637-41) as sections 1379 through 1379D, respectively; and

(2) by inserting after section 1376 (12 U.S.C. 4636) the following new section:

‘SEC. 1377. REMOVAL AND PROHIBITION AUTHORITY.—

‘(a) AUTHORITY TO ISSUE ORDER.—Whenever the Director determines that—

‘(1) any enterprise-affiliated party has, directly or indirectly—

‘(A) violated—

‘(i) any law or regulation;

‘(ii) any cease-and-desist order which has become final;

‘(iii) any condition imposed in writing by the Director in connection with the grant of any application or other request by such enterprise; or

'(iv) any written agreement between
such enterprise and the Director;

'(B) engaged or participated in any unsafe or unsound
conduct in connection with any enterprise; or

'(C) committed or engaged in any act, omission, or
conduct that constitutes a breach of such party's
fiduciary duty to the enterprise as defined by
regulations issued by the Director or other applicable
law;

'(2) by reason of the violation, conduct , or breach described
in any subparagraph of paragraph (1)—

'(A) such enterprise has suffered or will probably
suffer financial loss or other harm;

(B) the interests of the enterprise's investors have
been or could be prejudiced; or

'(C) such party has received financial gain or other
benefit by reason of such violation, conduct, or
breach; and

'(3) such violation, conduct , or breach—

'(A) involves personal dishonesty on the part of such
party; or

‘(B) demonstrates willful or continuing disregard by such party for the safety or soundness of such enterprise,

the Director may serve upon such party a written notice of the Director's intention to remove such party from office or to prohibit such party from any further participation, in any manner, in the conduct of the affairs of any enterprise. The Director shall notify each “appropriate federal banking agency,” as that term is defined at 12 U.S.C. 1813(q), and such other federal financial regulatory agencies as the Director considers appropriate of the notice that was served.

‘(b) SUSPENSION ORDER.—

‘(1) SUSPENSION OR PROHIBITION

AUTHORITY.— If the Director serves written notice under subsection (a) to any enterprise-affiliated party of the Director's intention to issue an order under such subsection, the Director may suspend such party from office or prohibit such party from further participation in any manner in the conduct of the affairs of the enterprise, if the Director—

‘(A) determines that such action is necessary for the protection of the enterprise; and

'(B) serves such party with written notice of the suspension order.

'(2) EFFECTIVE PERIOD.—Any suspension order issued under subsection (a)—

'(A) shall become effective upon service; and

'(B) unless a court issues a stay of such order under subsection (g) of this section, shall remain in effect and enforceable until—

'(i) the date the Director dismisses the charges contained in the notice served under subsection (a) with respect to such party; or

'(ii) the effective date of an order issued by the Director to such party under subsection (a).

'(3) COPY OF ORDER.—If the Director issues a suspension order under subsection (b) to any enterprise-affiliated party, the Director shall serve a copy of such order on any enterprise with which such party is affiliated at the time such order is issued.

'(c) PROCEDURES.—

'(1) ESTABLISHMENT.—The Director shall establish standards and procedures governing removal, prohibition, and suspension actions under this section. Such standards and procedures shall provide for written notice, stay of suspension, a hearing regarding continued participation, a hearing under Section 1373 (12 U.S.C.

4633), review by the Director, issuance of appropriate orders, judicial review under Section 1374 (12 U.S.C. 4634), and enforcement by the Director under Section 1375 (12 U.S.C. 4635).

‘(d) PROHIBITION OF CERTAIN SPECIFIC ACTIVITIES.—Any person subject to an order issued under this section shall not—

‘(1) participate in any manner in the conduct of the affairs of any enterprise;

‘(2) solicit, procure, transfer, attempt to transfer, vote, or attempt to vote any proxy, consent, or authorization with respect to any voting rights in any enterprise;

‘(3) violate any voting agreement previously approved by the Director;

‘(4) vote for a director, or serve or act as an enterprise-affiliated party; or

‘(5) engage in other activities for or on behalf of an enterprise, except as specifically approved in writing by the Director.

‘(e) INDUSTRY-WIDE PROHIBITION.—

‘(1) IN GENERAL.—Except as provided in subparagraph (2), any person who, pursuant to an order issued under this section, has been removed or suspended from office in an enterprise or prohibited from participating in the conduct of the affairs of an enterprise may not, while such order is in effect, continue or

commence to hold any office in, or participate in any manner in the conduct of the affairs of any enterprise.

(2) EXCEPTION IF DIRECTOR PROVIDES WRITTEN

CONSENT.— If, on or after the date an order is issued under this section that removes or suspends from office any enterprise-affiliated party or prohibits such party from participating in the conduct of the affairs of an enterprise, such party receives the written consent of the Director, the order shall, to the extent of such consent, cease to apply to such party with respect to the enterprise described in the written consent. If the Director grants such a written consent, the Director shall publicly disclose such consent.

(3) The Director shall notify each “appropriate federal banking agency,” as that term is defined at 12 U.S.C. 1813 (q), and such other federal financial regulatory agencies as the Director considers appropriate, of any order of removal or prohibition issued under this section and of any exception granted under paragraph (2).

‘(f) APPLICABILITY.—This section shall only apply to a person who is an individual, unless the Director specifically finds that it should apply to a corporation, firm, or other business enterprise.

‘(g) SUSPENSION OR REMOVAL OF ENTERPRISE-AFFILIATED PARTY CHARGED WITH FELONY.—

‘(1) SUSPENSION OR PROHIBITION.—

‘(A) IN GENERAL.—Whenever any enterprise-affiliated party is charged in any information, indictment, or complaint, with the commission of or participation in a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under State or Federal law, the Director may, if continued service or participation by such party may pose a threat to the enterprise or impair public confidence in the enterprise, by written notice served upon such party, suspend such party from office or prohibit such party from further participation in any manner in the conduct of the affairs of any enterprise.

‘(B) PROVISIONS APPLICABLE TO NOTICE.—

‘(i) COPY.—A copy of any notice under paragraph (1)(A) shall also be served upon the enterprise.

‘(ii) EFFECTIVE PERIOD.—A suspension or prohibition under subparagraph (A) shall remain in effect until the information, indictment, or complaint referred to in such subparagraph is finally disposed of or until terminated by the Director.

‘(2) REMOVAL OR PROHIBITION.—

‘(A) IN GENERAL.—If a judgment of conviction or an agreement to enter a pretrial diversion or other similar program is entered against an enterprise-affiliated party in

connection with a crime described in paragraph (1)(A), at such time as such judgment is not subject to further appellate review, the Director may, if continued service or participation by such party may pose a threat to the enterprise or impair public confidence in the enterprise, issue and serve upon such party an order removing such party from office or prohibiting such party from further participation in any manner in the conduct of the affairs of the enterprise without the prior written consent of the Director.

‘(B) PROVISIONS APPLICABLE TO ORDER.—

‘(i) COPY.—A copy of any order under paragraph (2)(A) shall also be served upon the enterprise, whereupon the enterprise-affiliated party who is subject to the order (if a director or an officer) shall cease to be a director or officer of such enterprise.

‘(ii) EFFECT OF ACQUITTAL.—A finding of not guilty or other disposition of the charge shall not preclude the Director from instituting proceedings after such finding or disposition to remove such party from office or to prohibit further participation in enterprise affairs pursuant to subsections (a), (d), or (e) of this section.

‘(iii) EFFECTIVE PERIOD.—Any notice of suspension or order of removal issued under this subsection shall

remain effective and outstanding until the completion of any hearing or appeal authorized under paragraph (4) unless terminated by the Director.

'(3) AUTHORITY OF REMAINING BOARD MEMBERS.—If at any time, because of the suspension of one or more directors pursuant to this section, there shall be on the board of directors of an enterprise less than a quorum of directors not so suspended, all powers and functions vested in or exercisable by such board shall vest in and be exercisable by the director or directors on the board not so suspended, until such time as there shall be a quorum of the board of directors. In the event all of the directors of an enterprise are suspended pursuant to this section, the Director shall appoint persons to serve temporarily as directors in their place and stead pending the termination of such suspensions, or until such time as those who have been suspended, cease to be directors of the enterprise and their respective successors take office.

(b) CONFORMING AMENDMENTS.—

(1) 1992 ACT.—Section 1317(f) of the Housing and Community Development Act of 1992 (12 U.S.C. 4517(f)) is amended by striking 'section 1379B' and inserting 'section 1379D'.

(2) FANNIE MAE CHARTER ACT.—The second sentence of subsection (b) of section 308 of the Federal National Mortgage Association Charter Act (12 U.S.C. 1723(b)) is amended by striking 'The' and inserting 'Except to the extent action under section 1377

of the Housing and Community Development Act of 1992 temporarily results in a lesser number, the’.

(3) FREDDIE MAC CORPORATION ACT.—The second sentence of subparagraph (A) of section 303(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(a)(2)(A)) is amended by striking ‘The’ and inserting ‘Except to the extent action under section 1377 of the Housing and Community Development Act of 1992 temporarily results in a lesser number, the’.

SEC. 154. ENFORCEMENT AND JURISDICTION.

Section 1375 of the Housing and Community Development Act of 1992 (12 U.S.C. 4635) is amended—

(1) by striking subsection (a) and inserting the following new subsection:

‘(a) ENFORCEMENT.—The Director may, in the discretion of the Director, apply to the United States District Court for the District of Columbia, or the United States district court within the jurisdiction of which the headquarters of the enterprise is located, for the enforcement of any effective and outstanding notice or order issued under this subtitle or subtitle B, or request that the Attorney General of the United States bring such an action. Such court shall have jurisdiction and power to order and require compliance with such notice or order.’; and

(2) in subsection (b), by striking ‘or 1376’ and inserting ‘1376, or 1377’.

SEC. 155. CIVIL MONEY PENALTIES.

Section 1376 of the Housing and Community Development Act of 1992

(12 U.S.C. 4636) is amended—

(1) in subsection (a)—

(A) (A) in the matter preceding paragraph (1), by striking ‘executive officer or director’ and inserting ‘enterprise-affiliated party’; and

(B) (B) by deleting the word ‘or’ at the end of paragraph (2), deleting the ‘.’ and inserting ‘;’ at the end of paragraph (4) and adding after paragraph (4) the following paragraphs, ‘(5) violates any condition imposed in writing by the Director in connection with the grant of any application or other request by such enterprise;

(6) engages in any conduct the Director determines to be unsafe or unsound

(2) in subsection (b)—

(A) in paragraph (1), by inserting ‘or enterprise-affiliated party’ after ‘enterprise’ and by deleting ‘\$5,000’ and inserting ‘\$10,000’.

(B) by deleting paragraphs (2) and (3) and inserting—

‘(2) SECOND TIER- Notwithstanding paragraph (1)—

‘(A) if an enterprise, or an enterprise-affiliated party—

‘(i) commits any violation described in subsection (a);

'(ii) recklessly engages in an unsafe or unsound
conduct in conducting the affairs of such enterprise;

or

'(iii) breaches any fiduciary duty; and

'(B) the violation, conduct, or breach—

'(i) is part of a pattern of misconduct;

'(ii) causes or is likely to cause more than a minimal
loss to such enterprise; or

'(iii) results in pecuniary gain or other benefit to such
party,

the enterprise or enterprise-affiliated party shall forfeit and
pay a civil penalty of not more than \$50,000 for each day
during which such violation, conduct, or breach continues.

'(3) THIRD TIER.—Notwithstanding paragraphs (1) and (2),
any enterprise that, or any enterprise-affiliated party who—

'(A) knowingly—

'(i) commits any violation described in any
subparagraph of subsection (a);

'(ii) engages in any unsafe or unsound conduct
in conducting the affairs of such enterprise; or

'(iii) breaches any fiduciary duty; and

'(B) knowingly or recklessly causes a substantial loss
to such enterprise or a substantial pecuniary gain or

other benefit to such party by reason of such violation,
conduct, or breach,

shall forfeit and pay a civil penalty in an amount not to
exceed the applicable maximum amount determined under
paragraph (4) for each day during which such violation,
conduct, or breach continues.

‘(4) MAXIMUM AMOUNTS OF PENALTIES FOR ANY
VIOLATION DESCRIBED IN PARAGRAPH (3).—The
maximum daily amount of any civil penalty which may be
assessed pursuant to paragraph (3) for any violation,
conduct, or breach described in such paragraph is not to
exceed \$2,000,000.’

(3) in subsection (d)—

(A) by striking ‘, executive officer or director’ each place such
term appears and inserting ‘or enterprise-affiliated party’;

(B) by striking ‘request the Attorney General of the United
States to’;

(C) by inserting ‘, or the United States district court within the
district in which the headquarters of the defendant is located,
or, if the defendant is an individual, in which the defendant
resides’ after ‘District of Columbia’; and

(D) by striking ‘, or may, under the direction and control of
the Attorney General, bring such an action’.

(4) in subsection (g), by striking ‘subsection(6)(3)’ and inserting ‘this section, unless authorized by the Director by regulation or order.’

SEC. 156. CRIMINAL PENALTY.

Subtitle C of title XIII of the Housing and Community Development Act of 1992 (12 U.S.C. 4631 et seq.) is amended by inserting after section 1377 (as added by the preceding provisions of this Act) the following new section:

‘SEC. 1378. CRIMINAL PENALTY.—

‘Whoever, being subject to an order in effect under section 1377, knowingly participates, directly or indirectly, (including by engaging in an activity specifically prohibited in such an order) in the conduct of the affairs of any enterprise without the prior written approval of the Director, shall be fined not more than \$1,000,000, imprisoned for not more than 5 years, or both, notwithstanding section 3571 of title 18.’

SEC. 157. SUBPOENA AUTHORITY.

Section 1379D, as redesignated in Sec. 153 above, is amended in the first sentence of subsection (c)—

(1) by inserting after ‘may’, ‘bring an action, or’; and

(2) by deleting ‘or may, under the direction and control of the Attorney General, bring such an action.’

SEC. 158. GENERAL SUPERVISORY AUTHORITIES.

Subtitle C of the Housing and Community Development Act of 1992 (12 U.S.C. 4631 *et seq.*) is amended by inserting the following new section—

‘Sec.1379E. GENERAL SUPERVISORY AUTHORITIES.

The Director is authorized to take enforcement actions under this title and other formal and informal enforcement actions, including but not limited to requiring prompt supervisory actions under subtitle B, as the Director deems necessary to enforce the compliance of any enterprise or any enterprise-affiliated party with applicable laws, regulations, rules, or orders.

Subtitle D—General Provisions

SEC. 171. CONFORMING AND TECHNICAL AMENDMENTS.

(a) AMENDMENTS TO 1992 ACT.—Title XIII of the Housing and Community Development Act of 1992 (12 U.S.C. 4501 *et seq.*), as amended by the preceding provisions of this Act, is further amended—

(1) in section 1315 (12 U.S.C. 4515) by striking subsection (f);

(2) in section 1319A (12 U.S.C. 4520)—

(A) by striking ‘(a) IN GENERAL- ‘; and

(B) by striking subsection (b);

(3) in section 1319C (12 U.S.C. 4522)—

(A) in subsection (a)(1), by inserting ‘under this title’ after ‘redressed’; and

(B) in subsection (b), by inserting ‘under this title’ after ‘issued’;

(4) in section 1319D (12 U.S.C. 4523), by inserting `to conduct duties relating to the regulation and supervision of the enterprises' before the second comma;

(5) in section 1319E (12 U.S.C. 4524)—

(A) by inserting 'relating to regulation and supervision of the enterprises' before 'in accordance with'; and

(B) by inserting 'in functions relating to the regulation and supervision of the enterprises' before 'shall be made available';

(6) by striking section 1319G (12 U.S.C. 4526);

(7) in section 1361(e)(1) (12 U.S.C. 4611)(e)(1) by striking the first sentence and inserting the following new sentence: 'The Director shall establish the risk-based capital test under this section by regulation.'; and

(8) in section 1364(c) (12 U.S.C. 4614(c)), by striking the last sentence;

(9) in section 1367(a)(2) (12 U.S.C. 4617(a)(2)), by striking 'with the written concurrence of the Secretary of the Treasury,';

(10) in section 1369A(i) (12 U.S.C. 4620(i)), by inserting 'having duties relating to regulation and supervision of the enterprises' before the period at the end;

(11) by striking section 1383; and

(12) by striking ‘Committee on Banking, Finance and Urban Affairs’ and inserting ‘Committee on Financial Services’ each place such term appears in sections 1319B, 1319G(c), 1328(a), 1336(b)(3)(C), 1337, and 1369(a)(3).

(b) AMENDMENTS TO FANNIE MAE CHARTER ACT.—The Federal National Mortgage Association Charter Act (12 U.S.C. 1716 et seq.) is amended in section 309(n)—

(1) in paragraph (1), by inserting ‘the Director of the Office of Federal Housing Enterprise Oversight,’ after ‘Senate,’; and
(2) in paragraph (3)(B), by striking ‘Secretary’ and inserting ‘Director of the Office of Federal Housing Enterprise Oversight’.

(c) AMENDMENTS TO FREDDIE MAC CORPORATION ACT.—The Federal Home Loan Mortgage Corporation Act is amended in section 307(f) (12 U.S.C. 1456).

(1) in paragraph (1), by inserting ‘the Director of the Office of Federal Housing Enterprise Oversight Housing Finance Supervision,’ after ‘Senate,’; and
(2) in paragraph (3)(B), by striking ‘Secretary’ and inserting ‘Director of the Office of Housing Finance Supervision’.

(d) AMENDMENT TO DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT ACT.—Section 5 of the Department of Housing and Urban Development Act (42 U.S.C. 3534) is amended by striking subsection (d).

SEC. 172. TERM OF DIRECTOR.

Section 1312(b) of the Housing and Community Development Act of 1992 (12 U.S.C. 4512(b)) is amended to read—

‘(b) TERM.—The Director shall be appointed for a term of 5 years unless sooner removed by the President, upon reasons to be communicated by the President to the Senate.’

SEC. 173. EFFECTIVE DATE.

Except as specifically provided otherwise in this title, the amendments made by this title shall take effect upon, and shall apply beginning on, the date of the enactment of this Act.

END