When I left the Treasury I went to the Social Security Administration, in which case I was not involved with GSE issues.

Q. And what were the major policy recommendations that were formulated while you were the director of GSE policy or financial institution policy?

A. That the structure of these GSEs, with a statute that provided for much lower capital requirements than other regulated financial institutions had and the weakness in the regulatory structure that was in place, posed risks.

We also examined the question at one point of -- in response to a congressional inquiry regarding the -- the removal of the government's relationship with the -- with the GSEs.

Q. Okay. And was your recommendation that there should be more capital in the companies to improve safety and soundness?

MR. SCHWIND: Objection, vague.

THE WITNESS: Look, I worked there for ten years and made lots of internal recommendations and was part of Treasury, you know, testimony and reports to Congress on GSEs, and the overall safety and soundness, including the capital condition, would have been component parts of any internal recommendations and external statements. But particulars regarding them -- it was a long time ago.

BY MR. THOMPSON:

Q. Okay. And I'm not asking for specific capital ratios, but I'm just saying: As a general matter, did you think that there should be more capital in the companies to increase their safety and soundness?

MR. SCHWIND: Objection, vague.

THE WITNESS: Yes.

BY MR. THOMPSON:

Q. Okay. Now, so you were at the Social Security Administration, and what did you do for them?

A. Initially I was the Associate Commissioner for Research, Evaluation, and Statistics.

Q. And what sort of things were you researching there?

A. The research office did a wide array of analytical studies regarding the various Social Security programs. It was also responsible for producing a series of statistical reports providing data on various aspects of the Social Security program.

Q. Okay. And then when did you leave to go to OFHEO?

A. The end of October 2006.

Q. Okay. And what role did you have at -- what was your position when you joined OFHEO?

A. I was the deputy director and chief operating officer.

Q. And what were your responsibilities in that role?

A. Well, as chief operating officer I was overseeing the day-to-day operations and management of the agency, and I served as a senior advisor to the director.

Q. Did you have any input on policies relating to the companies or the GSEs?

MR. SCHWIND: Objection, vague.

THE WITNESS: As the deputy director and as an advisor to the director, I would advise the director on policy issues having to do with the GSEs.

BY MR. THOMPSON:

Q. Were you focused on capital levels? Was that one of the policy issues that you analyzed when you were deputy director at OFHEO?

A. Capital levels was one of the things we would look at.

Q. And why was that?

A. Because it was a key regulatory responsibility of the agency and, as you have noted, is a key component -- or as I have stated, is a key component of the safety and soundness of a regulated financial institution.

Q. And who did you work with? Who was the director of OFHEO at that time?

A. Mr. James Lockhart.

Q. Now -- and forgive my ignorance, but when HERA was passed, did OFHEO become FHFA, or --

A. When HERA was passed Director Lockhart became director of FHFA, and there was a period of time to unwind and transfer the employees of OFHEO, and of the Federal Housing Finance Board, and certain employees of the Department of Housing and Urban Development, to the Federal Housing Finance Agency. And so I was certainly part of that transfer and actually helped manage its actual execution.

Q. And were you involved in any way in the formulation of HERA?

A. In any way? Yes.

Q. What involvement did you have?

A. While at OFHEO I participated in discussions with the director and other staff regarding the development of that legislation and its individual provisions, and I attended one or more meetings with the members of -- on Capitol Hill regarding the development of the legislation.

Q. Do you recall what parts of the legislation you were involved in?

MR. SCHWIND: I'm going to object and instruct the witness not to answer.

This is beyond the scope of the court's discovery order and this -- and on the basis of about let's define capital. All through this discussion up to now, capital meant equity. You've just used capital to include debt. So I just want to be clear about what it is we're defining.

Their cost of borrowing shows up, I believe, as the largest expense item in their income statement.

Q. And their cost of borrowing is affected, among other things, by credit risk; is that true?

A. Yes, that is typically something that affects the cost of the borrowing.

Q. And interest rate risk, correct?

A. Yes, that can affect -- if there's interest rate risk with the debt instrument.

Q. And regulatory risk?

A. I'm not sure how to interpret regulatory risk --

Q. Let me give you a hypothetical --

A. -- affecting cost of borrowing. I'm not sure how to interpret what you mean by regulatory risk affecting the cost of borrowing.

Q. For example, if there were perceived

regulatory risk that the United States would no longer serve as a backstop for the debt obligations of Fannie and Freddie, they would have a higher cost of interest; is that right?

MR. SCHWIND: Objection.

BY MR. THOMPSON:

Q. All other -- all other things being equal?

A. So you've posed that in the context of conservatorship, meaning that if an investor in the debt thought that the Treasury support -- the government support was inadequate, that that could cause the cost of borrowing to go up. I would say it could cause the cost of borrowing to go up and cause the borrowing to cease.

Q. Okay. And in terms of credit risk from the perspective of someone lending money as debt to Fannie and Freddie, one of the factors they would look at in terms of credit risk is whether the capital of the companies was adequate; is that true?

A. That is one of the things I would expect a debt investor to -- to consider.

Q. So -- and if the companies were highly leveraged and had a relatively small amount of capital, then all other things being equal, their cost of borrowing would be higher; is that right?

A. The "all other things being equal" being an important statement, yes.

Q. Now, deferred tax assets are another factor that play into the profitability of companies, correct? They can?

A. I'm sorry, deferred tax assets play -- complete that --

Q. Yeah. Okay. So isn't it true that if a company has a deferred tax asset valuation allowance on its balance sheet, the potential for reversal of that valuation allowance could have an impact on its future profitability, correct?

MR. SCHWIND: Objection, it's vague, it calls for speculation.

And, Counsel, again, the court has allowed discovery into profitability at two time frames. Your questions are asking just generally what's -- what goes into profitability. What time frame are we talking about here? Which one of the two time frames

are we talking about?
BY MR. THOMPSON:
Q. Both of the two time frames.
A. If I heard the question correctly, Mr. Thompson, I think you got the direction wrong. It's the profitability that determines the accounting for the -- for the tax asset, not the tax asset that produces the profitability.
Q. Okay. So you need to -- all right. So you need to know the profitability of the companies in order to assess whether the evaluation allowance is going to be reserved; is that the point?
MR. SCHWIND: Objection. It's vague, it's speculative, it calls for a legal conclusion and, again, this is not a -- this witness is not an expert into accounting for various assets.
THE WITNESS: Not being an accountant, it's my understanding that the accounting rules governing the valuation -- governing the deferred tax asset is dependent in part upon expectations regarding future profitability, which goes to the use of those tax credits.

looked at the companies using their own assumptions, that the company was more accurate with the benefit of hindsight? Did you ever notice that?

A. Mr. Thompson, as you yourself have established, lots of projections are done over time. If you want to set down in front of me a set of projections that went out under an FHFA name and a set of projections that were done by Fannie Mae and Freddie Mac and we can look at the differences and we can talk about the different assumptions and so forth, that's all fine.

Let me make it more accurate, Mr. Thompson. This is an exercise in doing projections about an uncertain environment in which Fannie Mae and Freddie Mac will be the first to tell you, because they make it quite clear in their securities disclosures, that it takes rather modest changes in any of a number of set of economic factors to have a material impact on what the actual results are.

Ex post, looking back and saying, this projection on this date produced a number and this other projection over here produced a different number, and this number ended up being right means that this model was better than this model, that's not how people that do this work think, Mr. Thompson.

Q. Did you ever engage in that analysis?

A. Not personally. That was not my role. But we did have discussions with my staff and the -- and the enterprises to continually look at, you know, how models can be updated, improved, enhanced, maybe more accurate. And you're constantly responding to a changing economic environment.

Q. Now, the FHFA's projections were always more pessimistic than the companies' in the 2011 and 2012 time period; is that right?

A. I can cannot affirm that.

Q. You don't know?

A. You've not given me specific projections from FHFA or from Fannie Mae or Freddie Mac. I can say that FHFA's projections, as published, showed under various house price paths what the potential path of the draws from the Treasury might be and that those varied based upon those inputs and that the companies themselves in their securities disclosures talked about things that reflected the kind of results that showed up in the -- in the scenarios that we publish, that there were outcomes in which -- you know, that the draws could, you know, do X, Y, Z.

I mean, you're asking me to, you know, affirm or describe that there are these competing internal projections at Fannie and Freddie from what they gave us and we published here, and I'm not aware of the circumstances -- you know, these differences that you're describing.

Q. The FHFA consistently underestimated the profitability of Fannie and Freddie while you were the acting director, correct?

A. Let me try again, Mr. Thompson --

Q. Just "yes" or "no," and then elaborate.

MR. SCHWIND: Ignore --

BY MR. THOMPSON:

Q. "Yes," "no," "I can't answer yes or no," and then give whatever answer you like.

MR. SCHWIND: You can ignore that instruction and give whatever answer you like,

And my question is: Was that a commitment that you shared?
A. No.
Q. Why not?
A. I'm not the administration.
Q. I know you're not. I'm saying --
A. Oh, was I committed to the outcome?
Q. Yes, sir.
A. No.
Q. Why not?
A. My commitment was to ensure that the conservatorship carried out its function and responsibility so that these two companies were capable of continuing to operate in a sound and solvent condition so the United States of America had a functioning secondary mortgage market, and that we kept these things together such that the Congress of the United States would ultimately determine what the -- the end of the conservatorship or the future of national housing policy, how these things would be resolved.
It was important to me to keep these

companies functioning in a sound and solvent way and that the ultimate resolution of this was to be determined somewhere down the road.

It was my expectation, which I've stated numerous times, that this would involve action by the United States Congress.

Q. Why was that your expectation? You had the power, if they were rehabilitated and in capital compliance, to set them back.

A. No, because I made clear, and I believe my predecessor had, but that the -- the authorities that we had could not make changes to these flawed charters and structure which gave rise to this failure in the first place. So it was my expectation that the right -- that what would happen here is for these companies to be resolved so that the things that contributed to this massive failure, this tremendous disruption to families around the United States and disruption to the financial system, would not be allowed to happen again. Because the things that contributed to it, including the structure of these companies and their peculiar charter set by

Congress and not changeable by FHFA, that there was an opportunity for Congress to determine whether and how they wanted to make any changes to -- to those charters. They retained that right to themselves.

Q. Now, did the Treasury Department ever make clear to you that they had a commitment to ensure that the common shareholders did not participate in future earnings of the companies?

A. I was not aware of any such commitment by the Treasury Department.

Q. Okay. Was every proposal that they ever made to you, was one feature of it one that would eliminate the common shareholders' ability to participate in the future profits of the company?

MR. SCHWIND: Objection, vague. Every proposal to do what, with respect to what?

BY MR. THOMPSON:

Q. To enter into the third amendment.

A. I understood the discussions of the third amendment to be FHFA having things that it needed to satisfy itself that it could carry out its conservator responsibility, that the Treasury they were retained by Treasury to do a fair valuation of the stock -- senior preferred stock, and as part of that they did a sort of future profitability projection.

And my question to you, sir, was: Have you ever seen this document or the projections that are on page 6339?

MR. SCHWIND: Can we start with this document? Did you want either one, or do you want to ask him whether he's seen this document?

BY MR. THOMPSON:

Q. Yeah, have you seen the document or have you seen the projections?

A. So, Mr. Thompson, I don't recollect having seen the document or the projections.

Q. Okay. To your knowledge, did you -- did this document play a role in your decision to enter into the third amendment?

A. From my standpoint, no. Since I hadn't seen it, it couldn't have played a role.

Q. Okay. Now, between September 30, 2011 and the date of the third amendment, the housing market

had improved; is that correct?
A. During that time period there was strengthening in the housing market.
Q. And you saw that in, for example, improved earnings at the companies; is that right?
A. I believe that companies' earnings in the latter part of that period were stronger than the earlier part of that period.
Q. And when you made decisions as acting director of FHFA, did you sometimes rely on projections?
MR. SCHWIND: Objection, vague.
THE WITNESS: I served as acting director for four and a half years, more than -- around then, and I had to make a lot of decisions. So did I make particular decisions based solely on projections or principally on projections? Not that I -- not that I recall, but --
BY MR. THOMPSON:
Q. Based in part on projections, did you make any decisions?
A. Projections certainly would have informed

certain decisions in some fashion.

Q. Okay. And if you were making an important decision, and if you were considering, among many other factors, projections, would you have relied on projections that were eleven months old?

MR. SCHWIND: Again, objection, vague, calls for speculation. If you'd like to ask him about a particular decision -- he just said he made many decisions over four years.

THE WITNESS: I'm not sure what my answer would be. Is that projection the most recent available? Is it the projections based on things that haven't changed in a material way since it was done? It's a highly dependent question, Mr. Thompson. Depends on things like what I just said.

BY MR. THOMPSON:

Q. When you decided to enter into the third amendment, one of the considerations you had was your concern that the companies would not generate enough profits in the future to pay a cash dividend; isn't that right?

to conserve was how much capital support is remaining there. Because, one, I do not know how long these conservatorships are going to go on; and two, every day that these companies operated for business they're issuing new mortgage-backed securities. These mortgage-backed securities have a full life of 30 years. So an investor in the mortgage-backed securities, in undertaking the purchase of this and looking to the capital support being provided by the Treasury as the backstop on the repayment of this security, has got to look at the sufficiency of that remaining capital draw to be there for the -- for the entire 30-year life of this mortgage-backed security.

So that's what I mean by, I needed to conserve the remaining capital support. Because every day, to make sure the country had an operating secondary mortgage market, I needed to be able to issue these long-dated mortgage-backed securities with a capital push and capital support from Treasury that was going to be adequate to get us through that.

And again, as I've said, that was a driving motivation for me in the whole discussion about the PSPA, with the added understanding that the PSPA already had in it this periodic commitment fee, and I had to be thinking about the impact of both the dividend and the commitment fee on our ability to ensure that capital adequacy over the indeterminate life of the conservatorship.

Q. Did you take any steps to try to quantify what the periodic commitment fee would be in the absence of reaching the third amendment?

A. I don't recall personally looking at quantifying the periodic commitment.

Q. Did anyone at FHFA, to your knowledge, attempt to quantify what the periodic commitment fee would be in the absence of the third amendment?

A. I don't recall.

Q. Okay. And was one of the assumptions behind the net worth sweep the idea that the companies did not have the ability to do a payment in kind dividend?

A. Was that one of the considerations?

Q. Yeah.

A. No.

Q. So did you -- when you made the decision, did you assume that the companies had the ability to do a payment in kind or did you assume that the companies did not have the ability to do a payment in kind?

A. So as I'm understanding your question, the stock certificate for the senior preferred stock in the dividend section where it says, here's the dividend, 10 percent, says if the companies fail to pay that dividend in cash, then the penalty is that there's an increase in liquidation preference at 12 percent.

So there's a penalty rate assigned, there's this higher rate assigned to liquidation preference, if the company does not make the dividend payment in cash in a timely way.

So if you're asking, did we consider -- let me -- I'm not --

Q. Did you understand the companies to have the option to do a 12 percent --

A. I -- I understood that 12 percent -- and this never came up to me. Nobody ever came to me and

and for the commitment that was still available to be paid. So --

Q. Do you recall why the companies weren't allowed to pay down the commitment, you know, or for -- could the companies say, we don't want the commitment, you know, we just want to operate without it?

A. I don't recall that. That was going to be part of the discussion that took place between my predecessor and the officials at the Treasury Department at the time the initial agreement was taking place. I was not the director of the agency then, so I can't answer.

A. One other thing, of course, about this document is it references what I keep saying about the circular draws as a positive change, eliminating circular draws.

Q. Now, our next one will be DeMarco 48.

(DeMarco Exhibit No. 48 was marked for identification.)

BY MR. THOMPSON:

Q. This is FHFA 4047. This is the statement that you released on the day of the net worth sweep, correct?

A. Uh-huh. Yep.

Q. And you say about halfway through, "Replacing the current fixed dividend in the PSPAs with a variable dividend based on net worth will help to ensure stability, fully capture financial benefits for taxpayers."

Is that because all the money is going to Treasury? Is that what you meant by that?

A. Meant that I understood there had been an exchange for one set of compensation to Treasury for another one and that I understood that making this change, while it satisfied my concerns as conservator, did not diminish the benefit that the taxpayer would get, you know, in terms of the support that they had been provided. That there was both, you know, upside and downside risk because if earnings got smaller, then --

Q. What's the downside risk? I mean to the Treasury on a net basis. I don't understand.

You've said that before. Where's the

downside risk to the Treasury? The company -- explain that.

A. The companies do not have earnings, right?

Q. Yeah.

A. And they don't have to pay a dividend. And to the second amendment, if the company didn't have earnings, it still had to pay a dividend.

Q. Now, when you say "fully capture financial benefits for taxpayers," is there a fair implication of that that means there are no benefits for anyone else?

A. I don't believe this describes what benefit there may be for anyone else.

Q. Well, I'm saying, is it -- since it's fully captured by the taxpayers, would it be a fair implication that there's nothing for anyone else?

A. I think that the -- that the phrasing here is not so specific. And I would point out again, as I've previously stated with regard to the decisioning here, the things that improved the capacity of Fannie Mae and Freddie Mac to continue to operate in a sound and solvent condition for the indefinite duration of