FHFA’s Approval of Senior Executive Succession Planning at Freddie Mac Acted to Circumvent the Congressionally Mandated Cap on CEO Compensation
Executive Summary

Pursuant to the Housing and Economic Recovery Act of 2008 (HERA), the Federal Housing Finance Agency (FHFA or Agency) is empowered to operate the Enterprises “with all the powers of the shareholders, the directors, and the officers” while they remain in conservatorship. With regard to succession planning for Enterprise senior executives, FHFA delegated responsibility to the respective boards of directors to develop a succession plan for the Chief Executive Officer (CEO) position and to select candidates for the CEO and President positions, subject to review by FHFA as conservator. According to FHFA, it has, as a practical matter, chosen to approve such selections after review. FHFA has retained the responsibility to approve compensation for senior executive officers.

In two evaluations that we are issuing today, we reviewed FHFA oversight of the Enterprises’ boards of directors succession planning efforts for the CEO. This evaluation focuses on FHFA oversight of the Freddie Mac Board of Directors (Board) and a companion report that focuses on the Fannie Mae Board of Directors. See FHFA’s Approval of Senior Executive Succession Planning at Fannie Mae Acted to Circumvent the Congressionally Mandated Cap on CEO Compensation, EVL-2019-001, available online at www.fhfaoig.gov/reports/auditsandevaluations.

Freddie Mac is in a period of significant transition in its executive and board leadership. Freddie Mac’s CEO, who has served as CEO since May 2012 and is also a Board member, advised the Board of his intention to retire during the second half of 2019. On March 21, 2019, Freddie Mac announced that the CEO will retire on July 1, 2019. In addition, four other Board members, including the Board Chairman, reached the end of their respective terms. Three of those members departed the Board in February 2019, and the fourth will depart in June 2019.

In April 2018, the Board Chairman notified the then-FHFA Director that he and the Chairman of the Nominating and Governance Committee of the Board had drafted a plan with recommendations to address the company’s transition issues and that the plan was unanimously supported by the Chairs of the Board Committees (Board Transition Plan).

The Board Transition Plan, which was provided to the then-FHFA Director in May 2018, stated that the Board had assessed several internal senior executives as potential candidates to succeed the CEO and narrowed its focus to two senior executives. It proposed that one of these two candidates be appointed as “Vice-CEO”.

According to the Board Transition Plan, the statutory cap on the compensation of Enterprise CEOs of $600,000 created challenges to Freddie Mac’s ability to recruit qualified external candidates and an external search could be disruptive to existing internal leadership. Recognizing that FHFA had “sole discretion to affirm or reverse any decision resulting from our [plan],” the Board Transition Plan sought FHFA’s approval or non-objection to its proposal to forego an external search for a CEO candidate.

After discussions about the Board Transition Plan, the then-FHFA Director advised the Board Chairman in writing, that the Board Transition Plan “strikes us as being very reasonable.” He concurred with the Board’s determination to forego an external search for the CEO and urged the Board to finalize its plan for CEO succession.

Over the following months, the Board refined the Board Transition Plan and periodically shared those refinements with FHFA. The refinements included: designation of the senior executive who would succeed the CEO after his retirement; creation of a “Deputy CEO” position, to be filled by this designated senior executive for one year; mentorship of the Deputy CEO by the CEO until his retirement; and a proposed compensation package for the Deputy CEO position at a level no less than the highest paid executive who reported to the CEO (then $3.25 million). Acting upon a written staff recommendation, the then-FHFA Director approved this executive compensation package for the Deputy CEO position on August 15, 2018.

Notwithstanding FHFA’s May 2018 response to the Board Transition Plan as “very reasonable,” FHFA notified Freddie Mac after August 15, 2018, that it determined that Freddie Mac would need to conduct an external search for a CEO and would need to title the new position “President,” rather than Deputy CEO. In response to FHFA’s query about the duties of the President position, the CEO advised that he saw the role of the President as identical to the role of Deputy CEO as originally proposed: to be an “understudy to the CEO, gradually taking over.” He described the duties of the President as “focus[ing] on learning corporation-level and non [multi-family] business activities to be as prepared as possible to become CEO upon the conclusion of the search (if it went to him).”

On September 5, 2018, FHFA advised Freddie Mac that it had relied on Freddie Mac’s request for approval of an annual compensation package for the Deputy CEO position and approved the compensation package for the new President position.

From September 2008 through September 5, 2018, Freddie Mac had no position of President or Deputy CEO. FHFA approved creation of the
position of President with the understanding that the individual in that position would serve as the “understudy” to the CEO and execute only those responsibilities previously executed by the CEO and now delegated to him for a one-year period. We found that FHFA’s approval of a $3.25 million compensation package for the Deputy CEO position (which was never created) and subsequent approval of the same compensation for the President position, acted to circumvent the congressionally mandated cap of $600,000 on CEO compensation. As a result of FHFA’s approval, Freddie Mac now provides a total of $3.85 million in compensation for the same set of CEO responsibilities for which it previously paid $600,000.

We provided FHFA with a draft of this report for technical comments, which it returned on March 4, 2019. In its technical comments, FHFA indicated that the external search for possible CEO candidates was underway and that the President intended to leave if he was not selected as CEO by the Board. We transmitted a final draft of this report to FHFA for management review and response, which was due on March 21, 2019. That same day, Freddie Mac announced that its current CEO would retire on July 1, 2019 and that its Board had appointed the current President as the new CEO, which FHFA had approved. Its Form 8-K filing on March 21 also disclosed that compensation for the new CEO, effective July 1, 2019, will “consist solely of an annual base salary of $600,000, a level established by FHFA” pursuant to the congressional cap and, as of that date, he “will no longer participate in the Executive Management Compensation Program or have any compensation subject to either corporate or individual performance.” Freddie Mac will continue to compensate its current President at an annual rate of $3.25 million, until his promotion takes effect on July 1, 2019. FHFA did not mention this appointment or the process used by the Board to reach its decision in its management response, dated March 21, 2019 (see Appendix). Indeed, FHFA represents in its management response that Freddie Mac is “conducting internal and external searches for the CEO position.” There can be no debate that this affirmative representation is factually inaccurate and creates a misleading impression.

We recommended that FHFA re-assess the appropriateness of the annual compensation of $3.25 million to Freddie Mac’s President. FHFA declined to accept our recommendation.

This report was prepared by Adrienne Freeman, Investigative Counsel, with assistance from Philip Noyovitz, Investigative Evaluator. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.
This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaoig.gov.

Kyle D. Roberts
Deputy Inspector General for Evaluation
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<tr>
<td>2017 Order</td>
<td>Conservatorship Order No. 2017-003</td>
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<td>Board</td>
<td>Freddie Mac Board of Directors</td>
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<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>DOC</td>
<td>Division of Conservatorship</td>
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<td>Enterprises</td>
<td>Fannie Mae and Freddie Mac, collectively</td>
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<td>FHFA or Agency</td>
<td>Federal Housing Finance Agency</td>
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<td>HERA</td>
<td>Housing and Economic Recovery Act of 2008</td>
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<td>LOI</td>
<td>Letter of Instruction</td>
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<td>OIG</td>
<td>Federal Housing Finance Agency Office of Inspector General</td>
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BACKGROUND ..........................................................................................................................................................................

Standards for Internal Control Systems in the Federal Government: The “Green Book”

FHFA, like other federal agencies, is responsible for implementing and maintaining an effective internal control system. Standards issued by the Comptroller General of the United States for internal controls in the federal government are set forth in the Standards for Internal Control in the Federal Government (also known as the Green Book). The Green Book defines an “Internal Control System” as a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an entity’s objectives will be achieved. The Green Book explains that an effective internal control system assists a federal agency in adapting to changing environments, evolving demands, evolving risks, and new priorities.

We use the standards set forth in the Green Book to assess the adequacy of the policies and procedures FHFA has put in place to facilitate its administration of the conservatorships of Fannie Mae and Freddie Mac (the Enterprises) and we review FHFA’s practices against the internal controls established by its own policies and practices.

FHFA’s Internal Controls for Conservatorship Decisions

FHFA, as Conservator, Exercises Sweeping Statutory Powers

Created by Congress in 2008, FHFA is charged by the Federal Housing Enterprises Financial Safety and Soundness Act, as amended by the Housing and Economic Recovery Act of 2008 (HERA), with supervision and regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. HERA vested FHFA with the authority to place the Enterprises into conservatorship and granted it sweeping powers to act as conservator. After FHFA placed the Enterprises into conservatorship in September 2008, the Agency succeeded to all rights, titles, powers, and privileges of the Enterprises, and of any shareholder, officer, or director with respect to the Enterprises and their assets. As conservator, FHFA is empowered by HERA to operate the Enterprises “with all the powers of the shareholders, the directors, and the officers.” These powers position FHFA to potentially control every aspect of Fannie Mae’s and Freddie Mac’s governance and operations.

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**FHFA Has Delegated Certain Authorities to the Enterprise Boards**

Although Congress granted FHFA authority to operate the Enterprises, FHFA determined, for reasons of efficiency, concordant goals with the Enterprises, and operational savings, to (1) delegate authority for general corporate governance and day-to-day matters to the Enterprises’ boards of directors and executive management, and (2) retain authority for certain significant decisions. Shortly after placing the Enterprises into conservatorship in September 2008, FHFA issued formal orders to each Enterprise board of directors that delegated specified general corporate governance authority to them and addressed specific governance matters. In conjunction with this order, FHFA issued to the Enterprises’ respective boards the first Letters of Instruction (LOI) that defined and outlined the scope of delegated and undelegated authorities. On November 15, 2012, FHFA revised and replaced the 2008 LOI to provide more specificity regarding the responsibilities of FHFA, the boards, and Enterprise management.

On July 12, 2017, FHFA issued Conservatorship Order No. 2017-003 (2017 Order) to the Enterprises’ boards, replacing Order No. 2008-006. The 2017 Order outlines functions, responsibilities, and authorities of the Enterprises’ boards. The 2017 Order also clarified that FHFA, as conservator, was exercising its statutory authority under HERA by which it “may, by regulation or order, provide for the exercise of any function by any stockholder, director, or officer of any regulated entity for which [FHFA] has been named conservator or receiver.” On June 27, 2018, FHFA issued Conservatorship Order No. 2018-002, replacing the 2017 Order. Order No. 2018-002 carries over all provisions in the 2017 Order with added language to make the conservator’s authority more explicit.

On December 18, 2017, FHFA issued another revision to the LOI, replacing all prior versions (2017 LOI). The 2017 LOI became effective on March 31, 2018. Under the 2012 and 2017 LOIs, FHFA delegated to the Enterprise boards of directors authority to address and resolve many of the same issues that boards of directors of public companies address and resolve, save for those matters carved out by FHFA for its review and decision (or for which prior notice must be provided by the Enterprises).

The orders and LOIs create significant differences between the responsibilities of Enterprise directors (for the duration of the conservatorships) and directors of publicly traded companies.

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In publicly traded companies, directors owe their fiduciary duties of care and loyalty to the shareholders. Enterprise directors, however, solely owe their fiduciary duties to the conservator and their authority is limited to the scope of the delegation from the conservator. Limits of the delegation of authority relevant to this evaluation are succession planning for directors and senior executive leadership of Freddie Mac and selection of a new CEO and President. In publicly traded companies, the boards of directors are responsible for succession planning for directors and senior executive leadership of Freddie Mac and for selecting a new CEO and President, as the need arises. Here, FHFA delegated responsibility to the Enterprise boards (1) to develop a succession plan for board positions and senior executive leadership and (2) to select candidates for vacant board positions and for the CEO and President positions. FHFA, however, retained the responsibility to approve the selections of directors and to review selection of the CEO. According to FHFA, it has, as a practical matter, chosen to approve such selections after review. FHFA also retained the responsibility to approve compensation actions for senior executive officers.

**FHFA Has Adopted Policies and Procedures to Facilitate its Execution of Retained Responsibilities**

Under the Green Book, agency management is responsible for establishing policies and procedures as an integral part of the agency’s operations. Generally, management implements “control activities” (the actions management establishes to achieve its objectives) through written policies.

FHFA’s Division of Conservatorship (DOC) is tasked with, among other things, evaluating the Enterprises’ requests for conservatorship approval and facilitating review of such requests and decision-making processes within FHFA. Consistent with the principles set forth in the Green Book, FHFA established an internal control framework that includes policies and procedures for processing formal Enterprise requests for conservator decision from FHFA as conservator. Those policies and procedures include the LOIs, the Conservatorship Decision Policy, the Conservatorship Decision Procedure, and the Official Documents Policy.
FACTS AND ANALYSIS .................................................................

Transition in Executive Leadership at Freddie Mac

Freddie Mac is in a period of transition. Freddie Mac’s CEO, who has served as CEO since May 2012 and is also a Board member, advised the Board of his intention to retire during the second half of 2019, which Freddie Mac had publicly announced. In addition, four other Board members, including the Board Chairman, reached the end of their respective terms. Three of those members departed the Board in February 2019, and the fourth will depart in June 2019.

Development of a Draft CEO Succession Plan and Discussions Between the Freddie Mac Board and the then-FHFA Director About This Plan

Development of a Draft CEO Succession Plan

In February 2018, Freddie Mac’s CEO set down his thoughts for a succession plan and, on April 15, 2018, shared those with the Board Chairman. At the same time, he advised the Board Chairman that he tentatively was considering retirement at some point between 2019 and 2020.

On April 18, 2018, the Board Chairman notified the then-FHFA Director by email that he and the Chairman of the Nominating and Governance Committee of the Board had drafted a plan with recommendations to address transition issues prompted by the CEO’s decision to retire from Freddie Mac in the near term, the expiration of the Chairman’s term in February 2019, and the departure of the FHFA Director from FHFA at the end of his term in January 2019 (Board Transition Plan). He explained that the Board Transition Plan incorporated the CEO’s thoughts on succession into its analysis and reached recommendations that the authors believed were “in the best long-term interests of” Freddie Mac and “balance[d] the need for executive stability and sound corporate governance principles.” He reported that the Board Transition Plan had been discussed with the chairs of other Board committees (but had not been “physically distributed to [them]”) and had their unanimous support. The Board Chairman advised that the Board sought to share its transition plan with the then-FHFA Director before sharing its recommendations with the CEO.

Roughly two weeks later, on May 3, 2018, the Board Chairman sent the Board Transition Plan to the then-FHFA Director. The Board Transition Plan set forth the anticipated

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6 Pursuant to FHFA regulation, no board member of an Enterprise may serve on the board of directors for more than 10 years or past the age of 72, whichever comes first. See 12 C.F.R. § 1239.20(a)(1)(i). The FHFA Director may waive limits on board service at the Director’s discretion and for good cause. 12 C.F.R. § 1239.20(a)(1)(ii).
transitions explained in the April 18, 2018, email and explained that the Board sought to take “actions in the near term to minimize potential disruption resulting from key transitions of the CEO, Board chair and Director of FHFA.” The Board Transition Plan addressed both the Board and CEO transitions. For the expected departures from the Board, the Board Transition Plan offered several options. (Because those options are not relevant to this evaluation, they are not discussed here.)

With respect to the CEO succession, the Board Transition Plan acknowledged that the CEO’s retirement would not likely impact “most of the senior executive team” but that at least one senior executive, “Candidate A,” could be a “flight risk” if a CEO succession plan was not put into place by year end 2018. The Board Transition Plan explained that the Board, over the past few years, had assessed several potential internal candidates who reported to the CEO to succeed him and narrowed its focus to two senior officers. Of these two senior officers, the Board sought FHFA concurrence to consider Candidate A for the CEO position. The Board Transition Plan envisioned that Candidate A would be:

- Appointed as “Vice-CEO” effective October 2018, with responsibility for the company’s three business lines, and
- Elevated to the CEO position, effective October 2019.

Recognizing that the FHFA Director had “sole discretion to affirm or reverse any decision resulting from our [plan],” the Board Transition Plan asked to “accelerate the timing of FHFA’s review and approval [of it]” to minimize future instability and retain the company’s “most promising senior executive talent.” It sought FHFA’s approval, or non-objection, to forego an external search for a CEO candidate for several reasons: the congressional cap on CEO compensation, “at a time when Washington D.C. is expected to be in political turmoil,” created challenges to Freddie Mac’s ability to recruit qualified external candidates; and an external search “could be disruptive” to the senior executive team.

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7 In 2015, the then-FHFA Director awarded annual target compensation of $4 million to the Enterprises’ CEOs, which he explained was designed to “promote CEO retention, allow reliable succession planning, and ensure the continuity, efficiency and stability of enterprise operations.” In response to the Director’s decision, Congress passed the Equity in Government Compensation Act of 2015. This legislation reversed those compensation packages and capped the annual compensation for the Enterprises’ respective CEOs at $600,000. The House Committee on Financial Services explained the need for the Equity in Government Compensation Act of 2015 in a committee report that referred to the bipartisan disapproval of the then-FHFA Director’s decision to allow the Enterprises to increase CEO salaries. The report quoted statements from the Treasury Department and the White House in support of limits on executive compensation due to taxpayers’ ongoing backstop of the Enterprises and stated that the Enterprises “continue to function in ways unlike private industry.” See House of Representatives, Rept. 114-339 Part 1 (Nov. 16, 2015) (online at https://www.congress.gov/congressional-report/114th-congress/house-report/339/1).
On May 4, 2018, Freddie Mac’s Chairman of the Board, Chairman of the Board’s Nominating and Corporate Governance Committee, then-FHFA Director, and a Special Advisor to the then-FHFA Director (who was also Acting Deputy Director of the FHFA Division of Conservatorship) met to discuss FHFA’s feedback to the Board Transition Plan (which had been sent to FHFA the previous day). Several days later, the then-FHFA Director provided feedback on the Board Transition Plan. By email dated May 9, 2018, he wrote that the approach of the Board Transition Plan “strikes us as being very reasonable.” He responded that he had “no interest during [his] tenure as Director in undertaking an outside search for a successor,” which the Freddie Mac Board treated as FHFA’s concurrence with its request to forego an external search for the CEO position. The then-FHFA Director concluded with the hope that this feedback would be sufficient to enable the Board to move forward and reach consensus on a plan for CEO succession.⁸

Refinement of the Board Transition Plan Between May and August 15, 2018

Over the course of the next three months, the Board refined the Board Transition Plan, which it shared with the then-FHFA Director and the Special Advisor verbally and through periodic written updates (on June 21, June 26, July 16, and July 25). Among other things, the Board developed key terms of the plan, including the transitional role of the primary internal candidate, a proposed executive compensation package, and timing and logistics. On July 16, 2018, the Board submitted a detailed description of the anticipated responsibilities of the Deputy CEO position during the one-year transition period. Those responsibilities included the following elements:

- Identification of Candidate A by name;

- Creation of a new executive officer position, “Deputy CEO,” for a one-year period, and appointment of Candidate A to that position, with an annual compensation package equal to the highest paid company executive (then $3.25 million);⁹

- Expectation that the current CEO would mentor the Deputy CEO during that one-year period to groom him for the CEO position, pursuant to a written development plan prepared and administered by the CEO;

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⁸ According to a June 21, 2018 email from the CEO to the then-FHFA Director, the Freddie Board met in executive session on June 7, 2018 to discuss the Board Transition Plan submitted to FHFA and discussed with the then-FHFA Director on May 4, 2018. No minutes for this executive session were provided to us by FHFA.

⁹ That compensation award would amount to an increase in Candidate A’s compensation by $500,000. FHFA was required to consult with the U.S. Department of the Treasury on this compensation award. See Section 5.10 of the Preferred Stock Purchase Agreement between Freddie Mac and Treasury, as provided in Part A of the Letter of Instruction.
We found no evidence that Freddie Mac and FHFA adhered to the procedures established by FHFA for matters requiring conservator approval under the 2017 LOI. Communications about the Board Transition Plan and its revisions were generally limited to conversations and emails among the FHFA Director and Special Advisor, the Board Chairman, and the CEO.

On August 3, 2018, Freddie Mac requested approval from FHFA for the annual compensation package proposed for the Deputy CEO position. While Candidate A had been compensated at a rate of $2.75 million in his position as the Executive Vice-President of Multi-Family, the CEO explained to the then-FHFA Director that the Board sought a $500,000 increase in his compensation so that his compensation would be at the same level as the highest paid direct report to the CEO during his one-year tenure as Deputy CEO. FHFA staff analyzed the proposed compensation for this “newly created and unique” position which would “have responsibility across the entire organization”\(^\text{10}\) and recommended approval on August 14, 2018. The following day, the then-FHFA Director concurred with the staff recommendation and approved the proposed annual compensation for the Deputy CEO position.

When FHFA staff recommended, and the then-FHFA Director approved, the proposed annual compensation of $3.25 million for Candidate A in the “newly created” Deputy CEO position, FHFA understood that the Board anticipated that the incumbent (if successful) would succeed Freddie Mac’s CEO, and his compensation as CEO would be reduced to $600,000. We provided FHFA with a draft of this report for its technical comments which it submitted on March 4, 2019. In those comments, FHFA represented that Candidate A had advised both the

\(^\text{10}\) That rule required Freddie Mac to provide FHFA 30 days written notice before a payment is made to any executive officer of annual compensation (where the amount of annual compensation has changed). Pursuant to its rule, FHFA will prohibit a “regulated entity” such as Freddie Mac from providing compensation to any executive officer that is not “reasonable and comparable.”
CEO and members of the Board that he would leave Freddie Mac if he was not selected as CEO so his position as President “is designed to be temporary, not permanent.”

Adjustments by FHFA and the Board to the Board Transition Plan After August 15, 2018

1. FHFA directed Freddie Mac to conduct an external search for a new CEO. Although the then-FHFA Director found the Board Transition Plan “reasonable” and advised that he had “no interest during [his] tenure as Director in undertaking an outside search for a successor” in May 2018, he reversed his position at some point between August 15 and August 28, 2018. After consultation with Treasury, FHFA determined that Freddie Mac should engage in an external search for a CEO candidate. An August 28, 2018, email from the Special Advisor to the CEO confirmed that Freddie Mac would expand its search to include external candidates.

The Board retained an executive search firm, Korn Ferry, in October 2018, to conduct the external search for a candidate for the CEO position. Pursuant to the retention agreement, Korn Ferry will assess external and internal candidates through interviews and assessments to aid in an “apples to apples” benchmarking and evaluation by the Board.11

2. FHFA directed Freddie Mac to change the title of the new position from Deputy CEO to President but envisioned that the role and responsibilities would not change. Because FHFA determined that Freddie Mac should expand its search to include external candidates and select a CEO candidate after its search was completed, the Special Advisor reported to us that he and the then-FHFA Director determined that the title of Deputy CEO was “not appropriate.” FHFA decided that the more appropriate title for this new position would be “President,” and informed the CEO of this change by email dated August 28, 2018. In its technical comments to a draft of this report, FHFA stated that the change in title of the newly created position from Deputy CEO to President did not change the roles and responsibilities for the position.

In an email exchange on August 28, 2018, the Special Advisor and the CEO discussed the role of the President position. The CEO described it as mirroring the position of Deputy CEO that was not created: to be an “understudy to the CEO, gradually taking over” with the expectation that the President would, over time, gradually take on responsibilities of the CEO. The CEO explained that, unlike the newly appointed President of Fannie Mae, the President of Freddie Mac would “focus on learning corporation-level and non-M[ulti]F[amily] business activities to be as prepared as possible to become CEO upon the conclusion of the search (if it

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11 The agreement with Korn Ferry established a six-month timeframe to complete the search and provides for an extension of up to nine months. Korn Ferry submitted an update to Freddie Mac on January 15, 2019, that contained background information on several proposed candidates.
went to him at that time).” While FHFA responded that it was “a bit open to exactly how [the President’s] role is initially structured” in the short run, it directed Freddie Mac to consider, after roughly three months, “how you describe this role publicly recognizing it will be compared to Fannie’s president role.”

FHFA notified Freddie Mac on September 5, 2018, that it approved the increase in compensation for Candidate A upon his promotion to President. That same day, Freddie Mac announced that the current CEO intended to retire in the second half of 2019 and, as a result of his decision, it was implementing its CEO succession plan. It announced that Candidate A had been elevated to the position of President. It explained that the Board had formed a search committee and intended to consider internal and external candidates, and identified Candidate A as the internal candidate for the CEO position. The following day, Freddie Mac disclosed in a Form 8-K filing, the same information as well as an annual compensation package of $3.25 million for Candidate A as President.

In our view, FHFA’s approval of the $3.25 million compensation package for the “temporary” position of President acted to circumvent the congressionally mandated cap of $600,000 on CEO compensation. From September 2008 through September 5, 2018, Freddie Mac had no position of President or Deputy CEO. The Board expected that the President, as the “understudy” to the CEO, would execute only those responsibilities previously executed by the CEO and now delegated by the CEO to him during a one-year transition period. FHFA’s approval authorized Freddie Mac to provide a total of $3.85 million in compensation—$3.25 million for the President and $600,000 for the CEO—for the same responsibilities for which it previously paid $600,000, an increase of over 500%.

We transmitted a final draft of this report to FHFA for management review and response, which was due on March 21, 2019. That same day, Freddie Mac announced that its current CEO would retire on July 1, 2019 and that its Board had appointed the current President as its new CEO, which FHFA had approved. Its Form 8-K filing on March 21 also disclosed that compensation for the new CEO, effective July 1, 2019, will “consist solely of an annual base salary of $600,000, a level established by FHFA” pursuant to the congressional cap and, as of that date, he “will no longer participate in the Executive Management Compensation Program or have any compensation subject to either corporate or individual performance.” Freddie Mac will continue to compensate its current President at an annual rate of $3.25 million, until July 1, 2019. FHFA did not mention this appointment or the process used by the Board to reach its decision in its management response, dated March 21, 2019 (see Appendix). Indeed, FHFA represents in its management response that Freddie Mac is “conducting internal and external searches for the CEO position.” There can be no debate that this affirmative representation is factually inaccurate and creates a misleading impression.
FINDING

FHFA’s Approval of the Board Transition Plan and $3.25 Million in Compensation for the President Acted to Circumvent the Congressionally Mandated Cap of $600,000 on CEO Compensation.

CONCLUSION

In 2015, the then-FHFA Director awarded an annual target compensation of $4 million to each Enterprise CEO in order to “promote CEO retention, allow reliable succession planning, and ensure the continuity, efficiency and stability of enterprise operations.” Congress rejected that rationale: it suspended those awards and imposed a salary cap of $600,000 on the CEO position. Since Congress passed that legislation, the position of CEO at Freddie Mac has been held by one individual who was paid a total of $600,000 for those services.

From September 2008 through September 4, 2018, Freddie Mac had no position of President or Deputy CEO. FHFA approved creation of the position of President with the understanding that the individual in that position would serve as the “understudy” to the CEO and execute only those responsibilities previously executed by the CEO and now delegated to him during a one-year transition period. FHFA’s approval of a $3.25 million compensation package for the Deputy CEO position (which was never created) and subsequent approval of the same compensation for the President position, acted to circumvent the congressionally mandated cap of $600,000 on CEO compensation. As a result of FHFA’s approval, Freddie Mac is paying a total of $3.85 million in compensation for the same set of responsibilities for which it previously paid $600,000. Effective July 1, 2019, Freddie Mac’s new CEO will receive annual compensation of $600,000.

RECOMMENDATION

We recommend that FHFA:

Re-assess the appropriateness of the annual compensation package of $3.25 million to the Freddie Mac President with consideration paid to the following factors: the congressional intent behind the statutory cap on compensation; Freddie Mac’s continued conservatorship status and the burdens imposed on the taxpayers from that status; the 10-year practice at Freddie Mac where one individual executed the CEO responsibilities with annual compensation capped at $600,000 since 2015; and the
temporary nature of the position of President, in light of FHFA’s representation that Candidate A will leave Freddie Mac if he is not selected for the CEO position.

FHFA COMMENTS AND OIG RESPONSE

We provided FHFA an opportunity to respond to a draft of this evaluation report and its response is included in the Appendix to this report. Because FHFA disagreed with our recommendation to re-assess the appropriateness of the annual compensation award of $3.25 million to the Freddie Mac President, we consider this recommendation to be closed as rejected.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this report was to evaluate FHFA’s oversight of the Enterprise boards of directors, with a particular focus on succession planning for the CEO position. Based on information that came to our attention during this evaluation, we also sought to assess FHFA’s oversight of Freddie Mac’s compensation practices relating to its President.

To achieve this objective, we requested and reviewed FHFA guidance pertaining to CEO succession planning. Additional materials reviewed include FHFA correspondence with the Freddie Mac Board and CEO, documentation of FHFA’s review of compensation arrangements for the Freddie Mac President, and Freddie Mac Board documentation of its succession planning activities.

In addition to our document review, we interviewed a Special Advisor to the Acting Director and the DOC Deputy Director.

The field work for this report was completed between October 2018 and February 2019.

This evaluation was conducted under the authority of the Inspector General Act and in accordance with the Council of the Inspectors General on Integrity and Efficiency’s Quality Standards for Inspection and Evaluation (January 2012). These standards require us to plan and perform an evaluation based upon evidence sufficient to provide a reasonable basis to support its findings and recommendations. We believe that the finding and recommendation discussed in this report meet those standards.
We appreciate the opportunity to respond to the Office of Inspector General (OIG) evaluation reports.

In its role as conservator of Fannie Mae and Freddie Mac, FHFA “succeed[ed] to…all rights, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity.”¹ In carrying out this significant authority, FHFA authorizes the boards of directors and senior management of the Enterprises to run the day-to-day operations of the companies. FHFA provides strategic direction for the Enterprises, requires the Enterprises to seek advance approval of certain business activities, and oversees and monitors Enterprise activities.

Background. The selections of board members and chief executive officers (CEOs) are significant, foundational decisions for any company. This remains the case for the Enterprises under conservatorship. In fact, because these individuals are accountable to the FHFA Director as conservator, the reliance upon the boards of directors and senior management under conservatorship makes the selection of these individuals critical to the effectiveness of FHFA’s responsibilities as conservator. As a result, the Director, board chairs, and CEOs engage with

¹ 12 USC 4617(b)(2)(A)(i).
one another in ways that would not otherwise occur outside of conservatorship. For example, the Director often attends executive sessions of Enterprise board meetings, communicates directly with the board chairs, and meets regularly with the CEOs of each Enterprise.

In recognition of the importance of the boards of directors at each company, FHFA has taken consistent steps to ensure that the companies have qualified and actively-engaged board members with clearly defined responsibilities. FHFA approves the selection of board members and has worked with each board of directors to delineate their responsibilities during conservatorship. These responsibilities include succession planning for company leadership, including the role of CEO. FHFA’s oversight of this process depends upon not only frequent dialogue with the boards but also the leadership of the boards to develop and carry out a well-crafted succession planning process.

While last year’s announcements about CEO searches at both Fannie Mae and Freddie Mac were the first public statements about this process, the boards of directors at both companies, in consultation with FHFA, have focused on succession planning efforts long before these announcements. The long-term nature of these discussions reflects both the importance of the topic and the commitment of the boards and FHFA to maintaining the stability of the companies during the inherently uncertain circumstances of conservatorship.

The selection of a CEO for any company is a challenging undertaking, and there are additional challenges unique to the conservatorships of Fannie Mae and Freddie Mac. This includes the uncertainty of the protracted conservatorships of the Enterprises and the compensation restrictions for the CEO role. While these factors have the effect of limiting the overall candidate pool for the CEO positions at each Enterprise, FHFA does not believe that they preclude finding qualified, experienced CEO leadership.

The interim leadership decisions made last year resulted in the CEO and President roles being held by different individuals at both Fannie Mae and Freddie Mac, a common corporate management arrangement.² In Fannie Mae’s case, the CEO role is being held on an interim basis by an individual who had previously served on the board of directors. A different person, who was a Fannie Mae executive in another capacity, is serving in the position of President at Fannie Mae. In Freddie Mac’s case, the existing CEO has announced his intent to retire in the second

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² For example, there is a range of corporate management arrangements in place across the 23-member peer group FHFA currently uses for assessing the comparability of Enterprise executive officer compensation. Among this peer group, some companies combine the roles of CEO and President and have no other officer titled as President. Other companies in the peer group combine the roles of CEO and President, but also have other officers titled as President. Another subset of companies separate the roles of CEO and President entirely (meaning, the CEO does not have the title President, and one or more other officers in the company do have the title President). Lastly, some companies in the peer group have a CEO and no officer titled as President. Each company presumably determines its structure based on different variables, to provide the best corporate governance.
half of 2019. A separate individual, who was also a Freddie Mac executive in another capacity, is serving in the position of President at Freddie Mac.

Both companies are conducting internal and external searches for the CEO position.

While both companies have split the CEO and President roles during their respective search processes, they reflect different succession planning approaches by the board of directors at each company. The Fannie Mae board of directors envisions that the company would retain separate CEO and President positions upon selection of a permanent CEO. The Freddie Mac board of directors envisions that, upon the selection of a new CEO, the position of President would be eliminated.

Identifying separate individuals for the roles of CEO and President at both companies does not diminish the essential executive responsibilities of the CEO role. The CEO retains ultimate management decision-making responsibility – and accountability – for the strategic direction set by the board and the conservator. The CEO also certifies company financial statements with the Chief Financial Officer and is the only corporate officer to serve on the board of directors.

The decision to have the positions of CEO and President at each Enterprise held by different individuals, whose compensation is set differently depending on their positions, did not – and does not – violate the CEO pay cap in the Equity in Government Compensation Act of 2015 (EGCA) and is consistent with other requirements of the Enterprise charter acts and the Safety and Soundness Act.

*Scope of the EGCA.* The EGCA explicitly addresses compensation provided to the “chief executive officer” and does not address compensation to be provided to any other Enterprise officer. In contrast, the Enterprise charter acts authorize their respective boards to provide compensation to each “officer” that is “reasonable and comparable with compensation for employment in other similar businesses (including publicly held financial institutions or other major financial services companies) involving similar duties and responsibilities” and further require “that a significant portion of potential compensation of all executive officers (as such term is defined in subsection (h)(3) of this section) . . . shall be based on the performance” of the Enterprise.\(^3\) FHFA is required to prohibit an Enterprise from providing compensation to an “executive officer” if that compensation does not meet the foregoing “reasonable and

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\(^3\) 12 USC 1452(c) (Freddie Mac) and 1723a(d)(2) (Fannie Mae). The quoted language is from Freddie Mac’s charter act; Fannie Mae’s charter act contains a substantively identical provision. Freddie Mac’s charter act further states that directions on compensation of “executive officers” are “all without regard to any other law except as may be provided by . . . laws hereafter enacted by the Congress expressly in limitation of this sentence.” Id. at 1452(c). The EGCA expressly limits only the compensation of the “chief executive officer.”
comparable” standard.\textsuperscript{4} For these purposes, “executive officer” is statutorily defined and includes, separately, the positions of “chief executive officer” and “president.”\textsuperscript{5}

The Enterprises’ governance structure during conservatorship has been transparently communicated through their Securities and Exchange Commission filings. At the time the EGCA was enacted, Fannie Mae’s governance structure combined the roles of “chief executive officer” and “president,” with the same incumbent serving in both positions. Freddie Mac’s governance structure assigned the position of “chief executive officer” to one incumbent and did not assign the position of “president” to any incumbent.

Considering the express language of the EGCA and the broader statutory language in the Enterprises’ charter acts and the Safety and Soundness Act, FHFA reasonably interprets the EGCA as applying only to the “chief executive officer.” Relevant to this interpretation is the canon of statutory construction that Congress is presumed to act with awareness of other existing, relevant, statutory provisions including, in this case, statutory provisions on executive compensation that distinguish the positions of “chief executive officer” and “president.”\textsuperscript{6}

The legislative history of the EGCA also supports FHFA’s interpretation. As the House Report cited in these OIG evaluation reports notes (at footnote 7 in the evaluation report for Freddie Mac and footnote 19 in the report for Fannie Mae), prior to enactment of the EGCA the House Financial Services Committee considered H.R. 2243, which would have directed FHFA to suspend the pay of all Enterprise executive officers and establish a compensation system in accordance with the pay provisions applicable to FHFA, with no executive officer whose pay was suspended being compensated at a rate higher than the highest-paid FHFA employee.\textsuperscript{7} That Committee subsequently voted to amend H.R. 2243 by substituting the text ultimately enacted as the EGCA. Thus, legislation with a broader application was considered, but a narrower approach

\textsuperscript{4} 12 USC 4518(a).

\textsuperscript{5} 12 USC 4502(12) (stating that “[t]he term ‘executive officer’ means, with respect to an enterprise, the chairman of the board of directors, chief executive officer, chief financial officer, president, vice chairman, any executive vice president, and any senior vice president in charge of a principal business unit, division, or function.”).


\textsuperscript{7} \textit{Compare} H.R. 2243, 115\textsuperscript{th} Cong., as introduced on May 8, 2015, with H.R. 2243, 115\textsuperscript{th} Cong., as reported by the House Financial Services Committee (HFSC) on November 16, 2015. The HFSC action to amend H.R. 2243 followed Senate action, where S. 2036 – ultimately enacted as the EGCA – was introduced in and passed by the Senate on September 15, 2015, and referred to the House the following day. The substituted language that formed the amendment to H.R. 2243 was the language of S. 2036. Thereafter, the whole House took up and passed S. 2036 as referred by the Senate by voice vote, also on November 16, 2015, and that bill – the EGCA – was signed by the President on November 25, 2015.
was ultimately taken. This history reflects congressional intent that Enterprise executive officers other than the chief executive would continue to be governed by the statutory provisions then – and currently – in place, which FHFA continues to implement and which apply to the president.

*Interpretation of “Chief Executive Officer.”* The EGCA does not define the term “chief executive officer.” FHFA interprets the essential function of the “chief executive officer” of an Enterprise to be the person with sole ultimate managerial decision-making authority for the Enterprise as a whole, with direct accountability to the board of directors.

FHFA also recognizes that it is permissible, and may be appropriate, to assign some responsibilities and duties that could be, or once were, undertaken by the CEO to other officers, such as a president or executive vice president, who support and are accountable to the CEO. No statute FHFA administers with regard to the Enterprises prevents this. Many corporations have a president who reports to the CEO and is second-in-command of the organization. Some corporations have more than one president.

Regarding the specific decisions under OIG review, the Fannie Mac board determined it was in the best interest of the company to adopt a structure that separated responsibilities of the CEO from those of the company president. The officer now in the president position was promoted from within the company, and the board is currently seeking a CEO.

The Freddie Mac board initially determined it was in the best interest of that company to name a current officer as the “Deputy CEO” – clearly indicating that this individual was not the CEO and thus not yet subject to the EGCA cap, but was in line to become the CEO and was aware that the cap would apply if and when that person became CEO. FHFA and the Freddie Mac board subsequently determined that Freddie Mac should consider external candidates for the CEO position and, as a result, considered the title “Deputy CEO” a misnomer given its intended use as designating the expected next CEO. Against that background, the board changed the title of “Deputy CEO” to President.

In each case, the executive officer who ultimately became President at each Enterprise has taken on new responsibilities. That increase in job scope was the basis for an increase in compensation that did not cause the officer’s total direct compensation to exceed a level that would be reasonable and comparable, in accordance with each Enterprise’s charter act and the Safety and Soundness Act.⁸

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⁸ 12 USC 4518(a) requires FHFA to prohibit an Enterprise from providing compensation to any executive officer (as defined at sec. 4502(12)) that is not reasonable and comparable with compensation for employment involving similar duties and responsibilities in other similar businesses, including other publicly held financial institutions or major financial services companies.
Conclusion. For these reasons, the decisions discussed here further FHFA’s overarching responsibilities as conservator, including supporting the stability of senior Enterprise leadership, and do not exceed the CEO compensation limitations put in place by the EGCA. At each Enterprise, the compensation of the individual currently serving as CEO is subject to the EGCA cap, and the existing CEO salaries for both companies are in compliance with this restriction. In addition, the individuals selected for the CEO positions as a result of the current search process will also be subject to this compensation restriction. Compensation for the positions of President at Fannie Mae and Freddie Mac have been handled in a manner similar to other senior level executives at the two companies and consistent with statutory requirements.

The ongoing conservatorships add complexity to the already complex tasks of corporate governance, including succession planning, assigning executive responsibilities, and selecting CEOs. FHFA will continue to responsibly assess these issues and reach responsible decisions in the Agency’s role as conservator, including on the selections of permanent CEOs at both companies. FHFA does not plan to re-open its decisions related to the individuals currently serving as President at Fannie Mae and Freddie Mac.

FHFA agrees that it will evaluate how to modify its systems to maintain and monitor sensitive conservatorship requests and will implement approved recommendations after completion of the Agency’s evaluation by September 30, 2019.
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