Federal Housing Finance Agency

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Dear Senator:

Thank you for your correspondence regarding executive compensation at Fannie Mae and Freddie Mac. At a time when the country faces persistent unemployment of nine percent or more and has an urgent need to address an enormous budget deficit, I well understand your concern about the possibility of any wasteful spending. Losses at Fannie Mae and Freddie Mac (the Enterprises) have already resulted in more than $170 billion in taxpayer expense, and I consider it the most important part of my job to minimize any further taxpayer costs.

When FHFA put the Enterprises into conservatorship in 2008, the individuals responsible for the Enterprises' failures left the companies and no severance or golden parachutes were permitted. In establishing a new executive compensation program, we reduced senior executive pay by an average of 40 percent, and developed, in consultation with the Treasury Department, a new pay structure similar to that designed for large, special-assistance TARP firms. FHFA announced the executive pay structure in late 2009 and that structure remains in place today. Over the past two years, we have reduced the number of top level positions, and as these positions turn over, we have further reduced pay levels.

By law, the conservatorships are intended to rehabilitate the Enterprises as private firms. Their officers are not public employees, and FHFA has used market compensation measures to target executive compensation at or below the median of comparable private sector positions at financial institutions roughly similar in size and/or complexity as the Enterprises. FHFA has followed the structure set forth for exceptional assistance TARP firms, a structure in keeping with requirements in the Enterprises' own charter acts for significant incentive compensation. Accordingly, one-third of each top executive's target compensation is based on a combination of individual and corporate performance. Furthermore, deferred salary is a significant component of the remainder of target compensation for the top executives in order to incentivize retention – executives who choose to leave the company forfeit it. One-half of deferred salary is based on corporate performance, thereby allowing for a reduction in effective salary should corporate performance lag expectations. Simply put, most of the so-called bonuses are simply deferred salaries.

We have worked hard to follow the law, best practices, and the lead of the Treasury in its compensation structure design for government-dependent firms. This structure helps to focus executives on the priorities established jointly by the boards of directors and FHFA intended to minimize taxpayer cost and maintain the flow of credit to our troubled housing markets.

Today, as Conservator I need to ensure that the companies have people with the skills needed to manage the credit and interest rate risks of $5 trillion worth of mortgage assets and $1 trillion of annual new business that the American taxpayer is supporting. I have concluded that it would be irresponsible of me to risk this enormous contingent taxpayer liability with a rapid turnover of management and staff, replaced with people lacking the institutional, technical, operational, and risk management knowledge requisite to the running of corporations with thousands of employees and more than $2 trillion in financial obligations each. That conclusion is further buttressed by the realization that, from an Enterprise executive or staff's point of view, continued employment at an Enterprise risks substantial job and career uncertainty. The public scrutiny and criticism is often harsh, and almost everyone expects the Enterprises to cease to exist, at least in their current form, in the future. At the same time, the taxpayer is backing Enterprise financial commitments that have thirty year lives, and we will need expert management of those guarantees for years to come. Given the amount of money at risk here, small mistakes can easily be amplified to losses far greater than the compensation paid to Enterprise executives.

Executive compensation has been the most vexing issue I have faced as Conservator. The decisions FHFA faces in overseeing multi-year conservatorships are unprecedented and striking the right balance of limiting pay while attracting and retaining competent executives is a continuing challenge. As difficult as these judgments are, I recognize they should be re-evaluated from time-to-time.

Chairman Johnson has requested that I testify before the Committee on Banking, Housing and Urban Affairs on November 15, 2011. At that hearing, I will explain more fully the Fannie Mae and Freddie Mac compensation packages and my concern with changes to these packages that could disrupt the functioning of the companies and thereby add even greater losses on the American taxpayer. I look forward to sharing my detailed testimony with you following the hearing. But, I respectfully submit that the best assistance Congress could give FHFA on this matter is, after more than three years of conservatorship, to take action to provide a clear path forward to end the conservatorships and reduce the taxpayer exposure to the mortgage market. That is the only way to truly resolve this matter.

Sincerely,

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Edward J. DeMarco
Acting Director