



FY 2002
PERFORMANCE REPORT

February 27, 2003

DIRECTOR'S MESSAGE

Fiscal Year 2002 marked another year of accomplishment for the Office of Federal Housing Enterprise Oversight (OFHEO). The agency is on track to achieve its long-term goals.

Two key indicators of OFHEO's mission were achieved in FY 2002. OFHEO classified Fannie Mae and Freddie Mac as adequately capitalized during each quarter, and through our examination process, determined that each Enterprise exceeded safety and soundness standards. For the quarter ending September 30, 2002, the Risk-Based Capital Standard was fully enforceable for the first time in the Agency's history.

Of its 21 Performance Goals for FY 2002, OFHEO completed 19 on time, one later than planned and made substantial progress on the last. During the year the Agency was also focused on: Enterprise financial disclosure, interest rate risk, derivatives, and a study of systemic risk. These efforts have already borne fruit during FY 2003.

OFHEO remains committed to fulfilling the statutory mission that Congress has set out for us. OFHEO oversight of the Enterprises plays a vital role in ensuring that the Nation's housing finance system remains strong. As OFHEO celebrates its tenth year of service, I remain committed to the goal of keeping OFHEO a strong and capable regulator and I look forward to achieving another successful year.

Armando Falcon, Jr.
February 27, 2003

FY 2002 Performance Report

OFHEO's MISSION

OFHEO PROMOTES HOUSING AND A STRONG ECONOMY BY ENSURING THE SAFETY AND SOUNDNESS OF FANNIE MAE AND FREDDIE MAC AND FOSTERING THE STRENGTH AND VITALITY OF THE NATION'S HOUSING FINANCE SYSTEM.

Highlights of OFHEO's Performance ¹

In FY 2002, with a budget of \$27 million, OFHEO's accomplishments continued to contribute to the Office achieving its long-term strategic goals. At the end of FY 2002, two key indicators for achieving the mission were again realized.² The Office classified both Enterprises as adequately capitalized each quarter and determined through examinations that they exceeded safety and soundness standards. For the quarter ending September 30, 2002, OFHEO used its Risk-Based Capital Standard as well as the Minimum Capital Standard in determining the Enterprises' capital classifications. This was the first time that OFHEO's Risk-Based Capital Standard was fully enforceable.

FY 2002 was the first year that OFHEO planned its annual performance in accordance with its FY 2000-2005 strategic plan. More than a year before FY 2002 began, OFHEO established four strategic objectives with 18 performance goals, as well as a crosscutting Human Resources Strategy with three performance goals. OFHEO achieved 19 of its 21 FY 2002 performance goals, and achieved one of those remaining goals a quarter later than planned. During the year, OFHEO placed increased emphasis on several issues that emerged as increasingly important, primarily Enterprise disclosure, systemic risk, interest rate risk, and derivatives. These efforts contributed to OFHEO's not meeting all 21 of its original goals. In FY 2002, OFHEO also achieved three deferred FY 2001 performance goals related to implementing the Risk-Based Capital Standard, as described in the FY 2001 Annual Performance Report.

OFHEO's operations are funded by assessments on the Enterprises. Thus, OFHEO's operations represent no cost to the taxpayer. However, OFHEO's budget is subject to the appropriations process, unlike other financial regulators'. Given the Enterprises' rapid growth in volume, complexity, and new activities, this process limits OFHEO's flexibility to adapt quickly to the Enterprises' changing risk profiles. During FY 2002, when presenting OFHEO's FY 2003 budget to Congress, the Administration supported removing OFHEO from the Appropriations process. In October 2002, at the end of the last Congress, this measure was introduced in the Office of Federal Housing Enterprise Oversight Funding Reform Act of 2002 (H.R. 5695). The Administration continues to support this proposal in the FY 2004 budget.

¹ The Office of Federal Housing Enterprise Oversight ("OFHEO" or the "Office") was established as an independent office within the Department of Housing and Urban Development by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of P.L. 102-550). The Office is headed by a Director appointed by the President for a five-year term.

² OFHEO is charged by law to ensure the capital adequacy and financial safety and soundness of two government-sponsored enterprises ("GSEs" or the "Enterprises") – Fannie Mae and Freddie Mac.

FY 2002 Performance Plan and Report

The FY 2002 Performance Report describes what OFHEO accomplished, as compared to its FY 2002 Performance Plan, to achieve the goals and objectives in the FY 2000-2005 Strategic Plan.

OFHEO accomplishes its mission primarily by conducting examinations of the Enterprises, by assessing their capital adequacy, and by conducting research and analysis about the Enterprises and the markets in which they operate. OFHEO's role as a regulator, among other things, is to establish, monitor and implement regulations that will ensure that both Enterprises are adequately capitalized and operate in a safe and sound manner. It is these activities, and the strategies and processes used to develop and implement them, that are included in OFHEO's Annual Performance Plan. The best measure of OFHEO's overall performance is whether its actions result in safe and sound operations and adequate capital levels at each Enterprise.

Mortgage Markets and the Enterprises in FY 2002

Fannie Mae and Freddie Mac (formally named the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, respectively) are publicly held companies chartered by Congress. They were established to create a secondary mortgage market to ensure a ready supply of mortgage funds for housing, including housing for low-and moderate-income families. At the end of FY 2002, Fannie Mae and Freddie Mac held or guaranteed about \$3 trillion in mortgages.

This has been an important year for OFHEO, as it monitors and assesses the dynamics of the Enterprises and the secondary and primary mortgage markets. The Enterprises have realigned their businesses to emphasize asset management rather than credit guarantee. At year-end 1992, Fannie Mae and Freddie Mac held 19 percent of their book of business in portfolio and guaranteed 81 percent in the form of mortgage-backed securities. By September 2002, the proportion of the book of business held in portfolio had increased to 43 percent, with a corresponding decline in the guarantee business to 57 percent of the total. This realignment in business strategy significantly alters the risk profile of the Enterprises, shifting risk management from credit guarantee to both credit risk and interest rate risk management. Thus, OFHEO has had to shift its oversight activities to focus more on interest rate risk management, even as credit exposures were growing rapidly.

In response to more ambitious affordable housing goals and the shift in business strategy, the Enterprises have expanded business products, with increasing sophistication and complexity. Fannie Mae and Freddie Mac undertook activities to purchase high loan-to-value mortgages to support the drive to higher rates of homeownership, promoted the expansion of reverse mortgages for elderly homeowners, and developed the means to reach less credit-worthy borrowers. The Enterprises funded their expanded portfolios with innovative debt products, including instruments denominated in foreign currencies, and a program of regular issuances. To manage these assets and liabilities, the Enterprises have increased their use of derivative instruments from a notional amount of \$72 billion at year-end 1993 to \$1.3 trillion in September 2002—a more than eighteen-fold increase. Each of these initiatives represents a heightening of the sophistication and complexity embedded in the risk profiles of Fannie Mae and Freddie Mac.

Dramatic advances in technology provide the foundation for these business initiatives. The Enterprises employ cutting-edge risk management techniques, built on quantitative models, to manage the many alterations of their risk profiles. Automated underwriting and related technology innovations by Fannie Mae and Freddie Mac have revolutionized the mortgage finance process and have led to significant shifts in the structure of the mortgage finance industry. Communication technologies and E-Commerce represent further expansion opportunities for the Enterprises to streamline their businesses. These technologies carry with them operational challenges that not only permit Fannie Mae and Freddie Mac to leverage their resources but also heighten their operational risks.

Those trends are very likely to continue as the Enterprises search for new opportunities to meet their stated financial goals of continued strong earnings growth. Through its examinations, capital assessments, and research and analysis, OFHEO has and will continue to provide oversight in these areas as the Office carries out its mission.

Managing and Measuring Performance

During the year, OFHEO managers maintained ongoing communications about their progress in achieving OFHEO's performance goals. They also documented progress formally on a quarterly basis and met with the Director to discuss progress in achieving the goals. In virtually all cases, senior management was aware of progress toward achieving performance goals in real time--before the quarterly report was prepared.

For FY 2002, OFHEO's \$27 million budget request was enacted in appropriations. This was a 22 percent increase over the FY 2001 level of \$22 million. Because OFHEO's appropriation is for a single account, and management has access to real-time budget information, management was able to redirect resources in a timely manner to facilitate achieving OFHEO's performance goals and address emerging issues.

OFHEO's staff is its most valuable resource. The Office relies on those with cutting-edge professional skills and a breadth and depth of knowledge in their fields. Their technical competence, effective teamwork and focused performance are crucial to OFHEO's achieving its goals. OFHEO continued to attract and maintain a high performance workforce, increasing to 112 full-time equivalent employees in FY 2002. OFHEO's ability to achieve its mission and keep pace with the Enterprises is highly contingent on attracting and retaining personnel with appropriate skills.

The performance information in OFHEO's Annual Performance Report is complete and reliable. Performance information is available and reported for all goals. OFHEO's managers report their performance and progress against the performance goals, and can rely on this information as they manage their operations. Most of OFHEO's performance indicators reflect data and milestones internal to the Office. The data used as input to the capital calculations are an exception. For the minimum and risk-based capital calculations, senior officers of each Enterprise transmit their data and attest to their completeness and accuracy. OFHEO is able to validate the minimum capital data through comparison with published Enterprise data with a high level of integrity, and has been satisfied with the data received. For the risk-based capital standard, OFHEO uses data validation protocols to ensure consistency and integrity of the data received. This allows ready identification of data issues, which OFHEO resolves with the Enterprises. OFHEO will continue to improve the sophistication of its validation checks. OFHEO had the financial simulation

model used in its risk-based capital regulation independently tested during FY 2001. During FY 2002, OFHEO and the Enterprises worked in concert to ensure the replication of model results by OFHEO and the Enterprises.

OFHEO did not conduct any program evaluations during FY 2002. OFHEO's enabling statute prescribed a set of studies by the General Accounting Office (GAO) and the Congressional Budget Office (CBO), which they conducted during FY 2002. For the initial risk-based capital standard (discussed in Strategic Objective 1), OFHEO may not incorporate Enterprise purchases of new mortgages into the stress test used to calculate the risk-based capital standard. The statute requires that once the initial risk-based capital regulation is final, the GAO and the CBO study the advisability and appropriate form of any new business assumptions. The GAO issued its study in June 2002, recommending that incorporating new business assumptions into the risk-based capital stress test is not advisable. In January 2003, CBO issued a report that did not make recommendations, but offered observations on the possible inclusion of new business activities in the stress period. OFHEO will consider their reports in considering future revisions of the risk-based capital standard.

STRATEGIC GOAL

TO ENSURE FANNIE MAE AND FREDDIE MAC REMAIN SAFE AND SOUND THROUGH EFFICIENT AND EFFECTIVE REGULATION AND BY FOSTERING A STRONG AND VITAL HOUSING FINANCE SYSTEM.

OFHEO's strategic goal supports the clear and important mission of the Office. It recognizes the critical role that OFHEO plays in ensuring the safe and sound operations of the Enterprises. The goal also recognizes that OFHEO must foster the health of the nation's housing finance system in order to ensure the safety and soundness of the Enterprises. Without a strong housing finance system, the Enterprises could face limitations on their ability to buy and sell financial instruments, which could affect their safety and soundness.

STRATEGIC OBJECTIVES

OFHEO established four strategic objectives to support the achievement of the strategic goal and ultimately, the accomplishment of OFHEO's mission.

1. Ensure the Enterprises are adequately capitalized.
2. Ensure the Enterprises comply with safety and soundness standards and other legal requirements.
3. Enhance public understanding of the nation's housing finance system.
4. Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.

STRATEGIC OBJECTIVE 1: ENSURE THE ENTERPRISES ARE ADEQUATELY CAPITALIZED.

Adequate capital protects an Enterprise from severe losses due to unexpected events such as economic crises or management missteps. Without sufficient capital, a company could fail under such circumstances. The Enterprises must be sufficiently capitalized to withstand severe economic conditions, which is when they would be most needed to support the nation's housing finance system. Regulatory capital standards may require an Enterprise to hold more capital than the Enterprise might otherwise choose to hold, thereby providing greater protection for the nation's housing markets.

To help ensure that Fannie Mae and Freddie Mac are adequately capitalized, OFHEO has instituted a comprehensive program of capital regulation consistent with statutory requirements. This program imposes a minimum capital requirement and a risk-based capital requirement on each Enterprise. Both requirements are calculated at specific points in time and at least quarterly. The minimum capital requirement is calculated using a traditional ratio method that requires an Enterprise to hold capital equal to specific percentages of broad business categories. The risk-based capital requirement is calculated on the basis of specific risks inherent in the Enterprises' holdings and activities, especially the risks of unexpectedly high losses due to defaults by mortgage borrowers and adverse changes in interest rates. OFHEO uses a stress test—a model that estimates how the Enterprises would perform under stressful economic conditions—to determine each Enterprise's risk-based capital requirement. The stress test determines the amount of capital that each Enterprise would need to remain solvent during a 10-year period of large movements in interest rates and high levels of mortgage default and loss.

Performance Goal 1.1: Each Enterprise's actual capital meets or exceeds applicable capital requirements on at least a quarterly basis.

Performance Measure 1.1(1): Using OFHEO's minimum capital standard, the ratio of core capital to required minimum capital is equal to or greater than one on at least a quarterly basis for each Enterprise.

Performance Measure 1.1(2): Using OFHEO's risk-based capital standard, the ratio of total capital to required risk-based capital is equal to or greater than one on at least a quarterly basis for each Enterprise. (applicable when the risk-based capital regulation is fully enforceable)

Performance Measure 1.1(3): Whenever an Enterprise does not comply with OFHEO's capital standards, OFHEO receives an acceptable capital plan.

Actual Performance:

2002	<p><u>Goal Met.</u> Quarterly minimum capital classification ratios Fannie Mae: 1.02 to 1.03 Freddie Mac: 1.01 to 1.03</p> <p>Third Quarter CY 2002 risk-based capital ratios (first enforceable application of the risk-based capital standard) Fannie Mae: 1.332 (increasing interest rate scenario is binding) Freddie Mac: 4.696 (decreasing interest rate scenario is binding)</p>
2001	<p>Quarterly minimum capital classification ratios Fannie Mae: 1.02 to 1.03 Freddie Mac: 1.01 to 1.03</p>
2000	<p>Quarterly minimum capital classification ratios Fannie Mae: 1.01 to 1.03 Freddie Mac: 1.03 each quarter</p>
1999	<p>Quarterly minimum capital classification ratios Fannie Mae: 1.01 to 1.02 Freddie Mac: 1.03 to 1.04</p>

For each quarter of FY 2002, both Fannie Mae and Freddie Mac were adequately capitalized, and have been each quarter since OFHEO began determining capital adequacy. OFHEO is statutorily required to determine capital adequacy of the Enterprises on the basis of both minimum and risk-based capital standards. For FY 2002, only the minimum capital standard was applicable for the first three quarters. For the quarter ending September 30, 2002, both the minimum and risk-based capital standards were used. This was the first quarter for which the risk-based capital standard was fully enforceable. Because the minimum capital requirement was larger than the risk-based capital requirement, in accordance with OFHEO’s capital regulations and the 1992 Act, the minimum capital requirement was the binding requirement for the quarter ending September 30, 2002.

Minimum capital represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. For purposes of minimum capital, an Enterprise is considered adequately capitalized if core capital—common stock; perpetual non-cumulative preferred stock; paid-in capital; and retained earnings—equals or exceeds minimum capital. OFHEO’s risk-based capital standard is the amount of total capital—core capital plus a general allowance for foreclosure losses—that an Enterprise must hold to absorb projected losses flowing from future severe interest-rate and credit risk conditions, plus 30 percent to cover management and operations risk.

**FY 2002 Minimum Capital Requirement
(Dollars in millions)***

	12/01	3/02	6/02	9/02
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Actual Core Capital	25,182	25,500	26,382	26,484
Required Capital	24,182	24,571	25,227	25,756
Surplus (Deficit)	1,000	929	1,155	729
Ratio (Actual/Required)	1.041	1.038	1.046	1.028

Freddie Mac

	12/01	3/02	6/02	9/02
Actual Core Capital	19,336	20,558	21,445	22,656
Required Capital	18,515	19,390	19,520	20,538
Surplus (Deficit)	821	1,169	1,925	2,118
Ratio (Actual/Required)	1.044	1.060	1.099	1.103

* numbers may not add due to rounding

During FY 2002, the Enterprises continued to successfully manage to their capital requirements. For each quarter, each Enterprise held between \$729 million and \$2.1 billion more than their minimum requirement. The ratios of Fannie Mae's actual core capital to required minimum capital ranged from 1.028 to 1.046. The ratios for Freddie Mac ranged from 1.044 to 1.103. OFHEO makes the minimum capital determinations after the Enterprises complete their quarterly reconciliation and submit data to OFHEO for review. The final determinations for the quarter ending in September of 2002 are made in FY 2003. During the year, OFHEO also monitored the Enterprises' minimum capital levels on a monthly basis and found that they met the standard at those points as well. Over the last several years, the actual core capital and required minimum capital levels for both firms have been higher each quarter than in the previous quarter. These higher levels support the growth of both Enterprises.

**FY 2002 Risk-Based Capital Requirement
(Dollars in millions)**

Fannie Mae

	3/02 *	6/02 *	9/02
Actual Total Capital	26,290	27,178	27,278
Required Capital	20,228	22,103	21,440
Surplus (Deficit)	6,062	5,075	5,838
Ratio (Actual/Required)	1.300	1.003	1.272

Freddie Mac

	3/02 *	6/02 *	9/02
Actual Total Capital	21,360	22,220	23,101
Required Capital	5,680	10,764	4,919
Surplus (Deficit)	15,680	11,456	18,182
Ratio (Actual/Required)	3.760	2.064	4.696

* The risk-based capital standard was not fully enforceable for these quarters.

For the second and third quarter of the fiscal year, OFHEO calculated each Enterprise's performance and compared it to the risk-based capital standard, as part of the implementation of the risk-based capital rule. For the quarter ending September 30, 2002, OFHEO used these calculations in developing the capital classification. At September 30, both Enterprises held substantially more capital than necessary to pass the risk-based capital stress test. For each quarter, Fannie Mae held between \$5.1 billion and \$6.1 billion more than its risk-based capital requirement. Freddie Mac held between \$11.5 billion and \$18.2 billion above its risk-based capital requirement. The ratios of Fannie Mae's actual total capital to required risk-based capital ranged from 1.003 to 1.3. The ratios of Freddie Mac's actual total capital to risk-based capital ranged between 2.064 and 4.696. The Enterprises' success in meeting their risk-based capital requirements reflect the effectiveness of their interest rate risk management, the restrained magnitude of stress test interest rate changes in the current low-rate environment and, to a lesser extent, continuing house price appreciation.

Performance Goal 1.2: Ensure the Risk-Based Capital stress test incorporates new products and activities.

Performance Measure: All new products and activities of each Enterprise are identified, evaluated, and reflected appropriately in the calculation of the Enterprise's risk-based capital requirement.

Actual Performance:

2002	Goal Met. New products and activities treated in the calculation in accordance with the rule.
2001	Risk-based capital rule published. Includes provision for treatment of new products and activities.
2000	Risk-based capital rule under development.
1999	Risk-based capital rule under development.

The risk-based capital rule includes provision for determining the treatments of new products and activities and updating those treatments in future quarters in order to reflect risk more appropriately. During FY 2002, OFHEO developed a process to implement this aspect of the regulation. As provided in the rule, OFHEO will implement treatments for any new activities that arise during a particular quarter and will consider public input on these treatments for application in future quarters. During FY 2002, OFHEO developed appropriate treatments of several new products. OFHEO is posting on its web site these treatments of new products and activities with the results of the risk-based capital calculations, and began with the results for the quarter ending September 30, 2002.

Performance Goal 1.3: Ensure the Risk-Based Capital model is updated to incorporate new techniques in measuring risk.

Performance Measure: Improved risk measurement techniques relevant to Enterprise risks are identified and, in future years, incorporated into OFHEO’s risk-based capital stress test, as appropriate.

Actual Performance:

2002	Goal Met. Amendments proposed this year and projects initiated to consider future changes.
2001	Risk-based capital rule issued.
2000	Risk-based capital rule under development.
1999	Risk-based capital rule under development.

During FY 2002, OFHEO began several projects, such as enhancing empirical modeling to measure interest rate risk and exploring potential supplementary risk measurement techniques. After research and analysis, OFHEO will incorporate revisions to the model, as appropriate. The amendments made to the risk-based capital standard in FY 2002 are described in Performance Goal 1.5.

Performance Goal 1.4: Improve reliability and availability of the computer resources that support the regulatory infrastructure.

Performance Measure: The number of times a capital calculation is delayed due to the reliability and availability of computer resources is zero.

Actual Performance:

2002	Goal Met. No delays.
2001	Not applicable.
2000	Not applicable.
1999	Not applicable.

During FY 2002, OFHEO purchased and installed a large server, which enabled the system to carry out risk-based capital runs and analysis as well as other analytical and research tasks without delays.

Performance Goal 1.5: Revise the capital adequacy regulations when appropriate to incorporate new products and improvements in risk measurement developed through Performance Goals 1.2 through 1.3 and any alterations of legal standards or regulations.

Performance Measure: Proposed changes to minimum and risk-based capital rules completed in a reasonable timeframe.

Actual Performance:

2002	Goal Met. Several amendments proposed and issued in final.
2001	Risk-based capital rule issued.
2000	Risk-based capital rule under development.
1999	Risk-based capital rule under development.

During FY 2002, OFHEO proposed and issued several amendments to the RBC rule. Amendments included improved treatments to address counterparty risk on the securities held by the Enterprises, mortgage credit enhancements, and derivative contracts. Amendments were also made to the treatment of new debt issued when assets outlast liabilities during the stress test and to the treatment of multifamily loans.

STRATEGIC OBJECTIVE 2: ENSURE THE ENTERPRISES COMPLY WITH SAFETY AND SOUNDNESS STANDARDS AND OTHER LEGAL REQUIREMENTS.

OFHEO must maintain its ability and capacity to ensure that specific issues and emerging trends are identified early and that potential vulnerabilities of the Enterprises are appropriately addressed. Critical to its mission is the knowledge, skills and expertise OFHEO acquires through its Examination Program. Maintaining a solid understanding of the Enterprises' exposures, risk management techniques, operating strategies, and financial condition is critical to OFHEO's responding rapidly and effectively.

OFHEO maintains a prospective focus to identify potential problems at the Enterprises or in the marketplace before they can cause significant harm. Also, OFHEO is committed to ensuring its supervisory practices are both up-to-date and adaptable to the rapid changes in the environment and the evolution of products and services provided by the Enterprises.

Performance Goal 2.1: Ensure each Enterprise operates in a safe and sound manner by conducting a continuous, risk-based examination of each Enterprise.

Performance Measure: Completion of an annual examination report for each Enterprise that covers the relevant areas of risk.

Actual Performance:

2002	Goal Met. Completed CY 2001 examination and began CY 2002 examination.
2001	Completed CY 2000 examination and began CY 2001 examination.
2000	Completed CY 1999 examination and began CY 2000 examination.
1999	Completed CY 1998 examination and began CY 1999 examination.

OFHEO issued the Report of Examination for the calendar year 2001 examination and met with the Boards of Directors of both Enterprises. Four major risk areas comprised the 2001 examination—credit risk, market risk, operations risk, and corporate governance. These risk areas contain 11 program areas, such as interest rate risk, liquidity management, model exposure, and information technology, for which over 100 factors are assessed at the start of the year and updated at least quarterly.

The annual examination cycle for the Enterprises commences on January 1 and concludes on December 31. OFHEO’s 2002 Report to Congress describes OFHEO’s examination criteria and findings for CY 2001 in these areas.

OFHEO initiated the CY 2002 examinations in January of 2002, adding accounting as a focus area in the risk-based examinations. Throughout the year, OFHEO continued to reevaluate the risk areas to address emerging issues or concerns. OFHEO’s examination process is described in more detail in the examinations handbook, available on OFHEO’s web site.

Performance Goal 2.2: The Enterprises meet or exceed safety and soundness standards.

Performance Measure: The number of safety and soundness concerns not having an appropriate action taken is zero.

Actual Performance:

2002	Goal Met. Both Enterprises were financially sound and well managed.
2001	Both Enterprises were financially sound and well managed.
2000	Both Enterprises were financially sound and well managed.
1999	Both Enterprises were financially sound and well managed.

As described in OFHEO’s 2002 Report to Congress, the CY 2001 examinations, which were completed during FY 2002, found both Enterprises financially sound and well managed. In each of the 11 program areas, both Enterprises exceeded safety and soundness standards. Throughout the year, examinations staff discuss leading edge practices with the Enterprises, as well as any issues that might arise during the year. For example, in response to market developments, OFHEO increased the frequency of surveillance activities pertaining to interest rate risk management by the Enterprises and met with Enterprise executives regularly to monitor and test interest rate risk sensitivity measures, risk positions, and management initiatives.

Performance Goal 2.3: Conduct surveillance and monitoring to complement and support the risk assessment process of the examination function.

Performance Measure: Complete planned internal analytical reports quarterly.

Actual Performance:

2002	Goal Met. Reports prepared quarterly.
2001	Reports prepared quarterly
2000	Reports prepared quarterly.
1999	Reports prepared quarterly.

Each quarter, OFHEO prepares reports to assess the condition and performance of the Enterprises. These analytical reports are for internal use and cover the business activity, asset/liability management, asset quality, capital, earnings and market indices for the Enterprises, as well as quarterly economic trends and outlook. OFHEO is planning to enhance the surveillance and monitoring capabilities with an Examiner Workstation—a comprehensive tool to access information necessary to assess risk from a single software application on each examiner’s computer. During FY 2003, OFHEO will conduct a feasibility study and is planning to develop a prototype with resources requested for FY 2004.

Performance Goal 2.4: Ensure new mortgage programs do not risk significant deterioration of the Enterprises’ financial conditions.

Performance Measure: No new mortgage programs approved by the HUD Secretary cause significant deterioration of the enterprises’ financial conditions.

Actual Performance:

2002	Goal Met. No new programs identified by the Secretary of HUD.
2001	No new programs identified by the Secretary of HUD
2000	No new programs identified by the Secretary of HUD.
1999	No new programs identified by the Secretary of HUD.

During FY 2002, the Department of Housing and Urban Development did not identify any new programs to OFHEO for safety and soundness review. However, the Enterprises introduced a number of new products and activities that were not identified as new programs, which OFHEO continues to monitor and evaluate for potential safety and soundness implications.

Performance Goal 2.5: Ensure that executive compensation at the Enterprises is not excessive.

Performance Measure 2.5(1): The Enterprises comply with the executive compensation regulation.

Performance Measure 2.5(2): OFHEO takes appropriate action with respect to any instances of excessive compensation provided to executive officers of the Enterprises.

Actual Performance:

2002	Goal Met. No instances of excessive executive compensation were found.
2001	Monitored overall executive compensation. Termination agreements not excessive.
2000	Monitored overall executive compensation. Termination agreements not excessive.
1999	Monitored overall executive compensation. Termination agreements not excessive.

OFHEO completed a review of executive compensation that updated the peer group of industry comparables used to benchmark Enterprise executives' compensation. OFHEO promulgated an executive compensation regulation in FY 2001, a year earlier than originally planned. During FY 2002, no instances of excessive executive compensation were found.

Performance Goal 2.6: Ensure the Enterprises comply with applicable laws, regulations and directives.

Performance Measure: Any identified instances of non-compliance with regulations or directives are resolved to OFHEO's satisfaction.

Actual Performance:

2002	Goal Met. No instances of violation identified.
2001	No instances of violation identified.
2000	No instances of violation identified.
1999	No instances of violation identified.

OFHEO continued to monitor the Enterprises' compliance with applicable laws; no violations were identified. During the year, OFHEO issued several final regulations to strengthen its regulatory infrastructure. These include regulations on Prompt Supervisory Response and Prompt Corrective Action, Flood Insurance, Corporate Governance, and a comprehensive Safety and Soundness rule.

STRATEGIC OBJECTIVE 3: ENHANCE PUBLIC UNDERSTANDING OF THE NATION'S HOUSING FINANCE SYSTEM.

Enhancing the public's understanding of the nation's housing finance system, including the roles and activities of the Enterprises and OFHEO, contributes directly to the strength and vitality of that system. The public—borrowers, investors, market participants, policymakers, and other stakeholders—will make better decisions about the allocation of their resources if they are well informed. OFHEO, with its expertise in housing finance, is uniquely positioned to provide the public with information and analysis that leads to more informed decision-making by the public.

Performance Goal 3.1 (1): Analyze and report about the secondary mortgage market annually.

Actual Performance:

2002	<u>Goal not met.</u> Report published in September 2002, one quarter later than scheduled.
2001	Report published in July 2001.
2000	Included in Annual Report sent to Congress June 15, 2000.
1999	Included in Annual Report sent to Congress June 15, 1999.

OFHEO's issued its annual report, "Mortgage Markets and the Enterprises in 2001" in September 2002, one quarter later than scheduled. OFHEO's staff efforts were redirected from completing this report in June to work on OFHEO's systemic risk report and disclosure issues. Although the report was issued a quarter later than scheduled, OFHEO believes that it provides valuable information to the public on developments in the housing sector and the primary mortgage market, the secondary mortgage activities of Fannie Mae and Freddie Mac, and the financial performance of the Enterprises. It is available on OFHEO's web site.

Impact on Future Plans:

OFHEO will continue to issue this report annually within a timeframe that makes it useful to the audience. The Office will set a target date for publication taking recent experience with resource availability and other priority projects into account.

Performance Goal 3.1 (2): Report on OFHEO activities and examination results and conclusions in the OFHEO annual Report to Congress.

Actual Performance:

2002	Goal Met. Annual Report sent to Congress June 15, 2002.
2001	Annual Report sent to Congress June 15, 2001.
2000	Annual Report sent to Congress June 15, 2000.
1999	Annual Report sent to Congress June 15, 1999.

OFHEO published its annual Report to Congress on June 15, describing OFHEO’s activities and the results and conclusions of OFHEO’s examination of the Enterprises. This report is available on OFHEO’s web site.

Performance Goal 3.2: Analyze and report quarterly on house price trends through OFHEO’s House Price Index (HPI) Report.

Actual Performance:

2002	Goal Met. HPI issued quarterly.
2001	HPI issued quarterly
2000	HPI issued quarterly.
1999	HPI issued quarterly.

OFHEO publishes the House Price Index (HPI) quarterly, just two months after the quarter end. It documents changes in the home prices for the nation, each state, many Metropolitan Statistical Areas (MSA’s), and the nine census regions. During this critical period for housing markets and the economy, OFHEO has used the HPI to provide pertinent and timely information to the public on the cyclical status of housing prices. Each quarter’s HPI report is on OFHEO’s web site.

Performance Goal 3.3: Undertake research and analysis of emerging issues identified in FY 2001.

Performance Measure: Completion of FY 2002 goals of FY 2001 research plan (as revised).

Actual Performance:

2002	Goal not met. Several projects were completed. Others were delayed or deferred.
2001	Research and analysis have been ongoing. Developed a preliminary research agenda for FY 2002.

2000	Research and analysis have been ongoing.
1999	Research and analysis have been ongoing.

Although OFHEO revised its preliminary research agenda at the start of the second quarter of FY 2002, the expectations in the agenda proved to be too ambitious. With OFHEO’s small staffing level, even a small number of emerging issues can require redirecting OFHEO’s research and analytical efforts. While several projects were completed, others were delayed or deferred so that staff could work more intensively on risk-based capital implementation and improvement, disclosure issues with the SEC and the U.S. Treasury, the systemic risk report and a project on credit risk funded by the Small Business Administration. While some of OFHEO’s research and analysis includes projects for internal purposes, all OFHEO reports and staff working papers that can be made available to the public are posted on OFHEO’s web site.

Impact on Future Plans:

Given OFHEO’s small staff size, it is inevitable that staff will be redirected to address issues that arise. OFHEO has taken recent experience with resource availability and emerging issues into account in planning its research agenda, and will update the research agenda by the middle of the fiscal year.

Performance Goal 3.4: Disseminate research findings as completed.

Performance Measure: Publication of completed research findings in accordance with OFHEO plans and policies.

Actual Performance:

2002	<u>Goal Met.</u> Research and analysis published and presented.
2001	Research and analysis has been published and presented
2000	Research and analysis has been published and presented.
1999	Research and analysis has been published and presented.

During FY 2002, OFHEO initiated a Working Paper Series featuring papers by OFHEO economists and analysts. The views in these papers are those of the authors and do not necessarily represent the policies or positions of OFHEO. The first two papers were “Patterns of Default and Prepayment for Prime and Subprime Mortgages”, and “Alternative Methods of Increasing the Precision of Weighted Repeat Sales House Price Indices”. OFHEO staff also presented papers and led or participated in panels at professional and industry conferences, including the Credit Research Center’s Conference on Subprime Lending, the Opal Group’s Fixed Income Summit on Credit Risk Models, the American Enterprise Institute Conference on GSE’s, and the American Economic Association’s session on Regulation and Lending Practice.

Performance Goal 3.5: Enhance awareness of Enterprise risks and activities.

Performance Measure 3.5(1): Disclose information related to Enterprise compliance with the revised minimum capital regulation.

Performance Measure 3.5(2): Disclose information related to Enterprise compliance with risk-based capital standard. (when fully enforceable)

Actual Performance:

2002	Goal Met. published information related to the risk-based capital calculations, drafted a proposed disclosure regulation and addressed other disclosure issues.
2001	Issued Annual Report to Congress and Report on Secondary Mortgage Markets.
2000	Issued Annual Report to Congress, including report on Secondary Mortgage Markets.
1999	Issued Annual Report to Congress, including report on Secondary Mortgage Markets.

OFHEO has actively worked to enhance awareness of Enterprise risks and activities. Although not captured in the performance measures, OFHEO initiated a review of Financial Disclosures in April of 2002. The Enterprises substantially enhanced the public’s awareness of Enterprise risk and activities when they voluntarily agreed to subject themselves to mandatory regulation by the SEC under the Securities Exchange Act of 1934. In August 2002, OFHEO, the SEC, and the U.S. Treasury established a task force on disclosure related to mortgage-backed securities (MBS), and issued a joint staff report on disclosure practices in the MBS markets in February 2003. They found that additional disclosures in the MBS markets would be desirable, feasible, and useful to investors. The joint staff report is available on OFHEO’s web site.

Although the risk-based capital standard was not fully enforceable until September 13, 2002, OFHEO worked with the Enterprises to implement the rule, and on June 27, 2002, OFHEO announced the results of the Enterprises’ performance against the risk-based capital standard for the first quarter of calendar year 2002. OFHEO’s announcement also included an analysis of the key factors that affected the Enterprises’ risk-based capital levels. OFHEO also published the results of the risk-based capital stress test for the second quarter of 2002 with an analysis of the results and changes from the prior quarter. When the risk-based standard was part of the capital classification for the first time for the third quarter of the calendar year, OFHEO continued to provide analytics with the announcement. Each quarter, OFHEO plans to expand its analysis of factors that affect the Enterprises’ risk-based capital levels. OFHEO’s findings for each quarter are available on its web site.

For the minimum capital standard, OFHEO continued to report the minimum capital and core capital levels, and did not revise the minimum capital regulation, as originally anticipated. OFHEO drafted a proposed disclosure regulation, and intends to issue a disclosure rule in FY 2003.

Performance Goal 3.6: Communicate effectively with all stakeholders on regulatory issues.

Performance Measure: Consider and respond appropriately to all Congressional inquiries within 7 days.

Performance Measure: Consider and respond appropriately to all public inquiries within 7 days.

Actual Performance:

2002	<u>Goal Met.</u> Responded to all inquiries from Congress and the public within 7 days.
2001	Responded to all inquiries from Congress and the public within the 15-day goal.
2000	Responsive to Congress and the public. Data not collected.
1999	Responsive to Congress and the public. Data not collected.

OFHEO continued to respond effectively to inquiries from the Congress and the public. OFHEO continued briefings with Congressional committee members and staff on issues related to ongoing oversight of the Enterprises, hearings, legislation and the implementation of the risk-based capital regulation. OFHEO continues to post proposed and final regulations, reports, guidelines, speeches, testimony and other pertinent information on its web site, www.ofheo.gov, as soon as it is available.

STRATEGIC OBJECTIVE 4: CONTRIBUTE TO FEDERAL EFFORTS TO PROMOTE EFFICIENT AND EFFECTIVE FINANCIAL MARKETS AND HOMEOWNERSHIP.

In recent years, new technologies, consolidation, and new approaches to pricing and managing financial risks have transformed the U.S. financial system and made safety and soundness regulation of financial institutions increasingly complex. The Enterprises have become the dominant firms in the housing finance markets and are increasingly important participants in the financial system as a whole. These developments have important implications for the Federal policy objectives of promoting the efficiency of the financial system and mortgage markets, ensuring the safety and soundness of the Enterprises, increasing homeownership, and enhancing the availability of affordable housing. OFHEO will work with other Federal agencies to coordinate efforts to analyze current trends, understand their implications for federal policy objectives, identify and analyze policy options, share regulatory knowledge and expertise, and promote regulatory best practices related to safety and soundness examination issues.

Performance Goal 4.1: Cooperate with other Federal financial regulators on regulatory issues.

Performance Measure 4.1(1): Initiate interactions with other regulators on emerging trends and issues identified in FY 2001.

Performance Measure 4.1(2): Respond within 30 days to requests from other Federal agencies for information about housing finance markets and the Enterprises.

Performance Measure 4.1(3): Participate in on-going task forces and forums with other regulatory agencies.

Actual Performance:

2002	<u>Goal Met.</u> Cooperated with other Federal financial regulators on regulatory issues.
2001	Worked with HUD on regulatory issues of a common interest. Cooperation with Federal financial regulators has been ongoing.
2000	Cooperation has been ongoing.
1999	Cooperation has been ongoing.

While OFHEO had contributed to Federal efforts in an ongoing way, this was the first year that OFHEO raised its participation to the strategic objective level. OFHEO continued work with the other Federal financial regulators, the U.S. Treasury, the Securities and Exchange Commission (SEC), the Council of Economic Advisors, the Justice Department, and the Department of Housing and Urban Development on a variety of issues. These include subprime lending practices, mortgage fraud, the mortgage protection program, corporate disclosure, Federal Housing Administration (FHA) issues, early warning systems for risk management and risk modeling, examination practices, and planning, performance management and performance measurement. OFHEO has been asked to lead an interagency working group on Communication and Coordination for the Financial and Banking Information Infrastructure committee, a standing committee of the President's Critical Infrastructure Protection Board. OFHEO also worked with the SEC and the U.S. Treasury to study disclosure related to mortgage-backed securities, as described in Performance Goal 3.5.

Human Resources Strategy: *Ensure OFHEO's human resources efficiently support the regulatory mission.*

OFHEO management recognizes that OFHEO's workforce is a critical foundation for attaining all four of its strategic objectives. A skilled, motivated and diverse workforce, with the unique talents and abilities required to oversee the government sponsored enterprises is key to OFHEO's success. This same workforce continues to be in high demand nationwide. OFHEO's small size and its specialized information systems, and financial analysis and economics requirements make

recruitment and retention of these highly specialized staff a priority and a challenge. OFHEO's experience with staff turnover and the associated erosion of depth in key mission-related areas makes it necessary to ensure that OFHEO's small staff has sufficient breadth and depth to carry out the full range of duties and minimize disruption during staff turnover.

Performance Goal 5.1: Ensure that OFHEO's performance appraisal system provides incentives for staff to achieve OFHEO's strategic goals.

Performance Measure: OFHEO staffs' Job Performance Plans are tied to OFHEO's annual performance plans and strategic plans.

Actual Performance:

2002	<u>Goal Met.</u> Staff Job Performance Plans are tied to strategic and annual performance plans.
2001	Staff Job Performance Plans are tied to strategic and annual performance plans.
2000	Staff Job Performance Plans are tied to strategic and annual performance plans.
1999	Staff Job Performance Plans are tied to strategic and annual performance plans.

Performance expectations are described in each staff member's Job Performance Plan. These Job Performance Plans were renewed or revised at least at the start of the performance appraisal period to ensure an appropriate link with OFHEO's Strategic Plans and Annual Performance Plans, which are shared with every employee. OFHEO staffs' pay adjustments are not automatic but are based on their performance.

Performance Goal 5.2: Ensure that OFHEO's staff maintain expertise in their professions by maintaining and enhancing their knowledge and skills necessary to regulate large complex financial institutions and achieve OFHEO's goals.

Performance Measure 5.2(1): OFHEO staff participate in professional development activities or training programs averaging two per staff member per year.

Performance Measure 5.2(2): OFHEO staff participate in interagency forums, or joint projects with other financial regulators or professional groups averaging one per staff member per year.

Actual Performance:

2002	Goal Met. Staff participated in professional development activities and interagency projects and forums.
2001	Staff participation in professional development activities and interagency forums has been ongoing. Data not available.
2000	Staff participation in professional development activities and interagency forums has been ongoing. Data not available.
1999	Staff participation in professional development activities and interagency forums has been ongoing. Data not available.

OFHEO staff continue to expand their horizons through technical training and interagency projects. This investment ensures that staff stay abreast of changes in the Enterprises and in the financial, regulatory and technological environment in which the Enterprises and OFHEO operate, and stay current in their professions. In addition to the interagency projects that were described in the other performance goals, skill development included participation in courses and conferences in Best Audit Practices, Fixed Income Analytics, the Credit Risk Summit, MBA's e-Mortgage Workshop and Java for Distributed System Development, among others.

Performance Goal 5.3: Ensure OFHEO's compensation system and complementary human resources programs are comparable to other Federal financial regulators.

Performance Measure 5.3: No more than 10% of applicants decline a job offer because OFHEO's compensation system and complementary human resources programs are less attractive to the applicant than those of another Federal financial regulator.

Actual Performance:

2002	Goal Met. No offers were declined.
2001	Data not available.
2000	Data not available
1999	Data not available

OFHEO continued to hire staff as planned. No offers were declined.