

# THE SODERQUIST CENTER

## **Freddie's CEOs Reveal Ethical Deficiencies**

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*Editor's note: This is the final article in the four-part series published in November and December on Fannie Mae and Freddie Mac's financial crisis.*

Like Fannie Mae, Freddie Mac kept Congressional allies and investors happy by buying risky subprime and Alt-A loans. For years, Freddie appeared profitable. In 2003, however, Freddie announced it overstated its profits from the previous three years by \$6.9 billion.

Freddie's financial wrongdoing became known when the firm changed its auditor to PriceWaterhouseCoopers from Arthur Andersen. Freddie dismissed Arthur Andersen after Andersen's involvement in Enron's financial misdeeds. Unlike Andersen's previous positive reports, PriceWaterhouseCoopers found extensive problems with Freddie's accounting and financial condition.

During Leland Brendsel's three years as Freddie's CEO, the company misrepresented its net income by 30.5 percent in 2000, 23.9 percent in 2001, and 42.9 percent in 2002. In December of 2003, the Securities and Exchange Commission accused Brendsel and four other Freddie executives of committing a multibillion-dollar fraud on investors. The SEC alleged Brendsel created a corporate culture that allowed improper earnings management, failed to implement adequate internal controls, and failed to provide Freddie's internal accountants with enough resources to do their jobs.

The SEC accused Brendsel, Chief Operating Officer David Glenn, Chief Financial Officer Vaughn Clark, and Senior Vice Presidents Hazir Dossani and Robert Dean of pressuring employees to report false, smooth and dependable earnings growth to investors. According to SEC enforcement director Linda Chatman Thomsen, Freddie's improper accounting "was the result of a corporate culture that sought stable earnings growth at any cost."

Freddie's board of directors forced Brendsel and his executive team to resign in 2003. Richard F Syron replaced Brendsel as Freddie's CEO with the expectation Syron would improve Freddie's corporate culture.

In September of 2007, Syron announced, "the Freddie Mac of today is a very different company than the Freddie Mac of the past." The record shows, however, that Syron managed Freddie like Brendsel did.

In 2004, Syron received internal memos from more than two dozen Freddie executives warning him that Freddie's financial practices threatened to engulf the company in a financial crisis. The executives

recommended that Freddie slow down its buying of high-risk subprime and Alt-A loans. They also recommended that Syron expand the company's financial cushion to deal with bad loans.

Syron ignored both recommendations. He speeded up buying risky loans and reduced Freddie's financial cushion. Freddie's chief risk officer under Syron, David Andrukonis, recalls Syron telling him that Freddie would continue to buy high-risk loans because, "We couldn't afford to say no to anyone." Andrukonis left Freddie in 2005.

Regardless of Syron's failings, compensation paid to him by Freddie exceeded \$38 million by 2008.

Eugene M. McQuade, who joined Freddie in 2004, was to replace Syron as CEO in 2008. McQuade's job was to repair Freddie's financial reporting. In 2008, McQuade turned down the opportunity to replace Syron. He said doubts over Freddie's future made the job less appealing.

In 2007, Brendsel and those who made up his management team paid large civil penalties. Brendsel paid \$2.5 million to the SEC and disgorged previously received salaries and bonuses of \$10.5 million. He also waived claims for an extra \$3.4 million in compensation.

Former COO Glenn paid the SEC \$400,000; former CFO Clarke paid \$154,227; former senior vice presidents Dossani and Dean paid \$136,663 and \$99,658 respectively.

Financial settlements with Freddie's investors and fines paid by Freddie to the SEC exceeded \$590 million by the end of 2008. Freddie also lost billions in value from buying bad loans.

CEO Richard Syron unintentionally described Freddie's lack of effective leadership in remarks he made in 2007. Syron said, "If I had better foresight, maybe I could have improved things a little bit. But frankly, if I had better foresight, I never would have taken this job in the first place."