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FOR IMMEDIATE RELEASE
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OFHEO, SEC REACH SETTLEMENT WITH FANNIE MAE; PENALTY IMPOSED

Washington, DC – James B. Lockhart, Acting Director of the Office of Federal Housing Enterprise Oversight (OFHEO), today announced that Fannie Mae has agreed to implement corrective measures and pay a collective penalty of \$400 million dollars as part of settlements with OFHEO and the Securities and Exchange Commission (SEC). The agreements come as OFHEO released its Report of the Special Examination of Fannie Mae. The report details an unethical corporate culture where Fannie Mae employees manipulated accounting and earnings to trigger bonuses for senior executives from 1998 to 2004. ([To view release and report](#))

OFHEO entered into the agreement in lieu of pursuing administrative or enforcement actions and to expedite movement toward reforms at the Enterprise.

"The penalty and settlements represent a major step in correcting a dangerous course that had been followed by one of the largest financial institutions in the world," said Lockhart. "Unprincipled corporate behavior and inadequate controls will simply not be tolerated," said Lockhart."

The settlement reached today addresses the finding of the special examination report and aims to remedy past practices, prevent future occurrences and put the Enterprise on a safe and sound course for the future. Key aspects of the settlement include:

Growth Limit. OFHEO has directed that Fannie Mae limit growth of its portfolio mortgage assets to the level of December 31, 2005. OFHEO's action is based on the ongoing internal controls, risk management and accounting deficiencies and the need for the Enterprise to provide OFHEO an acceptable business plan for managing its market activities. Guidance is provided on matters that could be submitted to OFHEO demonstrating progress in remediating these issues. Procedures are in place for the Acting Director to modify the limit or lift the limit based on his assessment of plans and progress. The existing capital requirements and capital planning along with limits on corporate actions such as dividend payments under OFHEO supervision remain in effect.

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Penalty. OFHEO has directed Fannie Mae to pay a \$400 million penalty to the government. This level of penalty signals that unsafe and unsound conditions cannot be tolerated at firms that have a public mission and enjoy public benefits.

Corporate Governance and Controls. OFHEO has directed Fannie Mae to undertake a comprehensive reform program aimed a top-to-bottom change, from corporate culture and tone to specific changes in journal entries, accounting procedures, briefings of the Board and officers on legal responsibilities, operational risk, reorganization of internal audit and other control functions. Strong emphasis will be placed on implementation of those plans with dates certain.

Personnel. OFHEO has directed Fannie Mae to undertake a review of current and separated employees for remedial actions. At the same time, Fannie Mae is directed to put in place qualified individuals with appropriate skills and adequate resources, and to provide a strong training program.

"We have had a good working relationship with the SEC and other agencies during this examination and in bringing together a settlement today," Lockhart said.

"As the OFHEO report shows, the image of Fannie Mae as one of the lowest-risk and 'best in class' institutions was a façade. In fact, it was just the opposite. They promoted unconstrained growth while undermining proper internal controls by under investing in systems, risk management and staff," Lockhart said. "Our examination found an environment where the ends justified the means. There was a systematic effort by senior management to manipulate accounting, reap financial rewards, and prevent the rest of the world from knowing about it," said Lockhart.

(To see full text of Stipulation and Consent Order [HERE](#).)

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OFHEO REPORT: FANNIE MAE FAÇADE **Fannie Mae Criticized for Earnings Manipulation**

Washington, DC – James B. Lockhart, Acting Director of the Office of Federal Housing Enterprise Oversight (OFHEO), today released its Report of the Special Examination of Fannie Mae. The report details an arrogant and unethical corporate culture where Fannie Mae employees manipulated accounting and earnings to trigger bonuses for senior executives from 1998 to 2004. The report also prescribes corrective actions to ensure the safety and soundness of the company.

"The image of Fannie Mae as one of the lowest-risk and 'best in class' institutions was a facade," said Lockhart. "Our examination found an environment where the ends justified the means. Senior management manipulated accounting; reaped maximum, undeserved bonuses; and prevented the rest of the world from knowing. They co-opted their internal auditors. They stonewalled OFHEO," Lockhart said.

"Fannie Mae's executives were precisely managing earnings to the one-hundredth of a penny to maximize their bonuses while neglecting investments in systems internal controls and risk management," Lockhart said. "The combination of earnings manipulation, mismanagement and unconstrained growth resulted in an estimated \$10.6 billion of losses, well over a billion dollars in expenses to fix the problems, and ill-gotten bonuses in the hundreds of millions of dollars."

The OFHEO report is the product of more than two years of in-depth review involving nearly 8 million pages of documents. The report includes the following key findings:

- Fannie Mae senior management promoted an image of the Enterprise as one of the lowest-risk financial institutions in the world and as "best in class" in terms of risk management, financial reporting, internal control, and corporate governance. The findings in this report show that image was false.

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- A large number of Fannie Mae's accounting policies and practices did not comply with Generally Accepted Accounting Principles (GAAP). The Enterprise also had serious problems of internal control, financial reporting, and corporate governance. Those errors resulted in Fannie Mae overstating reported income and capital by a currently estimated \$10.6 billion.
- During the period covered by this report—1998 to mid-2004—Fannie Mae reported extremely smooth profit growth and hit announced targets for earnings per share precisely each quarter. Those achievements were illusions deliberately and systematically created by the Enterprise's senior management with the aid of inappropriate accounting and improper earnings management.
- By deliberately and intentionally manipulating accounting to hit earnings targets, senior management maximized the bonuses and other executive compensation they received, at the expense of shareholders. Earnings management made a significant contribution to the compensation of Fannie Mae Chairman and CEO Franklin Raines, which totaled over \$90 million from 1998 through 2003. Of that total, over \$52 million was directly tied to achieving earnings per share targets.
- Fannie Mae's Board of Directors contributed to those problems by failing to be sufficiently informed and to act independently of its chairman, Franklin Raines, and other senior executives, failing to exercise the requisite oversight over the Enterprise's operations, and failing to discover or ensure the correction of a wide variety of unsafe and unsound practices, even after the Freddie Mac problems became apparent.
- Senior management did not make investments in accounting systems, computer systems, other infrastructure, and staffing needed to support a sound internal control system, proper accounting, and GAAP-consistent financial reporting. Those failures came at a time when Fannie Mae faced many operational challenges related to its rapid growth and changing accounting and legal requirements.
- Fannie Mae senior management sought to interfere with OFHEO's special examination by directing the Enterprise's lobbyists to use their ties to Congressional staff to improperly generate a Congressional request for the Inspector General of the Department of Housing and Urban Development (HUD) to investigate OFHEO's conduct of that examination and to insert into an appropriations bill language that would punish the agency by reducing its appropriations until the Director of OFHEO was replaced.

"As a government-sponsored enterprise, Fannie Mae has a unique position among American corporations and an extremely important mission," said Lockhart. "It is also the second largest borrower in the world, only behind the U.S. government. As such, Fannie Mae has a special mandate and position of public trust. The previous management team violated that trust and did serious harm to Fannie Mae," Lockhart said.

The report ends with recommendations from OFHEO's staff to the Acting Director, which he has accepted. Some of the key recommendations include:

- Fannie Mae must meet all of its commitments for remediation and do so with an emphasis on implementation – with dates certain – of plans already presented to OFHEO.
- Fannie Mae must review OFHEO's report to determine additional steps to take to improve its controls, accounting systems, risk management practices and systems, external relations program, data quality, and corporate culture. Emphasis must be placed on implementation of those plans.

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- Fannie Mae must strengthen its Board of Directors procedures to enhance Board oversight of Fannie Mae's management.
- Fannie Mae must undertake a review of individuals currently with the Enterprise that are mentioned in OFHEO's report.
- Due to Fannie Mae's current operational and internal control deficiencies and other risks, the Enterprise's growth should be limited.
- OFHEO should continue to support legislation to provide the powers essential to meeting its mission of assuring safe and sound operations at the Enterprises.

OFHEO will announce a settlement with Fannie Mae before 10 a.m.

The full text of the OFHEO report can be found at
<http://www.ofheo.gov/media/pdf/FNMSPECIALEXAM.PDF>

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**PROPOSED BOARD OF DIRECTORS RESOLUTION
MAY 23, 2006**

WHEREAS, Fannie Mae and the Office of Federal Housing Enterprise Oversight ("OFHEO") entered into an Agreement dated September 27, 2004 and a "Supplement to the Agreement of September 27, 2004" dated March 7, 2005 in connection with OFHEO's special examination of Fannie Mae's accounting policies and practices and related internal controls; and

WHEREAS, OFHEO has proposed that Fannie Mae enter into a Stipulation and Consent to the Issuance of a Consent Order (the "Stipulation and Consent") to resolve the matters addressed by the "Report of Findings to Date" dated September 17, 2004 and the "Report of the Special Examination of Fannie Mae" dated May 23, 2006; and

WHEREAS, the Securities and Exchange Commission (the "Commission") intends to file a Complaint (the "Complaint") against Fannie Mae in the United States District Court for the District of Columbia relating to matters under investigation; and

WHEREAS, the Commission has proposed that Fannie Mae consent to the entry of a judgment resolving the matters to be addressed by the Complaint (the "SEC Settlement"); and

WHEREAS, the Board of Directors believes it is in the best interests of the company to enter into the Stipulation and Consent and the SEC Settlement (collectively, the "Settlement Agreements"); it is therefore,

RESOLVED, that the Board of Directors authorizes the Chairman of the Board of Directors and the Chief Executive Officer, on behalf of Fannie Mae, to enter into the Settlement Agreements in substantially the same terms described to the Board of Directors, subject to the negotiation of final terms consistent with the discussions of the Board of Directors and as finally approved by the Chairman of the Board of Directors.

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