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OFFICE OF FEDERAL HOUSING  
ENTERPRISE OVERSIGHT

*Annual Performance Plan*

*FY 2004*

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**MARCH 28, 2003**

## **OFHEO's FY 2004 ANNUAL PERFORMANCE PLAN**

### **OFHEO 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.**

### **OVERVIEW**

#### **Introduction**

Congress created the Office of Federal Housing Enterprise Oversight (OFHEO) in 1992 to ensure that Fannie Mae and Freddie Mac (the Enterprises) are adequately capitalized and operating safely so they could continue to accomplish their important public missions. These government sponsored enterprises play a critical role in housing finance, keeping funds flowing to mortgage lenders, and in turn, to homeowners. Through effective regulation of the Enterprises, OFHEO contributes to a robust housing sector in the United States and the health of the nation's economy.

OFHEO was established as an independent office within the Department of Housing and Urban Development (HUD) by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the Act) (Title XIII of P.L. 102-550). Its operations are funded through assessments on Fannie Mae and Freddie Mac and represent no direct cost to the taxpayer. To fulfill its mission, OFHEO has regulatory authority similar to other Federal financial regulators such as the Office of the Comptroller of the Currency (OCC) and the Federal Reserve Board (FRB). OFHEO's responsibilities include broad rulemaking authorities and specific authorities to conduct annual examinations, set capital standards, take enforcement actions and conduct research.

OFHEO primarily accomplishes its mission by conducting examinations of the Enterprises, assessing their capital adequacy, and conducting research and analysis on the Enterprises, the environment in which they operate, and the nature of the risks that they face.

#### **The Enterprises that OFHEO Regulates**

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.

In performing their mission, they link capital market investors and primary lenders and have become two of the nation's largest financial institutions. The linkage helps provide continuous access to funds for mortgage lenders and lower interest rates for borrowers. In calendar year 2001, the two Enterprises assisted in the funding of over \$1 trillion of mortgages. In recent

years, the Enterprises' market share of residential mortgage debt has increased. By September 2002, Fannie Mae and Freddie Mac held in portfolio or guaranteed in the form of mortgage-backed securities 45 percent of the \$6.7 trillion in total residential mortgage debt outstanding. Over the past decade, they have assisted in funding \$5 trillion of mortgages. In the fourth quarter of 2002, the homeownership rate was 68.2 percent, surpassing the previous record level of 68.1 percent set in the third quarter of 2001.

To assist Fannie Mae and Freddie Mac in achieving their public mission, they receive numerous explicit benefits from the Federal government. These include an exemption from state and local income taxes, an exemption from the registration requirements of the Securities and Exchange Commission (SEC), and conditional credit lines available with the U.S. Treasury. However, the most important benefit is implicit. Because of investors' belief in an implied U.S. government guarantee on their securities, the Enterprises have been able to borrow money more cheaply and without the practical volume restrictions faced by other AAA-rated companies. This market perception also allows the Enterprises to operate with a higher degree of leverage than fully private firms.

The Enterprises have two principal lines of business--guaranteeing securities backed by pools of mortgages and investing in mortgages. These activities provide the linkage to the capital markets that enables the Enterprises to carry out their mission, but also expose the Enterprises to risks. These business lines, their growth, and associated risks are described more fully in OFHEO's FY 2000-2005 Strategic Plan.

To finance their operations, the Enterprises are active as major players in the capital markets. They enter the debt markets to fund the growth in their assets and enter into derivatives transactions to hedge against the risks inherent in funding mortgage assets with debt. These activities are also described more fully in OFHEO's FY 2000-2005 Strategic Plan.

The Enterprises held or guaranteed over \$3.1 trillion in mortgages as of the end of 2002. The Enterprises changed their business strategies over the last few years in favor of rapidly increasing their mortgage portfolio investments. As a consequence, at the end of 2002, their mortgage portfolios accounted for 43 percent of their total mortgage business, up from 19 percent in 1992. In dollar terms, the Enterprises increased their mortgage portfolio holdings from \$190 billion in 1992 to \$1.4 trillion. This realignment in business strategy significantly alters the risk profile of the Enterprises, shifting risk management from credit risk to both credit risk and interest rate risk management.

In response to more ambitious affordable housing goals and the shift in business strategy, the Enterprises have developed new business products with increasing sophistication and complexity. Fannie Mae and Freddie Mac structured 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 complex funding strategies. For example, 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, representing 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 the Enterprises' 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.

Another developing trend is the extent to which consumers are prepaying mortgage loans more rapidly than in the past. This development may represent a shift in the market risk of the Enterprises. OFHEO must be positioned to evaluate this and other trends and understand any changes in an Enterprise's risk profile as it evolves.

Events of the past year have precipitated a crisis in confidence in corporate America. The nation has been faced with revelations in the areas of corporate leadership and accountability. The President has called upon corporate executives to perform their duties in good faith and to disclose relevant facts to the public. The Administration has developed a ten-point program to provide better information for investors, make corporate officers more accountable, and develop stronger, more independent audit systems. OFHEO and the Enterprises are taking additional steps to ensure that the integrity of the Enterprises' operations and financial conditions continues to be at the highest levels.

In prior years, OFHEO has determined that the Enterprises are managed in a way that exceeds safety and soundness standards and has classified them as adequately capitalized. OFHEO's FY 2004 Performance Plan and Budget Request are designed so that OFHEO can continue to evaluate the Enterprises in this dynamic environment.

**OFHEO'S MISSION STATEMENT**

**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.**

OFHEO has developed a strategic goal and three strategic objectives to achieve its mission.

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

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

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\* OFHEO developed its strategic objectives for the FY 2000-2005 Strategic Plan and made a revision in the FY 2003 Performance Plan.

***STRATEGIC OBJECTIVE 1: ENSURE THE ENTERPRISES COMPLY WITH SAFETY AND SOUNDNESS STANDARDS, ARE ADEQUATELY CAPITALIZED, AND COMPLY WITH OTHER LEGAL REQUIREMENTS.***

OFHEO's primary duty as a regulator is to ensure that the Enterprises have the financial strength to fulfill their important role in the nation's housing finance system. Providing a comprehensive and effective oversight program requires attention to the Enterprises, the dynamic environment in which they operate, the risks inherent in their activities, and their management. Maintaining risk-based standards and understanding the risk profiles of the Enterprises is basic to OFHEO's ability to ensure their continuity.

OFHEO must maintain its ability and capacity to ensure that specific issues and emerging trends that may affect safety and soundness are identified early and that potential vulnerabilities are appropriately addressed. Critical to accomplishing its mission are the knowledge, skills and expertise OFHEO acquires through its examinations and the insights gained from its research and analysis. 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.

Ensuring capital adequacy is a key part of the oversight program. 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.

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 1.1:      The Enterprises meet or exceed safety and soundness standards.**

Performance Measure:      Each Enterprise responds appropriately to 100% of OFHEO's safety and soundness concerns.

Means and Strategies:

On a calendar year cycle, OFHEO conducts risk-based examinations annually at each Enterprise. In advance of the examination, OFHEO completes and communicates the Examination Strategies for each Enterprise.

An integral part of the examination program is identifying risks, developing risk-focused examination strategies and updating those strategies as risk profiles change. OFHEO bases the examination strategies on an analysis of the risk profiles of each Enterprise combined with a comprehensive and systematic review of the assessment factors and the corresponding evaluation criteria for each of the examination program areas.

Each quarter, OFHEO updates the risk profile for each Enterprise and revises the examination strategies as necessary. This updated risk profile benefits from: the analytical work conducted through the Surveillance and Monitoring program; the financial analysis tools; technical work being conducted and special studies; economic analysis; and environmental analysis.

Throughout the course of conducting the examination, OFHEO communicates with Enterprise personnel not only to gather information, but also to share findings and discuss observations. The communications conducted during the examination range from informal to formal. Regardless of the format, OFHEO has the same goal for all communications: that the free flow of information further the objective of ensuring the safe and sound operations of the Enterprises.

Communications are tailored to the individual structure and dynamics of the Enterprises, and the timing of the communications depends on the situation being addressed. OFHEO keeps each Enterprise's executive management and Board of Directors appropriately informed and communicates with them as often as required by the Enterprise's condition and the nature of the findings from examination activities. OFHEO brings to the immediate attention of the Board and executive management those issues that introduce a risk exposure to the stable operation of the Enterprise, otherwise fall under the normal duties and responsibilities of the Board or warrant the Board's attention. Technical issues and matters relating to a single line of business or activity will generally be brought to the attention of operating managers, with the Board and executive management kept appropriately informed.

A primary goal of the examination process is to influence positive changes at the Enterprises to enhance their financial safety and soundness. The nature of OFHEO's efforts relates directly to the risk presented by an issue. If, for example, in the course of an examination, OFHEO identifies a significant issue in risk management systems or an undesirable risk level, OFHEO will require management to develop and execute a corrective action plan, and will ensure that the Board holds management accountable for executing the action plan. OFHEO will review the action plan to ensure that it identifies the steps or methods required to cure the root causes of significant deficiencies, and to determine whether the plan is likely to resolve any significant concerns within an appropriate time frame. As part of follow-up, OFHEO will verify that the action plan has been executed and evaluate its success.

OFHEO considers the responsiveness of the Enterprises in recognizing the issue and formulating an effective solution when determining if OFHEO needs to take incremental supervisory action. If an Enterprise is unresponsive or unable to effect the resolution of

meaningful issues, OFHEO will take more formal steps to ensure that deficiencies are corrected.

To comprehensively examine the Enterprises' risks as they continue to grow, realign their business strategies, expand business products to meet their public mission, and employ cutting-edge risk-management techniques based on rapid changes in technology, OFHEO's FY 2004 budget request includes the second phase of a planned expansion of examination staff and complementary technology initiatives. The new examiners will provide needed depth in examining the Enterprises' core credit, market, and interest rate risk areas to keep pace with continued rapid growth of the two companies. They will also provide capacity to expand the scope and depth of the program to include new and emerging risk areas including accounting practices, risk measurement methods, structured financial transactions, business recovery planning, internal financial models, and compliance with capital requirements, particularly risk-based capital. The increased capacity will also bolster the program's infrastructure to ensure that industry "best practices" are used as evaluation criteria for all of the risk areas being examined and to conduct regulatory benchmarking to ensure consistency and relevance of safety and soundness standards.

OFHEO's database expansion and improved retrieval and reporting tools will provide enriched information for the examiners to better evaluate risks. The Examiner Workstation investment will provide examiners with a comprehensive tool to access information necessary to assess risk from a single software application on their computer, both onsite and off-site (at the Enterprises). The Examiner Workstation is similar in concept to initiatives being developed at the Federal Reserve and the OCC. During FY 2004, OFHEO will develop a prototype of the Examiner Workstation.

Related FY 2003 Goal and Prior Year Performance Information:

2004	The Enterprises meet or exceed safety and soundness standards. Each Enterprise responds appropriately to 100% of OFHEO's safety and soundness concerns.
2003	The Enterprises meet or exceed safety and soundness standards. The number of safety and soundness concerns not having an appropriate action taken is zero. (FY 2003 Performance Goal 1.1)
2002	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.



**Performance Goal 1.2: Each Enterprise is adequately capitalized.**

Performance Measure 1.2(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 1.2(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.

Performance Measure 1.2(3): Using a variety of analytics, environmental scans and early warning systems, each Enterprise is determined by the OFHEO Director to be adequately capitalized on at least a quarterly basis.

Performance Measure 1.2(4): Continually review and update, as appropriate, the risk based capital rule and model and other measures of capital adequacy to reflect developments and new risk measurement techniques relevant to Enterprise risks.

Performance Measure 1.2(5): Whenever an Enterprise does not comply with OFHEO's capital requirement, OFHEO receives an acceptable capital plan.

Means and Strategies:

Determining the adequacy of an institution's capitalization is central to a financial safety and soundness regulator's responsibility. When assessing the capital adequacy of Fannie Mae and Freddie Mac, it is important for OFHEO to consider a series of relevant factors as part of its analysis: the various strengths and vulnerabilities of each Enterprise; the quality of the management teams; the health of the U.S. economy; and the health of the U.S. housing markets. Through its regulatory programs, OFHEO determines whether the level of capital is sufficient to allow the Enterprises to function as viable institutions in the environment in which they operate.

Capital adequacy can be determined appropriately only on a case-specific basis. The interaction of many factors, both qualitative and quantitative, must be considered when evaluating an Enterprise's capital. Although a quantitative assessment of Enterprise risks is primary, evaluation of capital adequacy is also influenced by prevailing and anticipated economic conditions and numerous subjective considerations. Among the subjective considerations rendered by OFHEO are determinations about the Enterprises' quality of: executive and operating management; liquidity management and debt performance;

earnings; assets and counterparty exposures; risk management and risk diversification; and its operating procedures, internal controls, and strategic planning.

Through its various regulatory programs, OFHEO undertakes to ensure the Enterprises remain appropriately capitalized. Capital compliance with the statutory prescriptions is achieved through quarterly measurements. In addition, there are routine updates about the Enterprises' financial condition and operating environment provided through the Agency's examinations, scenario analyses, economic analysis, alternative modeling tools, and research. Augmenting quantitative measurements of capital are the qualitative assessments about the Enterprises' financial condition and operating environment, which position the Director to make informed decisions about capital adequacy.

OFHEO will continue to determine if each Enterprise meets the quantifiable capital requirements at least quarterly on the basis of OFHEO's minimum capital and risk-based capital standards, as required by law. These are the first two performance measures. For the minimum capital standard, an Enterprise must have core capital – common stock, perpetual non-cumulative preferred stock, paid-in capital, and retained earnings – equal to or exceeding its minimum capital requirement. For the risk-based capital standard, an Enterprise must have total capital (core capital plus a general allowance for loan losses) equal to or exceeding its risk-based capital requirement.

FY 2004 is the second full year that the risk-based capital standard will be used for capital classification. For the calculation of the risk-based capital level, each Enterprise submits data in a format specified by OFHEO. This Risk-Based Capital report, after initial validation of the data by OFHEO, is used to run the Financial Simulation Model, which applies the stress test and produces the risk-based capital level for each Enterprise. OFHEO reviews the results of the model thoroughly to verify their accuracy, and to identify sources of change in the risk-based capital level of an Enterprise from prior quarters.

The risk-based capital standard is designed to take into account the dynamic nature of the Enterprises' businesses. As part of the process to measure risk-based capital levels, every quarter OFHEO must evaluate the risk implications of novel debt instruments, hedging vehicles, credit enhancements, mortgage products and other new Enterprise activities. The risk-based capital standard has the flexibility to incorporate these new activities into the existing stress test in the quarter when they first appear. Initial treatments are proposed by the Enterprises and OFHEO approves them or assigns alternative treatments. As appropriate, OFHEO will describe treatments of new Enterprise activities at the time of the risk-based capital classifications, on the OFHEO web site to inform the public and to invite comments. If the risk or volume of any instrument changes in future quarters, the Director may consider it a new activity and OFHEO will perform the necessary research, analysis, and software development to more accurately capture risk; adjust the standard data reporting format; and, if warranted, propose changes to the risk-based capital rule. OFHEO anticipates that ongoing maintenance of the risk-based capital rule, especially for treatments of new Enterprise products and activities in the stress test, will require extensive interaction with the Enterprises and the public.

During FY 2004, OFHEO will continue to verify, analyze, and present both the results and findings of the Financial Simulation Model and additional risk analysis in an effective manner. OFHEO will perform additional risk analysis and tests to address risks that may not be reflected in the stress test. These results, coupled with the additional information about the quality of the Enterprises' operations and financial conditions, will provide additional information to the Director to make informed decisions about capital adequacy. They are captured in Performance Goal 1.2(3).

Maintaining the most up-to-date and effective risk-based capital rule and other measures of risk and capital adequacy is essential to meeting OFHEO's safety and soundness mandate. Because of its importance in ensuring capital adequacy, OFHEO has made this an additional Performance Measure 1.2(4). In order for OFHEO to regulate the Enterprises effectively, the risk-based capital standard must respond to innovations in the housing finance markets and the Enterprises' operations. Over time, as the Enterprises take on new risks, and as the market and industry practices evolve, OFHEO must study how these affect the capital adequacy of the Enterprises to ensure that the risk-based capital analysis appropriately captures risk.

As additional historical data become available and as new techniques are developed to more accurately measure risk, OFHEO also must determine whether and how to incorporate these into the risk-based capital standard and other approaches to determining risk and capital adequacy. This requires that OFHEO continue with its ongoing program of research and analysis. In FY 2004, OFHEO will continue to research those areas already identified, and will further study suggestions and comments from the public on enhancing and refining the risk-based capital model. OFHEO has identified specific areas needing further study in FY 2004, such as borrower credit scores and subprime mortgage loans, and alternative ways of evaluating capital adequacy and the risk of failure in financial institutions. In addition, on an ongoing basis, OFHEO will be analyzing the results of the model in order to identify developing trends and emerging issues that must be explored in order to determine whether and how the risk-based capital stress test and analysis should be modified to reflect accurately the evolving risk exposure of each Enterprise.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Each Enterprise is adequately capitalized.
2003	Each Enterprise is adequately capitalized. Each Enterprise's actual capital meets or exceeds applicable capital requirements at least quarterly (ratio of actual capital to required capital is greater than one). (FY 2002 Performance Goal 1.2) Ensure the Risk-Based Capital model and other measures of capital adequacy are updated to incorporate new techniques in measuring risk. (FY 2002 Performance Goal 1.3)
2002	Quarterly minimum capital classification ratios Fannie Mae: 1.028 to 1.05 Freddie Mac: 1.04 to 1.103  Third Quarter CY 2002 risk-based capital ratios (first enforceable application of the risk-based capital standard)

	<p>Fannie Mae: 1.332 (increasing interest rate scenario is binding)                  Freddie Mac: 4.696 (decreasing interest rate scenario is binding)</p> <p>To ensure that the risk-based capital model is updated to incorporate new techniques in measuring risk, several projects are under development, such as enhancing empirical modeling to measure interest rate risk and exploring potential supplementary risk measurement techniques.</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>

**Performance Goal 1.3:        Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure.**

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

Means and Strategies:

OFHEO periodically reviews the Enterprises' compliance with laws, regulations and directives that are under OFHEO's jurisdiction. OFHEO's internal reviews may be conducted by committees or working groups, in some cases as issues arise (e.g., the Enterprises' use of derivatives). If compliance is associated with OFHEO's established risk assessment factors for examination, the review may be part of the risk-based examination (e.g., compliance with the National Flood Insurance Act or OFHEO's Policy Guidance on non-mortgage liquidity investments). OFHEO also monitors the early-alert triggers described in the Prompt Supervisory Response regulation so that any needed regulatory response would be timely. OFHEO will also monitor Enterprise disclosure to ensure that it conforms with applicable laws and regulations.

OFHEO's statute requires the Director to prohibit the Enterprises from providing excessive compensation to any executive officer. Additionally, the Enterprises' Charter Acts require the Enterprises to obtain the prior approval of OFHEO's Director before entering into or changing agreements to provide termination benefits to executive officers. OFHEO reviews overall compensation and termination benefits to see that they meet statutory requirements for comparability with payments made by comparable organizations.

OFHEO, with the assistance of an executive compensation consulting firm, has completed an extensive study of executive compensation at the Enterprises in FY 2002. The study identified an updated peer group of comparable firms. Using that peer group and other publicly available information, OFHEO will continue to monitor changes in executive compensation at the Enterprises in FY 2004 to ensure that such compensation is not excessive. Also, when an Enterprise submits for OFHEO's approval an agreement or amendment to an agreement that provides termination benefits to an executive, OFHEO will review and act upon the Enterprise's request. OFHEO will also monitor the Enterprises' compliance with the executive compensation regulation and, if necessary, take appropriate steps to assure their compliance.

If during the course of examinations or through other means, facts or allegations arise that suggest an Enterprise may have violated a law not within the purview of OFHEO's direct enforcement authority, OFHEO may investigate the matter and determine if specific regulatory action is required or may determine to refer specific facts and allegations to the appropriate regulatory or law enforcement authority for further action. Should a violation of law be determined by another regulator or by a judicial body under a statute not within OFHEO's direct enforcement authority, OFHEO may take such supervisory action as deemed necessary within its authorities relating to safety and soundness and the charter acts.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure.
2003	Ensure the Enterprises comply with applicable laws, regulations and directives. (FY 2003 Performance Goal 1.4)
2002	No instances of violation.
2001	No instances of violation.
2000	No instances of violation.
1999	No instances of violation.

**STRATEGIC OBJECTIVE 2: 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 2.1: Enhance awareness and understanding of housing and mortgage market developments and Enterprise risks and activities.**

Performance Measure 2.1 (1): Analyze and report about house price trends quarterly through the House Price Index (HPI) report.

Performance Measure 2.1(2): Analyze and report about the secondary mortgage market annually.

Performance Measure 2.1(3): Report on OFHEO activities and examination results and conclusions in the OFHEO annual Report to Congress.

Means and Strategies:

OFHEO provides information about house prices, mortgage markets, and the Enterprises on a regular basis through several vehicles. OFHEO's quarterly House Price Index (HPI) documents changes in home prices for the nation, each state, the nine census regions, and metropolitan statistical areas (MSAs). Originally developed for use in OFHEO's stress test as part of the risk-based capital model, this repeat transactions index provides the public with a reliable indicator of movements in real estate values. OFHEO posts the HPI on its web site each quarter. Many researchers, analysts and practitioners rely on OFHEO's HPI. In addition to the HPI, in FY 2004 OFHEO will also update median house price data that it will begin publishing in FY 2003. These data, which give OFHEO additional information on house prices, will be provided to HUD and the Treasury Department for their use in implementing other programs and will also be made available to the public.

OFHEO publishes an annual review of housing finance market developments, including the financial performance and activities of the Enterprises, as well as comprehensive historical Enterprise data. OFHEO also issues publicly its annual Report to Congress, which summarizes the results and conclusion of OFHEO's annual risk-based examination

of the Enterprises and describes OFHEO’s activities in the preceding calendar year. The review and the report are available by June 15th, annually.

On a quarterly basis, OFHEO will disclose appropriate information about each Enterprise’s compliance with both the minimum and risk-based capital standards. The information will include non-proprietary details relating to the calculation of the minimum capital requirement and a description of the Enterprise’s performance in the risk-based capital stress test. OFHEO will also continue analyses of appropriate disclosure of information about Enterprise risks and activities to expand public awareness of the financial health of the Enterprises.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Enhance awareness and understanding of housing and mortgage market developments and Enterprise risk and activities.
2003	Enhance awareness and understanding of housing and mortgage market developments and Enterprise risk and activities. (FY 2003 Performance Goal 2.1)
2002	Analysis of the secondary mortgage market issued September 2002. Annual Report on OFHEO activities and examination results and conclusions sent to Congress June 15, 2002. House Price Index (HPI) Report issued quarterly.
2001	Annual Report sent to Congress June 15, 2001. HPI Report issued quarterly. Analysis of secondary mortgage market issued separately, July 2001.
2000	Annual Report sent to Congress June 15, 2000. HPI Report issued quarterly.
1999	Annual Report sent to Congress June 15, 1999. HPI Report issued quarterly.

<p><b>Performance Goal 2.2:      Undertake research and analysis of risks and emerging issues.</b></p>
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Performance Measure:      Completion of FY 2004 research as called for in the FY 2003 research plan (as revised).

Means and Strategies:

OFHEO’s research enables the Office to understand how changes in the market impact the Enterprises and conversely how changes in Enterprise operations impact the market. OFHEO relies primarily on its first strategic objective, “Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements, to achieve its mission”. OFHEO’s research is designed to support the Office’s supervisory efforts in fostering safety and soundness through examinations, capital standards, and the regulatory regime. OFHEO’s seven broad objectives for its research and analysis describe the areas in which additional investigation will be crucial

to keeping OFHEO's supervisory structure pro-active and at pace with the dynamics of the markets and the Enterprises. The objectives are:

- Enhance OFHEO's risk based capital stress test.
- Evaluate alternative approaches to assessing the risk of failure and capital adequacy of financial institutions.
- Develop an early warning system to use within OFHEO to monitor the ongoing safety and soundness of the Enterprises.
- Assess disclosures by the Enterprises and other public firms.
- Understand how the Enterprises affect and are affected by the economy.
- Understand the Enterprises and the financial sector.
- Understand the potential costs and benefits of changes in public policies related to the housing finance system.

In the fourth quarter of FY 2003, OFHEO will adopt a research plan for FY 2004 to ensure that research priorities are set to address current issues, using the most recent research information and available data and resources. The plan will identify the topics on which OFHEO plans to conduct empirical research and policy analysis during the fiscal year. The timing of the development of the plan will allow OFHEO to select topics based on knowledge of current issues, the most recent research, and available data and resources. The plan will establish goals for the preparation of reports, staff studies, professional papers, or other analyses or publications. OFHEO will revise the plan as needed during FY 2004 to take into account research priorities that emerge during the year.

Because of the proprietary nature of certain information, some of the projects will be for internal use only and others will be available for public dissemination. Reports, staff studies, and other analyses released by OFHEO will provide valuable information to the public and enhance understanding of the housing finance system, the Enterprises, and related policy issues.

OFHEO's FY 2004 budget request is key to achieving this goal during FY 2004 and in the future. OFHEO's FY 2000-2005 Strategic Plan envisions an active research and analysis agenda to increase OFHEO's and the public's understanding of the Enterprises and the mortgage industry. The budget anticipates continuing OFHEO's level of effort in research, data, modeling and analytical tools, and information technology, and continuing to develop the data warehouse. Without the requested funding, these research and analysis activities would need to be scaled back, as they would be prioritized behind running the quarterly risk-based capital stress test, producing the quarterly House Price Index, and enhancing the stress test to accommodate new GSE activities. Opportunities for research and analysis that could improve the stress test and OFHEO's framework for analyzing risk and capital adequacy, as described in Performance Goal 1.2, would be slowed or foregone.



Related FY 2003 Goal and Prior Year Performance Information:

2004	Undertake research and analysis of risks and emerging issues.
2003	Undertake research and analysis of risks and emerging issues. (FY 2003 Performance Goal 2.2)
2002	Research and analysis of emerging issues have been ongoing. OFHEO made progress on its research agenda.
2001	Research and analysis have been ongoing. Additional research priorities have been developed.
2000	Research and analysis have been ongoing.
1999	Research and analysis have been ongoing.

**Performance Goal 2.3: Communicate effectively with all stakeholders on regulatory issues.**

Performance Measure 2.3(1): Consider and respond appropriately to all Congressional and public inquiries within 7 days.

Means and Strategies:

OFHEO will continue to expand its communications with Congress to ensure that legislators have an understanding of the condition and activities of the Enterprises as well as OFHEO’s operations, proposals, and regulatory activities. In addition to providing testimony and reports to Congress, OFHEO will continue to strengthen its existing and develop new relationships with the legislative branch.

OFHEO will respond appropriately to public inquiries regarding the Enterprises as well as OFHEO’s operations, proposals and regulatory activities to ensure appropriate transparency. OFHEO representatives will continue to speak at industry forums to provide information about the secondary mortgage market, the Enterprises, and OFHEO’s regulatory role.

OFHEO will continue to update its web site timely with OFHEO products: Reports, testimony, speeches, news releases, the quarterly house price index, capital classifications and staff working papers. OFHEO will also continue to respond timely and effectively to inquiries from Congress and the public.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Consider and respond appropriately to all Congressional and public inquiries within 7 days.
2003	Consider and respond appropriately to all Congressional and public inquiries within 7 days. (FY 2003 Performance Goal 2.3--revised)

*OFHEO FY 2004 Performance Plan*

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2002	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.

**STRATEGIC OBJECTIVE 3: 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 3.1: Cooperate with other Federal financial agencies on regulatory issues.**

Performance Measure 3.1(1): Respond within 30 days to requests from other Federal agencies for information about housing finance markets and the Enterprises.

Performance Measure 3.1(2): Participate in on-going task forces and forums with other regulatory agencies.

Means and Strategies:

In FY 2004, OFHEO will continue to support interagency efforts to identify and analyze emerging trends and policy issues related to housing finance, homeownership, and affordable housing, as well as broad public policy issues affecting the Enterprises. OFHEO will participate in and host seminars, brown-bag lunch presentations, and other informal meetings of federal and nonfederal researchers, analysts, and examiners, and may sponsor more formal meetings.

To support OFHEO's research and analysis, the Office is continuing to develop a data warehouse which will have a comprehensive database on housing finance markets and the forms of federal credit assistance--direct loans, loan guarantees, insurance, and government sponsored enterprises (GSEs)--that promote homeownership and affordable housing. OFHEO anticipates using the data warehouse to provide information (within well-defined confidentiality rules and controls) to other federal agencies, as requested, to support on-going federal research needs. OFHEO will implement the next stages of this data warehouse as described in OFHEO's Strategic Plan and 5-Year IT Strategic Plan (see Performance Goal 4.2).

OFHEO will continue to participate in a number of interagency task forces and forums related to housing finance, safety and soundness regulation, and housing, such as: the Interagency Task Force on Fair Lending, the Interagency Task Force on Predatory Lending, the Ad Hoc Credit Scoring Group, the HUD GSE Working Group, the Working Group on Mortgage Fraud, the GSE Examination Council, the Federal Financial Regulators Results Act Working Group, the Financial and Banking Information Infrastructure Committee, and the Federal Financial Institutions Examination Council (FFIEC) Information Systems Subcommittee.

As described in Performance Goal 2.3, OFHEO will continue to expand ways to communicate with all stakeholders. Through improved interaction with stakeholders, OFHEO will stay abreast of private sector efforts to promote efficiencies in the market, expand homeownership and achieve other public policy goals, and will help ensure that public policy development takes private sector efforts into account.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Cooperate with other Federal financial agencies on regulatory issues.
2003	Cooperate with other Federal financial agencies on regulatory issues. (FY 2003 Performance Goal 3.1)
2002	Worked with other Federal financial regulators on regulatory issues.
2001	Worked with HUD on regulatory issues of a common interest. Cooperation has been ongoing.
2000	Cooperation has been ongoing.
1999	Cooperation has been ongoing.

**Performance Goal 3.2:      Ensure there is sufficient disclosure of information regarding Enterprise operations to allow market participants to trade their obligations efficiently and effectively in the financial markets.**

Performance Measure 3.2(1): Any identified instances of non-compliance with laws, regulations or directives regarding disclosure are resolved to OFHEO's satisfaction.

Means and Strategies:

Market discipline can be a useful supplement to regulation in promoting safety and soundness. Adequate financial disclosure is essential for such discipline and can also contribute to the efficiency of financial markets, generally.

OFHEO will continue to monitor the Enterprises' compliance with rules and regulations on financial disclosure. OFHEO will also update regulatory standards, as appropriate, to ensure their continued effectiveness in facilitating market innovations, accommodating changes in financial products, and addressing emerging market risks. OFHEO will work in concert with the Securities and Exchange Commission, the Treasury Department, and other Federal agencies to ensure complementary activities and uniformity of supervisory standards.

***THIS IS A NEW PERFORMANCE GOAL.***

Related FY 2003 and Prior Year Performance Information:

2004	Ensure there is sufficient disclosure of information regarding Enterprise operations to allow market participants to trade their obligations efficiently and effectively in the financial markets.
2003	Issue final disclosure regulation. Complete joint staff review with the Securities and Exchange Commission and the Treasury Department on disclosure related to Mortgage-Backed Securities.
2002	Drafted proposed disclosure regulation. Participated in joint staff review with the Securities and Exchange Commission and the Treasury Department on disclosure related to Mortgage-Backed Securities.
2001	No related performance goal.
2000	No related performance goal.
1999	No related performance goal.

**RESOURCE MANAGEMENT STRATEGY: MANAGE OFHEO RESOURCES EFFECTIVELY TO ENABLE THE OFFICE TO FULFILL ITS MISSION.**

OFHEO's success in achieving its strategic objectives depends on the effective management of its resources and seamless financial and administrative support functions. The size of OFHEO's budget in relation to its mission requires OFHEO to use its limited resources efficiently and that its resources be tied directly to the achievement of its mission. As a small office, OFHEO relies on staff and management to accomplish its goals through matrix management of cross-organizational teams, timely information for decision-making, and coordination.

OFHEO's management philosophy reflects the Administration's government-wide management goals. A lean organization, OFHEO relies on private sector services and products wherever practicable. OFHEO's procurement processes are increasingly electronic and reliant on performance-based contracting.

**Performance Goal 4.1: Maintain a high-caliber workforce.**

Performance Measure: Revise Individual Development Plans for each staff member annually to ensure OFHEO staff maintains and enhances the expertise and skills necessary to achieve the Office's goals.

Means and Strategies:

OFHEO's staff are its most valuable resources. 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 will focus additional efforts to continue to attract and maintain a high performance workforce, and provide appropriate training and incentives for achievement of OFHEO's performance goals.

OFHEO must continue to invest in staff development in order to enable the staff to perform their jobs effectively. This is particularly important with OFHEO's small size. This investment ensures that staff stay abreast of changes in the Enterprises and in the financial, regulatory, and technological environments in which the Enterprises and OFHEO operate. For OFHEO to carry out its mission in regulating large, complex financial institutions with a small staff, the staff must be current in the breadth and depth of the skills they need so that OFHEO can achieve its goals. Many positions are unique. They are involved with specialized technical models, management of proprietary and technical information, and responsibilities that are distinctive to, and necessary for, a safety and soundness regulator as envisioned by Congress. In FY 2002, OFHEO staff and managers established Individual Development Plans (IDPs) for each staff member. In FY 2004, managers and staff will review progress and agency needs and update the IDPs as appropriate.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Maintain a high-caliber workforce. Revise Individual Development Plans for each staff member annually to ensure OFHEO staff maintains and enhances the expertise and skills necessary to achieve the Office's goals.
2003	Maintain a high-caliber workforce. Revise individual development plans for each staff member annually to ensure OFHEO staff maintains and enhances the expertise and skills necessary to achieve the Office's goals. (FY 2003 Performance Goal 4.1--revised)
2002	Individual Development Plans were established for all employees. Training and development have been ongoing.
2001	Training and development have been ongoing.
2000	Training and development have been ongoing.
1999	Training and development have been ongoing.

<b>Performance Goal 4.2:</b>	<b>Provide effective information resources management services to OFHEO managers and staff.</b>
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Performance Measure: Implement the FY 2004 component of OFHEO's 5-Year IT Strategic Plan.

Means and Strategies:

OFHEO's regulation of the Enterprises is highly dependent upon the strategic use of technology. The use of information technology is an integral part of OFHEO's mission and of the operation of the Enterprises that the Office regulates. Without technologies comparable to those used by other organizations with similar risk assessment and analytical requirements, OFHEO would not be able to provide independent analysis of safety and soundness issues to accomplish its mission. OFHEO examiners use technology to analyze the performance of the Enterprises and the mortgage markets in order to update the risk profiles of the Enterprises. The Enterprises' risk-based capital requirements are calculated using a large and complex computer model that simulates the cash flows of the Enterprises' assets and obligations under stressful conditions. Research projects often depend on large and well-maintained databases, advanced software, and very high-speed computational facilities. OFHEO also relies heavily on technology to implement its administrative processes. To maintain the technological capability to perform these functions effectively and efficiently so that OFHEO can accomplish its FY 2000-2005 Strategic Plan, OFHEO will continue to review its 5-year IT Strategic Plan each year, and ensure that the annual component of the plan ties to the Office's Annual Performance Plan. The FY 2004 component of OFHEO's 5-Year IT Strategic Plan contains the following goals:

- Develop a prototype of the Examiner Workstation.
- Work with OEO to implement the next version of the Surveillance and Monitoring System.
- Provide data to support OFHEO's analysis and research.
- Continue to enhance the reliability of OFHEO's IT infrastructure.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Implement FY2004 Component of 5-Year IT Strategic Plan
2003	Implement FY2003 Component of 5-Year IT Strategic Plan (FY 2003 Performance Goal 4.2)
2002	5-Year IT Strategic Plan Approved
2001	Not Applicable.
2000	Not Applicable.
1999	Not Applicable.

**Performance Goal 4.3: Maintain a strong internal control and risk management program.**

Performance Measure: No material weakness identified by OFHEO's external auditor or external review.

Means and Strategies:

To ensure that OFHEO's resources are managed effectively and efficiently, OFHEO must maintain a strong internal control and risk management program. OFHEO will continue to seek an independent audit of its financial statements and an independent review of its information security program. OFHEO will revise policies and procedures as necessary to ensure that OFHEO resources are used to achieve its strategic objectives and ultimately its mission.

In addition to strong internal controls, OFHEO will improve its ability to manage its resources by integrating its financial and human resources management systems into a single integrated system compliant with JFMIP standards, and linked to an executive information system to support management's decision making process. Currently, OFHEO uses separate systems, with different service providers, for its financial management and human resources management functions. Also, these functions are manually tied to OFHEO's system for tracking its performance in accomplishing OFHEO's Annual Performance Plan. Integrating these functions into a single efficient system will provide OFHEO managers with better and more timely information to help them manage OFHEO resources more effectively. A single integrated system will also strengthen OFHEO's internal control and risk management program.



OFHEO's information security program provides for the protection of its information assets, including the hardware and software used to create and maintain the information. Information security at OFHEO is a shared responsibility among the Information Systems Security Officer, several information professionals, and everyone in OFHEO, amounting to about one full time equivalent workyear. During FY 2004, OFHEO will continue its program of information security monitoring and staff training, and will update risk assessments of its systems to ensure the associated risks have been mitigated. OFHEO will also continue its internal review program, and follow up with its third independent review of its information security program.

Related FY 2003 Goal and Prior Year Performance Information:

2004	Maintain a strong internal control and risk management program
2003	Maintain a strong internal control and risk management program. (FY 2003 Performance Goal 4.3)
2002	OFHEO received a clean audit opinion on its financial statements. OFHEO conducted an independent review of its IT security, which was completed in FY 2003. No material weaknesses were found.
2001	OFHEO received a clean audit opinion on its financial statements. OFHEO conducted its first independent review of its IT security program. No material weaknesses were found.
2000	OFHEO received a clean audit opinion on its financial statements.
1999	OFHEO received a clean audit opinion on its financial statements.

**OFHEO's FY 2000-2005 Strategic Plan and FY 2004 Annual Performance Plan**

**Strategic Plan**

OFHEO issued a new Strategic Plan for FY 2000 - 2005 in September 2000. This is the third Annual Performance Plan developed in accordance with this Strategic Plan. There are four major components to OFHEO's Strategic Plan: (1) the mission statement, (2) a strategic goal, (3) strategic objectives, and (4) means and strategies to achieve the objectives.

OFHEO's **mission statement** reflects its congressional mandate to ensure the safety and soundness of Fannie Mae and Freddie Mac and emphasizes the need to foster the strength and vitality of the nation's housing finance system. It also recognizes that success in carrying out this mission promotes a robust housing sector and a strong economy.

To accomplish its mission, OFHEO will focus on one **strategic goal** and the three **strategic objectives** that are necessary to accomplish the strategic goal. In the FY 2000-2005 Strategic Plan, OFHEO describes how achieving the strategic goal is linked to accomplishing the mission and how the strategic objectives are necessary to achieve the strategic goal. The strategic plan also describes management strategies that are necessary to achieve these strategic objectives.

OFHEO made an adjustment to its strategic plan by combining the first two strategic objectives into one. It now reads:

Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements.

This better demonstrates the connectivity between capital adequacy and safety and soundness. An Enterprise's capital adequacy is one of the indicators of safety and soundness and depends on factors in addition to meeting the minimum and risk-based capital standards.

**Annual Performance Plan**

The FY 2004 Annual Performance Plan describes what OFHEO will do in FY 2004 with the budget request to achieve the goals and objectives described in the Strategic Plan. There are three major components to OFHEO's Annual Performance Plan: (1) strategic objectives which link to the Strategic Plan, (2) performance goals for FY 2003 and (3) means and strategies.

The **strategic objectives** included in OFHEO's Strategic Plan, as amended, are the starting point in the FY 2004 Annual Performance Plan. They provide a valuable link between the Strategic and Annual Performance Plans and help ensure that strategic goals and objectives as well as the resulting strategies, inputs, outputs, and outcomes are sufficiently integrated and tie into the mission. The performance measures noted for each Strategic Objective in the strategic plan are examples of the performance measures that OFHEO uses for its Annual Performance Goals in the Annual Performance Plans.

The **performance goals** in the Annual Performance Plan link directly to each strategic objective included in OFHEO's Strategic Plan. In most cases, these performance goals must be met annually. In other cases, the performance goals represent incremental progress toward achieving

the strategic objectives. Their achievement also depends on OFHEO's achieving its FY 2003 performance goals. To measure whether or not OFHEO achieves its goals, OFHEO uses outcome measures where relevant and available, and uses output measures when they are the best indicators of achieving a goal. Outcomes are the results of what OFHEO does. Outputs are OFHEO's products. As for all regulators, the outcomes or results of OFHEO's work are achieved through the actions of others. The Office provides regulation, supervision, guidance, review and a variety of products that influence the Enterprises and the financial markets. For FY 2004, OFHEO consolidated performance goals related to capital and expanded the performance measures to highlight key milestones and activities.

The third major component of the Annual Performance Plan consists of *means and strategies*. These are the key activities and actions that describe how the office will achieve each performance goal. The discussion describes the linkages between the performance goal and strategic objective, the significance of the goal, and the processes and technologies expected to be used to accomplish the goal.

### **Monitoring and Reporting on Performance**

During FY 2004, OFHEO will evaluate its performance internally, make appropriate adjustments, and continue to analyze and reallocate its budgetary resources to enable the Office to achieve its annual performance goals. OFHEO will continue using the systems in place to monitor actual performance against the Performance Plan, and will enhance these systems with the investment in a new integrated financial and administrative management system. On a quarterly basis, OFHEO's progress in meeting its performance goals is discussed among senior management and disseminated to OFHEO staff. Because OFHEO's appropriation is for a single account, and management has access to real time budget information, management will be able to redirect resources timely, if necessary, to accomplish the Office's goals.

As required by the Government Performance and Results Act of 1993 and the Reports Consolidation Act of 2000, OFHEO will submit a performance report for FY 2004 to Congress by February 27, 2005, to discuss the Office's actual performance as compared with the FY 2004 Annual Performance Plan.

### **Program Evaluations**

OFHEO regularly evaluates its activities, strategies and progress toward achieving its goals throughout the year. The Office uses regular management meetings, "all hands" meetings, and management reports to communicate and discuss organizational goals and objectives, and the status of activities, which further their achievement. OFHEO management also uses the budget formulation and execution processes as opportunities to determine resource needs, reallocating Office resources to meet its strategic goal and objectives. In its review, OFHEO uses cost-effectiveness as one of the primary criteria for determining overall effectiveness in the achievement of the Office's mission.

In 1995, the General Accounting Office (GAO) conducted an audit of OFHEO's operations, as required by OFHEO's enabling statute. In 1997, the GAO conducted a second study to assess OFHEO's fulfillment of its safety and soundness mission, as required by a provision in the VA-HUD Appropriations Act of 1997 (P.L. 114-204). OFHEO described these reports in its last

Strategic Plan and used them to complement internal evaluations, making appropriate changes in operations.

In January 2001, GAO reported on a comparison of the enforcement authorities available to bank regulators, OFHEO and the Federal Housing Finance Board (FHFB). The report noted that OFHEO's enforcement powers are based on broad safety and soundness authorities that are similar in scope and nature to the powers of federal bank regulators. GAO suggested several appropriate enhancements and clarifications to OFHEO's explicit enforcement authority to effect greater comparability. Testifying at the House Capital Markets Subcommittee Round Table on GSEs in September 2000, before the GAO reported its findings, OFHEO's Director had included these enhancements in a broad set of legislative recommendations to Congress. GAO also indicated that OFHEO has properly employed its current informal and formal authorities to address any ambiguities and uncertainties in the law. OFHEO continues to encourage passage of legislation to enhance its authority.

In July 2001, the GAO completed a study of the adequacy of the capital structure of the Federal Home Loan Bank System, as required by the Consolidated Appropriations Act of 2001. As part of this study, the GAO compared the risk-based capital standards for the Federal Home Loan Banks promulgated by the Federal Housing Finance Board and the risk-based capital standard completed by OFHEO for the Enterprises. The study noted differences in approaches, models and processes, and made no new recommendations.

OFHEO's enabling statute also prescribed another set of studies. 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 Congressional Budget Office (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.

In FY 2003, the HUD Inspector General initiated an audit of the administrative operations of OFHEO.

### **Verification and Validation of Performance Information**

The Office is systematically monitoring and tracking progress in achieving its performance goals. OFHEO maintains information, as described in the performance measures themselves, so that the Office's performance can be validated. OFHEO's managers report ongoing 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 outputs internal to the Office. The data used as input to the capital calculations are an exception. For the minimum capital 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, 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 with OFHEO resolves with the Enterprises. OFHEO will continue to improve the sophistication of its validation checks. OFHEO had the financial simulation model used in the risk-based capital calculation 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's FY 2004 Budget Proposal**

In order to treat the Office of Federal Housing Enterprise Oversight (OFHEO) similarly to other financial regulators, the FY 2004 Budget Request proposes legislation that would provide direct funding to OFHEO. If enacted, this provision would put OFHEO on par with other safety and soundness regulators such as the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Federal Housing Finance Board, the Federal Reserve Board and the National Credit Union Administration. This provision provides the Office with the flexibility to set resources in response to any rapid changes in the financial condition of Fannie Mae and Freddie Mac (the Enterprises) or in the markets in which they operate and serve. The provision is also consistent with the fact that OFHEO is not funded by taxpayer dollars. Rather, like other safety and soundness regulators, OFHEO is funded through annual assessments on the institutions that it regulates.

OFHEO's proposed fiscal year 2004 Budget is essential for the Office to meet the congressionally mandated mission of ensuring the financial safety and soundness of Fannie Mae and Freddie Mac. The size, scope, and complexity of the Enterprises' activities continue to expand dramatically, as has the range of risks embedded in those activities. In addition, the Enterprises continue to exploit technology as a strategic resource by developing and applying sophisticated risk management techniques, automated underwriting and cost control tools for seller/servicers, and communication and product delivery channels, with an emphasis on the Internet. These business initiatives require a commensurate increase in staffing and in the application of technology by OFHEO to ensure effective and efficient supervision of the Enterprises. The budget requests the minimum funding necessary to achieve the goals.

To provide OFHEO with necessary capacity to ensure effective and dynamic oversight of the Enterprises, OFHEO is proposing a budget of \$32.4 million, an increase of 8.1 percent over the FY 2003 budget request of \$30 million. The proposed fiscal year 2004 budget would fund OFHEO's existing oversight activities and continues the initiative proposed with the FY 2003 Budget Request to strengthen safety and soundness programs. This initiative will be accomplished by bolstering OFHEO's capacity to oversee Enterprise risk management activities.

The developments and trends within the Enterprises and the industry continue to tax the resources of OFHEO to keep pace with the Enterprises. An increase in examinations staffing is imperative to ensure that OFHEO has the capability to assess the consequences of further growth and innovation by Fannie Mae and Freddie Mac. OFHEO also must continue to share with the Enterprises a commitment to technology that will permit the Office to leverage the expertise and skills of the staff, and is requesting funds to complete development of a prototype of an automated examination tool—the Examiner Workstation (described in Performance Goal 1.1). These mandates form the basis for OFHEO's fiscal year 2004 budget proposal. The FY 2004 Performance Plan describes what OFHEO would accomplish with the resources proposed.

In performing its various regulatory functions, OFHEO functions as one program and uses cross-organizational teams comprised of staff members from various OFHEO offices, depending on the nature and complexity of the task. Thus, it is difficult to directly link OFHEO resource levels to specific performance goals as reflected in the means and strategies. OFHEO's estimates of the resources associated with each strategic objective are shown in the following table. OFHEO does not currently have capacity to monitor expenditures in accordance with its strategic objectives. However, the integrated administrative and financial management system proposed in the FY 2003 budget will provide OFHEO with that capability in the future.

### FY 2002\* – FY 2004 Resource Allocation Estimates

*Dollars in Millions*

	Strategic Objective 1 <sup>1</sup>		Strategic Objective 2 <sup>2</sup>		Strategic Objective 3 <sup>3</sup>		Total
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars
04	24.3	75.0	6.0	18.5	2.1	6.5	32.4
03	23.3	77.7	4.5	15.0	2.2	7.3	30.0
02	NA	NA	NA	NA	NA	NA	27.3

*FTE*

	Strategic Objective 1 <sup>1</sup>		Strategic Objective 2 <sup>2</sup>		Strategic Objective 3 <sup>3</sup>		Total
	FTE	Percent	FTE	Percent	FTE	Percent	FTE
04	112	74.2	28	18.5	11	7.3	151
03	101	74.8	24	17.8	10	7.4	135
02	NA	NA	NA	NA	NA	NA	112

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

\* For FY 2002, estimates are unavailable. For FY 2003, data are revised.