Members of the Congressional Oversight Panel, thank you for inviting me to speak today. I am Paul Heran, Program Executive of the Making Home Affordable – Compliance (MHA-C) division at Freddie Mac.

I am responsible for leading the MHA-C division in its examination, compliance, and consulting roles as a financial agent of the U.S. Department of the Treasury. I report to Freddie Mac’s Chief Administrative Officer and Chief Compliance Officer, who in turn reports directly to the Company’s CEO. Prior to joining Freddie Mac, I was an audit partner with Ernst and Young (E&Y). During my 34-year career at E&Y, I focused on auditing financial services firms, including mortgage banking companies, and ended my tenure there as Directing Partner of the Bank Audit Practice.

In my testimony, I summarize our key accomplishments to date; outline the role, structure and operations of MHA-C; discuss our working relationship with Treasury; summarize our role in identifying and addressing servicer performance issues in the Home Affordable Modification Program (HAMP); and describe Freddie Mac’s compliance with Treasury’s rules regarding conflicts of interest.

Key accomplishments to date

Freddie Mac was honored to be asked by Treasury in February 2009 to fulfill the role of compliance agent for HAMP. Our task essentially was to create a wholly new business function and organization, hire staff (which, as noted below, included transferring qualified personnel from the existing Freddie Mac organization), and begin operations immediately. Under the best of circumstances, such an assignment is very challenging. Yet in a very short time, in the midst of the recent financial crisis, Freddie Mac was able to get a comprehensive and effective compliance program up and running.

MHA-C is comprised of highly skilled professionals whose accomplishments include establishing a strong partnership with Treasury, productive and effective arms-length working relationships with the servicers whose HAMP operations we audit, a comprehensive examination program, a series of audit reports for Treasury, and a system of effective feedback to servicers. While our task is by no means complete, and we continue to strengthen and refine MHA-C’s processes, procedures and organization, we believe we are fulfilling the important responsibilities Treasury has assigned to us and are contributing to the overall effectiveness of HAMP.
We also believe our work with Treasury on key initiatives has significantly improved the administration and effectiveness of HAMP. These include evaluating the servicers’ use and/or reproduction of the Net Present Value (NPV) models (which provide a key component of determining borrower eligibility for HAMP), developing and executing the “Second Look” initiative (to determine whether borrowers have been effectively solicited and evaluated for HAMP modifications), and our evaluation of the accuracy of incentive payments made to servicers from TARP funds.

**MHA-C’s role, structure and operations**

MHA-C is responsible for evaluating compliance for non-GSE loans that are currently administered by over 100 servicers who have operations throughout the United States. Its responsibilities include evaluating and reporting on the compliance of servicers with HAMP’s requirements; and consulting and reporting to Treasury on issues and lessons learned to improve the operation of HAMP.

Treasury actively manages MHA-C. Senior level officials within Treasury’s Office of Financial Stability direct and closely monitor MHA-C’s activities. In addition, at least three Treasury employees are assigned to work full time on-site in MHA-C’s office and oversee the activities of MHA-C. All of MHA-C’s principal activities, including conducting examinations and reporting our observations, are performed under protocols and guidelines established by Treasury and in consultation with Treasury officials.

Moreover, MHA-C senior management reports on the program’s status, issues and challenges at weekly meetings of Treasury’s MHA Compliance Committee. The committee is composed of senior Treasury officials leading the MHA program and is chaired by the Treasury official with overall responsibility for compliance. This meeting is followed by more targeted, detailed discussions with the committee chair concerning planned activities, results, and current challenges.

Freddie Mac has created MHA-C as a separate business unit within the Company staffed by employees dedicated to MHA-C activities. MHA-C utilizes office space, computer servers and other equipment that are separate from the rest of the Company to minimize the risk of potential and actual conflicts of interest, which I will discuss in more detail below.

From the start, MHA-C has sought to fill positions with both permanent employees and contractors, reflecting our specific skill set requirements (e.g., extensive backgrounds and experience in auditing, mortgage servicing and other areas), the limited duration of HAMP, and the need to establish our compliance program and operations in a very short time frame. MHA-C currently has 132 full-time, permanent employees and 118 full-time contractors.

Organizationally, MHA-C is composed of the following groups:
• **Testing and Monitoring**, which is responsible for internal control and compliance audits onsite at servicers’ locations.

• **Loan File Operations**, which is responsible for the loan file review process (at MHA-C’s centralized location), in which a representative sample of files is reviewed. The process includes the evaluation of borrowers both rejected from and accepted into the program.

• **NPV**, which provides evaluation of reproduced NPV models and the use of Treasury’s model.

• **Servicer Oversight**, which conducts short notice audits as needed.

• **Reporting and Risk Analytics**, which is responsible for data analysis and identifying resultant compliance trends and patterns at the program and servicer levels.

• **Program Disbursements Testing**, which provides an evaluation of HAMP incentive payments.

• **Quality Assurance**, which is responsible for monitoring the quality of MHA-C’s own work product and internal control self-assessments.

• **Internal Operations**, which provides internal operational support.

**Compliance examinations**

MHA-C’s compliance examination program reviews servicers’ compliance with the requirements of HAMP. Among other things, the examinations include:

• Testing the servicers’ internal controls, which are designed to support HAMP.

• Verifying that borrowers are solicited, that eligible borrowers are identified and included in the servicer’s loan modification program, and that ineligible borrowers are not included.

• Reviewing the use of the NPV tool required by Treasury.

• Examining a sample of loan files to validate compliance with HAMP requirements.

• Reviewing the computation and payment of TARP funds to servicers, investors and borrowers.

• Providing useful programmatic information and feedback to Treasury.
MHA-C’s review of the NPV model use provides an example of the scope of these examinations. MHA-C periodically reviews usage of the model by servicers and actively monitors all servicers with recoded models. Testing includes both controls over the model use and, in the case of recoded models, the actual calculation of the model. Where issues have been identified in recoded models, servicers have been required to validate results in the Treasury model.

In consultation with Treasury, MHA-C selects servicers to audit, numbers of loans to review, and areas of examination focus based upon risk. Each testing group within MHA-C conducts its activities under an operating model that has been reviewed and approved by Treasury. MHA-C also develops with Treasury a schedule of planned audits and other compliance activities. For these planned activities, MHA-C provides servicers 30 days notice to allow for coordination, document gathering, and required security clearances. However, MHA-C also routinely conducts short notice audits with less advance notice to respond to adverse audit results and address emerging program risks.

While the detailed procedures vary by MHA-C group, at the conclusion of each audit activity, in consultation and based on procedures agreed to with Treasury, MHA-C provides the servicer with summaries of all preliminary observations. These observations may be incidences of noncompliance with program guidelines, internal control weaknesses or, in the case of loan file review, specific differences with servicer conclusions on solicitation and eligibility. Subsequently, MHA-C finalizes audit work papers and prepares additional communications or formal reports to servicers. All workpapers, communications and reports are subjected to MHA-C and Treasury quality assurance reviews. Generally, upon receipt of a formal report, the servicer has 30 calendar days to provide a written response to each observation included in the report. Depending on the severity of the observation and/or guidance from Treasury, MHA-C accelerates communication and may require an accelerated response and corrective action to expedite the remediation. Also, based on severity of observations, MHA-C may conduct additional short notice audits.

**MHA-C reports to Treasury**

As noted above, MHA-C is in daily and ongoing contact with Treasury regarding the entire spectrum of issues relating to MHA-C’s work. Thus much of our reporting to Treasury consists of informal workplace communications, including our participation in weekly Treasury MHA Compliance Committee Meetings. However, MHA-C also provides Treasury with several periodic status reports:

*Business Status Reports* – A compilation of all the audit work MHA-C has and is performing or scheduled to perform for all servicers.

*Second Look Reporting (for detecting loans that may not have been solicited, or may have been inappropriately denied inclusion in HAMP)* – Summarizes the servicers that were examined, the number of files reviewed, and the results. These results are reported to Treasury during Compliance Committee meetings.
Budget Reporting – Accrual, invoice, financial results, and contractor reports, as well as quarterly financial forecasts and the annual budget reports.

MHA-C also produces other reports on an ad hoc basis as directed by Treasury.

Actions taken against noncompliant servicers

Following MHA-C’s review of a servicer, MHA-C notifies the servicer of actions needed to correct noncompliance with HAMP rules, guidelines or procedures. In consultation with Treasury, MHA-C may direct a servicer to perform remediation activities in response to MHA-C’s observations. For example, if a servicer did not uphold its solicitation obligations as defined in the guidelines, MHA-C may restrict a servicer’s foreclosure activities until solicitation is completed. Also, if a recoded NPV model is determined to provide unreliable results, a servicer may be required to validate results in the Treasury approved model until the recoded model’s reliability can be substantiated.

Decisions to impose financial remedies on a servicer are addressed by Treasury’s MHA Compliance Committee. MHA-C provides detail on its observations but does not participate in financial remedy decisions.

Conflicts of interest compliance

Freddie Mac is committed to complying with the conflict of interest requirements and restrictions outlined in MHA-C’s Financial Agency Agreement (FAA) with Treasury, related Treasury regulations, and additional requirements provided by Treasury. In the course of fulfilling our duties as compliance agent for HAMP, we have access to confidential and proprietary information about servicers participating in HAMP and evaluate service compliance with HAMP guidelines.

To address potential conflicts of interest related to this work, Freddie Mac has established an extensive compliance program to address both organization and personal conflicts of interest and reasonably ensure the confidentiality of this information. A dedicated team within Freddie Mac’s Compliance, Regulatory Affairs and Mission Division has been tasked with the responsibility for implementing a conflicts of interest compliance program that applies to all Freddie Mac officers, employees, and vendors – including those associated with MHA-C.

The compliance program is designed to reasonably ensure compliance with the requirements of the FAA and Treasury’s regulations and additional requirements established by Treasury. Organizational conflicts of interest are addressed by establishing MHA-C as a separate business unit within Freddie Mac accountable under the FAA to Treasury. Corporate policies, including an information wall policy and other controls, are designed to restrict the flow of servicer specific and borrower specific information from MHA-C to other parts of the Company including those employees who are implementing Freddie Mac’s own Home Affordable Modification Program. Freddie
Mac has also established a series of controls to identify and manage personal conflicts of interest, including the disclosure and review of personal financial information and restrictions on gifts and entertainment from servicers and others.

Furthermore, appropriate business units, including MHA-C, have adopted policies and procedures that further specify conflicts of interest requirements and the processes to comply with those requirements. The obligations under the FAA and Treasury’s regulations are regularly communicated through an established communications and training program to all Freddie Mac employees and contractors working under MHA-C or providing advice to Treasury.

On a quarterly basis, Freddie Mac certifies to Treasury regarding organizational conflicts of interest, personal conflicts of interest and confidentiality. In addition, annually, Freddie Mac certifies to the continued accuracy of representations and warranties contained in the FAA. Freddie Mac also has a process of testing key controls to reasonably ensure that they are operating as intended. These controls are also subject to audit by Freddie Mac’s Internal Audit Division and further testing by Treasury.

**Conclusion**

As outlined in my testimony, MHA-C has fulfilled and continues to fulfill the compliance role Treasury set forth. In a very short time, MHA-C has created an effective organization and set of compliance testing programs. MHA-C works closely with Treasury and effectively with HAMP servicers. In so doing, MHA-C has contributed to the progress of HAMP in helping borrowers. MHA-C continues to refine and improve processes and procedures, and will continue efforts to support Treasury and the Making Home Affordable Program.

Thank you again for this opportunity to discuss the role and activities of MHA-C with you. I am happy to answer any questions you may have.