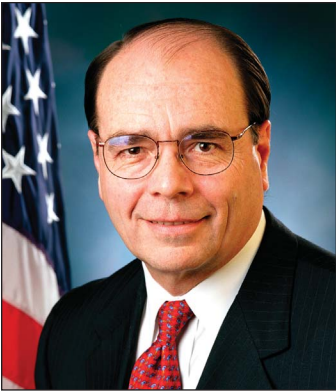


OFHEO STRATEGIC PLAN

2006-2011





MESSAGE FROM THE DIRECTOR

I am pleased to provide the Office of Federal Housing Enterprise Oversight's (OFHEO) Strategic Plan for Fiscal Years 2006-2011. OFHEO and the housing finance market, including Fannie Mae and Freddie Mac (the Enterprises), are at a critical juncture. The powers and tools that this agency or a newly revamped agency will have to regulate these Enterprises will shape and define how we all operate going forward.

As I was sworn in as OFHEO's third Director in its 13 year history in June of 2006, this is an excellent time to produce a new strategic plan. This plan builds upon the previous plan but puts even more emphasis on strengthening OFHEO's legislative and regulatory position.

OFHEO has an important and compelling mission "to promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac." These Enterprises own or guarantee 41 percent of residential mortgages in the U.S. and are among the largest guarantors and borrowers in the world. In short, they and, thus, we are critical to the success of our nation's housing finance system.

OFHEO is focused on dealing with major accounting scandals and management failures at Fannie Mae and Freddie Mac and is forcing both Enterprises to correct significant accounting, internal control and management weaknesses identified through our Special Examinations. The costs of these problems are adding up: earnings were misstated by an estimated \$16 billion, fines exceeded one-half billion dollars, lawsuits will total well over a billion dollars, and remedial costs will exceed two billion dollars. The Enterprises are making progress in addressing these problems, but it will take several more years to complete their efforts. OFHEO will continue to seek corrective action by each company while continuing oversight of their operations, policies, procedures and risks. However, a much stronger regulatory framework is crucial to future success.

I highlight below several components of OFHEO's Strategic Goals to ensure this success:

- ▲ **Enhance supervision to ensure the Enterprises operate in a safe and sound manner.** Perform targeted examinations that explore areas of concern in a more in-depth and focused way, pursuing higher risk issues arising from ongoing examinations. Review the risk-based capital standard and develop new measures of capital adequacy. Also work proactively with other regulators to identify risk areas of common interest.
- ▲ **Provide support for statutory reforms establishing a new regulatory regime by identifying where changes are needed to address risks, issues and emerging trends, and to make recommendations to Congress as necessary.** Support legislative efforts to improve OFHEO's regulatory tools through research and analysis related to the risk of the Enterprises and potential systemic risk associated with the Enterprises. Conduct analysis to reinforce the need for legislated changes.
- ▲ **Continue to support the national policy of an efficient secondary mortgage market by providing timely information and analysis on key policy issues such as loan limit changes and Enterprise market share.** Continue to issue and expand upon OFHEO's quarterly House Price Index. Improve transparency of the Enterprises' condition and risks through consistent reporting and disclosure through a uniform Enterprise call report and comparative financial analyses. Work with other Federal agencies to coordinate efforts that could affect the nation's mortgage markets and housing finance system.

It is my hope that all stakeholders will work with us to achieve the goals set forth in this plan. I believe that enhanced supervision and in particular a stronger regulatory regime, as proposed by the Congress and supported by OFHEO, will be better for homeownership growth, affordable housing, the nation's housing finance system and all of you as Enterprise stakeholders.



James B. Lockhart III
Director

OFHEO VALUES

OFHEO is results-oriented and accomplishes its public mission through teamwork, mutual respect and the contribution of every OFHEO employee. Four core values guide the mission and operations of OFHEO:

Integrity

- ▲ *We adhere to the highest ethical and professional standards. We treat the Enterprises, the public, policy makers and other stakeholders with impartiality and respect.*

Independence

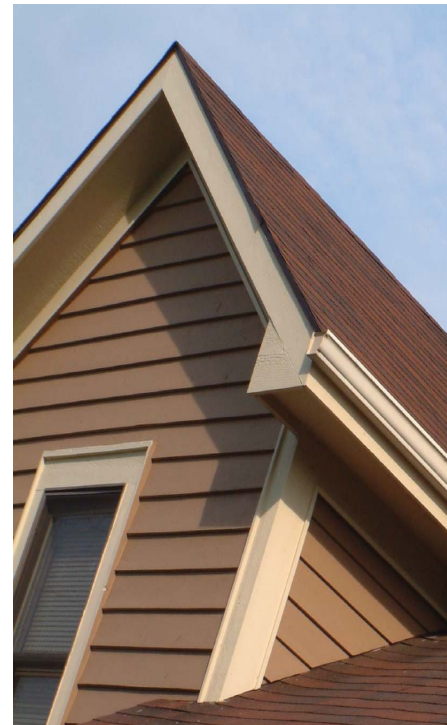
- ▲ *We are an arms-length regulator of the Enterprises and maintain our objectivity. Our evaluations of the Enterprises are unbiased and remain free from external influence.*

Professionalism

- ▲ *We maintain a highly skilled, dedicated and diverse workforce that reinforces our ability to manage change in a dynamic environment. We strive for excellence in our actions and work products in order to achieve results.*

Accountability

- ▲ *We are accountable for our actions and results, both as individuals and as an organization. We strive to use agency resources and authorities efficiently and effectively to achieve our mission and goals. As public servants, we are accountable to the American people.*



OFHEO'S MISSION

To promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.

OFHEO's mission statement embraces its congressional mandate to ensure the safety and soundness of Fannie Mae and Freddie Mac. Through oversight of the Enterprises, OFHEO contributes to a stable housing sector and a strong national housing finance system.

OFHEO was established as an independent agency within the Department of Housing and Urban Development by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title 13 of P.L. 102-550). OFHEO's primary mission is ensuring the capital adequacy and safe and sound operation of two government-sponsored enterprises — the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Fannie Mae and Freddie Mac (the Enterprises) are congressionally-chartered, publicly-owned corporations whose shares are listed on the New York Stock Exchange. They were created to provide a secondary mortgage market to support affordable housing and to provide stability and liquidity to the secondary mortgage market. The Enterprises buy mortgages from commercial banks, thrift institutions, mortgage banks, and other primary lenders, and either package them into mortgage-backed securities (MBS) for resale to investors or hold these mortgages in their own portfolios as mortgages or MBS. These secondary mortgage market operations play a major role in creating a ready supply of mortgage funds for American homebuyers. The Enterprises have become two of the world's largest financial institutions. Their combined guaranteed MBS represent 26% of the secondary mortgage market and their portfolio holdings 14%.

Since 2003, when OFHEO initiated a Special Examination of Freddie Mac, and shortly thereafter initiated a Special Examination of Fannie Mae, OFHEO identified serious deficiencies and sought corrective action. Through these in-depth and sustained examinations, culminating in a series of reports and subsequent agreements, the agency found a disregard of accounting rules, internal controls, and disclosure standards; mismanagement; earnings manipulation and the failure of Boards of Directors to be adequately informed.

OFHEO now has consent and other agreements with both Enterprises. Both companies now face a 30% capital surplus requirement due to their operational risk problems and both are subject to specific limits on the growth of their portfolios as they get their houses in order. Fannie Mae and Freddie Mac are making progress in fixing their problems and reforming their corporate cultures and management practices, but it is slower than OFHEO and the Enterprises would like, and is expected to take several more years.

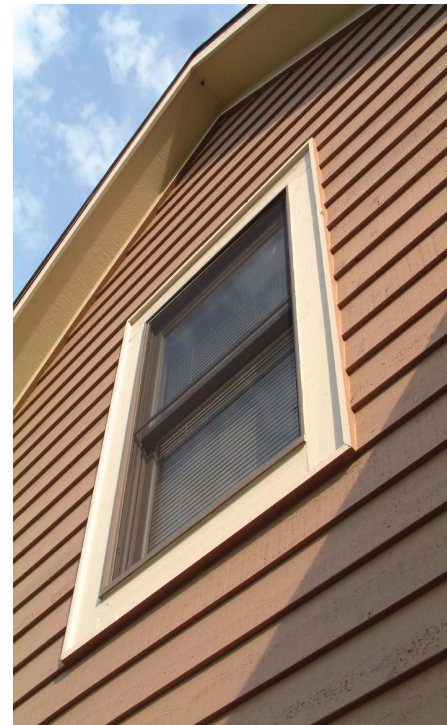
To achieve its mission, OFHEO has adopted three strategic goals and a resource management strategy:

1. Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.

2. Provide support for statutory reforms to strengthen our regulatory powers.

3. Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

**Resource Management Strategy:
Manage effectively OFHEO's human capital and other resources to support our mission.**





OFHEO'S STRATEGIC GOALS

STRATEGIC GOAL 1

Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.

OFHEO's primary duty as a regulator is to ensure that the Enterprises have the financial strength and operational capacity to fulfill their important role in the nation's housing finance system. Providing a comprehensive and effective oversight program requires attention to the Enterprises' operations and management, the risks inherent in their activities and the dynamic environment in which they operate. OFHEO will enhance and strengthen its oversight by applying meaningful risk-based standards, assessing the Enterprises' changing risk profiles, targeting resources to diagnose emerging issues, monitoring adherence to law and regulation, verifying that required improvements are made, taking remedial action, and following through on litigation that can result from enforcement actions.

Means and Strategies

PERFORMANCE GOAL

The Enterprises comply with safety and soundness standards.

- ▲ Complete annual, risk-based examinations of the Enterprises to ensure that they comply with safety and soundness standards, are addressing issues identified and are making recommended improvements.
- ▲ Perform targeted examinations that explore areas of concern in a more in-depth and focused way, pursuing higher risk issues arising from ongoing examinations.
- ▲ Enhance focus on operational and model risks of the Enterprises by developing ways to measure and assess these risks and applying those measures consistently to both Enterprises.
- ▲ Enhance validation of information received from the Enterprises.

STRATEGIC GOAL 1

**STRATEGIC
GOAL 1**

PERFORMANCE GOAL

The Enterprises are adequately capitalized.

- ▲ Strengthen the capital regime that ensures the Enterprises' capital adequacy by reviewing the risk-based capital standard and developing additional measures of capital adequacy, some of which may require legislation. Explore issues related to market risk; credit risk including counterparty risk and concentration risk; operational risk including reputational risk; fair value accounting; and economic capital.
- ▲ Ensure the Enterprises hold a sufficient amount of capital to meet OFHEO's capital requirements by monitoring the Enterprises' capital plans and assessing capital levels against regulatory standards.

**STRATEGIC
GOAL 1**

PERFORMANCE GOAL

The Enterprises comply with applicable laws, regulations, directives and agreements, including executive compensation, corporate responsibility and disclosure.

- ▲ Monitor the Enterprises' compliance with applicable laws, regulations, directives and agreements, including executive compensation, corporate responsibility and disclosure, and take enforcement action if necessary.
- ▲ Follow through on necessary enforcement actions and ensuing litigation that result from OFHEO's supervisory activities, including special examinations of the Enterprises.
- ▲ Closely monitor compliance with consent and other agreements between the Enterprises and OFHEO to ensure that changes are made on schedule and verified. Take enforcement actions when necessary to ensure that the Enterprises are making operational improvements.

PERFORMANCE GOAL

Strengthen regulatory infrastructure to enhance the supervision of the Enterprises.

- ▲ Proactively provide additional guidance, including necessary regulations, policy statements and directives, to the Enterprises to prevent problems from arising or worsening, facilitate quick resolutions, improve the transparency of supervision processes, apply uniform standards to both Enterprises, and clarify OFHEO's expectations of them.
- ▲ Establish a quality assurance function to maintain consistent application of the supervisory standards and examination practices across Enterprises and ensure that appropriate policies are followed.
- ▲ Work with other regulators to identify risk areas and supervisory issues of common interest. Coordinate and share information, findings and views with other regulators to ensure consistent policy and standards that recognize the interactions among financial institutions.
- ▲ Implement OFHEO's automated supervisory tools to improve and integrate supervisory functions and processes and to manage information effectively.
- ▲ Conduct applied research and in-depth analysis on a wide range of safety and soundness and capital adequacy issues that will increase OFHEO's understanding of the Enterprises, the markets in which the Enterprises are engaged, and the risks that affect OFHEO's ability to carry out its responsibilities.

STRATEGIC GOAL 1

STRATEGIC GOAL 2

Provide support for statutory reforms to strengthen our regulatory powers.

OFHEO's ability to ensure the financial safety and soundness of the Enterprises faces certain limitations within current law. As OFHEO has identified problems through its special examinations of both Enterprises, the agency has had to rely on consent agreements with each Enterprise to affect change. Going forward, OFHEO needs the full set of regulatory powers, similar to the tools available to the bank regulators, so it may act quickly to address problems. OFHEO will continue to work with both the Administration and the Congress to identify and support appropriate changes to its statutory authorities that strengthen OFHEO's ability to carry out its mission.



Means and Strategies

PERFORMANCE GOAL

Support efforts to strengthen OFHEO's authorities.

- ▲ Support statutory changes to strengthen OFHEO's regulatory tools through research and analysis related to the risks of the Enterprises and risks in the secondary mortgage market, including potential systemic risk associated with the Enterprises. Conduct historical, financial and comparative analyses to clarify the need for and scope of statutory changes.
- ▲ Identify risks, issues and emerging trends that are internal or external to the Enterprises and affect OFHEO's ability to carry out its responsibilities. Make recommendations to Congress on any needed statutory changes to OFHEO's authorities to ensure the Enterprises' safety and soundness. Examples include broader flexibility in setting capital standards that better measure risk, including economic capital, and limiting growth of the Enterprises' portfolios.
- ▲ Analyze legislative proposals and the effects of possible changes.
- ▲ Respond to requests from other Federal agencies and Congress on alternative approaches to implement OFHEO-recommended statutory changes and to explain the need for change.
- ▲ Conduct outreach to the housing and mortgage finance industry and other stakeholders to explain the need for statutory changes and possible effects of those changes, and to gather their input.

STRATEGIC GOAL 2

STRATEGIC GOAL 3

Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

Fostering an efficient secondary mortgage market is the best way to ensure that there is a steady stream of funds for homeownership and affordable housing. The market has become increasingly dynamic and complex, and the Enterprises comprise a large share of that market. The Enterprises contribute to the smooth operation of the markets by providing liquidity and stability and by meeting affordable housing goals. For any market to work efficiently, its participants must have access to reliable information to make decisions. OFHEO will work with other Federal agencies to coordinate efforts that could affect the secondary mortgage market, and will provide information and analysis to the public for informed decision-making to encourage market efficiency.

Means and Strategies

STRATEGIC GOAL 3

PERFORMANCE GOAL

Promote an efficient secondary mortgage market by increasing transparency of mortgage market developments and Enterprise risks and activities.

- ▲ Expand the quarterly House Price Index (HPI) and related products by, for example, producing a median HPI, expanding the geographical areas covered and providing analysis of specific markets.
- ▲ Increase transparency of mortgage market and Enterprise-related developments by publishing conclusions and findings of OFHEO's annual examination through the Annual Report to Congress.
- ▲ Address emerging issues and external events affecting the Enterprises and the housing finance markets through timely policy analysis.
- ▲ Produce research and analysis focused on key policy issues, such as the implications of loan limit changes, concentration within the mortgage markets and Enterprise market share.

- ▲ Improve transparency of the Enterprises' conditions and risks through consistent reporting and disclosure by developing a uniform Enterprise call report and comparative financial analysis of the Enterprises.
- ▲ Make consistent and transparent disclosures of the Enterprises' conditions and OFHEO's operations through OFHEO publications and information posted on the agency's web site.

PERFORMANCE GOAL

Communicate effectively with all stakeholders on Enterprise risks and activities, mortgage markets, the nation's housing finance system and regulatory issues.

- ▲ Reach out to groups within the industry, Wall Street and other investment communities, and mortgage markets through educational efforts such as speeches, conferences and forums to share information and discuss issues of common interest.
- ▲ Provide timely and accessible information to the public on the OFHEO web site.
- ▲ Respond quickly and thoroughly to public inquiries and to requests for information from other Federal agencies.

PERFORMANCE GOAL

Cooperate with other Federal agencies on mortgage markets, the nation's housing finance system and regulatory issues.

- ▲ Work closely with HUD on issues related to the regulation of the Enterprises, including Enterprise products and activities, charter issues and affordable housing goals.
- ▲ Cooperate with other Federal agencies on issues of common interest affecting the regulation of the Enterprises, the mortgage markets and the nation's housing finance system.

STRATEGIC GOAL 3

STRATEGIC GOAL 3

**RESOURCE
MANAGEMENT
STRATEGY**

RESOURCE MANAGEMENT STRATEGY

Manage effectively OFHEO's human capital and other resources to support our mission.

OFHEO's success in achieving its strategic goals depends on the effective management of resources and seamless financial, administrative and information technology support functions. The size of the budget in relation to the mission requires OFHEO to use limited resources efficiently and ensures that resources are tied directly to the achievement of the mission. As a small but growing agency, OFHEO relies on staff and management to accomplish its goals through cross-organizational teams that are results-oriented. OFHEO managers use timely information for decision-making that links strategic planning, program performance, budget, and operational strategies. OFHEO uses appropriate competitive sourcing to provide efficient and cost-effective services. OFHEO's management philosophy reflects the government-wide management goals outlined in the President's Management Agenda.

Means and Strategies

PERFORMANCE GOAL

Maintain a diverse workforce that is skilled, flexible and performance-oriented to fulfill the goals of the agency.

- ▲ Continue to implement Human Capital Management initiatives to broaden workforce planning efforts, address talent management, and continue support for staff growth and skill development.
- ▲ Reinforce strategic alignment and accountability by strengthening the linkage between the agency's strategic goals and individual job performance goals.
- ▲ Implement the Federal human capital survey to assess needs and make improvements to OFHEO's operations and positively affect recruitment and retention of key staff.
- ▲ Maintain hiring practices consistent with merit system and veterans' preference principles and conduct an independent annual review of OFHEO's delegated examining processes.
- ▲ Maintain equal employment opportunity through outreach efforts.

PERFORMANCE GOAL

Provide effective information resource management services to OFHEO managers and staff to support the goals of the agency.

- ▲ Manage information resources effectively to ensure a secure, well-functioning system and continue to implement the Investment Review Board process to make cost-effective information technology investment decisions.
- ▲ Continue to implement E-Gov initiatives to integrate information systems and automate agency-wide financial functions, improve communications with stakeholders and automate human capital management with OPM's Electronic Official Personnel Folder (E-OPF) system. Continue using government-wide web-based systems for recruiting staff and requesting contract proposals.

PERFORMANCE GOAL

Maintain a strong internal control and risk management program.

- ▲ Maintain strong internal controls, publish financial statements timely, engage an independent external auditor annually, and continue to receive clean audit opinions.
- ▲ Complete an external review of OFHEO's information security each year and continue to receive opinions with no material weaknesses.

PERFORMANCE GOAL

Ensure the continuity of OFHEO's business functions.

- ▲ Ensure that OFHEO's Continuity of Operations Plan is up-to-date and fully tested on a regular basis, and that staff are familiar with the functions they may have to perform in an emergency.

**RESOURCE
MANAGEMENT
STRATEGY**

**RESOURCE
MANAGEMENT
STRATEGY**

**RESOURCE
MANAGEMENT
STRATEGY**

PERFORMANCE GOALS AND MEASURES

The following table provides OFHEO performance goals and measures that are representative of the annual goals the Office will use to measure and manage its performance.

STRATEGIC GOAL 1	
<i>Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.</i>	
PERFORMANCE GOALS	REPRESENTATIVE PERFORMANCE MEASURES
The Enterprises comply with safety and soundness standards.	<ul style="list-style-type: none"> Percentage of Enterprises with CAMELSO ratings of 1, 2, or 3 (CAMELSO stands for Capital adequacy, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk and Operational risk). For both Enterprises, the percentage of OFHEO's five risk assessment categories (Governance, Market, Credit, Operational, Model) with an acceptable risk/risk management profile. Average number of days to issue report of examination to Enterprise Boards of Directors and meet with them after field work is complete.
The Enterprises are adequately capitalized.	<ul style="list-style-type: none"> The Enterprises meet OFHEO's determination of capital adequacy. Complete planned enhancements to the standards against which the Enterprises are measured.
The Enterprises comply with applicable laws, regulations, directives and agreements, including executive compensation, corporate responsibility and disclosure.	<ul style="list-style-type: none"> Any identified instances of non-compliance with laws and regulations are resolved to OFHEO's satisfaction. Percentage of actions required by formal regulatory agreements with the Enterprises that are resolved as planned. Percentage of Matters Requiring Attention (MRA) and items related to OFHEO guidances and directives in non-compliance that are resolved to OFHEO's satisfaction.
Strengthen regulatory infrastructure to enhance the supervision of the Enterprises.	<ul style="list-style-type: none"> Revise and implement policies, guidances and regulations for the Enterprises to augment current regulatory infrastructure. Implement a quality assurance function and other planned initiatives to strengthen supervision of the Enterprises. Implement an Enterprise Call report.

STRATEGIC GOAL 2	
<i>Provide support for statutory reforms to strengthen our regulatory powers.</i>	
PERFORMANCE GOALS	REPRESENTATIVE PERFORMANCE MEASURES
Support efforts to strengthen OFHEO's authorities.	<ul style="list-style-type: none"> Conduct and disseminate research and analysis to identify issues and areas requiring legislative change. Make recommendations to Congress about legislative changes OFHEO needs to accomplish its mission. Respond to all Congressional inquiries.

STRATEGIC GOAL 3

Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

PERFORMANCE GOALS

REPRESENTATIVE PERFORMANCE MEASURES

Promote an efficient secondary mortgage market by increasing transparency of mortgage market developments, and Enterprise risks and activities.

- Report about house price trends through the House Price Index (HPI) report.
- Report on OFHEO activities, examination results and conclusions, housing, mortgage market developments, and the secondary mortgage market in the OFHEO annual Report to Congress.
- Publish reports to enhance understanding of mortgages, mortgage markets and the nation's housing finance system.

Communicate effectively with all stakeholders on Enterprise risks and activities, mortgage markets, the nation's housing finance system and regulatory issues.

- Percentage of survey respondents visiting OFHEO's website who find it a useful resource.
- Respond to all public inquiries.
- Meet with industry stakeholders to address current topics and receive input from the industry.

Cooperate with other Federal agencies on mortgage markets, the nation's housing finance system and regulatory issues.

- Meet with HUD to discuss issues related to the regulation of the Enterprises, including affordable housing goals.
- Respond to requests from other Federal agencies for information about housing finance markets and the Enterprises.

RESOURCE MANAGEMENT STRATEGY

Manage effectively OFHEO's human capital and other resources to support our mission.

PERFORMANCE GOALS

REPRESENTATIVE PERFORMANCE MEASURES

Maintain a diverse workforce that is skilled, flexible, and performance-oriented to fulfill the goals of the agency.

- Develop a workforce planning strategy to assess workforce talent (skills and competencies), based on needs to meet OFHEO's strategic goals.
- Implement the Federal Human Capital Survey for OFHEO.
- Conduct targeted outreach to obtain the skills needed and promote diversity.

Provide effective information resource management services to OFHEO managers and staff to support the goals of the agency.

- Implement each fiscal year's component of the OFHEO 5-Year IT Strategic Plan.
- Percentage of time OFHEO's IT systems are available for use by the OFHEO staff.
- Maintain certification and accreditation for all major OFHEO systems.

Maintain a strong internal control and risk management program.

- Receive a clean opinion and no material weaknesses on OFHEO's external audits and external reviews.

Ensure the continuity of OFHEO's business functions.

- Complete continuity of operations testing as outlined by Federal Preparedness Circular 65.

STRATEGIC PLANNING PROCESS

OFHEO management developed its strategic plan — long-term strategic goals and the means and strategies to achieve them — in a collaborative process that focused on the environmental and operational factors that may have a significant impact on the Enterprises over the next five years. Before OFHEO began developing its new strategic plan, the agency requested input from stakeholders on issues and areas of focus that were important to them. These comments, as well as input from OFHEO employees, were considered as the plan developed. As OFHEO worked through the OMB Performance Assessment Rating Tool (PART) process, OFHEO developed new measures of achievement for the agency's goals and included those measures in this plan as well. Through its website, OFHEO solicited comments on its draft plan from the public, Congress, OFHEO staff, and other stakeholders and reviewed and considered them before making the plan final.

The five-year strategic plan provides direction and focus to OFHEO management and staff on a daily basis. The OFHEO Director presents the goals and strategies within the strategic plan to the staff at an all-hands meeting. Individual office directors and managers further explain to staff how their work products and projects relate to the overarching strategic plan as annual performance plans and project plans are developed. OFHEO uses two mechanisms to ensure accountability of managers and staff for goal achievement. On a quarterly basis, senior management, led by the OFHEO Director, meets to review progress toward achieving annual performance goals and discusses any obstacles or issues that would prevent the goal from being achieved. This quarterly monitoring keeps the annual goals visible and the focus of managers' attention. Every OFHEO employee's annual job performance plan and individual development plan is also connected to the annual performance plan. OFHEO employees are rated annually based on their performance in completing projects and products that lead to the achievement of OFHEO's goals.

EXTERNAL FACTORS

The following factors could affect OFHEO's ability to achieve its strategic goals in the next five years either by affecting Enterprise performance and the housing finance system, or by limiting OFHEO's ability to ensure the safety and soundness of the Enterprises' operations and condition.

Limitations of Authority

OFHEO has statutory limitations on its powers and abilities as a regulator that may affect its ability to ensure the safety and soundness of the Enterprises. Because of their government-sponsored enterprise (GSE) status, the credit markets do not provide the normal market discipline to keep the Enterprises in check, and OFHEO may not be able to adequately address issues and concerns that arise without additional authorities. Specifically:

- ▲ OFHEO needs flexibility in setting capital requirements in order to strengthen regulation of the Enterprises. OFHEO's enabling Act prescribes specific risks and elements that limit the effectiveness of the capital rules in addressing Enterprise risks. For example, the current minimum capital rule sets requirements at levels below what large banks are required to hold, and the current risk-based capital rule is limited to two precise scenarios that do not address the full array of Enterprise risks. Perversely, the current risk-based capital numbers are lower than the minimum capital numbers.
- ▲ OFHEO needs explicit authority and Congressional guidance to limit portfolio growth of the Enterprises. This tool will ensure that the Enterprises are appropriately focused on their mission and proper risk management, and do not contribute to the possibility of systemic disruption in the financial sector through unconstrained growth. Since 1990, both Enterprises have grown their portfolios of mortgage assets at annual rates that far outstrip residential mortgage market growth.

- ▲ Combining mission and new product approval authority with safety and soundness oversight in a single regulator would further enhance Enterprise regulation. While OFHEO currently works with HUD on new product approval and charter issues, OFHEO is in the difficult position of considering only safety and soundness elements of activities that could be in violation of an Enterprise's charter.
- ▲ OFHEO also needs bank regulator-like powers such as independent litigation authority, receivership powers and better enforcement authorities in order to have the right tools at its disposal. The absence of receivership authority creates uncertainty and contributes to the possibility of a systemic disruption in the financial sector.
- ▲ Finally, OFHEO needs independent funding authority so that the uncertainty associated with the appropriations process does not hinder effective long-term planning nor preclude the ability to act on a short-term basis to address emerging problems at the Enterprises.

Economic Variables

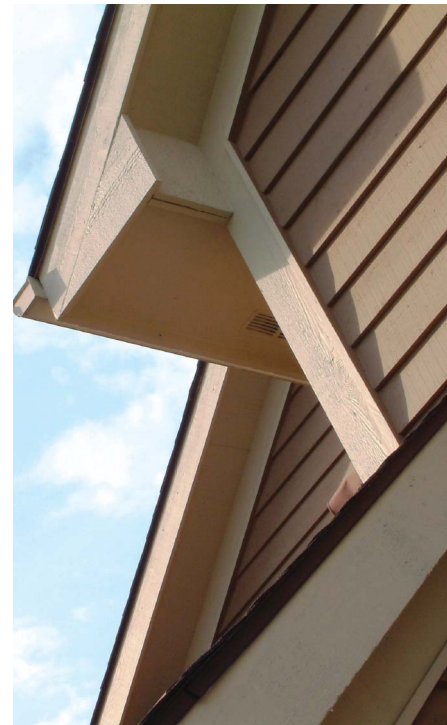
The Enterprises are large financial institutions focused in one main line of business, residential mortgages. Factors in the economic environment that affect the mortgage market also affect the Enterprises' business and operations, and could affect their safety and soundness. For example, economic events affecting mortgage demand, such as significant increases in unemployment, significant decreases in house prices, or sharp, prolonged changes in interest rates, could significantly affect the financial condition of the Enterprises. During exceptionally adverse economic periods, the Enterprises may be unable to meet regulatory standards. OFHEO would require strengthening of Enterprise financial practices or business operations to mitigate an identified weakness.

Enterprise Capacity and Management

Both Enterprises are currently engaged in a multi-year effort to make significant and lasting changes in their operations to substantially improve compliance with accounting and internal control standards, correct management deficiencies, and transform their organizational cultures. To meet the requirements of the consent agreements with OFHEO and sustain safe and sound operations, both Enterprises will need to implement planned commitments for remediation on an aggressive time frame. Both Enterprises have appointed new management teams to lead the efforts and have shifted their focus to making these changes, investing significantly in changing systems, practices, and culture, and employing substantial contract assistance to reinforce staff. At the same time, the Enterprises are continuing to run their complex businesses and keep pace with ever-changing markets. Despite their best efforts, the Enterprises may face capacity constraints or other issues that may prevent them from making the changes necessary to improve their operations. Failure of Enterprise management that cannot be detected through regulatory oversight, such as fraud, negligence, or incompetence in the conduct of business operations and risk management, could also prevent OFHEO from meeting its goals. OFHEO can mitigate these events through the use of its enforcement authorities, if necessary.

Technological and Physical Risk

In the current environment, private firms and government agencies have experienced problems in ensuring the security of their information and continuity of operations. OFHEO and the Enterprises maintain policies to prevent problems within their control from occurring and to provide for continuity of operations when circumstances are beyond their control. Even if an organization is prepared and has safeguards in place to protect data and physical assets, the velocity of change in technology and security threats pose risks that may materialize and could jeopardize OFHEO's ability to achieve its goals.



PROGRAM EVALUATIONS

Program evaluation is an important feedback tool that can provide managers with information to ensure that OFHEO's goals are meaningful, and the strategies for achieving them are effective. OFHEO uses program reviews and program evaluation from many sources in revising its strategic and annual goals and measures, its broad strategies, and its ongoing operations and structure to best achieve its mission. OFHEO has not had an external evaluation of its mission functions since the Government Accountability Office (GAO) last evaluated OFHEO's development of its supervisory program in 1998. In FY 2008, OFHEO intends to initiate an independent program evaluation to assess the effectiveness of its supervision of Fannie Mae and Freddie Mac, and will make changes as appropriate after considering the findings.

Internal

OFHEO regularly evaluates its activities, strategies and progress toward achieving its goals throughout the year. OFHEO uses regular management meetings, all hands meetings, management reports, and performance review meetings to communicate and discuss organizational goals and objectives, and the status of activities to achieve these goals. The agency uses cross-agency internal task forces to review internal processes and products, and to recommend improvements or to implement them. OFHEO is developing a quality assurance function to ensure that its supervisory policies are effective and followed consistently. OFHEO will implement the Federal Human Capital Survey and make improvements after receiving employee feedback.

External

OFHEO also relies on the GAO, the Congressional Budget Office (CBO), the HUD Inspector General (OIG), the Office of Management and Budget (OMB), the Office of Personnel Management (OPM), and external auditors for reviews and audits and considers their findings to improve operations.

Government Accountability Office

The GAO, an arm of Congress, periodically conducts targeted reviews of OFHEO and other financial regulators, and testifies before Congress on its observations and recommendations. Based in part on the GAO 2001 report on a comparison of the enforcement authorities available to bank regulators and the Federal Housing Finance Board (FHFB), and testimony by GAO officials, OFHEO continues to encourage passage of legislation to clarify and enhance its authorities, and has elevated these efforts to its second strategic goal.

Congressional Budget Office

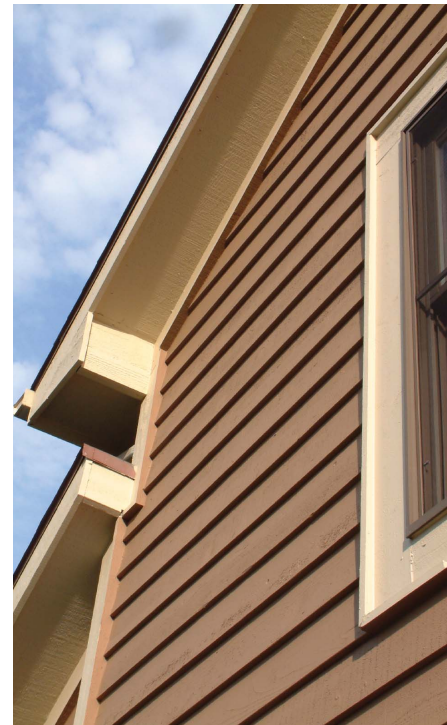
The CBO, also an arm of Congress, periodically issues reports and analytical studies of issues related to the costs, benefits, and risks of the GSEs and their oversight, and testifies before Congress on their findings. In October 2003, the CBO Director testified on the Regulation of the Housing Government-Sponsored Enterprises, in which he made recommendations on how effective regulation can reduce but not eliminate the risks to taxpayers from the GSEs. In June 2006, CBO issued an analytical study on Measuring the Capital Positions of Fannie Mae and Freddie Mac, and made recommendations on how to better capture the fair value of capital in accordance with changing accounting standards. OFHEO has used the information in these studies, along with information from other sources, to develop its strategic goals, the content of its consent agreements with the Enterprises, and the improvements it will consider in its capital oversight and supervisory operations.

Office of Management and Budget

The Office of Management and Budget, the President's budget office, is conducting formal assessments of the effectiveness of agency programs. OMB is currently working with OFHEO to evaluate the agency using its Program Assessment Rating Tool (PART), and will issue its findings in February 2007. The key performance measures in OFHEO's FY 2006-2011 Strategic Plan will be reflected in the OMB PART review.

Office of Inspector General

The HUD Office of Inspector General periodically conducts reviews of various aspects of OFHEO operations. The results of these reviews provide input to OFHEO in its management of office operations to achieve its goals. In a March 2005 report, the HUD Inspector General concluded that



OFHEO's compensation, staffing and the skills and expertise of OFHEO staff are comparable to other regulatory agencies. During FY 2005, based on a recommendation from the OIG, OFHEO followed up on its commitment to design and conduct an employee time usage study to validate OFHEO managers' estimate of the personal services cost of achieving each strategic goal.

Office of Personnel Management

In FY 2004, the Office of Personnel Management audited OFHEO's Delegated Examining Unit, and found that OFHEO's hiring processes support the Merit System Principles and the Veteran's Preference Act, as amended. During FY 2006, OPM also audited OFHEO's Human Resource Management Programs, and found that OFHEO is managing its human capital in support of its mission. They required one action, which OFHEO is implementing, and made additional recommendations. These reviews will be conducted periodically by OPM, and OFHEO will continue to evaluate and implement their recommendations to improve its human capital management.

External Auditors and Reviewers

Every year, OFHEO contracts with an accounting firm to conduct an independent audit of OFHEO's financial statements and internal controls. OFHEO also contracts annually for an independent review, in accordance with the Federal Information Security Management Act (FISMA), of its information security program. No material weaknesses have been reported from these reviews. OFHEO uses these audits and reviews to implement improvements in these areas.





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September 2006