

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT



FY 2001 PERFORMANCE REPORT

MARCH 29, 2002

DIRECTOR'S MESSAGE

Fiscal year 2001 marked another year of accomplishments for the Office of Federal Housing Enterprise Oversight (OFHEO) bringing the office even closer to achieving its long-term strategic goals.

Even with an enacted budget that was less than the requested level, OFHEO achieved 18 of its 22 stated Performance Goals, including publication of the risk-based capital rule. Of the four outstanding performance goals, there are three that are related to the implementation of the risk-based capital rule that have been deferred to FY 2002. The final outstanding goal, requiring investments in the Surveillance and Monitoring System for examinations, may be considered in the future, as resources are available.

By the end of FY 2001, two key indicators for achieving OFHEO's mission were realized. OFHEO achieved one of its top priorities - completing the risk-based capital regulation, which will be fully enforceable a year after its publication. The rule ensures the Enterprises have enough capital on hand to weather extreme financial downturns in a 10-year period. Even though the regulation was published later in FY 2001 than anticipated, OFHEO made the final rule available to the public on its website in August 2001. Additionally, the Office classified both Enterprises as adequately capitalized each quarter and determined through examinations that they exceeded safety and soundness standards.

While important, these successes are only a part of OFHEO's ongoing commitment to fulfilling its statutory mission. In conclusion, FY 2001 was another truly exciting year and OFHEO is moving forward with the comprehensive regulatory oversight program Congress laid out for us. I remain committed to ensuring that OFHEO is a strong and capable regulator and look forward to another successful year.

Armando Falcon, Jr.
March 29, 2002

FY 2001 Performance Report

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.

Highlights of OFHEO's Performance ¹

In FY 2001, with a budget of \$ 22 million, OFHEO's accomplishments brought the Office closer to achieving its long-term strategic goals. At the end of FY 2001, two key indicators for achieving the mission were realized.² The Office classified both Enterprises as adequately capitalized each quarter and determined through examinations that they exceeded safety and soundness standards. OFHEO also accomplished a long-awaited milestone by publishing a final risk-based capital rule on September 13, 2001.

More than a year before FY 2001 began, OFHEO established 22 performance goals and sent them to Congress in the FY 2001 Performance Plan. At the start of the fiscal year, the enacted budget was less than the requested level, and OFHEO was revising the schedule for promulgating the risk-based capital regulation. At that time, OFHEO recognized that it would not achieve five of the goals, but did not revise the Performance Plan. OFHEO achieved one of those goals later in the year by publishing the final risk-based capital rule. The other three goals related to implementing the risk-based capital rule are deferred to FY 2002. The final goal, requiring investments in the Surveillance and Monitoring System for examinations, may be considered in the future, as resources are available. OFHEO achieved 17 of its 22 Performance Goals, and an 18th by the end of the year.

FY 2001 Performance Plan and Report

The FY 2001 Performance Report describes what OFHEO accomplished as compared to its FY 2001 Performance Plan to achieve the goals and objectives in the FY 1998 - FY 2003 Strategic Plan. In September 2000, OFHEO issued a Strategic Plan for FY 2000 - FY 2005, which provides a framework for OFHEO's FY 2002 and future Annual Performance Plans and operations.

OFHEO primarily accomplishes its mission by conducting examinations of the Enterprises, by assessing their capital adequacy, and by conducting research and analysis about the Enterprises and the markets in which they operate. OFHEO's role as a regulator, among other things, is to

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

² OFHEO is charged by law to ensure the capital adequacy and financial safety and soundness of two government-sponsored enterprises ("GSEs" or the "Enterprises") – Fannie Mae and Freddie Mac. OFHEO is funded through assessments on Fannie Mae and Freddie Mac. Thus, OFHEO's operations represent no cost to the taxpayer.

establish, monitor and implement regulations that will ensure that both Enterprises are adequately capitalized and operate in a safe and sound manner. It is these activities, and the strategies and processes used to develop and implement them, that are included in OFHEO's Annual Performance Plan. The best measure of OFHEO's overall performance is whether its actions result in safe and sound operations and adequate capital levels at each Enterprise.

OFHEO employs a minimum capital standard to determine capital adequacy. This fiscal year, OFHEO achieved one of its top priorities—completing the risk-based capital regulation, which will be fully enforceable a year after its publication. This regulation allows the Office to also apply a stress test to the Enterprises to determine capital adequacy. The stress test is used to produce a measurable risk-based capital level for each Enterprise, adding to the sophisticated regulatory tools available to OFHEO.

Mortgage Markets and the Enterprises in FY 2001

Fannie Mae and Freddie Mac (formally named the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, respectively) are publicly held companies chartered by Congress. They were established to create a secondary mortgage market to ensure a ready supply of mortgage funds for housing, including housing for low-and moderate-income families. At the end of FY 2001, Fannie Mae and Freddie Mac held or guaranteed about \$2.6 trillion in mortgages.

This has been an important year for OFHEO, as it monitors and assesses the dynamics of the Enterprises and the secondary and primary mortgage markets. The Enterprises have realigned their business to emphasize asset management rather than credit guarantee. At year-end 1992, Fannie Mae and Freddie Mac held 19 percent of their book of business in portfolio and guaranteed 81 percent in the form of mortgage-backed securities. By September 2001, the proportion of the book of business held in portfolio had increased to 44 percent, with a corresponding decline in the guarantee business to 56 percent of the total. This realignment in business strategy significantly alters the risk profile of the Enterprises, shifting risk management from credit guarantee to both credit risk and interest rate risk management.

In response to more ambitious affordable housing goals and the shift in business strategy, the Enterprises have expanded business products, with increasing sophistication and complexity. Fannie Mae and Freddie Mac undertook activities to purchase high loan-to-value mortgages to support the drive to higher rates of homeownership, promoted the expansion of reverse mortgages for elderly homeowners, and developed the means to reach less credit-worthy borrowers. The Enterprises funded their expanded portfolios with innovative debt products, including instruments denominated in foreign currencies, and a program of regular issuances. To manage these assets and liabilities, the Enterprise have increased their use of derivative instruments from a notional amount of \$72 billion at year-end 1993 to \$1.6 trillion in September 2001—a more than twenty-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 represent the foundation for these business initiatives. The Enterprises employ cutting-edge risk management techniques, built on quantitative models, to manage the many alterations of their risk profiles. Automated underwriting and related technology innovations by Fannie Mae and Freddie Mac have revolutionized the mortgage finance process and have led to significant shifts in the structure of the mortgage finance

industry. Communication technologies and E-Commerce represent further expansion opportunities for the Enterprises to streamline their business. These technologies carry with them operational challenges that not only permit Fannie Mae and Freddie Mac to leverage their resources but also heighten their operational risks.

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

Managing and Measuring Performance

During the year, OFHEO managers maintained ongoing communications about their progress in achieving OFHEO's performance goals. They also documented progress formally on a quarterly basis. In virtually all cases, senior management was aware of progress toward achieving performance goals in real time--before the quarterly report was prepared. OFHEO did not conduct any program evaluations during FY 2001.

For FY 2001, OFHEO's budget of \$22 million was enacted in appropriations. This was a 13 percent increase over the FY 2000 level of \$19.5 million. Because OFHEO's appropriation is for a single account, and management has access to real-time budget information, management was able to redirect resources in a timely manner to facilitate achieving OFHEO's performance goals.

OFHEO's staff is its most valuable resource. The Office relies on those with cutting-edge professional skills and a breadth and depth of knowledge in their fields. Their technical competence, effective teamwork and focused performance are crucial to OFHEO's achieving its goals. OFHEO continued to attract and maintain a high performance workforce, increasing to 105 full-time equivalent employees in FY 2001. OFHEO's ability to achieve its mission and keep pace with the Enterprises is highly contingent on attracting and retaining personnel with appropriate skills.

The performance information in OFHEO's Annual Performance Report is complete and reliable. Performance information is available and reported for all goals. OFHEO's managers report their performance and progress against the performance goals, and can rely on this information as they manage their operations. Most of OFHEO's performance indicators reflect data and milestones internal to the Office. The data used as input to the capital calculations are an exception. For the minimum capital calculation, senior officers of each Enterprise transmit their data and attest to their completeness and accuracy. OFHEO is able to validate the data through comparison with published Enterprise data with a high level of integrity, and has been satisfied with the data received. When the risk-based capital standard is used for capital calculations, OFHEO anticipates an ability to validate aspects of the data submission through various means.

Strategic Goal 1: To effectively regulate the Enterprises by ensuring that they are adequately capitalized and operate in a safe and sound manner.

The statutory duty of the Director of OFHEO is to “ensure that the Enterprises are adequately capitalized and operating safely.” OFHEO was given two primary regulatory tools to accomplish these statutory responsibilities. The first is the authority to develop and enforce capital standards for the Enterprises. In FY 2001, OFHEO published a final rule implementing the risk-based capital standard. This standard will not be binding until 12 months after publication. With the publication of the final rule, OFHEO will commence the ongoing activities associated with keeping the rule current and effective; evaluating possible changes to the capital standard that may be necessary to reflect developments in the Enterprises, the mortgage finance industry, and the economy; and enhancing the underlying analytical software.

The second regulatory tool is the authority to conduct safety and soundness examinations of the Enterprises’ operations. In FY 2001, OFHEO finished its third annual (calendar year (CY) 2000) comprehensive risk-based examination of the Enterprises and initiated its CY 2001 examination. Capital standards and examinations are mutually reinforcing and complementary tools. Information and findings from one become integrated with the other in an iterative process. OFHEO has identified five strategic objectives with supporting performance goals for FY 2001 that will enable the Office to reach this strategic goal. OFHEO’s performance is described below.

Strategic Objective 1.1: To ensure that the Enterprises are adequately capitalized by issuing and implementing the risk-based capital requirements.

Measure: Promulgation of risk-based capital regulation.

Performance Goal 1.1(a): Publish final risk-based capital regulation.

Performance Measure: Promulgation of risk-based capital regulation.

Target: January 2001

Actual Performance: **FY 2001:** Goal met later in the year.
FY 2000: *Review public comments on NPR1 and NPR 2 and formulate a plan to publish final risk-based capital rule three months after comment period closed. Goal met.*
FY 1999: *Publish a notice of proposed rulemaking by the end of the second quarter. Goal met.*

OFHEO published the final risk-based capital rule on September 13, 2001. Promulgating this rule has been one of OFHEO’s top priorities. The rule ensures the Enterprises have enough capital on hand to weather extreme financial downturns in a 10-year period. As described in the FY 2000 Performance Report, having extended the comment period and receiving over 2,000 pages of substantive comments from over 35 commenters, OFHEO recognized that the

regulation would be published later in FY 2001 than originally planned. Although the publication date was September 13, 2001, OFHEO made the final rule available to the public on its web site in August 2001.

Impact on Future Plans:

The risk-based capital rule became effective on September 13, 2001, but by law, OFHEO cannot enforce compliance with it until a year later. In FY 2001, after the final rule was announced, OFHEO established a task force to facilitate its implementation.

Performance Goal 1.1(b): To provide the Enterprises’ with an opportunity to integrate the stress test into their risk management systems before the risk-based requirement is used to determine their capital classification.

Performance Measure: Issue Pro Forma Capital Calculations

Target: Quarterly

Actual Performance: **FY 2001:** Goal not met.
FY 2000: No related goal.
FY 1999: No related goal.

As described in Performance Goal 1.1 (a), the one-year implementation period began when the rule was published in final. Pro forma capital calculations will be issued later in FY 2002.

However, OFHEO undertook other activities to achieve this goal. OFHEO has begun to work with the Enterprises to adapt their systems to the structure of the stress test. OFHEO also provided them with information about the rule, such as the treatment of public data sources, without revealing significant aspects of the rule during the rulemaking process.

As part of this work, OFHEO has coordinated with the Enterprises to develop a risk-based capital report for their data submission for the risk-based capital calculation. Working with OFHEO to make this report operational is assisting the Enterprises in understanding the stress test model and beginning to integrate it into their systems.

Impact on Future Plans

OFHEO’s implementation task force, noted in Performance Goal 1.1(a), is working closely with the Enterprises to ensure transparency and understanding of the rule and the software that implements it. This will allow the Enterprises to manage risks better and to maintain capital adequacy.

Performance Goal 1.1(c): To ensure that the Risk-Based Capital Model and the Risk-Based Capital Rule are up to date.

Performance Measure: New products and activities are identified and evaluated, and appropriately included in the quarterly capital calculation in the quarter in which they first appear.

Target: 100%

Actual Performance: **FY 2001:** Goal not met.
FY 2000: No related goal.
FY 1999: No related goal.

This goal was delayed because the final rule was published later than originally planned. The rule contains provisions for treating new products and activities so that they will be included in the quarterly capital calculation.

Impact on Future Plans:

The implementation task force is facilitating a process to identify new products and activities, and incorporate them into the stress test. This process will allow them to be included in the capital calculation for the quarter in which they first appear.

Performance Goal 1.1(d): To update and enhance the Risk-based capital stress test software and data submission process to support the risk-based capital calculation and the risk-based capital rule.

Performance Measure: Complete and document changes to the risk-based capital stress test software necessary to implement the stress test in the final rule.

Target: January 2001

Performance Measure: Collaborate with the Enterprises to ensure that the Enterprise data submission and delivery process for the stress test specified in the final rule makes necessary data available to OFHEO within 30 days after the end of a quarter.

Target: January 2001

Performance Measure: Develop efficiencies in the analytical power of the stress test software.

Target: On an as-needed basis

Actual Performance:

FY 2001: Goal not met.

FY 2000: *Streamline the risk-based capital calculation process by reducing by 50% the time from receipt of Enterprise data to calculation of the risk-based capital requirement.* Strategy changed to adopt the risk-based capital report. Goal no longer relevant as indicated in FY 1999 Performance Report.

FY 1999: *Streamline the risk-based capital calculation process by reducing by 50% the time from receipt of Enterprise data to calculation of the risk-based capital requirement.* Although substantial progress was made to toward achieving this goal, it was not met. Strategy was changed.

OFHEO did not achieve this goal in the targeted time frame, as it was linked to the publication of the final risk-based capital rule--Performance Goal 1.1(a). By the end of the fiscal year, OFHEO updated the risk-based capital stress test software to reflect the published rule and reviewed it internally. OFHEO also contracted for an independent review and test of significant parts of the model and received a favorable evaluation. OFHEO and the Enterprises worked together during the year on the risk-based capital data submission report to ensure an effective data submission process.

Impact on Future Plans:

These efforts will continue through the implementation period. The task force established in FY 2001 to implement the rule will facilitate the completion of this goal. OFHEO and the Enterprises will continue to update and enhance the risk-based capital stress test software, ensure that the data submission process is efficient, and the capital calculation is completed timely.

Performance Goal 1.1(e):	To ensure that emerging risk factors are researched, analyzed and appropriately incorporated into the stress test.
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<u>Performance Measure:</u>	Analyze the impact of using credit scores in determining the credit risk of subprime mortgages.
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<u>Target:</u>	September 2001
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<u>Performance Measure:</u>	Additional research priorities determined.
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<u>Target:</u>	September 2001
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Actual Performance:

FY 2001: Goal met.

FY 2000: No related goal, but research and analysis have been ongoing.

FY 1999: No related goal, but research and analysis have been ongoing.

During FY 2001, OFHEO developed a preliminary research agenda that it is refining in FY 2002. This agenda includes research already begun on topics such as credit scores and subprime loans. It also includes research on issues raised by commenters during the rulemaking process, so that OFHEO can study and consider them for inclusion in the risk-based capital standard in the future.

Strategic Objective 1.2: **To ensure that the Enterprises meet applicable capital standards.**

Measure: Comparison of actual capital to required capital standard on at least a quarterly basis.

Performance Goal 1.2(a): **To require the Enterprises to meet applicable capital standards on at least a quarterly basis.**

Performance Measure: Comparison of actual capital to required capital standard on at least a quarterly basis.

Target: Ratio of 1 or greater.

Performance Measure: Percent of time acceptable capital plans are obtained from the Enterprises when standards are not met.

Target: 100 percent.

Actual Performance:

FY 2001: Goal met.

FY 2000: Goal met.

FY 1999: Goal met.

For each quarter of FY 2001, both Fannie Mae and Freddie Mac were adequately capitalized. OFHEO is statutorily required to determine capital adequacy of the Enterprises on the basis of both minimum and risk-based capital standards. For FY 2001, only the minimum capital standard was applicable. Minimum capital represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. For purposes of minimum capital, an Enterprise is considered adequately capitalized if core capital—common stock; perpetual non-cumulative preferred stock; paid-in capital; and retained earnings—equals or exceeds minimum capital.

**FY 2001 Minimum Capital Classification
(Dollars in millions)**

Fannie Mae

	12/00	3/01	6/01	9/01
Actual Capital	20,827	21,482	22,978	23,778
Required Capital	20,294	21,033	22,177	23,130
Surplus (Deficit)	533	488	801	648
Ratio (Actual/Required)	1.03	1.02	1.03	1.03

Freddie Mac

	12/00	3/01	6/01	9/01
Actual Capital	14,380	15,770	16,870	17,743
Required Capital	14,178	15,164	16,303	17,335
Surplus (Deficit)	202	606	567	408
Ratio (Actual/Required)	1.01	1.04	1.03	1.02

During FY 2001, the Enterprises continued to successfully manage to their minimum requirement. For each quarter, each Enterprise held between \$202 million and \$801 million more than their minimum requirement. The ratios of their actual to required capital ranged from 1.01 to 1.04. OFHEO makes the minimum capital determinations after the Enterprises complete their quarterly reconciliation and submit data to OFHEO for review. The final determinations for the quarters ending in June and September of 2001 are made in FY 2002. During the year, OFHEO also monitored the Enterprises' minimum capital levels on a monthly basis and found that they met the standard at those points as well. Over the last several years, the actual and required capital levels for both firms have been higher each quarter than in the previous quarter. These higher levels support the growth of both Enterprises.

Impact on Future Plans:

This performance goal is a key indicator of the financial safety and soundness of the Enterprises. OFHEO continues to maintain this performance goal in its Annual Performance Plans for future years. In addition to using the minimum capital standard as a measure, a year after the risk-based capital regulation is final, OFHEO will also use the risk-based capital standard as a second measure of achieving this performance goal. OFHEO's risk-based capital standard is the amount of total capital—core capital plus a general allowance for foreclosure losses—that an Enterprise must hold to absorb projected losses flowing from future severe interest-rate and credit risk conditions, plus 30 percent to cover management and operations risk.

Strategic Objective 1.3: **To ensure that each Enterprise operates in a safe and sound manner by conducting a continuous, risk-based examination of each Enterprise.**

Measure: Completion of an annual examination report for each Enterprise which covers all risk areas.

Performance Goal 1.3(a): **To complete a comprehensive, risk-based annual examination for each Enterprise for CY 2000.**

Performance Measure: Deliver the CY 2000 report of examination to each Board of Directors.

Target: February 2001.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

As described in OFHEO’s 2001 Report to Congress, the CY 2000 examinations, which were completed during FY 2001, found both Enterprises financially sound and well managed. In each of the 10 program areas, both Enterprises exceeded safety and soundness standards. OFHEO finished fieldwork by the end of the calendar year, and delivered the Report of Examination to each Board of Directors by the target date.

Four risk areas comprised the 2000 examination—credit risk, market risk, operations risk, and corporate governance. These risk areas contain 10 program areas (such as interest rate risk, liquidity management, and information technology) for which examination objectives are determined annually and updated quarterly. OFHEO’s 2001 Report to Congress describes OFHEO’s CY 2000 findings in these areas.

Performance Goal 1.3(b): **To conduct a comprehensive, risk-based annual examination for each Enterprise for CY 2001.**

Performance Measure: Develop and communicate CY 2001 examination strategies and objectives to the Enterprises.

Target: By January 2001.

Performance Measure: Communicate interim findings and conclusions to each Enterprise.

Target: Following quarter end.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

During the fourth quarter of CY 2000, OFHEO developed the examination strategies and objectives for the CY 2001 examination and communicated them to the Enterprises before the start of the calendar year. Beginning with the CY 2001 examination, OFHEO began implementation of a fifth examination program area—exposures arising from the Enterprises’ use of computer-based financial models. Model risk and OFHEO’s oversight in this program area are described more fully in OFHEO’s 2001 Report to Congress. As an ongoing part of the examination process, OFHEO discussed interim findings and conclusions with the Enterprises.

Performance Goal 1.3(c): To conduct surveillance and monitoring, risk assessment, and analysis.

Performance Measure: Prepare surveillance and monitoring reports.

Target: At least Quarterly.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

Each quarter, OFHEO prepares surveillance and monitoring reports to assess the condition and performance of the Enterprises. These analytical reports are for internal use and cover the business activity, asset/liability management, asset quality, capital, earnings, and market indices for the Enterprises. OFHEO planned to enhance the functionality of the Surveillance and Monitoring system. However, enacted appropriations were less than planned and support for these Surveillance and Monitoring system improvements was diverted to the risk-based capital project.

Strategic Objective 1.4: To ensure that the Enterprises respond appropriately to examination issues.

Measure: Percent of examination issues identified for follow-up that receive the appropriate dialogue and response.

Performance Goal 1.4(a): To promote timely responses and corrective measures for examination issues.

Performance Measure: Percent of examination issues identified in the annual Report of Examination that are not being appropriately addressed.

Target: 0%

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

Throughout the examination, the Office maintained continuous dialogue between OFHEO’s examination personnel and the Enterprises. Through routine discussions during the examination

process and regular meetings with senior Enterprise representatives, OFHEO explained its position and sought input on its findings. As a result, OFHEO fostered prompt response to any potential concerns, issues or opportunities identified to enhance an Enterprise's operations.

Performance Goal 1.4(b): **To communicate examination conclusions to the Boards of Directors and require their appropriate response, including any directives provided to the Enterprises' management.**

Performance Measure: Obtain response from Boards of Directors to conclusions shared in the annual Report of Examination.

Target: Within 30 days of the Board meeting date, subsequent to the issuance of the annual Report of Examination.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

OFHEO met with the Board of Directors at each Enterprise to discuss the conclusions in the annual report of examination at the first regularly scheduled board meeting after the report's issuance. The Boards responded in a timely manner.

Performance Goal 1.4(c): **To enhance the effectiveness of communications between OFHEO's examination staff and Enterprise officials.**

Performance Measure: Survey the Enterprises on qualitative aspects of the examination program.

Target: Achieve a "high" performance level for the quality of communications with the examination staff, using the survey's rating scale.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

OFHEO continued its annual survey, soliciting qualitative feedback from the Enterprises regarding the effectiveness of the examination program and the quality of communications. The survey addressed topics such as the timeliness and interactive nature of communications, the customization of the risk-based examination to the Enterprise's risk profile, and the results-oriented nature of the recommendations. For the third consecutive year, the survey results exceeded the target performance level. OFHEO will continue to evaluate surveys conducted by other federal regulators, other federal organizations as well as those used by certain private sector entities, to enhance the survey.

Strategic Objective 1.5: To ensure that future changes in risk do not impair the ability of the Enterprises to perform their missions in a safe and sound manner.

Measure: Maintenance of ongoing monitoring and evaluation of Enterprise risks and activities through new program reviews, as well as periodic reports and studies.

Performance Goal 1.5(a): To ensure that new programs do not risk significant deterioration of the Enterprises' financial conditions.

Performance Measure: Number of new programs approved which cause significant deterioration of the Enterprises' financial conditions.

Target: Zero.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

During FY 2001, the Department of Housing and Urban Development did not identify any new programs to OFHEO for safety and soundness review. However, the Enterprises introduced a number of new products and activities that were not identified as new programs, which OFHEO continues to monitor and evaluate for potential safety and soundness implications.

Performance Goal 1.5(b): To ensure that OFHEO is knowledgeable of all the relevant risks for safety and soundness that impact the Enterprises.

Performance Measure: In depth profiles for Enterprises that incorporate a comprehensive assessment of the risks (both from the business operations and the external operating environment) that pose a potential concern for financial safety and soundness.

Target: Quarterly.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

During FY 2001, OFHEO combined its internal resources and findings to make a comprehensive evaluation of risks quarterly. OFHEO relied on its quarterly risk assessments, examination findings, internal analytical updates, research and policy papers, and the quarterly House Price Index. Considering these factors enabled OFHEO to remain knowledgeable of all relevant risks to the Enterprises' safety and soundness. In future years, OFHEO plans to enhance its comprehensive assessment of relevant risks that pose a potential concern for safety and soundness.

Strategic Goal 2: To promote an efficient secondary mortgage market through an independent and balanced approach to regulatory oversight of the Enterprises.

OFHEO continues to evolve in its relationships with the Enterprises and Congress, as well as relevant interest groups. In order for OFHEO to be effective at regulating the Enterprises, it is important that OFHEO be viewed as providing independent and balanced regulatory oversight. Fairness translates into providing an opportunity for all interested parties to comment on OFHEO's regulatory actions. Independent analysis of regulatory issues provides credibility to the actions taken by OFHEO and ensures that all points of view are examined. Working with other agencies on issues that may affect the Enterprises' safety and soundness provides a broadening of views and a balanced approach to regulatory oversight. Providing transparency in the secondary mortgage market promotes market efficiency. OFHEO has identified three strategic objectives with supporting FY 2001 performance goals that will enable the Office to reach this strategic goal. OFHEO's performance is described below.

Strategic Objective 2.1: To maintain OFHEO's independence in its relationships with the Enterprises.

Measure: Use of internal modeling capacity to regularly analyze Enterprise risks. Participation in development and training programs and in examination activities with other financial regulators.

Performance Goal 2.1(a): To use internal modeling and analytic capacity to regularly analyze Enterprise risks.

Performance Measure: Use the Financial Simulation Model (the stress test software) to assist OFHEO in developing risk profiles for the Enterprises.

Target: Run specific simulations on an as needed basis.

Performance Measure: Use Surveillance and Monitoring system to assist OFHEO in analyzing risks for the Enterprises.

Target: Develop Surveillance and Monitoring reports on an as needed basis.

Actual Performance:
FY 2001: Goal not met.
FY 2000: Goal not met.
FY 1999: Goal met.

This goal was not achieved this year. Because the final rule was published later than originally planned, the stress test software was not available for other analytical runs. Because available resources were devoted to promulgating a final Risk-Based Capital Rule, the Surveillance and Monitoring System, intended to enhance the surveillance and monitoring function that complements and supports the examination program, was not developed.

Impact on the Future:

During FY 2002, OFHEO expects to devote its resources to implementing the risk-based capital rule, and does not expect to run additional simulations until future years. No funds are available to develop the Surveillance and Monitoring System.

Performance Goal 2.1(b): To maintain the objectivity of the examinations process, OFHEO examiners will participate in professional development and training programs and in joint projects with other financial regulators and will participate in examination related regulatory forums.

Performance Measure: To participate in professional development and training programs and in joint projects with the other financial regulators to broaden examiners’ expertise and maintain objectivity.

Target: An average of at least two professional development and training programs or joint projects with other financial regulators per OFHEO examination staff member per year.

Performance Measure: To participate in examination related forums with the other financial regulators.

Target: At least eight.

Actual Performance:
FY 2001: Goal met.
FY 2000: Goal met.
FY 1999: Goal met. (measure more limited in scope)

OFHEO participated in professional development and training programs that exceeded the target level. OFHEO examiners participated in national meetings on corporate governance, audit—best practices, technology, information systems audit and control, and mortgage banking. They attended courses such as evaluating quality of earnings and risk, pricing swaps, fixed income analytics, quality control in mortgage lending, and detecting and avoiding mortgage fraud.

OFHEO examiners also participated in examination forums exceeding the target level. These included the Federal Financial Institutions Examination Council (FFIEC), its Subcommittee on Information Systems, the GSE Council, and ongoing meetings with the OCC, FDIC and the Federal Reserve Board of Governors to discuss examination policy and other examination issues that relate to large banks and the Enterprises.

Strategic Objective 2.2: To ensure an efficient, effective, and balanced approach to the regulation of the Enterprises.

Measure: Number of opportunities for public comment on proposed regulations. Maintenance of ongoing consultation with other government agencies.

Performance Goal 2.2(a): To provide the Enterprises and other stakeholders the appropriate opportunity for input on regulatory activities.

Performance Measure: Percent of proposed regulations issued placed on website within two weeks of publication in the Federal Register.

Target: 100 percent.

Actual Performance: **FY 2001:** Goal met.
 FY 2000: Goal met.
 FY 1999: Goal met.

OFHEO placed all of its proposed and final regulations on the web site when they were published in the *Federal Register*. The Risk-Based Capital rule was posted on the web site as soon as it was final, several weeks before its official publication in the *Federal Register*. OFHEO continues to use its web site to receive comments electronically on its proposed regulations.

Performance Goal 2.2(b): To communicate effectively with all stakeholders on regulatory issues.

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

Target: 100 percent response to all Congressional inquiries within 15 days.

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

Target: 100 percent response to all public inquiries within 15 days.

Actual Performance: **FY 2001:** Goal met.
 FY 2000: Responsive to Congress and the public. No related goal.
 FY 1999: Responsive to Congress and the public. No related goal.

OFHEO responded to all Congressional and public inquiries well within the time established. OFHEO continued briefings with Congressional committee members and staff on issues related to ongoing oversight of the Enterprises, hearings, legislation and the risk-based capital regulation. OFHEO also met with trade associations, the Wall Street Community, public interest groups and others involved or interested in the mortgage markets.

Performance Goal 2.2(c): Work with HUD on regulatory issues of a common interest.

Performance Measure: All significant interactions are reported in OFHEO’s quarterly report to the HUD Secretary.

Target: 100 percent.

Actual Performance: **FY 2001:** Goal met.
FY 2000: No related goal, but agencies worked cooperatively.
FY 1999: No related goal, but agencies worked cooperatively.

OFHEO and HUD continue to work on various regulatory issues. OFHEO routinely provides views to HUD’s Office of GSE Oversight on safety and soundness considerations involved in the Enterprises’ various non-traditional activities such as the Fannie Mae pilot program related to affordable housing/community development. OFHEO continued to work with HUD to develop the median house price index, which HUD will use in setting future FHA loan limits. OFHEO and HUD also initiated agreements to exchange mortgage data.

Strategic Objective 2.3: To promote transparency in the secondary mortgage market.

Measure: Information about the secondary mortgage market is made available timely.

Performance Goal 2.3(a): To provide information to the public about the secondary mortgage market.

Performance Measure: Analyze and report about the secondary mortgage market in OFHEO’s (annual) Report to Congress.

Target: By June 15, 2001.

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

Target: Quarterly.

Actual Performance: **FY 2001:** Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

OFHEO published its annual Report to Congress, describing OFHEO’s activities and the results and conclusions of OFHEO’s examination of the Enterprises. In a separate report published in July, *Mortgage Markets and the Enterprises in 2000*, OFHEO surveyed developments in the housing sector and the primary mortgage market, the secondary market activities of Fannie Mae

and Freddie Mac, and the financial performance of the Enterprises. Each quarter, OFHEO published the House Price Index (HPI), which documents changes in home prices for the nation, each state, many Metropolitan Statistical Areas (MSA's), and the nine census divisions. All of these publications are available on OFHEO's web site, and the annual Report to Congress and the quarterly HPI report are available in hard copy.

Strategic Goal 3: To effectively regulate the Enterprises by ensuring that they comply with all laws under our jurisdiction.

As the safety and soundness regulator for the Enterprises, OFHEO has the responsibility to ensure that they comply with all laws under its jurisdiction. As a result of their government-sponsored status, the Enterprises have been given many benefits that enable them to fulfill their public purpose. OFHEO continued to work to ensure that the Enterprises' actions and operations complied with the provisions of their Charter Acts and other applicable laws within its jurisdiction. OFHEO has identified two strategic objectives with supporting FY 2000 performance goals that will enable the Office to reach this strategic goal. OFHEO's performance is described below.

Strategic Objective 3.1: To ensure that executive compensation at the Enterprises is not excessive.

Measure: Percent of executive officer termination agreements acted upon by OFHEO. Percent of instances of excessive executive compensation acted upon by OFHEO.

Performance Goal 3.1(a): To ensure that executive compensation at the Enterprises is not excessive.

Performance Measure: Percent of instances of excessive executive compensation acted upon by OFHEO.

Target: 100 percent.

Performance Measure: Timely review of termination agreements for Enterprise executives.

Target: Within 90 days of receipt of request and all necessary materials from Enterprise.

Actual Performance:
FY 2001: Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

OFHEO continued to monitor overall executive compensation at the Enterprises. The Office also reviewed, as required by law, four executive termination agreements and determined that they were not excessive. OFHEO also initiated a study that will compare the compensation of executive officers at the Enterprises with that of executive officers with similar duties and

responsibilities at similar businesses. OFHEO is required by statute to prohibit excessive compensation of Enterprise executive officers. The study will provide an independent, objective assessment of the reasonableness and comparability of Enterprise executive compensation.

Strategic Objective 3.2: To ensure that the Enterprises do not violate other provisions of their Charter Acts or of OFHEO's statute.

Measure: Percent of supervisory actions to remedy Charter Act and other violations that are successful.

Performance Goal 3.2(a): To ensure that the Enterprises do not violate other provisions of their Charter Acts or of OFHEO's statute.

Performance Measure: Percent of successful supervisory actions to remedy Charter Act and other violations.

Target: 100 percent.

Actual Performance:
FY 2001: Goal met.
FY 2000: Goal met.
FY 1999: Goal met.

OFHEO found no instances in which the Enterprises violated other provisions of their Charter Acts or of OFHEO's statute.