

July 18, 2000

The Honorable James A. Leach
Chairman
Committee on Banking and Financial Services
US House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Leach:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

As a federal financial regulator, OFHEO is charged with the safety and soundness oversight of Fannie Mae and Freddie Mac (the Enterprises). The use of off-balance sheet derivative instruments is an integral part of the Enterprises' management of risks. The Enterprises' policies authorize management to enter into derivative financial instruments as end-users for risk management purposes.

FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

The Honorable James A. Leach
Chairman
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We are pleased to report that both Fannie Mae and Freddie Mac are well positioned to be in compliance with FAS 133 by the implementation date of January 1, 2001. The Enterprises recognize the potential significant impact on their accounting and financial reporting the standard will have and both Enterprises have devoted substantial resources to ensure an orderly and smooth transition. The Enterprises have taken steps to:

- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

Throughout the remainder of this year and into next year, OFHEO will carefully monitor and assess the Enterprises' efforts and results relating to the implementation of FAS 133. OFHEO's examiners will continue to communicate and work with Enterprise management and their external auditors to ensure timelines are met and the implementation is proceeding as planned. Examiners will assess new Enterprise systems, and review and evaluate documentation covering derivatives and hedge accounting. And, we will also continue to meet with accounting practitioners and financial regulators to discuss FAS 133 implementation issues facing other large financial institution.

OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Securities and
Government Sponsored Enterprises
US House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Baker:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

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Chairman
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- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

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OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable John LaFalce
Ranking Member
Committee on Banking and Financial Services
US House of Representatives
2129 Rayburn House Office Building
Washington, DC 20510

Dear Congressman LaFalce:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

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The Honorable John LaFalce
Ranking Member
Committee on Banking and Financial Services
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- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
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OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Paul Kanjorski
Ranking Member
Subcommittee on Capital Markets, Securities
and Government Sponsored Enterprises
2129 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Kanjorski:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

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The Honorable Paul Kanjorski
Ranking Member
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- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

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OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Tom Bliley
Chairman
Committee on Commerce
US House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Bliley:

Knowing of your interest, I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

The Honorable Tom Bliley
Chairman
Committee on Commerce
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- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

Throughout the remainder of this year and into next year, OFHEO will carefully monitor and assess the Enterprises' efforts and results relating to the implementation of FAS 133. OFHEO's examiners will continue to communicate and work with Enterprise management and their external auditors to ensure timelines are met and the implementation is proceeding as planned. Examiners will assess new Enterprise systems, and review and evaluate documentation covering derivatives and hedge accounting. And, we will also continue to meet with accounting practitioners and financial regulators to discuss FAS 133 implementation issues facing other large financial institution.

OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable John Dingell
Ranking Member
Committee on Commerce
US House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Dingell:

Knowing of your interest, I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

As a federal financial regulator, OFHEO is charged with the safety and soundness oversight of Fannie Mae and Freddie Mac (the Enterprises). The use of off-balance sheet derivative instruments is an integral part of the Enterprises' management of risks. The Enterprises' policies authorize management to enter into derivative financial instruments as end-users for risk management purposes.

FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

The Honorable John Dingell
Ranking Member
Committee on Commerce
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We are pleased to report that both Fannie Mae and Freddie Mac are well positioned to be in compliance with FAS 133 by the implementation date of January 1, 2001. The Enterprises recognize the potential significant impact on their accounting and financial reporting the standard will have and both Enterprises have devoted substantial resources to ensure an orderly and smooth transition. The Enterprises have taken steps to:

- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

Throughout the remainder of this year and into next year, OFHEO will carefully monitor and assess the Enterprises' efforts and results relating to the implementation of FAS 133. OFHEO's examiners will continue to communicate and work with Enterprise management and their external auditors to ensure timelines are met and the implementation is proceeding as planned. Examiners will assess new Enterprise systems, and review and evaluate documentation covering derivatives and hedge accounting. And, we will also continue to meet with accounting practitioners and financial regulators to discuss FAS 133 implementation issues facing other large financial institution.

OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Michael Oxley
Chairman
Subcommittee on Finance and Hazardous Materials
US House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Oxley:

Knowing of your interest, I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

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The Honorable Michael Oxley
Chairman
Subcommittee on Finance and Hazardous Materials
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We are pleased to report that both Fannie Mae and Freddie Mac are well positioned to be in compliance with FAS 133 by the implementation date of January 1, 2001. The Enterprises recognize the potential significant impact on their accounting and financial reporting the standard will have and both Enterprises have devoted substantial resources to ensure an orderly and smooth transition. The Enterprises have taken steps to:

- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

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Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Edolphus Towns
Ranking Member
Subcommittee on Finance and Hazardous Materials
US House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Towns:

Knowing of your interest, I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Phil Gramm
Chairman
Committee on Banking, Housing and Urban Affairs
US Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Gramm:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

As a federal financial regulator, OFHEO is charged with the safety and soundness oversight of Fannie Mae and Freddie Mac (the Enterprises). The use of off-balance sheet derivative instruments is an integral part of the Enterprises' management of risks. The Enterprises' policies authorize management to enter into derivative financial instruments as end-users for risk management purposes.

FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

The Honorable Phil Gramm
Chairman
Committee on Banking, Housing and Urban Affairs
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We are pleased to report that both Fannie Mae and Freddie Mac are well positioned to be in compliance with FAS 133 by the implementation date of January 1, 2001. The Enterprises recognize the potential significant impact on their accounting and financial reporting the standard will have and both Enterprises have devoted substantial resources to ensure an orderly and smooth transition. The Enterprises have taken steps to:

- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

Throughout the remainder of this year and into next year, OFHEO will carefully monitor and assess the Enterprises' efforts and results relating to the implementation of FAS 133. OFHEO's examiners will continue to communicate and work with Enterprise management and their external auditors to ensure timelines are met and the implementation is proceeding as planned. Examiners will assess new Enterprise systems, and review and evaluate documentation covering derivatives and hedge accounting. And, we will also continue to meet with accounting practitioners and financial regulators to discuss FAS 133 implementation issues facing other large financial institution.

OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Paul Sarbanes
Ranking Member
Committee on Banking, Housing and Urban Affairs
US Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Sarbanes:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

As a federal financial regulator, OFHEO is charged with the safety and soundness oversight of Fannie Mae and Freddie Mac (the Enterprises). The use of off-balance sheet derivative instruments is an integral part of the Enterprises' management of risks. The Enterprises' policies authorize management to enter into derivative financial instruments as end-users for risk management purposes.

FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

The Honorable Paul Sarbanes
Ranking Member
Committee on Banking, Housing and Urban Affairs
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- Modify existing systems and processes that will value and track derivatives and measure and track hedge effectiveness;
- Manage the impact of potential earnings and capital volatility caused by adoption of the standard;
- Ensure the resulting impacts from compliance with FAS 133 do not adversely affect adequate capitalization, including regulatory capital; and
- Properly disclose results to shareholders and regulators.

To do this, the Enterprises have identified all business processes affected by FAS 133 and are making changes as appropriate. Accounting systems are being upgraded to produce financial statements and documentation that meet FAS 133 requirements. Each Enterprise has identified transactions that qualify for hedge accounting treatment, in order to mitigate the financial statement impact in the transition to FAS 133. In addition, the Enterprises are evaluating the financial statement impact of alternative hedging strategies in tandem with their current approaches to managing risk. Both Enterprises are preparing the required changes to financial records and disclosures and plan to work with investors and analysts to ensure they understand the effect of these changes. Also, both Enterprises have provided their respective Boards of Directors with ongoing updates for the implementation efforts and the status of the project.

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OFHEO is mindful of the potential impact of FAS 133 on financial institutions, and we will continue to keep you informed in the event there are any issues related to Fannie Mae and Freddie Mac. I welcome the opportunity to meet with you or any members of your staff to further discuss issues or questions.

Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Rod Grams
Chairman
Subcommittee on Securities
US Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Grams:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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FAS 133 Will Revise Significantly The Accounting Treatment Of Derivatives

Current accounting practices allow derivative instruments to be carried off-balance sheet with the specific accounting treatment premised upon the type of derivative instrument and the financial goal of its application. The new standard requires derivative instruments to be recorded and carried on the balance sheet at their current fair market value. The standard also requires firms to implement a complex process for tracking and reporting derivative market values, offsetting risk positions, and hedge effectiveness. The scope and complexity of the standard presents significant operational and financial reporting issues across a wide spectrum of financial institutions. Successful compliance will require firms to establish well controlled, integrated accounting and reporting processes that result in accurate and timely financial reporting.

OFHEO is Continuing to Examine for FAS 133 Implementation

Since June 1998, when the Financial Accounting Standards Board (FASB) released FAS 133, OFHEO has dedicated examination resources to ensure that Fannie Mae and Freddie Mac have taken appropriate steps to manage their adoption of the standard. OFHEO will continue to monitor and assess the Enterprises' plans to achieve timely compliance with a minimum disruption of their current business processes.

The Honorable Rod Grams

We are pleased to report that both Fannie Mae and Freddie Mac are well positioned to be in compliance with FAS 133 by the implementation date of January 1, 2001. The Enterprises recognize the potential significant impact on their accounting and financial reporting the standard will have and both Enterprises have devoted substantial resources to ensure an orderly and smooth transition. The Enterprises have taken steps to:

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Sincerely,

Armando Falcon, Jr.
Director

July 18, 2000

The Honorable Christopher Dodd
Ranking Member
Subcommittee on Securities
US Senate
534 Dirksen Senate Office Building
Washington, Dc 20510

Dear Senator Dodd:

Knowing of your interest in issues affecting Fannie Mae and Freddie Mac (the Enterprises), I am writing to report on the Office of Federal Housing Enterprise Oversight's (OFHEO) work to ensure a smooth implementation of the systems necessary for Fannie Mae and Freddie Mac to comply with the Financial Accounting Standards Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

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The Honorable Christopher Dodd
Ranking Member
Subcommittee on Securities
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Sincerely,

Armando Falcon, Jr.
Director