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FCIC memo of staff interview with Adolfo Marzol

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Author/Creator

Adolfo Marzol, Kenneth B. Winer, Adrian L. Jensen, Brad Bondi, Thomas H. Stanton, Thomas Borgers, and Karen Dubas

**DRAFT
MEMORANDUM**

TO: File
FROM: Karen M. Dubas
DATE: January 29, 2010, 1:00 - 6:00 pm
RE: Memo re Interview with Adolfo Marzol

Foley
Adolfo Marzol, Kenneth B. Winer, Adrian L. Jensen

FCIC
Brad Bondi, Tom Stanton, Tom Borgers, Karen Dubas

This MFR is a paraphrasing of the dialogue and should not be quoted as a transcript.

BONDI: We'll start out with some questions, and we'd like to pass you some papers later and we'll give you a chance to look at them and talk about them with your lawyers.

We're with the Financial Crisis Inquiry Commission, formed under FERA of 2009. We were set up to investigate the causes of the financial crisis, and we have twenty-two mandates to address, including issues related to the housing bubble and institutions that failed or would have failed without government assistance. We have a public report to present to the President and Congress by December 15.

Fannie fits into several of the categories that Congress has asked us to look at. We're going to ask you some questions related to that, and we're not trying to play gotcha. If there are any question that you don't understand, please stop and ask me to explain, otherwise we'll assume that you understood. Please answer verbally and ask us to define any terms that you don't understand. We'd like to have an open dialogue with you.

We are officers of the U.S. government. You have to be truthful to us under law 18 U.S.C. 1001. Mr. Winer has probably already told you this.

MARZOL: He has.

I'll be keeping my blackberry on the table because my wife is out of town in Florida, and

I'd like to be available in case anything happens.

BONDI: Absolutely.

You spent a lot of time at Fannie, and you've seen the inside of the company. From your background, it seems like you know a lot about the company and what went wrong at Fannie that led them to their current problems.

MARZOL: It's very difficult for me to tell. I left Fannie in January 2006, and I've been gone for a number of years. I wasn't a party to or privy to the events subsequent to my departure or any of the events around the conservatorship of the company.

BONDI: Let's focus on what was going on at the company before you left. What might have led you to have concerns about risk at the company or the future of the business?

MARZOL: My recollection from 2005 was that there were a number of reasons to be concerned about the future of the company. It was the aftermath of the report by the regulator with the findings of problems with the company's accounting.

BONDI: By the regulator, do you mean OFHEO?

MARZOL: Yes, OFHEO was the regulator at that time. That report, in my recollection, caused heightened criticism of the company, and my recollection was that there was general discussion about the charter of the company, the role of the company, and the fundamental underpinnings of the housing finance system that the government wants or needs to have.

BONDI: Can you elaborate or give any examples?

MARZOL: Relative to those kinds of questions being raised about the company?

BONDI: Yes.

MARZOL: I'm not sure that I'm recalling a specific example. It was just a general sense of recollection that in the wake of the company's accounting problems, there was already controversy about the role of the company, and that seemed to be heightened.

BONDI: What about the role of the company?

MARZOL: Fannie Mae and Freddie Mac occupied a reasonably unique business model within the U.S. housing finance system because of the charters for these companies. There were only two companies with this charter—Fannie and Freddie—and they had virtually the same charter. While there are a number of unique aspects of their business model, one was that the companies made thirty-year fixed mortgages available at a good

cost to the consumer. That's my perception of the uniqueness of their business model—the ability to make the thirty-year fixed mortgage widely available.

BONDI: What were the risks that you viewed?

MARZOL: The period around 2005, maybe even back to 2004, was a very competitive period in the mortgage market for Fannie Mae. My recollection is that there were multiple dimensions to that competitiveness. Freddie had previously had a period of difficulties and seemed to be emerging from these difficulties as a revitalized competitor. Depository institutions had a strong appetite for mortgage assets, and the private label securitization market was quite strong certainly in 2005 and similarly in 2004. It was a period of meaningful competition for the business.

BONDI: What did the competition mean for the risks that faced Fannie?

MARZOL: One of the dynamics that was happening in the marketplace was that home prices had been rising, and affordability for homeowners was becoming more challenging. The competition in the market was trying to find a way to ameliorate affordability. Some of the things that the market was trying to do were reasonable, and some posed higher risk.

BONDI: What posed higher risk?

MARZOL: My recollection from 2005 was that there was an issue related to what we called "payment shock." That related to mortgage products where the initial mortgage payment is low, so the initial cost is more affordable, but there's ultimately the potential for the payment to rise years later. There's a possibility that the income of the household would not have risen enough to afford the higher payment

STANTON: Were these teaser rates?

MARZOL: My recollection in 2005 was that it wasn't isolated to the option ARM. In terms of a development in the mortgage marketplace that got my attention and gave me some concerns, the option ARM product was certainly one product.

STANTON: Did Fannie set parameters for the quality of the stuff that you were going to buy?

MARZOL: My memory on that is vague, and it may be because the option ARM came upon the market fairly quickly and caught momentum quickly. There was a period that I wasn't in a risk role—I stepped out as Chief Credit Officer and came back later as an interim Chief Risk Officer—and I'm a little vague on the origins of the ARM. In 2005, I did see that our single family business was doing the ARM, and I worked to familiarize myself with that product and became less comfortable with it.

BONDI: Can you describe the number of years that you were at each title?

MARZOL: I was Chief Credit Officer starting in the summer of 1998, the title changed to the Executive Vice President of Finance and Credit but was the same position, and I remained in that position through August of 2004. From August 2004 to January 2005, I was the Senior Vice President of Corporate Strategy. From January to October 2005, I served as the Interim Chief Risk Officer. I left the company in January 2006.

BONDI: What was the role of Chief Credit Officer at Fannie?

WINER: Are you talking about a point in time? Or are you wondering about the evolution?

MARZOL: It did evolve, and I'll give you a sense of the evolution. The different stages were roughly in two year segments: for the first two years, I reported to Frank Raines; for the second two years, I reported to Dan Mudd; and for the last two years, I reported to Tim Howard (he left in December 2004). The evolution of the position coincided with those three eras, more or less.

During the first era (Frank Raines), the Chief Credit Officer role was quite focused on the single family guarantee business, and the structure was one in which there were two major components to our credit risk management. At that time Fannie had five major regional offices that covered mortgage lenders. Each office had a Senior Vice President in charge of that office as well as its own risk staff. There was a regional Vice President of Risk and there were risk managers assigned to the lender accounts. Generally, the beginning of a decision to guarantee a pool of mortgages would start at the regional office

STANTON: What is the volume of loans that a SVP at a regional office would look at?

MARZOL: Originators would come to Fannie for one of two reasons: (1) typically for new business, the originator would want a master commitment from Fannie that for a period of time, the product that the originator was planning to originate would be sellable to Fannie (as long as it met certain specifications); (2) many originators are investors within their own right, and they wanted Fannie to consider guaranteeing some of those loans. The latter was a pool arrangement; the former was a flow.

BONDI: Did the regional office have a SVP of Risk?

MARZOL: There was a SVP of Marketing, then a VP of Risk.

Then there was a central credit team underneath me as the Chief Credit Officer. I can't remember how exactly the regional office reported up—there was some sort of matrix

management structure. When there were important policy questions about what a lender wanted, that would be escalated to the central credit group for review and decision.

BONDI: Who were the Senior Vice Presidents of Marketing at the regional offices in the summer of 1998?

MARZOL: They changed over time. To remember 1998 at this point—I wouldn't venture a guess

During the first two year increment, the framework for our single family guarantee business had the centralized risk group and the five regional offices.

Around 2000, the company made a decision to organize the company around more clearly defined business units. In that process of reorganization, the decision was made for each business unit to have its own head of business and a credit officer (probably a "business unit credit officer"). There were three major units—single family, multi-family, and the portfolio business.

BONDI: Who made the decision to switch to the business units?

MARZOL: I think it was discussed at a strategic planning session off-site. I don't recall who specifically made the decision. If I had to speculate, it was probably Frank Raines—it certainly wouldn't have been made over his objections.

STANTON: When did Frank Raines come back?

MARZOL: He returned in late 1998, and Jim Johnson handed off the reins to Frank Raines in early 1999.

BONDI: What was the reason to change the organization?

MARZOL: A number of us who had participated in those discussions had previously worked in those types of organizations. I had worked at Chase Manhattan, and that's how they were organized. It was a clear way of designing business segments, creating accountability, and designing standards that were appropriate for their unit. For a period of time, I was the credit officer for the single family business unit and Chief Credit Officer.

STANTON: Who did you report to?

MARZOL: As a business unit credit officer, I reported to Dan Mudd. He was our common boss.

STANTON: You had a clear voice to raise risk issues?

MARZOL: Yes.

Around 2000, the company organized more clearly around business units. Each unit had a credit officer that reported to me, and with my expertise in the single family business, it made sense for me to stay on as the single family credit officer. At some point, we appointed a credit officer for the single family business, and I removed my two hats and returned to only being the Chief Credit Officer. The business unit credit officers dotted line reported to me and straight line reported to the business unit head.

Around the time that my reporting relationship moved to Tim Howard in finance, my recollection is that we were trying to devolve more accountability and responsibility into the business units. The business units would not just be responsible for the revenue, but for the risks as well. There were three layers of risk: regional offices were the first set of eyes and ears, then the risk team in the business unit, and then the central risk team.

STANTON: How well did that work?

MARZOL: I recall that I was pleased with that change. It had its pros and cons—anyone who has been in a matrix management organization knows that. Overall, I was pleased with how that framework was implemented.

STANTON: To what extent at each of these levels would the voice of risk be heard against its counterpart, the voice of revenue?

MARZOL: It should function at all levels. I think that why I was pleased with the change is that before—when we didn't have the business unit credit officers—when the central risk unit said no, there was an element of "us" and "them". It's the outside risk group saying no, and there might be a sense that the central risk group doesn't understand the relationship that regional office has with the lenders.

With the business unit credit officer, when they said no, it was one of their own saying no. It was someone who was supposed to have all of the business unit's considerations in mind and still made the decision to reject it. It made the decision more legitimate.

STANTON: Were the business unit credit officers well regarded within in the business unit so they were listened to? Did they know how to say no?

MARZOL: I won't render an opinion about whether or not I was well regarded.

I do recall believing that within the risk organizations in our units, we had high quality people with a sound knowledge of the business and the risks that the company was trying to manage. My recollection is that the risk managers, particularly in the single family business, were well supported with information and risk management tools.

STANTON: What about by the head of the single family business unit?

MARZOL: I recall three heads of the single family unit:

- (1) Ann Logan, the former Chief Credit Officer of the company. Ann had a very strong credit orientation.
- (2) Lou Hoyes. When we sat down to discuss risk matters, there was rarely much difference between us. Lou Hoyes left the company around the end of 2003 or 2004 (I'm not sure of the date).
- (3) Tom Lund was the head of the single family business toward the end of my tenure. He came out of the GE mortgage insurance company and had previously been a regional SVP for Fannie. He understood the business and had a good sense for risk.

STANTON: If you had to summarize, you thought at least at this stage that the credit risk system was working pretty well?

MARZOL: When I stopped being the Chief Credit Officer, all things considered, I thought we had a pretty sound team and a reasonably sound process.

STANTON: What was the third part of the evolution of the company's organization?

MARZOL: Mostly what changed when I moved my reporting to Tim Howard (at Frank Raines's direction) was that a new risk governance framework was put in place at the company.

BONDI: Why was the reporting changed from Dan Mudd to Tim Howard?

MARZOL: At that time, Frank Raines wanted to have a more integrated view of the financial risks of the company. He was considering credit risk as a financial risk, and he really wanted to have Tim Howard be the Chief Risk Officer of the company. Tim Howard already had oversight of the portfolio business.

BONDI: What year was this?

MARZOL: Probably between the summer and the end of 2002.

STANTON: Did you read OFHEO's supplementary report of 2006 about Tim Howard's role?

MARZOL: I don't recall reading it.

STANTON: One issue they raised was Tim Howard's huge spectrum of responsibility—that he was essentially functioning as a Chief Risk Officer.

MARZOL: My recollection is that I had mixed feelings about how well that change worked. On the positive side, I've always been a finance person. Being with the finance team meant that I was with more kindred spirits, and I believe it fostered improved dialogue about how interest rate risk and credit risk might interplay with one another.

On the other hand, Tim Howard did have quite a broad spectrum of responsibilities. He was a very hard working man, but there could be times that you had to manage when you could engage him because he had other matters on his plate.

STANTON: So he was sensitive to risk if someone brought it to him, but he had a number of issues to contend with?

MARZOL: I never felt that he was insensitive.

There were two themes throughout the evolution of the Chief Credit Officer role: (1) there was a change in reporting relationships, and (2) there was a change from a more classically centralized risk function to one that delegates more responsibility to business units and business risk officers.

STANTON: Where was Rob Levin in all of this?

MARZOL: During what time period? He moved around. In 2004 he was the Executive Vice President of the Housing and Community Development division.

STANTON: Did he interface with risk management at all?

MARZOL: He would only have interfaced with risk management if it was a risk generating activity.

STANTON: So he wasn't worried about HUD housing goals?

MARZOL: He would have been because achievement and fulfillment of housing goals were a focus. But if it were a single family loan, it would have flowed through the single family business unit.

STANTON: In terms of their compliance with the housing goals, would Fannie go out and buy stuff and then at the end of the year would figure out how much they had complied? Or would they sit down at the beginning of year and set filters for how much of what type of loan they needed to get? Was it actively managed throughout the year, or was it counted up at the end of year?

MARZOL: I would categorize it more as something that was actively managed. At the beginning of the year, there would be projections done about business volumes, what mix

of business was likely in the year ahead, and how that would impact affordable housing goals. To the extent that the projections suggested that Fannie wouldn't achieve affordable housing goals, mitigating efforts would then be considered.

STANTON: What about private label securities?

MARZOL: My sense would be that this was before 2004?

STANTON: Because of how housing requirements were structured, that would have counted toward affordable housing goals?

MARZOL: There was a different risk management process in place for private label securities.

STANTON: Was the requirement AAA?

MARZOL: It evolved. The company had participated in the manufactured housing market by buying manufactured housing securities, so that had been a learning experience for us. Coming out of that we did a "lessons learned" exercise and tried to work toward enhancing our risk management practices.

STANTON: The manufactured housing experience? Can you elaborate?

MARZOL: I'll give you a little bit of history. The company had done a lot of analysis on the manufactured housing market. It was serving a lot of low- and moderate-income (LMI) people. Given the mission of the company, it made sense to look into manufactured housing. There were discussions that the company should participate directly in manufactured housing (MH) and guarantee MH loans that are not real estate—making a loan against a property where there is no real estate. A risk management decision was made not to participate in that. The senior management at the time concluded that it was still a market that the company wanted to participate in and learn about, and that it would limit its participation to buying AA and AAA securities. It was a way to participate in the market while staying at a very senior position in the credit risk for the underlying loans.

STANTON: What were the lessons learned?

MARZOL: I don't recall all of them, but some stayed ingrained in my memory. One was that rating agencies made a mistake with the servicing fee of the manufactured housing securities. The servicing fee—which generally should be one of the first things that gets paid so the servicer has an economic incentive to continue to pay the loans well—was at the bottom of the cash flow waterfall. In the deals that were brought to the market, when the performance of the security deteriorated and there were cash flow problems, the servicers' income became restricted at exactly the wrong time. There were lessons

learned about the structure of the security, and we wanted to try to make sure that the issue related to the fees didn't get repeated.

STANTON: What was the name of the lessons learned report?

MARZOL: Ask whomever you've been asking for the "Manufactured Housing Lessons Learned." In all likelihood it was from 2003 and 2004.

STANTON: Did it make you wary of rating agencies?

MARZOL: No, the general conclusion was that we should strive to complement a rating with our own ability to model the structure and do due diligence. We should build the capabilities to do our homework more directly.

STANTON: Were you working in the business unit or on the risk side to build the capability?

MARZOL: The capabilities were being built in more than one place inside the company. At some point a team was formed to develop the ability to model private label securities. I don't recall exactly where team was located.

STANTON: Roughly when was this?

MARZOL: I think around 2004, but that could be off.

BONDI: Were you a member of it?

MARZOL: No, but I would have been aware of the team and helping to champion it.

STANTON: Who led the team? What part of the business would they have been in?

MARZOL: Initially, they may have been located in the central risk group. At some point, they may have moved to portfolio business, but I'm not 100% confident in that.

BONDI: Do you have any names of members of the group?

MARZOL: Kieren Gifford (male).

BONDI: Is he still with company? Where is he now?

MARZOL: He left the company. I believe he works at Freddie Mac now.

Another name is Kent Willard.

BONDI: Is he still at Fannie?

MARZOL: He's not at Fannie—I think he's doing consulting work now.

BONDI: Can you remember anyone else?

MARZOL: There are probably other people, but those are the only names that I can recall.

STANTON: You left the company in early 2006. After the manufactured housing experience, they had put this team together to rate private label securities. Did that team continue throughout your time there?

MARZOL: Your presumption is a step ahead of how far that effort got. The team started being able to model cash-flow structures of the securities and—as I recall probably from sometime at end of 2005—was still working on building some of the default and prepayment models, particularly for subprime.

STANTON: So it still hadn't gotten off the ground?

MARZOL: There were some insights being generated. But wasn't at the point of independent confirmation for the rating of a bond.

STANTON: Did they do a rudimentary analysis of every bond, or were they still trying to build a more sophisticated model?

MARZOL: There was some analysis with looking at prepayment and loss curves, modeling bond structure, and starting assess some of the scenarios that would stress the bond. But we had not yet achieved the confidence level that we had a subprime and default model that we could rely upon.

STANTON: Had they figured out how to model subprime and nontraditional mortgages?

MARZOL: I would put subprime in a different category because of the number of unique characteristics in the subprime market.

BONDI: I've seen figures where Fannie's purchases of subprime significantly increased over the years. Would it be a safe assumption to say that they increased from 1998 through January 2006?

MARZOL: That's a difficult question to answer because there are many competing definitions of subprime. Depending on what definition that someone may or may not want to use, the answer to your question could be yes or no.

STANTON: Did the company have a definition of subprime?

MARZOL: I had my own definition of subprime, but it may not have been a uniformly accepted definition of subprime.

STANTON: You would have used this definition in terms of your work?

MARZOL: My view about subprime was that it related both to a class of specialty originators who focused on marketing and selling subprime loans, as well as a certain set of product features including the credit quality of the borrower and the origination practices from the lender that differed from Fannie's origination. The industry was generally recognized as subprime, and it reached borrowers that we may not have reached with loan products that were structured differently. I didn't define subprime loans solely by the borrower.

STANTON: So you can't just reach for a FICO score?

MARZOL: That was not how I thought about it.

BORGERS: What was the FICO score that you would have included in the model?

MARZOL: I would not have defined subprime just by virtue of FICO score. I'm not following your question.

STANTON: You mentioned the matrix of what aspects you would have considered as a part of a subprime loan. When you looked at the borrower piece, did you have a FICO range or score in mind that would have contributed to a subprime label?

MARZOL: The result of the matrix was that when you looked at a subprime security, there was a range of FICO scores, but I can't recall what that range was.

STANTON: Let's talk about mortgages. There was some talk that Fannie was going to originate some subprime or nontraditional mortgages. How was that interpreted?

MARZOL: I'm not sure I follow your question completely. It was a big portfolio with a large breadth of market that Fannie's guarantee program covered.

[BREAK at 2:15]

STANTON: Let's go to subprime. Fannie did enter subprime market and bought mortgages that had characteristics that were different from prime. How did Fannie deal with the different kinds of risk of these mortgages?

MARZOL: I'm going to make a presumption relative to your question—that you're

asking about Expanded Approval and Timely Payment Rewards (a Fannie product line). I didn't think of this product line as subprime, per se, but it was a higher risk and lower FICO initiative. To give that initiative some context—this is going back before my time as Chief Credit Officer—Fannie didn't use to collect FICO scores. My understanding is that in doing research, the company discovered that under its traditional underwriting guidelines, a meaningful number of lower FICO loans were being sold to and guaranteed by the company, and a disproportionate share of defaults came from these lower FICO scores. So there became an awareness about the importance of FICO as a part of the credit analysis.

At that time, Fannie had difficulty doing risk-based pricing—it was not a well accepted market practice. There was a phase in the evolution of the company—risk is about the trade-off between risk and reward, and we couldn't restrict it—that Fannie looked to try to restrict the number of FICO loans. This was probably the mid-90s, around the time of automated underwriting. It was maybe in second or third iteration of automated underwriting that FICO scores came to be more important.

Even with automated underwriting, Fannie learned that a significant number of low FICO loans were still being sold to us at normal prices. When risk-based prices came to be more accepted, Fannie still accepted the lower FICO loans, but not at a standard guarantee fee—they charged a higher and more appropriate guarantee fee. They offered a couple of levels of expanded guidelines and risk-based pricing. That puts the initiative into context.

This was also an initiative to see if we could serve the borrowers that were ending up in the subprime market with a better product at a better price, with a fixed rate instead of an adjustable rate. It was a better end-value proposition.

STANTON: Did they start applying FICO scores only at origination, or did they go back and reevaluate old loans for FICO scores?

MARZOL: I think there was some looking at FICO scores over the life of the loan. But researchers found that very quickly the payment history on the loan was just as informative as a FICO score, and you have to pay to get a FICO score.

STANTON: So when Fannie went in and applied FICO scores, they discovered that they had been buying higher risk loans. For some loans you can't price against the risk—you need to have a threshold. Did they have a hard stop on certain types of loans and put this into requirements for originators?

MARZOL: There were two different models at work—maybe three—with the expanded approval program:

1. Lenders who use Desktop Underwriter and are in the Expanded Approval program: They can say yes to more loans at a higher guarantee fee. There is a hard stop in those programs.
2. Lenders who use Desktop Underwriter who did not use the Expanded Approval program: They operated under a framework in which we would say yes to 70% of borrowers who came into payment system. They had to look at the other 30% of loans and decide whether they would meet Fannie's underwriting guidelines. If they sell any of those 30% of loans to Fannie, they take responsibility for loans—they assume risk and have recourse.
3. Lenders who are still doing business the traditional way: They engage in manual underwriting under Fannie's guidelines.

That structure existed until I left Fannie Mae, as far as I know. The utilization of Desktop Underwriter peaked around 50-60% in my last few years at the company. I'm not sure of the exact timing.

STANTON: Fannie Mae in 2006 was buying a lot of Alt-A loans, including low- and no-doc loans, interest-only, etc. Were they taking these in while you were still there? What risk framework did you build?

MARZOL: We were doing some of these while I was there. My recollection dates back to 1997, and we were having discussions and engagement back then about Fannie's involvement in Alt-A.

Our risk framework for Alt-A included a number of different elements, including defining parameters within the market to determine what parts we were willing to guarantee and monitoring performance. My recollection is that there was the use of supplemental credit enhancement—primarily mortgage insurance to protect the company in case of defaults. One more important element was that I tried not to give Alt-A lenders meaningful forward commitments. I was not committing the company to doing business for lengthy periods in the future, so if Fannie became uncomfortable, it would be relatively easy to shut off the business.

STANTON: We were in a well-known housing bubble. Did Fannie alter its credit standards to reflect this?

MARZOL: For some of us, bubbles are more readily recognized after the fact than during. Hindsight is 20/20 relative to bubbles.

Home prices were monitored at the company. Through around 2003, give or take a year, the perspective was that a good part of home price appreciation was reasonable. There had been a period of very slow home price growth in the early 1990s, and then there had been a catch-up. In late 2004 and 2005, particularly in the western regions, I recollect that home prices were pretty strong, and that was something that you had to have a risk

awareness of. As I recall in 2005, the market was evolving very quickly, products were evolving, the option ARM was becoming very popular, and the company's posture was to not chase the market. The company was losing market share (in 2004 and 2005) as the market was changing to option ARM and adjustable rate mortgages.

STANTON: The House Oversight and Government Affairs Committee held a hearing, and you emerged looking pretty good. It came out that in 2004-2005, you were alerting people of risk.

MARZOL: I never spoke to the Committee and I don't speak to the press, so anything you hear is conjecture, it's not something that I've said.

I have a couple of thoughts. Residential mortgages are all that Fannie does. We're not a diversified company. So from my perspective the whole management team lives and breathes with the development of the residential housing marketplace. I consider risk awareness to be part of my responsibility and part of the job. Risk awareness is making sure that you're being a contributor to "Are we aware of the external environment? Do we see the trends around us?" I viewed my role as fostering a risk-aware environment and making sure that the best information that we have is relayed to the management team.

BONDI: You said that people don't recognize bubbles as they grow. I see from your biography that you have twenty-five years of experience in the industry. I assume that you keep up with the mortgage market and read the press. Now that the bubble is behind us and you have the opportunity to reflect on your time at Fannie, if you could go back in time, what would you recommend that Fannie should do differently in 2005?

MARZOL: I think to some degree that's an unfair question. The answer is that I'd reject every loan that I now know went bad. It becomes such a hypothetical that I don't know what substance the answer gives you.

BONDI: Are there business lines or types of mortgages or lenders that you wouldn't do business with? Are there types of products or different modeling that you would do? How would you approach it?

MARZOL: I have a couple of thoughts. One relates to raising more capital and having the company be more strongly capitalized.

STANTON: Would that apply to pricing and reserving more capital against mortgages as they come in?

MARZOL: That's a good question, and there were discussions about that at Fannie. To what extent should pricing reflect the current market versus a more neutral long-term view? We took a neutral view because the risk is that while the market is strong, you

lower prices, and that in a negative trend, you'll have to jack up prices. We decided it would be better to have a more stable price scheme and that you would change credit standards during bad parts of the economy.

When I left Fannie, I thought that it was well-positioned. I thought that the bulk of the business was in pretty good shape. The company was not chasing the marketplace, which was evolving into products and risks that I had concerns about. The higher risk segments of the business were intentionally set up so that they could be turned off very quickly. That was very important to me as a Chief Credit Officer, because I thought that for Fannie it would be difficult to move quickly on credit parameters in advance of a downturn in the housing market. The most effective strategy would be to respond immediately to objective evidence.

STANTON: Did you have a financial warning system that would warn you early if the market was changing?

MARZOL: The research group had a pretty robust monitoring system, which included looking at delinquencies?

STANTON: Who was in charge of that?

MARZOL: It was in the Credit Research and Modeling Group. Parts of group would have been headed by Eric Rosenblatt, and Christian Deritis did some of the early performance modeling monitoring.

STANTON: Were there other systems to give you an early alert?

MARZOL: There was portfolio monitoring information. An early warning was early delinquency reports. Even the most timely home price information came in on lagged basis.

STANTON: Did you know the loan-to-value ratios to the extent that a property was leveraged between the first mortgage, the second mortgage, and a home-equity line of credit?

MARZOL: Maybe. For a newly originated mortgage, we were supposed to know. The lender was supposed to report if there was a second lien against the property.

STANTON: Except if it was a low- or no-doc loan?

MARZOL: No... I think we were made aware of the existence of second lien. But once a mortgage seasons, if the owner goes and takes out a second lien or HELOC, we would not know that.

BONDI: We're trying to understand the causes of the financial crisis and hopefully help avert crises in the future. Assume that Fannie leaves conservatorship and is back in business and that you were to return to Fannie Mae. How would you run Fannie's business overall if you were to be CEO? Is there anything that you would do differently?

MARZOL: The one thing I'd have liked to have seen the company do differently is that I think we could have dealt better with some situations from a credit perspective. When we needed to do transactions to meet housing goals (goals were both external and internal, included minority lending and affordable housing goals), the framework for making those tradeoffs and the process for approving the unique transactions that might have needed to be done to achieve those goals could have been done better. I don't think it put the company at risk, but could have been done better.

The concern that I had was that from a risk-management perspective in a good, well-run organization, a risk person should approve transactions. What do you do in a situation where a risk person wouldn't usually do this transaction, but there's a greater good and a greater corporate goal (including meeting a congressional housing goal) to consider? In the least risky way possible, it should be done.

STANTON: Did Fannie seek out the least risky way of achieving the goal?

MARZOL: I tend to think the answer is yes. There were mechanisms from our leaders to strive for the least costly, least risky ways to achieve these goals.

But when we are in that space of looking at unique transactions, who should sign off on them? Perhaps we shouldn't ask the risk people to sign off? These transactions could go in a different category: "Higher than our normally accepted risk, but for the greater good of our housing goals."

BONDI: If you did not have affordable housing goals, were there transactions that you as Chief Risk Officer would not have approved?

MARZOL: Yes, I think there were some.

BONDI: Which ones?

MARZOL: Relative to affordable housing goals, I don't have a specific recollection of a transaction. I just remember working with the risk team and feeling that they felt some negative impact on the risk culture because we asked risk managers to sign off on a transaction that from a risk perspective they wouldn't normally do.

STANTON: What was the time period for this?

MARZOL: I'm not sure of a specific time period... maybe 2001-2003. The company did

a lot of very high quality refinance business at that time, which is not very goals-rich business. One or two of those years were years in which meeting the affordable housing goals was something of a challenge.

STANTON: Going back to the “Manufactured Housing Lessons Learned,” would there have been other “Lessons Learned” documents during your time there for other issues?

MARZOL: I don’t recall another.

STANTON: Do you have a copy of the “Manufactured Housing: Lessons Learned” document?

MARZOL: Every document that I’ve had, I’ve turned over to Fannie. I had business documents on my personal computer from working at home. Soft copies of all of the documents have been made available to the company.

BONDI: We’ll follow up with Ken later. Let’s talk for a few more minutes, and then we’ll give you some documents to look over.

Let’s go back to the overall picture for affordable housing goals—both internal goals and goals set by Congress. Were there any deals with any particular lenders that posed a significant risk to Fannie Mae?

WINER: A risk of failing, or a risk of losing money?

BONDI: If you didn’t have the goals, were there any transactions with any lender that you wouldn’t have done?

MARZOL: There was a new product that was introduced to help the company improve its minority lending results that I didn’t support, but that the company decided to move forward with.

BONDI: What was the name, and when did it happen?

MARZOL: It was called the Minority Lending Initiative (MLI). I can’t recall when it was introduced. Possibly in the early 2000s, but I’m really not sure

BONDI: Did Fannie ever stop that initiative?

MARZOL: It was stopped, but I can’t recall when it started, and I can’t recall when it stopped. I think I was the Chief Credit Officer.

BONDI: Who was involved in the decision to stop it?

MARZOL: It included Tim Howard, Lou Hoyes, myself, and Peter Nicolescu (to the best of my recollection).

BONDI: Was this product with a particular lender? Help me to understand it.

MARZOL: My recollection is pretty vague—I think that there was at least one key lending partner that originated the product for sale to Fannie Mae. I think the name of that lender was Resource Bank Share or something like that.

BONDI: What was the volume?

MARZOL: In context, I would say the volume was small.

BONDI: Any ballpark guess of the dollar amount or % of originations?

MARZOL: I don't want to venture a guess.

BONDI: We've received some organizational charts from the company. I'd like to ask you a few questions about them.

[Document produced: org chart from January 26, 2004]

You are listed as the Executive Vice President for Finance and Credit with a line to Tim Howard. Under you is a Senior Vice President for Policy and Standards Bob Engelstad. Where is he now?

MARZOL: I think he's doing mortgage consulting of some sort. I believe in the DC area.

BONDI: What was his job?

MARZOL: He was the SVP responsible for credit policies and our credit governance processes.

BONDI: Under him is Joe Biegel, the VP for Credit Policy.

MARZOL: I think he is a financial planner. I think he moved from DC, but I'm not sure where.

BONDI: If you have contact information for anyone, let Ken know, and I'll follow up with him later.

MARZOL: I'd like to talk about that with Ken.

BONDI: Great, we'll follow up. What about the VP for New Product Credit Risk

Management, Susan Holik?

MARZOL: I don't know where she is, or if she's still with company. She was the point person for working with business units being considered or developed.

Kathy Rock may work at Freddie Mac now.

BONDI: What about the VP for Strategy & Credit Analysis?

MARZOL: Hal Gann—I think he lives in the DC area, but I don't know what he does professionally. The company had a small group that did corporate strategy work assisting the management group in developing strategy. There was another group inside that area which did market and competitor analysis.

BONDI: Would Mr. Gann have provided reports to you on competitors?

MARZOL: Yes.

BONDI: How would that report relate to you? How would you use it? What was the purpose in you getting it?

MARZOL: It was a way of being aware of the competitive environment and understanding what Freddie, banks, and thrifts might be doing.

BONDI: What about the VP for _____?

MARZOL: Gary Friend. I don't know where he is.

Barbara Ryan. I think she works at the FDIC.

BONDI: SVP for Credit Portfolio was vacant in this org chart. Was that ultimately filled?

MARZOL: I don't recall.

Carlos Perez: Still works at Fannie.

Darren Thompson: He is not with the company, and I don't know where he lives.

Kathryn Holliday. She left Fannie. I think she works in New York now.

Kieren Gifford still works at Freddie.

Eric Rosenblatt is still at Fannie Mae.

[DECEMBER 24, 2004 Org Chart]

What was the SVP for Corporate Strategy position that you held on this chart?

MARZOL: I was responsible for helping the management team set corporate strategy for the organization as well as analysis of the competition and the overall market place.

BONDI: Who were the primary competitors?

MARZOL: They were different in different businesses. For the single family guarantee business, the top competitors probably were Freddie Mac, banks and thrifts, private label securitization (Wall Street Firms), REITs, FHA, and Ginnie Mae. In the portfolio business, it would be Freddie Mac and every investor around the world that wants an MBS.

BONDI: The VPs for Corporate Strategy are the same Friend and Ryan as on the other org chart?

MARZOL: Yes.

BONDI: I have a broad question: while you were SVP for Corp Strategy, how did Countrywide fit into Fannie's corporate strategy?

MARZOL: Countrywide was, at that time, an important customer to Fannie. Fannie can't originate, so it has to deal with a third party originator. Thinking strategically, within the broader marketplace, there was consolidation happening. A small group of lenders was becoming fairly large in terms of the percentage of the market that they represented. That brought strategic positives and negatives for Fannie.

BONDI: Did Fannie Mae view Countrywide as a prime or subprime lender?

MARZOL: I would have viewed Countrywide as principally a prime lender that had a subprime origination arm.

BONDI: How did Fannie classify the loans that it purchased from Countrywide? In other words, did Fannie classify loans from Countrywide as subprime, as prime, or did it depend? And if it depended, what did it depend on?

WINER: Classify how?

BONDI: Internally.

MARZOL: I don't think we would have had a classification. To the best of my recollection, a normal guarantee business was defined around the lender. It was defined

around what we thought the product was.

BONDI: You would look behind each individual loan, and then classify it as subprime or prime?

MARZOL: First we would try to report on loans by objective facts: FICO score, LTV ratio, and the purpose of the transaction. Then we might do further classifications of loans to the extent that we think it could fit in as a part of a program. Is it a community lending program, Expanded Approval and Timely Payment Rewards, or another marketing program? It's a big portfolio and there are a lot of ways to sort through it.

BORGERS: They had the ability to break it down by FICO score?

MARZOL: We tried to get FICO scores pretty consistently on a fairly high percentage of loans, especially in 2004-2005.

BONDI: If you were to define subprime as FICO scores under 620 (industry standard) or under 660 (government standard), roughly what percentage of these type of loans were purchased from Countrywide by Fannie Mae from 2004 through when you left in 2006?

MARZOL: I don't have a recollection.

BONDI: How would I be able to get that information?

MARZOL: Ask Fannie for breakdowns of new business by FICO score, by year, and by lender.

BONDI: What risks did Countrywide pose as a lender to Fannie Mae?

MARZOL: One of the risks that Countrywide posed as a lender was that Countrywide was the largest servicer of mortgage loans for Fannie. Had there been a material problem in Countrywide's servicing operation that would be a risk for Fannie.

BONDI: Did you have any interaction with individuals from Countrywide?

MARZOL: On a couple of occasions, I have a recollection of having an interaction with Angelo Mozilo and Kevin Bartlett.

BONDI: What were the occasions with Mozilo?

MARZOL: My contact with Mozilo was when Fannie invited Mozilo to be a speaker at a management meeting. I had a drink with Mozilo the night before the speech, and I sat through his remarks the next morning.

BONDI: What was the time period?

MARZOL: I don't recall. 2004 or earlier.

BONDI: Any other interactions with Mozilo? Meetings, phone, email, letters?

MARZOL: I don't recall another interaction with Mozilo.

Kevin Bartlett ran the secondary marketing function for Countrywide at the time I interacted with him. I don't recall the time frame. The context of the interaction was that Countrywide was looking to improve its equity value and was potentially considering a sale of the company. The company asked me to go out to California, meet with Bartlett, and see if there were ways that Fannie could be helpful to Countrywide to enhance their shareholder's perception of value. Countrywide wanted to enhance their stock price and they felt that market didn't recognize their value. This was in the early 2000s.

BONDI: Who accompanied you?

MARZOL: I don't recall.

BONDI: There has been much speculation about what motivated Fannie to purchase subprime mortgages (defining as FICO scores <660 or <620). Purchasing is like providing a credit guarantee. What was the motivation for entering subprime space? Some say that it was an effort to meet housing goals; others say that it was an effort to compete; and others say that it was a combination of both. What do you think?

MARZOL: Defining subprime the way that you do, I would submit that Fannie has always serviced that portion of the market. There was no entry or exit point. We didn't always have FICO scores to call the loans subprime, but they still probably had the same characteristics.

I don't think of Fannie's guarantee business as having been active in subprime mortgages. We were active in subprime in that the company purchased AAA securities with subprime as collateral

BONDI: What motivated the purchase of those securities?

MARZOL: The purpose of the purchase was twofold: (1) profitability—the spreads on those securities were seen as attractive investments for the mortgage portfolio business, and (2) the securities were helpful toward the achievement of housing goals.

BONDI: Explain how purchasing those securities helped achieve affordable-housing goals.

MARZOL: If the company was able to obtain the loan level information on those loans, they could count toward the achievement of affordable housing goals.

BONDI: Was the motivation during a particular time period more oriented toward achieving affordable housing than profitability? Did it change over time?

MARZOL: It might have, but I don't have a clear recollection of a particular change at a certain point in time. I don't know that at a particular point in time one goal was stronger than another.

BONDI: From 1995-2005, the affordable-housing goals of Fannie changed, right?

MARZOL: To the best of my recollection, they did go up. There was some change in the composition, but that's not my area of expertise.

BONDI: Did this change in affordable housing goals, did that increase the overall risk portfolio of the company? Or rather, did Fannie's efforts to meet the changes in the affordable housing goals from 1995-2005, did those efforts increase risk?

WINER: Holding all else constant?

MARZOL: Is it my recollection that the percentage of affordable housing increased?

BONDI: Did the efforts by the company to meet these goals increase the risk portfolio of Fannie?

MARZOL: To some degree. If the company had only been a profit maximizer and had not been required to meet certain goals or set for itself certain affordable housing goals, I think that there are some higher risk loans that the company may not have participated in. On the other hand, a lot of those loans were low down-payment mtgs. One of the most significant barriers to home ownership was high down-payments. When the company did low down-payment mortgages, the charter required the company to credit enhance those mortgages. It was quite common to have significant credit insurance. It was also common for borrower to take some of the credit risk. But there was significant risk mitigation going the other direction.

BONDI: We're trying to investigate what happened at Fannie. What led Fannie to come under conservatorship of the U.S. government? I know I asked you earlier what you thought went wrong, and you said that a lot of things happened after you left the company. Do you have any theories about what went wrong that led to the conservatorship?

MARZOL: I have a perspective rather than a theory. The U.S. housing market saw a decline in home prices of a magnitude that was virtually unimaginable and historically

unprecedented. That decline has had wide ramifications in the company. I'm not aware of a significant player in the mortgage market that has not suffered significantly from this drop. By virtue of being a monoline entity whose only business line was in mortgages, it would be very difficult to imagine that home prices could suffer as they have, and that monoline entities would not be under significant distress.

BONDI: So you would say that you don't have any theories as to anything that Fannie Mae itself could have done better or differently that might have minimized the economic impact of the situation on Fannie.

MARZOL: I have two perspectives:

1. The first is somewhat firsthand, based on my experience from having been active in the mortgage market around 2007 while I was doing some consulting work. My perception is that Fannie and Freddie were somewhat slow to react to the changes in mortgage market conditions. Potentially a faster reaction might have had some impact on the margin.
2. The second is very much based off of what I read in the press. I've read in the media that late in the cycle Fannie might have expanded its participation in higher risk segments of the marketplace—there should be some data to support this. How much this would have contributed to their problems, I'm not sure.

[BREAK AT 3:50; RESUME AT 4:15]

BONDI: Ken, is it your relative "Winer" that came in and replaced Marzol?

WINER: Yes, he's my brother.

BONDI: Have you ever given a deposition or any interviews under oath during your time at Fannie Mae.

MARZOL: I was deposed by OFHEO in relation to their investigation of _____. It was in the spring of 2006 after I had left Fannie.

BONDI: Did they provide you or your attorney with a copy of the deposition?

WINER: I've seen a copy.

MARZOL: I was asked questions in relation to a class action derivatives lawsuit in the summer of 2008.

BONDI: Who asked the questions?

WINER: It was a deposition, I don't recall seeing that.

BONDI: Were you ever interviewed like this in relation to your work at Fannie?

MARZOL: Yes. The Fannie Mae board hired Paul Weiss to do an investigation and I was interviewed in the course of that. It was probably in 2005 after the report of accounting problems by the regulator. It was a very wide range of subject matter.

BONDI: When was your first day at the company?

MARZOL: I worked at Fannie from the beginning of February 1996 until the middle of January 2006.

BONDI: Did you resign?

MARZOL: I don't recall whether technically it was categorized as a resignation. I made a decision to leave the company.

BONDI: Did someone ask you to leave the company?

MARZOL: No. There was a legal agreement that the regulator required between the company and the departing employee with a certain legal characterization. I left because I wanted to leave.

BONDI: Did anyone suggest that it was time for you to leave, time for you to move on, etc?

MARZOL: No.

BONDI: Why did you decide to leave the company? You were there for ten years.

MARZOL: I want to give you some context. [REDACTED]

36 CFR 1256.56 - Privacy

BONDI: If you'd rather not go into this, you can just say that it was a family situation.

MARZOL: No, I think it's important to explain. [REDACTED]

36 CFR 1256.56 - Privacy

[REDACTED] I was offered a smaller and less demanding role, and I thought that was a generous offer.

Then the regulatory report came out for Fannie Mae, and it lead to the CEO and CFO

leaving. The company was in a difficult situation. The board had to appoint an interim CEO, CFO, and CRO, and they asked that I serve as an interim Chief Risk Officer. I felt duty bound to do that, but I got a commitment from the board and Dan Mudd to fill the CRO position quickly.

36 CFR 1256.56 - Privacy

I asked Mudd to hire a CRO or choose a new interim CRO, because I needed to focus on my family.

BONDI: I appreciate you giving that detail.

MARZOL: I've told it enough times that I don't mind telling it.

BONDI: Before I get into the documents that I gave you to review, I want to give you a 1999 newspaper article. Flip to the second page and look at the second full paragraph.

[Quote from the document about "moving into significant areas of risk..."]

This seems to be referring to a pilot program involving twenty-four banks and fifteen markets. Are you familiar with this program?

MARZOL: From reading this, this appears to refer to our Timely Payment Rewards mortgage program, which I referred to earlier.

BONDI: Were there any studies or analyses of this program that were done internally? Something similar to the Manufactured Housing Lessons Learned report?

MARZOL: I don't know that I want to categorize this report as similar, because the contexts were different, but there was ongoing assessment and analysis of this product and program.

This product had higher delinquency rates and generated much higher guarantee fees than our more traditional business. My recollection was that it had higher delinquencies, but I don't recall having material credit losses coming from this book.

BONDI: Did this book continue or did it end? It was a pilot program. What happened to it?

MARZOL: It was rolled out as a pilot and expanded to more lenders. I would think that the program continues to this day.

BONDI: Was this program rolled out in an effort to meet affordable housing goals?

MARZOL: My recollection is that this program met a lot of goals. It helped with market share and contributed service to our lenders. It was perceived as profitably priced for the risks involved, and it helped penetrate minority (and maybe LMI) borrowers. A further goal of this was to see if Fannie could bring a better product to borrowers who were being serviced with adjustable rate subprime.

BONDI: What about this quote: "In moving, even tentatively, Fannie Mae is taking significantly more risk, which... may run into trouble in the economic downturn... Similar to the S&Ls."

Do you agree with those two sentences?

MARZOL: I don't agree with them. Some of the business in this program is business that was being sold to Fannie Mae previously, and the program gave Fannie the opportunity to price it more fairly. Some of this business had deep-cover mortgage insurance, and some we bought lots of mortgage insurance for. This commentary is excessive.

BORGERS: What mortgage insurance?

MARZOL: It was borrower-paid mortgage insurance, and it included all of the mortgage insurance companies (PMI, MGIC, Radian, etc).

BONDI: Did you consistently buy insurance, or was it scaled back?

MARZOL: The borrower-paid insurance was consistent. The supplemental insurance we bought for a period of time, and then for various reasons we felt like we could use our credit enhancement money differently.

BONDI: Did the lending under this program get riskier at all?

MARZOL: I think there were changes to the composition of the loans that went into this program, but I don't recall if they were riskier.

BONDI: Who would be the best person to ask about this program? How it operated, its default rates, etc?

MARZOL: In the credit department it would be Bob Engelstad and Eric Rosenblatt, and in the single-family unit it was Bob Sandbourne and Hope Evans.

BONDI: Are they all former employees?

MARZOL: Rosenblatt is still there, but I don't know about the other three.

BONDI: Were you involved in any of the interactions with Congress or HUD with respect to affordable housing goals?

MARZOL: What do you mean by “involved with”?

BONDI: Affordable housing goals were revised, and there are some reports that Fannie objected to some of the increases in percentages. Were you involved in any of the objections to the increased goals? Did you ever meet with members of Congress or members of HUD?

MARZOL: I don't recall meeting with members of Congress nor with HUD on these topics. Generally for matters related to housing goals, the company had a team of internal experts on housing goals since there's some arcanery on the way things are scored or measured. Most of those experts are in the Housing and Community Development part of the company.

BONDI: Were you consulted with respect to the risk associated with any proposals to increase affordable housing goals? Did someone come to you about whether newly proposed or recently enacted goals proposed any additional risk to Fannie?

MARZOL: It's certainly possible, but I don't remember members of my staff being asked to do any analysis. My recollection of my own involvement is very limited; I had awareness as a senior manager that goals were going to be changed. The company wanted to have goals that could be reasonably achieved given market conditions.

BONDI: Would you have prepared any memos relating to the risk of proposed or recently decided goals?

MARZOL: I might have, but I don't recall one specifically.

BONDI: If you had done a memo, who would it have gone to?

MARZOL: That's too speculative to guess—it depends on what the purpose of the memo was.

BONDI: Was Frank Raines responsive to your concerns in respect to risk?

MARZOL: My recollection was that when I started as Chief Credit Officer and reported to Frank Raines for two years, on a number of occasions Raines said to me that most financial institutions get in trouble because of credit risk. He had awareness of and sensitivity to credit risk.

BONDI: What about Dan Mudd?

MARZOL: I reported to Dan for two years. When he started with the company, Dan Mudd did not really have a mortgage background. At first our interactions around risk were a little less than ideal, but I attribute that to his not coming from a mortgage background. He said that the nature of risk management at Fannie Mae proved to be different than the nature of risk management at GE.

BONDI: What about Tim Howard?

MARZOL: I don't recall a meaningful instance in which I wanted to raise a risk matter with Tim Howard and I felt that he was unresponsive.

[B Bondi shows DOCUMENT #1]

BONDI: Do you recognize what appears to be a memo from you to Dan Mudd in September 2004? Is that your signature? Did you write this?

MARZOL: I don't remember writing it, but I would presume the cover memo was written by me.

BONDI: The cover memo refers to "SLT."

MARZOL: That's the Senior Leadership Team.

BONDI: Look at the 16-month outlook (the attachment to the memo). Did you help draft or develop this document?

MARZOL: I don't recall.

BONDI: Who is the "we" in the outlook?

MARZOL: I'd speculate that it's the corporate strategy staff.

BONDI: Does Frank refer to Frank Raines?

MARZOL: I'd guess it would be Frank Raines.

BONDI: In the 16-month outlook, the Wild Cards section refers to "significant changes in HUD rules that could change our allocation of credit."

MARZOL: My recollection is that these goals are percentages, with both a numerator and a denominator. There are two ways to meet goals, and here—I remember discussions of credit allocation and of shutting off business that doesn't fulfill the goal in the denominator of the ratio.

BONDI: So if you do more business, that's in the denominator. If you increase the denominator, then the numerator of affordable housing also has to expand.

MARZOL: It's a ratio, so you can achieve it in two ways. You can add a unit to the numerator, or you can take a unit from the denominator that does not shrink the numerator.

BONDI: Did you recommend a path?

MARZOL: I don't remember that we got to a point in affordable housing where the company felt that it had to turn down qualified borrowers.

BONDI: So the focus was on increasing the numerator—increasing affordable housing?

MARZOL: To the extent that goals could be achieved, increasing affordable housing seemed to be a better choice than denying qualified borrowers.

BONDI: For the two different paths—either scaling back on the denominator or increasing the numerator—which of these two posed a greater risk?

MARZOL: I think it depends on the circumstance. There's a risk on each side. If you do need to reach for potentially higher risk business to meet the numerator, that could be a risk. But turning away fully qualified borrowers because they don't meet certain goals could pose a reputational risk. Fannie Mae's mission is to increase liquidity in the marketplace, so there could be adverse reputational consequences.

BONDI: Is there anything on this outlook that you remember authoring?

MARZOL: I don't recall.

BONDI: Did you receive a draft before it was finalized?

MARZOL: I don't recall.

BONDI: In the economic trends section, there is an economic outlook that says that new and existing home sales declined 12% in 2005. Did you see risk with 12% figure, and if so, what did you recommend?

MARZOL: I don't recall that data point.

BONDI: Do you think 12% would have been significant? Would it have raised red flags?

MARZOL: I don't recall. What raises a red flag is that the economic department projects a moderation in prices.

BONDI: Did Fannie make any changes to the business model in response to the moderation that you've described?

MARZOL: At this time period, the business unit credit officers have more responsibility for the risks that the company will take. I don't recall if this project caused specific changes..

BONDI: Would this decline of 12% have increased any risks for Fannie?

MARZOL: If there's a perception of risk in this outlook, it's in the home price appreciation.

BONDI: You're talking about the "lowering home price outlooks for 2005" bullet point.

MARZOL: I don't know that they were facts. The company had an economic department that regularly developed outlooks for different data points.

BONDI: As a risk manager, did you make any risk recommendations?

MARZOL: At that time, I was in the corporate strategy department.

BONDI: What about corporate strategy recommendations?

MARZOL: The recollection I have strategically is that the company weighed and tried to make decisions about the marketplace and products. I have the sense that the possibility of risk was rising, and there might have been the question of what the companies should be posturing in relation to that? Should they stay where they are and lose market share?

BONDI: What was your view or opinion?

MARZOL: As interim Chief Risk Officer, my sense was that the right posture was to lose market share and not try to chase the market in terms of where market trends were going.

BONDI: Is that what happened?

MARZOL: That's my perception of what the company was doing while I was there.

BONDI: Within the purchase mortgage market, there's a bullet point that says "_____." Did you have any response or recommendations?

MARZOL: Not in response to the bullet point on this page.

BONDI: What about more generally?

MARZOL: More generally, when I was the Chief Credit Officer, it was a market trend trend for a second mortgage to be on top of a first mortgage for a low-doc loan. The credit team made an effort to reach out to the mortgage insurance companies to see if we could craft a credible counter proposals so the market would do business with mortgage insurance instead of second mtg.
FM-COGR_2069778

DOCUMENT #2, 267253

BONDI: Do you remember authoring this document?

MARZOL: No.

BONDI: Was this ever transmitted to Mudd?

MARZOL: I believe there was a final version of this document that was transmitted to Dan Mudd. It's a document that I would have signed and that I would have had the final review on, but the staff might have drafted it. The interim CRO office had 40-50 people on staff.

BONDI: There are some red line changes. Are they yours?

MARZOL: I don't recall.

BONDI: Looking at the bullet point: "Challenging minority lending goals." Was the information in that bullet point transmitted to Dan Mudd?

MARZOL: I don't recall what would have been in the final version of the memo.

BONDI: Is there anything in that bullet point that you disagree with now or that you disagreed with in March 2005?

MARZOL: The only thing I'm not sure of is the impact on housing goals. I'm ambivalent about housing goals.

BONDI: Are there any documents that governed what kind of private-label securities that Fannie bought?

MARZOL: The Risk Policy Committee adopted a private-label securities policy. I think it was around 2004.

BONDI: Were you involved in drafting or editing?

MARZOL: I was involved in drafting, yes.

BONDI: Who oversaw the development of the document?

MARZOL: There was a team involved. Kathy Rock played a meaningful role.

BONDI: Did the policy change after the development of the document?

MARZOL: Changes were made to the policy.

BONDI: Why was it initially developed?

MARZOL: It was developed after the Lessons to be Learned from Manufactured Housing investments that Fannie had made.

BONDI: Was it associated with worries about risks of mortgage-backed securities that Fannie wanted to buy?

MARZOL: It was to improve risk management processes.

BONDI: “Total private label securities grew to ___ billion” Assuming that these figures are correct, would that increase have caused you concern on March 2, 2005?

MARZOL: The absolute level I don’t recall causing me meaningful concern, but I do have a sense that this pace of growth, if it were to continue, would be a risk concern from a concentration of risk perspective. The overall growth of the company wouldn’t match that growth rate.

BONDI: The subprime and Alt-A figures from 2005—are they correct?

MARZOL: I’d be reluctant to answer based on a draft memoranda.

BONDI: In the “Reliance on External Ratings,” there is concern. Did you have concern?

MARZOL: Yes.

BONDI: So you were concerned about rating agencies?

MARZOL: Yes. There were reasons to have some caution about the ratings. The issue of ratings and the reliability of ratings is one that had been discussed at Fannie and arose in context of manufactured housing. When the company decided to continue to participate in the private-label market, the decision was made in the context of continuing to review the risks?

BONDI: Did you express concern to Mudd that the rating agencies might not be properly rating?

MARZOL: Mudd was meaningfully involved in manufactured housing, and at GE he had a difficult experience with rating agencies. He believed that we needed to complement the rating agency assessment.

BONDI: Did you or anyone you know warn anyone from the rating agencies that they may have not been correctly rating the risk in the market?

MARZOL: I'm not aware that we would have warned them about their ratings.

BONDI: Who would have been responsible for monitoring the portfolio and the enhanced risk?

MARZOL: That would either be in the mortgage portfolio effort or in the interim CRO office.

BONDI: What would these documents be called at Fannie?

MARZOL: You could ask for "Fannie Mae's Bond Surveillance" or "Fannie Mae's Bond Watch."

BONDI: Moving on to the "New products and risk layering paragraph." Can you tell me if you would have agreed or disagreed with each sentence? What about the first sentence?

MARZOL: I have no reason to disagree with it.

BONDI: The second sentence?

MARZOL: I have no reason to disagree with it.

BONDI: The third sentence?

MARZOL: I believe I would have agreed with it.

BONDI: Were there any steps that Fannie took in respect to the risk described in this paragraph?

MARZOL: The principal step that a company can do is that if a product or loan includes a loan with certain characteristics, we wouldn't buy it. I do remember certain steps being taken to limit the number of interest-only loans that can be included in a subprime securitization. Also, the company was considering more broadly which consumers would be able to understand products with interest rates that reset or changed.

A dialogue occurred at the company that involved business unit leaders, the board, and risk officers about the right posture and balance for the company.

BONDI: On the front page of March 2, 2005 memo, there's a bullet under Policy and Limit Facts about a 10% cap on mortgages. Did that become policy?

MARZOL: I believe that a policy was implemented, but I'm not sure of specifics.

The "Risk Policy Committee" is a management committee. I was on it. In 2005, the others who may have been on it would be Peter Nicolescu (not still with company, now is a consultant with a firm in New York), Tom Lawler, Pam Johnson (business unit SF credit officer), Andy McCormick, Ramon Decastro (mtg portfolio biz), Mark Winer, Morgan Whittaker (staffer in CRO area that coordinated the meetings).

BONDI: How often would the Risk Policy Committee have to approve an investment where it exceeded the cap?

MARZOL: I don't remember the limit being exceeded, so I would assume very infrequently.

Document #3

FM-COGR-1771691

BONDI: This is an email from Tracey Amos. I don't see your name on the email. Did you receive this email or this attachment?

MARZOL: I don't recall this email or this presentation. Tracey Amos worked in the single-family business in some staff support role, but I don't recall her position. I'm not sure who she would have reported to. Every person's name on the email would have been in the single-family unit.

BONDI: Do you recall attending a senior management retreat in June 2005 or any meeting where this PowerPoint or a variation of it was shown?

MARZOL: No to the first question. I remember a quarterly business review in September or December of 2005 where there was some discussion of the company's subprime market.

BONDI: 177171: "efforts to develop a subprime infrastructure" Do you know what's meant by underground efforts?

MARZOL: No.

BONDI: While you were at Fannie, did you hear any terms about underground efforts to develop the subprime market?

MARZOL: No.

BONDI: Does it surprise you that “underground” is used in this slide?

MARZOL: Without having a recollection of someone presenting this and explaining what they were thinking about, I’m at a loss.

BONDI: Would you have used the term “underground” to describe the subprime infrastructure?

MARZOL: I don’t recall using the term underground. It’s very hard to characterize this or give it context.

DOCUMENT #8

BONDI: 00259828. “Customer Engagement plan for Countrywide.” Do you remember receiving this document?

MARZOL: No.

BONDI: Do you have any understanding of what this document might be?

MARZOL: My belief is that it was practice to try to have a written plan for managing our lender clients and to try to have a documented game plan toward that relationship.

BONDI: For a customer engagement plan of this sort, is this something that the Chief Credit Officer or the Chief Risk Officer would have been consulted on before this plan was engaged?

MARZOL: I don’t know well enough how these plans got put together. I don’t remember being consulted at this level of granularity for a particular lender.

BONDI: Who is Ann Marie Wheelock?

MARZOL: When is this from?

BONDI: I’m not sure.

MARZOL: Looking at this, she is probably the senior vice president of the western region. She would have been the senior regional person responsible for Countrywide. I’m

not sure where she is now, and I don't recall her having a direct or indirect reporting to me.

BONDI: 259839 Your name is mentioned in the document. It says to seek out and meet/greet professional opportunities and gain. Description of relationship with Hillis and Adolfo and Marzol. Do you remember receiving this customer engagement plan?

MARZOL: No.

BONDI: Who is Mark Hillis?

MARZOL: I don't recall.

BONDI: Do you remember talking or meeting with Mark Hillis?

MARZOL: I don't recall.

BONDI: What about a Seattle meet and greet with Pam related to WaMu?

MARZOL: No, I don't remember.

BONDI: What was your involvement with WaMu?

MARZOL: There are two things that I recall. Fannie Mae was not doing business with WaMu before I became Chief Credit Officer. I was tasked with at least part of the assignment of developing a relationship and getting at least some business with WaMu. Subsequent to that, people at WaMu took a liking to me, and after I became Chief Credit Officer, they once or twice invited me to Seattle to discuss credit and information about the market. They seem to place value on my point of view.

BONDI: From 2000 until you left in January 2006, who would you say were the most problematic lenders in terms of the risks posed to Fannie Mae with which the company did business?

MARZOL: My recollection is having a general sense that the lenders that I would describe as Wall Street aggregators, that we had more issues in doing business with those lenders.

BONDI: Any specific names in mind? Are you talking about guarantees or purchases of private mortgages?

MARZOL: I'm talking about guarantees. Not to single anyone out, but names that come to mind are Lehman Brothers, Credit Suisse, First Boston, Morgan Stanley—the Wall Street mortgage players. They were more problematic for Fannie Mae than our more

traditional lender base.

BONDI: What about Citigroup?

MARZOL: I don't have a recollection of particular concern about Citigroup.

BONDI: Are you familiar with any sales of mortgage-backed securities or mortgage products to banks in order for banks to meet their CRA obligations?

MARZOL: Sales from us to banks? I don't recall one.

BONDI: You mentioned how the purchase of private mortgage-backed securities could help Fannie achieve affordable housing goals. These are mortgages that have already been originated and are in banks and have already been securitized. How does the purchase of MBS help affordable housing?

MARZOL: Every mortgage that we purchase has already been originated. What Fannie does is give lenders greater confidence to originate a mortgage and help replenish funds after originating a mortgage by purchasing it. Fundamentally, I don't see any difference between purchasing a mortgage and purchasing an MBS.

BONDI: Were there any lenders that you, in any of your roles, deemed too risky and that were taken off a list of who Fannie would do business with. Would you have been part of that discussion?

MARZOL: Not necessarily. It would depend on the size and materiality of a lender. If a regional office decides not to do business with a small originator, I would probably not have been consulted.

BONDI: What was the largest lender that was taken off the list?

MARZOL: Taylor, Bean, & Whitaker is the most significant that I can remember. There was a revocation of their right to be a seller-servicer to Fannie. I don't remember when the decision was made, but I know that they appealed for reinstatement several times, and they were denied. I don't remember being a part of the decision to revoke, but I was part of the decision not to reinstate. This might have been the early 2000s.

BONDI: Is there anything that I didn't ask and that we didn't discuss that I should know about Fannie, the housing market, etc?

MARZOL: I'm not sitting here thinking that there's a big nugget of insight that you're missing.

BONDI: Are we asking the right questions?

MARZOL: I have a parting perspective relative to the mortgage market. Commercial real estate is having a crisis. Fannie Mae was a player in one small segment of commercial real estate. What were SIVs and CDOs about? What role did Basel I and II play?

In the mortgage market, my own view is that we have to put this crisis in the category that we made a large, collective mistake as a society. Every major participant made a mistake along the way. Borrowers stretched to buy more home than they can afford; speculators bought homes; mortgage brokers and loan officers wanted to increase their volumes; lenders were involved; there was a development of huge global market for securitization; the market for second mortgages and home-equity lines of credit expanded. I don't know of a single regulator that got it.

At some level, it's a very interconnected mosaic where every major participant made some mistakes.

BONDI: What's your view of OFHEO as a regulator?

MARZOL: I had a good relationship with OFHEO as a regulator. I was regulated by the OCC at Chase. At the examination level, it was competent. We worked well with OFHEO and we had a good relationship with them.

BONDI: Were you reporting directly to OFHEO?

MARZOL: The credit team got into a habit of producing an oversight report on new business called "The Credit Trends Report." That may have been provided to OFHEO quarterly.

BORGERS: In 2006 and 2007, what company did you work for? What was your title and function?

MARZOL: I didn't work for anyone for about nine months. In 2006-7, I started doing some consulting work. I did some work for Morgan Stanley. During the crisis, I tried to step in and serve as the interim CRO. I've done consulting work for Durall Financial (the largest mortgage lender in Puerto Rico).

BONDI: We ask that you keep this information confidential. Please don't discuss anything outside your lawyer?

WINER: Adolfo wants to cooperate. With requests for documents, you should probably go to Fannie Mae.

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