OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

NEWS RELEASE

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OFHEO SUBMITS ITS ANNUAL REPORT TO CONGRESS

WASHINGTON, D.C. — Armando Falcon, Jr., Director of the Office of Federal Housing Enterprise Oversight (OFHEO), safety and soundness regulator for Fannie Mae and Freddie Mac (the Enterprises), today released OFHEO's Annual Report to Congress.

"I am pleased to report that OFHEO has found both Fannie Mae and Freddie Mac to be well-capitalized and operating in a safe and sound manner," said Falcon.

HIGHLIGHTS OF THE REPORT INCLUDE:

1) Results and conclusions of OFHEO's annual examinations of Fannie Mae (p. 22) and Freddie Mac for 2001(p. 43).

2) An overview of the stress test and capital classifications of the Enterprises.

3) Detailed, new information on OFHEO's examination program including information on the Enterprises' derivatives use, corporate governance and audit practices.

4) An independent, unqualified audit opinion of OFHEO for the third consecutive year.

5) Detailed charts on the Enterprises' portfolios.

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Report to Congress

Office of Federal Housing Enterprise Oversight

June 15, 2002

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

June 14, 2002

The Honorable Paul S. Sarbanes
Chairman
Committee on Banking, Housing, & Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairmen:

I am pleased to transmit the 2002 Report to Congress from the Office of Federal Housing Enterprise Oversight (OFHEO). This report has been prepared to meet the statutory requirements in section 1319B of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of P.L. 102-550).

The views in this report are those of the Director and do not necessarily represent those of the President or the Secretary of Housing and Urban Development.

Sincerely,

Armando Falcon, Jr.
Director

CC: The Honorable Phil Gramm, Ranking Member, Senate Committee on Banking, Housing & Urban Affairs
The Honorable John J. LaFalce, Ranking Member, House Committee on Financial Services

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Dear Chairmen:

According to Section 1319B(a)(3) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, the Director of the Office of Federal Housing Enterprise Oversight (OFHEO) shall include any legislative recommendations to enhance the financial safety and soundness of Fannie Mae and Freddie Mac (the Enterprises) in this annual report to Congress. Pursuant to that requirement, I am forwarding the following recommendation which was submitted to the Congress earlier this year through the Administration's Fiscal Year (FY) 2003 budget request.

As noted in the FY 2003 budget, the Enterprises continue to grow in both size and scope. As the safety and soundness regulator of the Enterprises, OFHEO must be adequately positioned to address this growth and any unforeseen contingencies. I concur with the Administration's position that OFHEO should be permanently funded to ensure adequate resources and flexibility, on par with all other financial safety and soundness regulators. Such funding would not come from taxpayer dollars, but rather through direct assessment on the Enterprises. Congressional oversight of OFHEO would continue as it currently does with the other financial regulators.

The legislative recommendation which is identical to that recommended by the Administration follows:

> Section 1316(a) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4516) is amended in the first sentence by striking ", to the extent provided in appropriations Acts."

Sincerely,

Armando Falcon, Jr.
Director

CC: The Honorable Phil Gramm, Ranking Member, Senate Committee on Banking, Housing & Urban Affairs
The Honorable John J. LaFalce, Ranking Member, House Committee on Financial Services

DIRECTOR'S MESSAGE

I am pleased to report that 2001 was a very busy and productive year at the Office of Federal Housing Enterprise Oversight. I am proud of the role that OFHEO plays in ensuring the safety and soundness of two of the vital government-sponsored enterprises charged with providing liquidity to the primary mortgage market. I am also pleased to report that OFHEO has found both Fannie Mae and Freddie Mac to be well-capitalized and operating in a safe and sound manner.

We have included in this report details on OFHEO's work during 2001: A year in review summation; the results and conclusions of our examinations of the Enterprises; information on the completion of our risk-based capital rule; the development of rules and policy guidances for our Regulatory Infrastructure Project; the results of our quarterly house price index; the report of our independent audit; and numerous informational charts and tables to assist in understanding the Enterprises' business. As it has in past years, OFHEO received an unqualified, clean audit.

With the completion of our risk-based capital rule, OFHEO now has all the key elements of a strong, thorough oversight program in place: Examinations, Capital standards and Research. We continue to build upon that program to enhance our oversight. We will soon be expanding OFHEO's Examination staff, we will utilize the risk-based capital stress test as an analytical tool, we have research underway to increase our understanding of Enterprise risks and we have established working groups on derivatives and disclosure.

This year is already shaping up to be a very active year as well. We look forward to another successful year for OFHEO and the housing market.

Sincerely,

Armando Falcon, Jr.

Armando Falcon, Jr.

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CHAPTER ONE – Year in Review

During 2001 OFHEO continued to ensure the Enterprises are financially safe and sound and, thereby, able to foster the strength and vitality of the nation's housing finance system. OFHEO conducted risk-based examinations of both Enterprises, determined each Enterprise met its regulatory capital requirement throughout the year, finalized its risk-based capital rule, and continued to adapt its regulatory program to the evolution of the nation's housing finance system and changes in the mortgage industries' use of technology.

HOUSING MARKET FLOURISHES AMID A FALTERING ECONOMY

The year 2001 marked the end of the longest economic expansion in U.S. history, with the first recession in 10 years starting in March. Economic activity declined slightly during the late spring and summer, then more sharply for a brief period after September 11, before improving late in the year. On balance, the rate of economic output ended the year close to its rate at the end of the previous year, but the unemployment rate rose from 4 percent to 5.8 percent. In response, the Federal Reserve cut its Federal Funds rate target sharply over the course of the year from 6.5 percent to 1.75 percent. Mortgage interest rates, which had been declining in the latter half of 2000, fell somewhat further to the lowest rates since the 1960s. Rates on long-term, fixed-rate loans averaged a full percentage point below the 2000 average.

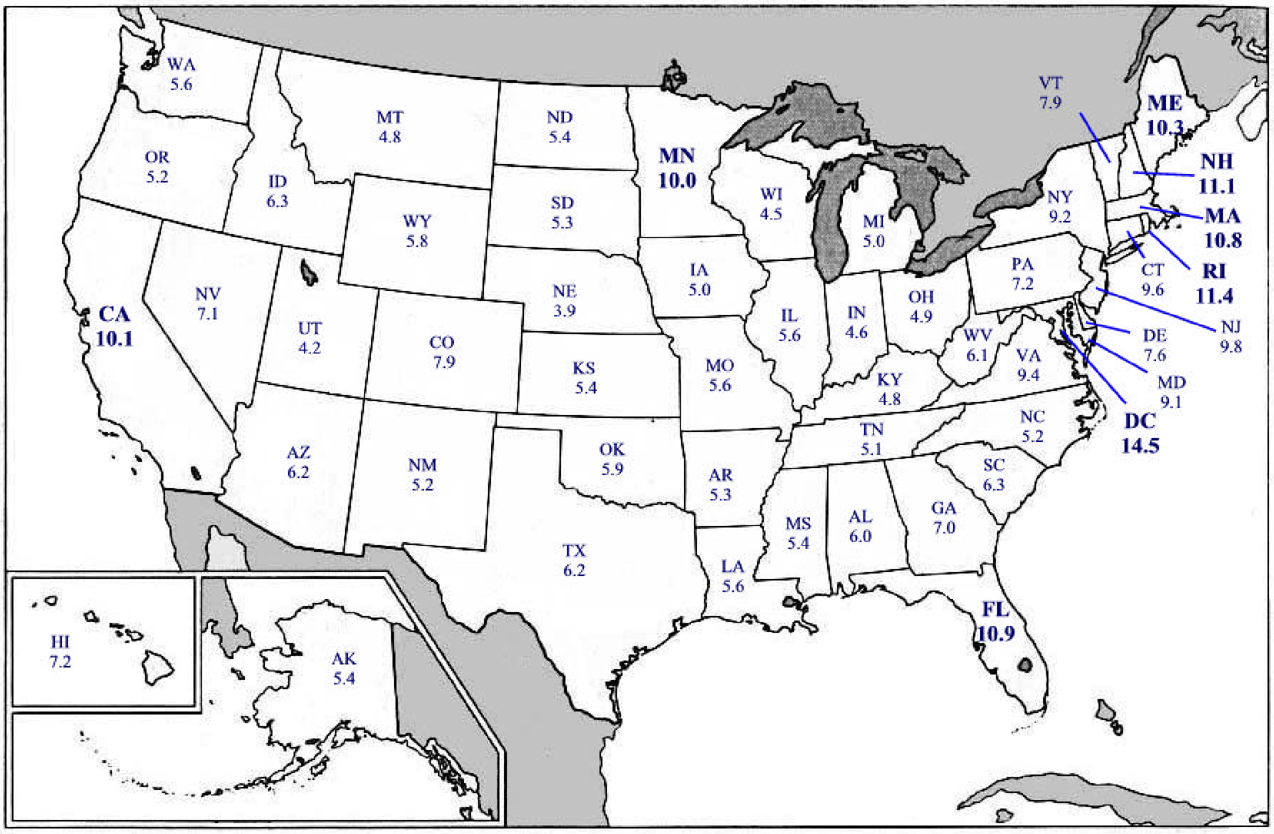
The housing market showed remarkable strength in 2001, despite the terrorist attacks and recession. Aided by the low interest rates, single-family housing starts exceeded 1.3 million units. Similarly, low mortgage rates resulted in strong home sales in 2001. Combined sales of new and existing homes totaled 6.2 million units, the best year ever, exceeding the 6.1 million record level of units set in 1999. Spurred by heavy refinancing activity, originations of single-family mortgages doubled the previous year's level, topping the $2.1 trillion mark. Originations in 2001 exceeded the previous record of $1.45 trillion set in 1998 by 45 percent. The expansion in home sales translated into increased homeownership. The homeownership rate increased to a record high 68 percent.

Home values, stimulated by heavy demand, continued their upward trend in 2001, albeit at more moderate rates than in 2000. Single-family home prices, as measured by OFHEO's House Price Index (HPI), increased 7.41 percent from the fourth quarter of 2000 to the fourth quarter of 2001. During the previous year average appreciation was 8.1 percent.[1]

[1] See **House Price Index table (Table 32)** on page 131 in Chapter Five - Historical Data Tables for more detailed HPI data.

House Price Appreciation
Fourth Quarter 2000 to Fourth Quarter 2001

Average U.S. appreciation was 7.41 percent



*States with house price appreciation above 10 percent are bolded for emphasis:
California, District of Columbia, Florida, Maine, Massachusetts, Minnesota, New Hampshire, and Rhode Island

The Enterprises' Financial Performance

Fannie Mae and Freddie Mac each had a very successful year in 2001. Both Enterprises' mortgage purchase volumes and securitizations were at record levels. Favorable market conditions also stimulated growth in the Enterprises' mortgage asset portfolios. The combined assets of Fannie Mae and Freddie Mac increased 25 percent in 2001, to $1.4 trillion. Portfolio growth and widening spreads between asset yields and debt yields enhanced the Enterprises' earnings. The Enterprises' combined operating net income (GAAP net income adjusted to better reflect the profitability of continuing operations) increased 21 percent in 2001, to $8.5 billion. That income growth enabled the Enterprises to continue their long histories of high rates of return on equity.

Fannie Mae and Freddie Mac continued to actively manage their exposure to credit risk. The proportion of single-family mortgages purchased that were evaluated using the Enterprises' automated underwriting systems prior to sale approached or exceeded 60 percent in 2001. The Enterprises also continued to limit their exposure to mortgage credit risk by obtaining credit enhancements on higher-risk single-family loans. Credit-related expenses – foreclosed property expenses plus provision for losses – declined at Fannie Mae and Freddie Mac despite the growth in their mortgage asset portfolios and mortgage-backed securities (MBS) held by other investors and generally weak economic conditions. Combined Enterprise credit-related expenses fell 19 percent during the year to an historically low $162 million.

Despite sizeable changes in interest rates in 2001, the Enterprises effectively managed their exposure to interest rate risk. This was accomplished by hedging asset acquisitions, making substantial use of derivatives, rebalancing hedges as interest rates changed, and continuing judicious risk management oversight.

Examination Activities

OFHEO conducted annual risk-based examinations of Fannie Mae and Freddie Mac in 2001, and provides the results and conclusions of the examinations in Chapter 3 of this report. Each quarter, the examination staff updates its evaluations using assessment factors covering more than 160 features of financial safety and soundness, which provides OFHEO with a comprehensive and timely understanding of the Enterprises' financial conditions and performance. The assessments provided by examiners evaluate the key aspects of risk and risk management and cover credit risk, interest rate risk, liquidity management, model risk, information technology, internal controls, business process controls, internal and external audits, management information, management processes, and the governance provided by the Enterprises' boards of directors.

Conducting comprehensive risk-based examinations is an important tool OFHEO employs to ensure the Enterprises operate prudently and remain safe and sound. We are committed to maintaining an excellent examination program by focusing on four core competencies: maintaining a quality examination framework; employing highly skilled personnel to conduct the program; utilizing tools that enhance the effectiveness and efficiency of examiners; and engaging in a quality improvement process to ensure continuous improvement as a cornerstone of the program.

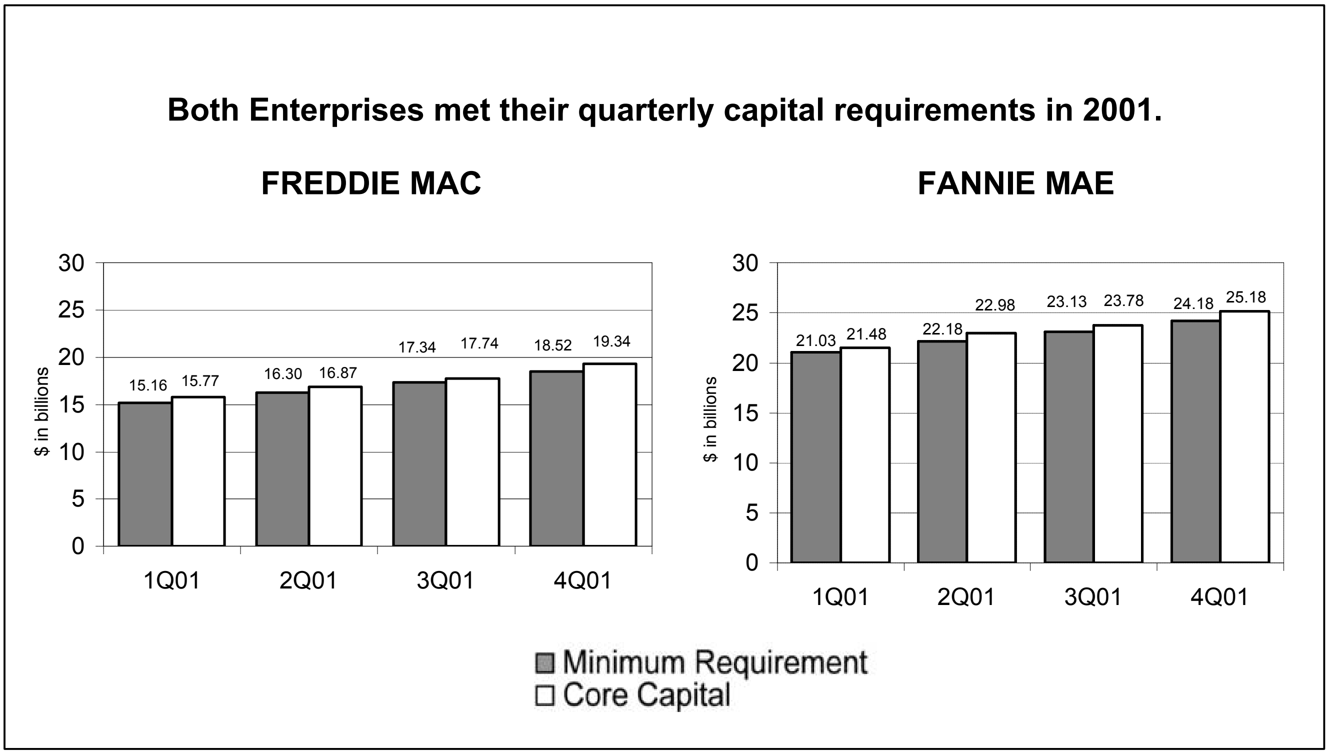
Like the examination programs of other financial safety and soundness regulators, OFHEO's includes both on-site examinations and off-site surveillance and monitoring. It is through the on-site examinations that specialists make hands-on assessments of qualitative factors – such as management capabilities, risk management strategies, and internal control processes – which cannot be reflected in routine regulatory reporting. Trained examiners with specialty skills test and verify the quality and integrity of risk management tools, risk measurements, financial and management reports, operational controls, documentation standards, and a host of other qualitative and quantitative judgments.

OFHEO's off-site surveillance and monitoring examination function is also an important element of prudential oversight. By (1) studying trends, (2) analyzing performance within the context of the broader marketplace, and (3) performing sophisticated analysis on features of risk at the Enterprises, the examination teams are well prepared to conduct on-site testing and evaluate the Enterprises critically.

Given the speed of change in the financial markets and at the Enterprises, OFHEO continuously improves its examination program and augments its examination specialties. The Office's commitment to innovation is reflected in the quality-improvement process embedded within the examination program, which incorporates self- and peer-assessments and a formal feedback process. OFHEO's examination activities continue to evolve to better capture the specific risks at the Enterprises.

CAPITAL REQUIREMENTS

Minimum Capital – OFHEO continued to enforce compliance with quarterly minimum capital standards for each Enterprise. The minimum capital requirements, which are required by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act), are similar to a bank's leverage capital requirement. Since the test has been applied to the Enterprises (second quarter of 1993), both companies have exceeded their minimum capital requirements and have always been classified as adequately capitalized. The chart below illustrates each Enterprise's capital in terms of their minimum capital requirement and the core capital they held each quarter for the past year.



Risk-Based Capital – In addition to minimum capital, the 1992 Act requires OFHEO to establish risk-based capital requirements for Fannie Mae and Freddie Mac. The Office is required to use a stress test – a model that simulates the financial performance of the Enterprises under specified adverse economic conditions – to establish those requirements. On September 13, 2001, OFHEO published a final risk-based capital regulation. In addition to making minor technical corrections to the regulation, OFHEO also proposed changes to the risk-based capital regulation which were finalized March 15, 2002, after a public comment period. OFHEO continues to evaluate and analyze new financial instruments and new risk measurement techniques to improve the stress test and align the capital requirements more closely to each Enterprise's risk.

OFHEO RULEMAKING

During 2001, OFHEO continued a comprehensive review of its regulatory infrastructure to enhance transparency and ensure the enforceability of supervisory standards. To address risk-based capital and further OFHEO's Regulatory Infrastructure Project, which was initiated in July of 2000 to enhance transparency and ensure the enforceability of supervisory standards, OFHEO adopted and proposed rules and regulations including:

<u>Civil Money Penalty Adjustment</u> – On January 4, 2001 OFHEO amended its enforcement regulations to provide for the increase of available civil money penalties pursuant to the Federal Civil Money Penalties Inflation Adjustment Act. This maintains the civil money penalty section of OFHEO's regulations at appropriate levels as required by law.

<u>Assessments</u> – On April 5, 2001 OFHEO published a final rule on the manner and procedures for collecting assessments from the Enterprises. The rule, which became effective May 7, 2001, recounts the agency's assessment procedures and addresses various possible problems that could result from delays in enactment of appropriations legislation. The rule provides for an orderly and predictable regime for collecting assessments.

<u>Enforcement Procedures</u> – On April 5, 2001, OFHEO published amendments to its enforcement regulations that clarify and elaborate on its procedures for imposing sanctions, including civil money penalties and cease and desist orders, on an Enterprise, its officers or directors. The rule provides a summation of processes and procedures for enforcement actions along with an explanation of the legal underpinnings of OFHEO's enforcement authorities.

<u>Prompt Supervisory Response and Prompt Corrective Action</u> – On April 10, 2001, OFHEO proposed for public comment a regulation to set forth procedures under which the agency would take prompt corrective action in response to specified declines in capital of an Enterprise, and to implement a system of prompt supervisory responses to specified developments that might warrant special supervisory review by the agency. The public comment period closed July 9, 2001, and a final regulation was adopted in early 2002. The rule clarifies procedures under the statutory system for employing capital as a measure for regulatory actions and goes further to create a process of action for issues of regulatory concern not tied to capital that fits within OFHEO's statutory authorities.

<u>Capital</u> – On July 31, 2001, OFHEO completed work on a final risk-based capital regulation, which was published on September 13, 2001. On December 18, 2001, OFHEO proposed for comment a set of amendments intended to refine and clarify certain aspects of the regulation. The rule, as amended, will complete a risk-sensitive and flexible regulatory capital structure for the Enterprises.

<u>Executive Compensation</u> – On September 12, 2001, OFHEO adopted a final regulation to codify policies and procedures involved in the agency's review of executive compensation policies and practices of the Enterprises. The rule largely formalizes procedures used by the

agency in performing its executive compensation oversight responsibilities and requires submission of relevant information by the Enterprises on a timely basis.

Corporate Governance – On September 12, 2001, OFHEO republished for public comment proposed regulations to address the applicability of minimum corporate governance standards to the Enterprises. The public comment period thereon was extended to November 9, 2001. The rule would strengthen OFHEO's enforcement of the corporate governance standards it applies to the Enterprises.

Flood Insurance – On September 12, 2001, OFHEO proposed and thereafter adopted on December 18, 2001, a regulation to codify the authority of the agency to oversee and enforce certain statutory requirements affecting the operations of the Enterprises regarding the National Flood Insurance Program, and to effect statutorily mandated adjustments to the civil money penalties applicable to violations of that statutory regime.

OFHEO POLICY GUIDANCES

Regulatory Review – On April 2, 2001, OFHEO issued a written Policy Guidance announcing a process for routine review of its rules and regulations to determine whether they have become inefficient or create unwarranted burden, and, where appropriate, to identify possible revisions or repeal where such conditions are found.

Safety and Soundness Standards for Information – On December 19, 2001, OFHEO issued a written Policy Guidance that addresses standards for the Enterprises to be used in developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of information that is handled or maintained by or on behalf of an Enterprise.

OFHEO ACTIONS ON EXECUTIVE COMPENSATION

The Director of OFHEO, under OFHEO's enabling statute and the Enterprises' charter acts, has oversight responsibility in the area of executive compensation. OFHEO's statute requires the Director to prohibit the Enterprises from providing excessive compensation to any executive officer. Additionally, the Enterprises must obtain the prior approval of the Director before entering into or changing termination agreements with their executive officers.

During 2001, an executive compensation consultant retained by OFHEO began a study comparing compensation provided by each Enterprise to its executive officers to that provided by similar businesses to executive officers with similar duties and responsibilities. That study, which is scheduled for completion in 2002, supplements the Director's ongoing review of executive compensation and updates an earlier study completed in 1997. Also in 2001, OFHEO approved a termination benefit provided under an agreement by an Enterprise to its executive officers.

OFHEO RESEARCH

During 2001, OFHEO continued research and analysis on a variety of topics. These include the potential effects of Fannie Mae and Freddie Mac on systemic risk, subprime loans and the housing market, credit scores as determinants of mortgage prepayment and default, improving the precision of repeat sales house price indices, and developing alternate models to project Enterprise performance. OFHEO established an interdisciplinary Research Council to coordinate research plans and activities and ensure that research and analysis is focused on OFHEO's achieving its strategic objectives and goals. In future years, OFHEO anticipates undertaking additional research and analysis, including looking at issues that arose in comments on the proposed risk-based capital rule and using the risk-based capital stress test to assess alternative stress scenarios to continue to analyze the Enterprises' safety and soundness.

CHAPTER TWO – Capital Regulation

OFHEO was required by the 1992 Act to establish minimum and risk-based capital standards as part of its role as safety and soundness regulator. These capital requirements are intended to ensure both Enterprises continue to operate and perform their crucial roles in the secondary mortgage market, keeping constant the flow of funds to mortgage lenders and prospective American homeowners. By ensuring the Enterprises are adequately capitalized, OFHEO minimizes the risk that American taxpayers will ever be asked to pay for losses at these complex financial institutions.

OFHEO evaluates capital adequacy from other perspectives as well. OFHEO's **examination program** conducts continuous, comprehensive examinations of the Enterprises to ensure they are operating under standards of financial safety and soundness. OFHEO's examination of the Enterprises provides a qualitative assessment of capital adequacy. The more direct and quantitative tools are OFHEO's **minimum** and **risk-based capital** standards, which are supplemented with other tests and analyses. OFHEO's minimum capital standard is calculated based on specific percentages for assets and off-balance sheet guarantees. The minimum capital level is therefore determined more by the size of the Enterprise than its specific risks. The risk-based standard, in contrast, requires that Fannie Mae and Freddie Mac each have enough capital to survive prolonged, severe problems in financial and economic markets, as well as management or operational failures. It, therefore, is directly related to the risks the Enterprises are exposed to in their current business.

Capital Classification Process

Each quarter, OFHEO calculates a minimum capital requirement, which includes both a 'minimum' and a lower 'critical' level, and a risk-based capital requirement for each Enterprise. OFHEO classifies an Enterprise as adequately capitalized if it meets both its minimum and risk-based capital requirements.

Each quarter, OFHEO proposes a capital classification in writing to each Enterprise. Each Enterprise has up to 30 days to review and comment on its proposed classification. After reviewing any comments from the Enterprise, OFHEO makes a final capital classification and releases it to the public.

Failure to meet the requirements triggers a range of regulatory responses, depending upon the capital classification of an Enterprise.

Implementation Period

When OFHEO published the final risk-based capital regulation on September 13, 2001, it became effective immediately. However, Congress mandated a one-year implementation period between the effective date of the regulation and the date when OFHEO enforces the rule. This period provides the Enterprises an opportunity to understand and manage to the requirements of the regulation. The first quarter that the risk-based capital calculation will be used to classify the Enterprises is the third quarter of 2002.

Risk-Based Capital Standard

OFHEO's risk-based capital standard is unique among financial regulators. Unlike ratio-based capital rules, OFHEO's standard is based on a 10-year stress test. A stress test measures risk in the context of a company's overall portfolio, including the effectiveness of a company's risk management activities. While companies often use stress tests for internal risk management, and rating agencies use stress tests to rate companies and securities, OFHEO is among the first financial institution regulators to use its own stress test to determine capital adequacy.

OFHEO's stress test simulates an Enterprise's financial performance over a 10-year period under severe economic conditions. **(Box 2.1.)** Key conditions describing the severe economic conditions used in OFHEO's stress test are defined in the 1992 Act and further specified in OFHEO's risk-based capital regulation. These conditions include high levels of mortgage defaults, with associated losses and large, sustained movements in interest rates.

OFHEO uses a sophisticated computer model to simulate each Enterprise's cash flows associated with mortgages and other financial assets and obligations under the severe economic conditions of the stress test. The modeling of incoming and outgoing cash flows captures the risks embedded in those financial assets and obligations and the benefits of the hedges each Enterprise has set in place. To meet OFHEO's risk-based capital standard, each Enterprise must have sufficient capital to survive the losses under these severe economic conditions plus an additional 30 percent for unspecified management and operations risks.

OFHEO's stress test aligns the capital requirement for each Enterprise with its specific risk profile. In doing so, it provides Enterprise management with incentives to carefully manage risk. For example, risk reduction activities such as the effective use of interest rate derivatives, the use of private mortgage insurance (PMI) for high loan-to-value (LTV) mortgages, and the use of callable long-term debt all work to lower the risk-based capital requirement. Conversely, activities that increase risk, such as taking on unhedged interest rate exposures, serve to increase the risk-based capital requirement.

An Enterprise's risk-based capital requirement is also sensitive to changing economic conditions that are beyond the control of management. For example, OFHEO's stress test relates economic conditions to mortgage performance and, ultimately, to capital requirements. House price growth influences mortgage credit losses. When house prices increase, homeowner equity rises, and, all else being equal, the probability of borrowers defaulting declines. Thus, rising house prices tend to lower capital requirements. On the other hand, falling house prices tend to increase capital requirements by lowering homeowners' equity which makes mortgages more risky.

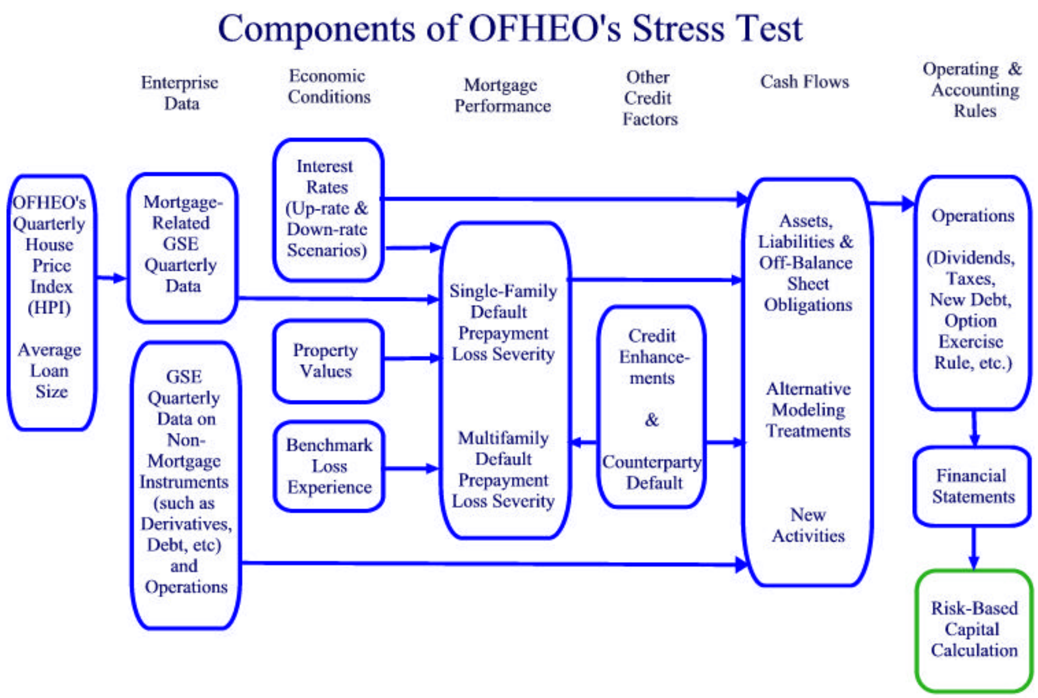
Changes in interest rates also affect the risk-based capital calculation. For example, a change in interest rates influences mortgage prepayments and income generated from adjustable rate mortgages. Changes in interest rates also influence how much it costs the Enterprises to issue new debt in the stress test, and the timing of the Enterprises' exercise of call options on existing debt.

The dynamic nature of a stress test facilitates OFHEO's understanding of how changes in the economy could impact the Enterprises. It will also help OFHEO uncover changes in capital needs **before** there could be a significant impact on the Enterprises' balance sheets. In contrast, capital standards based on static ratios are affected only **after** economic changes impact the balance sheet.

OFHEO's stress test provides the Enterprises with transparency, certainty, and flexibility in meeting their regulatory capital requirements. Both Enterprises have copies of OFHEO's stress test and have incorporated the test into their everyday business processes. An Enterprise can comply with OFHEO's risk-based capital standard by reducing risk or raising capital, or a combination of both. Therefore, each Enterprise can follow its own unique strategy to comply with OFHEO's risk-based capital standard.

Box 2.1.
OFHEO's Stress Test

OFHEO developed a stress test, as described by law, which is tailored to the specific risks of Fannie Mae and Freddie Mac – namely, the risks associated with guaranteeing and investing in mortgages. To run the stress test, OFHEO built a sophisticated financial simulation model to project separate financial performances for Fannie Mae and Freddie Mac over a 10-year period under severe economic conditions. The model uses actual data from the Enterprises to project cash flows for all of an Enterprise's assets, liabilities, and off-balance sheet obligations. The model calculates gains and losses and determines the amount of capital that each Enterprise must hold at the beginning of the stress test in order to maintain positive capital over the entire 10-year stress period.



Enterprise Data

The Enterprises provide OFHEO with the necessary data to run the stress test in their quarterly risk-based capital (RBC) data submissions. The data are sufficient to replicate the actual financial position of an Enterprise on the last day of the quarter, including assets, liabilities, and off-balance sheet obligations (e.g., guaranteed MBS and derivatives). These data represent the starting position of the Enterprises at the beginning of the stress test.

The data submissions are detailed enough to accurately project the cash flows associated with all of an Enterprise's on- and off-balance sheet items. In the case of mortgage loans, for example, data are aggregated by a common set of mortgage risk factors, such as mortgage type and loan-to-value ratios. In other cases, such as derivative and debt instruments, data are needed at the instrument level, including any specific contractual terms, to accurately measure their cash flows.

The stress test assumes no new business occurs during the stress period, except that mortgages the Enterprises have committed to purchase through written agreements with their seller/servicers are added to their positions during the first year of the stress test.

Economic Conditions

The economic conditions describing the severity of the stress test are prescribed by law and affect the Enterprises through large and prolonged changes in interest rates and severe mortgage defaults and their associated losses. In general, the Treasury 10-year constant maturity yield either goes up by 75 percent or down by 50 percent, with a 600 basis point cap. All other interest rates used in the stress test (federal funds rate, LIBOR, federal agency cost of funds, etc.) are tied to movements in Treasury rates.

The 1992 Act requires that OFHEO impose credit losses on all mortgage loans owned or guaranteed by an Enterprise. These losses must be reasonably related to an Enterprise's worst regional experience, known as the benchmark loss experience.[2] The benchmark loss experience entails a 10-year default rate of 14.9 percent, a loss severity rate of 63.3 percent, and a loss rate of 9.4 percent for 30-year fixed-rate single-family loans. In the stress test, loss rates are adjusted to reflect differences between mortgage characteristics, collateral values, and economic conditions affecting current loans and those affecting loans in the benchmark loss experience. OFHEO also calibrated losses on adjustable-rate single-family loans and on multifamily loans, as required by law, to be reasonably related to the benchmark loss experience.

Current economic conditions are reflected in the starting position data. For example, OFHEO uses its House Price Index (HPI) to estimate the current amount of homeowner equity in the

[2] The worst regional loss experience identified by OFHEO occurred for mortgages originated in Oklahoma, Arkansas, Louisiana and Mississippi from 1983 to 1984.

Enterprises' single-family mortgage portfolios. The amount of homeowner equity in a property is a key factor in determining whether a loan will default.

Mortgage Performance

Mortgage performance refers to whether a loan will stay current, prepay, or default during the stress test, and if a loan defaults, how severe the loss will be to the Enterprise. OFHEO uses sophisticated statistical models to simulate mortgage performance over the 10-year stress period. These models project rates of prepayment, default, and loss severity. OFHEO uses different models for single-family and multi-family mortgages. For single-family mortgages, for example, the models use a variety of factors, such as mortgage type (fixed vs. adjustable), age of the loan, the current amount of equity in the property, and the difference between current mortgage rates and stated loan rate, to determine which mortgages default or prepay.

Other Credit Factors

Once the stress test has calculated how much an Enterprise would lose if a mortgage defaulted, the model will adjust the losses downward to account for any third-party credit enhancements applicable to the defaulted loan. The primary credit enhancement used by the Enterprises is private mortgage insurance, but other types of credit enhancements are used such as spread accounts and lender recourse. Information on credit enhancements is contained in each Enterprise's quarterly RBC data submission to OFHEO.

To account for the strength of third party credit guarantees, OFHEO adjusts the value of the guarantees to the Enterprises based on the public credit ratings of the third party. Third party guarantees include private mortgage insurance and derivative counterparties. The lower the credit rating, the larger the 'haircut' (downward adjustment) applied to the value of the guarantee. OFHEO phases in the haircuts over the course of the stress test.

Cash Flows

OFHEO's simulation model projects the cash flows of all assets, liabilities, and off-balance sheet obligations for each Enterprise on a monthly basis over the 10-year stress test. Cash flows for each Enterprise are largely determined by the performance of its mortgage portfolio during the stress test, interest payments made on its outstanding debt, and the cash flows associated with its derivatives positions.

To generate cash flows for items where there are insufficient data, the activity is new, or the activity is so small that a specific treatment has not yet been included in the current RBC regulation, OFHEO uses Alternative Modeling Treatments (AMTs). AMTs are a series of simple, conservative rules which, when applied to a particular activity, allow OFHEO to generate reasonable cash flows for the activity. AMTs ensure all Enterprise activities are incorporated in the stress test.

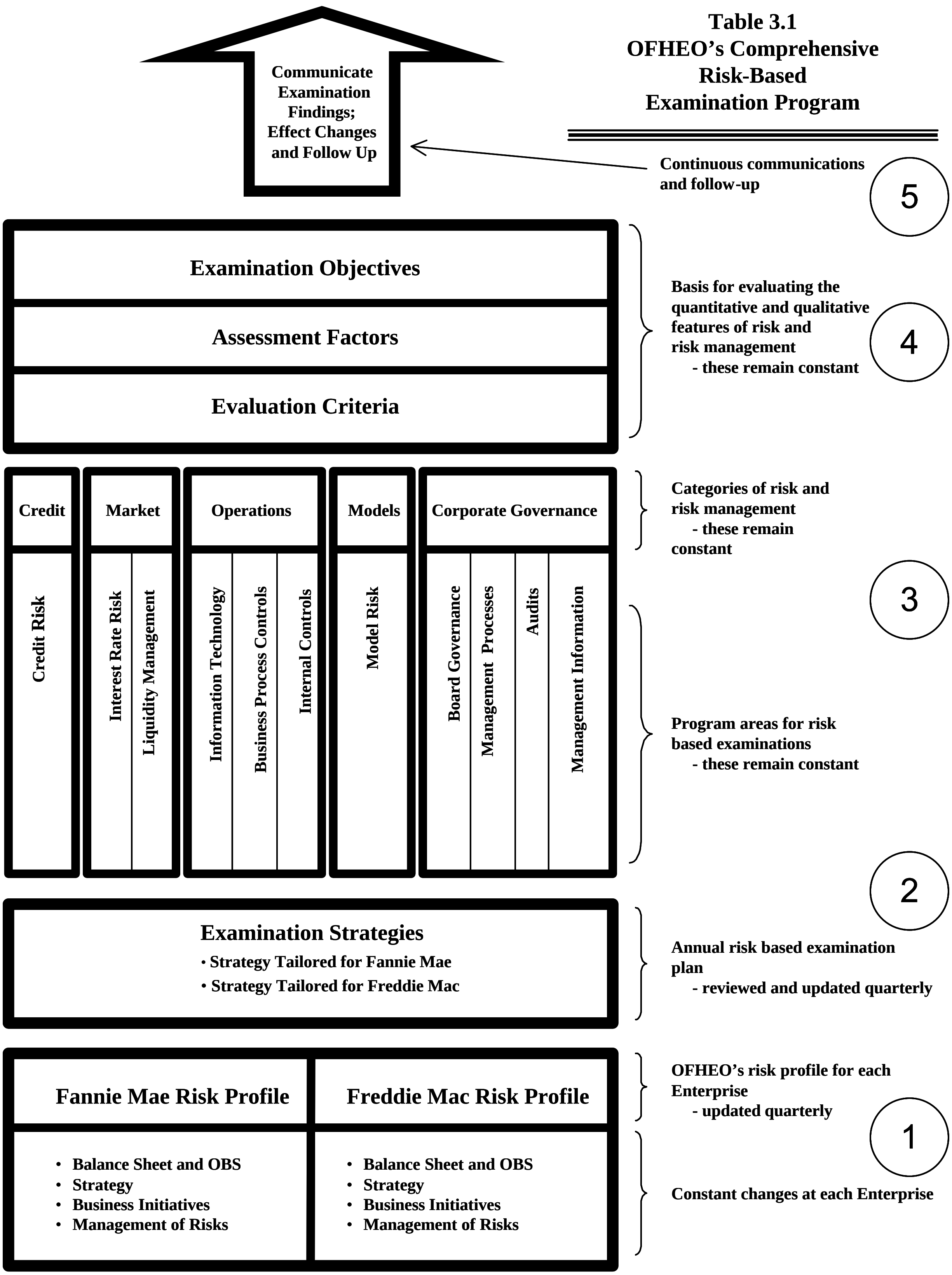
Operating and Accounting Rules

There are additional operating and accounting rules that influence the amount and timing of cash flows. These include rules on dividend payouts, rules that determine when a financial option is exercised (calls and puts), assumptions about operating costs, and accounting rules that determine tax payments. In addition, because of the 'no new business assumption' and the need to keep the financial statements in balance each month, OFHEO developed rules for investing excess funds and issuing new debt.

The resulting cash flows from the simulation model are used to generate *pro forma* financial statements for each Enterprise on a monthly basis during the 10-year stress test. These statements are generated using a close approximation to Generally Accepted Accounting Principles (GAAP). These financial statements show the resulting capital positions of each Enterprise for each month of the stress test.

Using the *pro forma* financial statements, the stress test determines the amount of capital needed to maintain positive capital throughout the 10-year stress period. Once that amount of capital has been determined, an additional 30 percent is added to protect against management and operations risks, which are not quantifiable. The total for each Enterprise is its risk-based capital requirement.

Table 3.1
OFHEO's Comprehensive Risk-Based Examination Program



CHAPTER THREE – OFHEO's Examination Program

INTRODUCTION

OFHEO's annual risk-based examination program is an integral part of a system designed to ensure the ongoing safety and soundness of Fannie Mae and Freddie Mac. The examination program assesses the appropriateness and effectiveness of the Enterprises' policies and processes for risk management, and assesses the companies' financial performance. Using a risk-based approach allows OFHEO to recognize the unique operations of each Enterprise while applying uniform safety and soundness standards throughout the year. This aspect of the examination program's design ensures that OFHEO is responsive to changes at the Enterprises while not imposing unnecessary burdens. The analysis and testing conducted during the examinations add further depth and perspective to OFHEO's oversight of Fannie Mae and Freddie Mac. The examination program contributes to OFHEO's capital adequacy framework, by further informing the Director's evaluation about the appropriateness of the balance of risk and capital at each Enterprise. **The 2001 examinations found both Enterprises to be financially sound and well- managed.**

The process OFHEO employed in its comprehensive annual risk-based examinations to reach these conclusions is briefly described below, and depicted in Table 3.1. This information is provided to give context for the summary of the examination results and conclusions for each Enterprise. The description of the examination process corresponds to the chart in Table 3.1, beginning with the base of the chart and concluding at the top. Numeric references to the chart are included in the text that describes the examination process.

OFHEO's Examination Program

1

Risk Profiles

Through a wealth of resources (including OFHEO knowledge, external sources and proprietary Enterprise information and data), the examination process begins by assessing the quantity of risk and quality of risk management at each Enterprise. OFHEO reviews each Enterprise's risk profile at least quarterly, and revises its views if, for example, the Enterprise has planned or undertaken substantive new business initiatives, or if the Enterprise has substantially changed its level of risk or the manner in which it manages risks.

Examination Strategies

2

Based upon OFHEO's unique position to understand the Enterprises' risk profiles, OFHEO develops detailed examination strategies to provide effective, efficient oversight of each Enterprise. The annual written examination strategies are dynamic and represent a blueprint of the examination work to be conducted for the next year. The examination strategies are reviewed and updated quarterly based on Enterprise, industry and economic developments. In conjunction with the strategies, OFHEO creates work plans that describe how the strategies will be achieved. The work plans outline the scope, timing and resources needed to meet the objectives and examination activities set forth in the strategies.

Program Areas for Risk-Based Examinations and Categories of Risk and Risk Management

3

Once OFHEO has strategies and work plans in place, examiners implement the strategies by completing exam work in each of the program areas for risk-based examinations. These are the program areas that capture the areas of risk and risk management being assessed at the Enterprises, with each program area focusing on specific sources of risk or risk management practices and tools. Later in this Chapter, OFHEO presents results and conclusions by program area for both Fannie Mae and Freddie Mac.

In order to enhance examinations and maximize expertise, OFHEO has grouped the program areas into four categories of risk and risk management, and aligned its examiner force expertise into five teams that correspond to the categories of risk and risk management, and provide analytical expertise and financial monitoring.

The focus of the eleven program areas, grouped by category, are:

CREDIT

- **Credit Risk Program** – the risk that borrowers and counterparties will fail to meet their contractual or other obligations to the Enterprise.

MARKET

- **Interest Rate Risk Program** – the risk from movements in interest rates, including changes in: the level of interest rates; the shape of the yield curve; the level of volatility; and the relationships or spreads among various yield curves or indices.
- **Liquidity Management Program** – the risk that could arise from an Enterprise's inability to efficiently meet its obligations as they come due and to transact the next incremental dollar of business cost effectively.

MODEL EXPOSURE

- **Model Risk Program** – the risk that could arise from inappropriate results or application of financial models used for decision support in selecting, pricing and managing risk.

OPERATIONS

- **Information Technology Program** – the infrastructure, or the general controls, needed to safeguard data, protect computer application programs, prevent system software from unauthorized access, and ensure continued computer operations in case of unexpected interruptions.

- **Business Process Controls Program** – assesses the process employed to ensure business initiatives and endeavors are considered and evaluated within a complete business context with particular attention directed to risk assessment and risk management framework.
- **Internal Controls Program** – the plan of organization, methods and procedures adopted by management to ensure: goals and objectives are met; resource use is consistent with laws, regulations and policies; resources are safeguarded against waste, loss and misuse; and reliable data are obtained, maintained and fairly disclosed in reports.

CORPORATE GOVERNANCE

- **Audit Program** – the risk that the Board or management's reliance on internal or external audits is misplaced.
- **Management Information Program** – the risk that management will make decisions based on ineffective, inaccurate or incomplete information or reports.
- **Management Processes Program** – the processes used to drive behaviors to support the Enterprise's defined corporate goals, standards and risk tolerances.
- **Board Governance Program** – the manner in which the Board discharges its duties and responsibilities.

Evaluation Criteria, Assessment Factors and Examination Objectives 4

OFHEO conducts examination work in each of the 11 program areas by using evaluation criteria, assessment factors and examination objectives. The examination objectives are broad in scope, the assessment factors are more narrowly focused and the evaluative criteria are narrower still.

The approximately 700 evaluation criteria in the examination program detail both qualitative and quantitative items that examiners consider when making decisions about the assessment factors. The evaluation criteria are designed to assist the examiners and to ensure the examination work is consistent at both Enterprises by creating transparency and understanding of the framework within which examiners make judgments.

Examiners use the information and data from the evaluation criteria to form their expert opinions about the almost 100 assessment factors which in turn link directly to one or more of the examination objectives for each of the program areas. Sources for the assessment factors include industry standards and benchmarks, best practices and examiner expertise.

For each program area there are four or five examination objectives. These are the broad statements of what OFHEO's examiners will achieve through their work in each of the eleven program areas. To make a determination on an examination objective, OFHEO's examiners are required to opine on each of the supporting assessment factors. By using the evaluation criteria to reach judgments about the approximately 100 assessment factors, OFHEO achieves its examination objectives, and reaches the examination results and conclusions that are reported in this chapter.

Communication of Examination Findings

5

Throughout the course of conducting examinations, OFHEO communicates with Enterprise personnel not only to gather information, but also to share findings and discuss observations. OFHEO is committed to continuous, effective communication with the Enterprises. OFHEO has the same goal for all communications; that the free flow of information furthers the objective of ensuring the safe and sound operations of the Enterprises. Communications are tailored to the individual structure and dynamics of the Enterprise, and the timing of the communication depends on the situation being addressed. OFHEO keeps executive management and the Board appropriately informed and communicates directly with them as often as required by the Enterprise's condition and the findings from examination activities. OFHEO brings those issues that introduce an exposure to the stable operation of the Enterprise, otherwise fall under the normal duties and responsibilities of the Board, or warrant the Board's attention to the immediate attention of the Board and executive management. Technical issues and matters relating to a single line of business or activity are generally brought to the attention of operating managers with the Board and executive management kept appropriately informed.

Throughout the 2001 annual examination cycle, OFHEO's examiners had ongoing dialogues with the operating management at both Enterprises about the operations and processes covered by each of the 11 examination program areas. In these discussions, the examiners shared their views about discrete opportunities the companies had to strengthen their operations and processes, including initiatives that, if implemented, would enhance existing tools and processes and minimize the resulting exposure to financial risk. The goal of ensuring the Enterprises' operations meet or exceed financial safety and soundness standards at any given point in time is supported by this iterative process and netted results that found both companies to be well-managed and financially sound.

Effect Changes and Follow Up

5

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

OFHEO will consider the responsiveness of the Enterprise in recognizing the issue and formulating an effective solution when determining if OFHEO needs to take incremental action. If an Enterprise is unresponsive or unable to effect the resolution of meaningful issues, OFHEO will take more formal steps to ensure deficiencies are corrected.

While "effect changes and follow up" is at the top of the chart for the comprehensive annual risk-based examination process, in practice, the final step starts the examination cycle anew.

In accordance with our examination program, the results and conclusions for each program area are reported in relation to safety and soundness standards – whether they meet, exceed, or fail to meet safety and soundness standards. Throughout the annual examination cycle, January through December 2001, OFHEO's examiners had ongoing dialogues with operating management at Fannie Mae and Freddie Mac about each company's operations and processes in the program areas covered by Credit Risk, Market Risk, Operations Risk, Model Risk, and Corporate Governance. In these discussions, the examiners shared their views about discrete opportunities the company had to strengthen its operations and processes, including initiatives that, if implemented, would enhance existing tools and processes and minimize the resulting exposure to financial risk. The goal of ensuring the Enterprises' operations meet or exceed financial safety and soundness standards at any given point in time is supported by this iterative examination process. At year-end 2001, both Fannie Mae and Freddie Mac exceeded safety and soundness standards in all examination program areas.

Throughout the year, operating management at both Fannie Mae and Freddie Mac were responsive and effective in addressing issues raised for their attention and action.

The results which are reported below reflect the examination work conducted from January through December 2001, and do not necessarily reflect the current condition or operations of the Enterprises. The results and conclusions presented for 2001 are similar to the results and conclusions reported in 2000. As described above, OFHEO's comprehensive risk-based examinations apply a consistent set of standards to assess and evaluate each Enterprise's financial condition, business operations, and internal controls. These standards remain consistent from year-to-year and are appropriately updated to reflect enhancements in regulatory best practice, developments in risk management or market practices, and innovations at either Enterprise. The similarity between the 2000 and 2001 examination results and conclusions stems from the Enterprises' continuing strong financial performance, their maintenance of sound financial fundamentals, their maintenance of effective risk management and control practices, and a favorable business environment.

Fannie Mae Examination Results and Conclusions

Fannie Mae's credit risk management and credit risk management framework exceed safety and soundness standards, and they have resulted in a high-quality portfolio and manageable credit exposure. The portfolio is diversified and the profile of credit risk is in compliance with the internally prescribed limits that examiners have deemed to be appropriate. Policies, procedures, internal controls and management reporting for the credit function are effective. Fannie Mae is appropriately compensated for the credit risk it assumes. Management prudently manages counterparty exposure. New products and initiatives are well researched prior to implementation. The process for determining the reserve for losses and credit risk sharing strategies are effective, as are the tools used to manage credit risk. Fannie Mae effectively identifies, quantifies and tracks its credit risk exposures. Management has an effective means for following up on credit-related issues. The technology and controls supporting the credit risk management function are effective. Management effectively reconciles differences between actual and expected credit portfolio performance.

Fannie Mae's interest rate risk management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to interest rate risk are appropriate and effective. Management has a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk. Fannie Mae's management effectively follows up on issues related to interest rate risk. Fannie Mae appropriately researches and controls the extent to which new products and initiatives may impact the interest rate risk profile. The technology and controls supporting the interest rate risk management function are effective. The tools used to model interest rate risk, and the strategies to alter the exposures to interest rates are prudent and effective. Management effectively incorporates tactical and strategic issues into the management of interest rate risk. The responsibilities for strategy and analytics functions are appropriately separated from those for the execution functions. Derivative instruments are used prudently for hedging risks and in accordance with the standards used by other large financial intermediaries. **(Box 3.1.)**

Fannie Mae's liquidity management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to liquidity management are appropriate and effective. Management has an effective methodology for quantifying and monitoring liquidity, and management appropriately evaluates the impact of various events and alternative environments when developing and updating contingency plans. The planning process for liquidity management is effective. Fannie Mae appropriately considers the impact new products and initiatives may have on liquidity. Management effectively follows up on issues and initiatives that influence liquidity. Technology and controls for liquidity management are prudent and effective. The quality of tools Fannie Mae uses to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are comprehensive and effective. An appropriate separation of duties exists between the strategy and analytics functions and the execution function. Fannie Mae effectively analyzes and is well positioned to respond to trends and anomalies in the market and funding spreads. Liquidity management is appropriately integrated with other management and financial performance issues.

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Operating processes are in place to ensure secure, effective and efficient data center processing and problem management. There are effective policies and processes in place to ensure data, information and computing resources are secure and accessed only by authorized users. There are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster and these are routinely tested and enhanced. Management has processes in place that ensure information technology plans effectively address business unit and corporate objectives. Effective processes are in place to ensure appropriate controls are implemented and maintained. Documentation for system development and maintenance is complete. Fannie Mae has implemented effective processes to ensure data and information are processed accurately and in a timely manner. Effective controls are in place and regularly tested to secure networks and/or firewalls from unauthorized or inappropriate actions. Fannie Mae has policies and procedures to ensure the conduct of e-commerce is secure. Fannie Mae has effective controls over end-user computing.

Fannie Mae's internal control framework and the management of that framework exceed safety and soundness standards. Management has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. Implemented controls properly address risks assessed by management. Management has a reliable process for ensuring the timely resolution of control-related issues. Internal Audit appropriately identifies and communicates control deficiencies to management and the Board of Directors. There are established policies and procedures that delineate internal control process and standards resulting in a sound control environment. Management routinely tests and ensures compliance with established internal controls.

The framework for business process controls and the management of that framework exceeds safety and soundness standards. The processes and control environment used when Fannie Mae considers and/or develops new or substantially revised business initiatives are effective. The use of pilot programs and the communication flows surrounding new or substantially revised business initiatives are effective. The balance between risk management, internal controls and the pressure to develop new or substantially revised business initiatives is appropriate. Fannie Mae's corporate culture fosters the introduction of new ideas and values intellectual capital. Both the analysis and review conducted for potential new or substantially revised business initiatives, and the periodic analysis conducted after a new or substantially revised business initiative is launched, are effective and comprehensive.

The audit functions exceed safety and soundness standards. **(Box 3.2.)** The Internal and External Audit functions have the appropriate independence. Auditors performing the work possess appropriate professional proficiency. The scope of Internal and External Audit work performed is appropriate and comprehensive, and the audit work is documented and complete. The management of the Internal Audit department is effective. Executive management and the Board of Directors are appropriately involved with and follow up on identified audit issues. The auditor's risk assessment process is effective. Internal Audit is appropriately involved in new products and new initiatives.

The Board discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. **(Box 3.3.)** In discharging its duties and responsibilities, the Board of

Directors operates with the appropriate independence. The Board is appropriately engaged in the development of a strategic direction for the company, and the Board ensures management appropriately defines the operating parameters and risk tolerances of the Enterprise in a manner consistent with the strategic direction; legal standards; and ethical standards. The Board has an effective process for hiring and maintaining a quality executive management team, and the Board effectively holds the executive management team accountable for achieving the defined goals and objectives. The Board is appropriately informed of the condition, activities and operations of the Enterprise, and has sufficient, well-organized time to carry out its responsibilities.
The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards and provides end-users with accurate and reliable information. Management and the Board of Directors receive complete and comprehensive reports on Fannie Mae's performance relative to established goals and objectives. Management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively. Management reporting permits management to evaluate and gauge the quality of their decisions. Information systems are linked to Fannie Mae's overall strategy, and are developed and refined consistent with the strategic direction and plan. The reports management uses for decision making are accurate. Enterprise strategy, roles and responsibility are effectively communicated. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements. Communications across the company are effective.

Key management processes that influence company-wide talent and behaviors exceed safety and soundness standards. The strategic planning process is comprehensive. Business unit goals, implementation plans and programs designed to achieve the corporate plan are effective. Management is able to monitor and manage change. Key performance measures are appropriate, effective and align with strategy. The behavior management programs are effectively designed to achieve corporate goals and objectives. Fannie Mae has effective programs for career and management development, and for identifying and recruiting competent people. Fannie Mae's proprietary risk management programs and systems are effective. Management effectively conveys an appropriate message of integrity and ethical values. Management's philosophy and operating style are consistent, and they have a pervasive effect on the company. The organizational structure and the assignment of responsibility provide for accountability and sound controls.

Box 3.1.
DERIVATIVES – FANNIE MAE

Fannie Mae is an end-user of derivatives to manage its business more effectively and mitigate financial risks. Its goals for using derivatives are: to lower debt costs associated with the purchase of mortgage assets; to reduce market risks associated with the issuance of debt; and to effectively match the Enterprise's funding composition with changes occurring in the interest-rate characteristics of its mortgage assets that result from changes occurring in the overall interest rate environment. In pursuing these goals, Fannie Mae enters into derivative contracts that are common in the financial markets and widely used for risk management activities. Management does not speculate with derivatives. Derivative activities are transacted in accordance with approved policies and procedures and closely supervised and scrutinized by senior management and the Board of Directors.

Derivatives are important instruments for Fannie Mae's management of its business and risk exposures. The volume of derivatives increased from $324.7 billion notional amount on December 31, 2000 to $533.1 billion notional amount on December 31, 2001. Notional principal amount is a commonly used measure for the volume of derivatives, but it does not accurately reflect the market and credit risk associated with derivatives. A better measure for the exposure to risk in derivatives is the replacement cost for the economic value of contracts. Replacement cost for derivative positions will regularly fluctuate along with changes in the market. On December 31, 2001, Fannie Mae had a replacement cost of $110 million for its $533.1 billion notional principal amount in derivatives.

OFHEO carefully scrutinizes Fannie Mae's use of derivatives. Derivative exposures are incorporated into regulatory capital requirements, both minimum and risk-based, and OFHEO conducts on-site examinations that include a review of derivatives activity. Examiners verify and evaluate a variety of risk management strategies and practices during on-site examinations, which include: (a) testing transactions and controls; (b) evaluating strategies and their implementation; (c) evaluating the quality of tools used to identify, measure, and monitor risk – including the tools and methodology for valuing derivatives and the off-setting cash positions; (d) testing for the level of compliance with limit structures and for the quality of analyses that forms and defines the limit structure; (e) testing the integrity of the audit program and the accuracy of financial records; (f) evaluating the quality of technology that supports the business and the integrity of the security framework for that technology; (g) evaluating the quality of personnel, management, and board oversight; (h) evaluating the quality of policies and procedures and testing for adherence to these policies and procedures; (i) critiquing the quality of counterparty credit risk analysis and maintenance of the ongoing analysis; (j) proctoring the implementation of FAS 133 and ongoing compliance; (k) making recommendations that can strengthen systems, processes and practices; and (l) requiring remedial actions to address weaknesses, where appropriate.

The following table highlights selected observations from OFHEO's testing and verification work that is regularly conducted on Fannie Mae's derivative activities. The information in this table augments the overall opinions on derivatives that are expressed on page 22.

BOX 3.1. DERIVATIVES - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.1.a. Topic: Derivatives activity is governed by sound policies, procedures and effective internal controls and consistent with the prescribed purpose.	
• OFHEO evaluates the appropriateness of policies, procedures, internal controls, and reports. • OFHEO evaluates the process for establishing limits, the appropriateness of limit structures, and the appropriateness of prescribed practices. • OFHEO evaluates the level of directorate and management oversight and reporting. • OFHEO's evaluations reflect, among other things, the perspective gained from years of examination and market experience, comparisons with practices at other large financial intermediaries and end-users, and emerging best practices.	• Management operates with policies and procedures that cover the use of derivatives. (Examiners verify and evaluate.) • Clear lines of responsibility and accountability exist, including independent risk oversight. (Examiners verify and evaluate.) • Controls are in place that safeguard the integrity of data used for models, reporting, and decision-making. (Examiners test, verify, and evaluate.) • Models are independently validated, subject to formal change management, and controlled to preclude unauthorized & untested changes to the models. (Examiners verify and evaluate.) • Contingency plans and business continuity plans provide for disaster recovery and enable continued monitoring of risk positions in the event of business interruption. (Examiners verify and evaluate.) • Technology, tracking systems, and records are effective enabling the Enterprise to document, analyze, and monitor risk positions and compliance with risk limits. (Examiners verify and evaluate.) • Derivative reporting is appropriately comprehensive and tailored to meet the respective audience's needs. (Examiners test, verify, and evaluate.) • Management systems and reporting for derivatives are comprehensive and capture the risks and other important attributes for consideration. (Examiners test, verify, and evaluate.) • Compliance programs and audit coverage are effective in policing compliance with policies, procedures, limits, strategies, and internal controls for derivatives transactions and activities. (Examiners verify and evaluate.) • There is appropriate separation of duties among personnel working with derivatives and overseeing derivatives activities. Independent risk oversight proctors activities and compliance. There is adherence to risk limits and formal reports are regularly generated that track compliance, usage, and approved exceptions to limits. (Examiners test and verify.) • Reporting and risk management protocols exist for new initiatives and require detailed tracking, reporting, and analysis to evaluate performance or any unexpected outcomes. (Examiners verify and evaluate.)

BOX 3.1. DERIVATIVES - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.1.b. Topic: Risk management techniques are employed to effectively manage risk.	
• OFHEO evaluates the quality of the process and the results of credit analyses and limit setting for derivatives counterparty. • OFHEO evaluates the documents, philosophy, methods and practices employed in netting exposures for derivatives. • OFHEO evaluates the policy, practices, and approaches employed in managing collateral for derivatives.	• The measurement of credit risk and fair market value for derivatives is independent and separate from any influence of portfolio management activities. (Examiners verify and evaluate.) • The methodology for determining mark-to-market exposure for collateral requirements is based on real market prices and prudent modeling techniques & practices. (Examiners test, verify, and evaluate.) • There are comprehensive credit analyses performed for derivatives counterparties by credit specialists who are separate from portfolio operations. Credit limits and procedures are prescribed along with collateral requirements. • Counterparties are required to meet credit ratings that exceed investment grade as determined by leading outside credit rating agencies and management has procedures to ensure creditworthiness of its counterparties in the event there is a material adverse change. (Examiners test and verify.) • The credit exposure for derivatives counterparties is continuously monitored, including collateral positions, by an independent risk management function. • Derivatives activities are conducted with an appropriately diverse set of derivatives counterparties. The credit quality of these counterparties is routinely monitored with corrective measures employed when needed or warranted. (Examiners test, verify, and evaluate.) • Collateral posting requirements are clearly delineated, and consistently implemented. (Examiners test, verify, and evaluate.) • Derivative transactions are governed by master agreements. (Examiners verify and evaluate.) • Netting is employed to mitigate counterparty exposure levels. (Examiners verify and evaluate.) • Derivative positions are regularly revalued with net exposures effectively managed, including the requirement of additional collateral when required under credit policies. (Examiners verify and evaluate.) • Counterparties are recognized, reputable, and creditworthy with substantial presence in the derivatives market. (Examiners verify and evaluate.)

<table>
<tr><th colspan="2">BOX 3.1.
DERIVATIVES - FANNIE MAE</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FANNIE MAE</th></tr>
<tr><td colspan="2">3.1.c. Topic: Derivatives activities are governed by and implemented through qualified and experienced professionals and subject to effective limits and reporting.</td></tr>
<tr><td>• OFHEO evaluates the qualifications and expertise of individuals and groups charged with planning, implementing, overseeing, and auditing the use of derivatives.
• OFHEO evaluates the appropriateness and effectiveness of limit structures and due diligence process.</td><td>• Personnel involved in executing, managing, and overseeing derivatives activities are experienced technicians and practitioners. (Examiners verify and evaluate.)
• There is the appropriate separation of duties between transactors, operations, analytics, and risk governance personnel. (Examiners test and verify.)
• There is an effective risk oversight framework staffed with qualified individuals and representing the appropriate disciplines needed to achieve comprehensive oversight. (Examiners verify and evaluate.)
• Sufficient human and financial resources are dedicated to provide quality risk management technology and tools that enable quality management of interest rate risk, hedging activities, and derivatives use. (Examiners verify and evaluate.)
• The risk management function is staffed with specialists. (Examiners verify and evaluate.)
• Analyses are comprehensive, including evaluations performed under multiple & different scenarios. (Examiners verify and evaluate.)
• Qualified and experienced staff perform analyses, accounting, and operations functions. (Examiners verify and evaluate.)
• Effective and timely systems enable management to monitor compliance with limits and determine intra-day risk exposures and changes in risk & risk positions. (Examiners verify and evaluate.)
• Risk limits are routinely evaluated and updated with timely reporting of compliance with those limits. (Examiners verify and evaluate.)
• Risk management systems and practices preclude individuals from taking risk positions that are undetected by management and the risk oversight activities. (Examiners verify and evaluate.)
• The board of directors and senior management are appropriately involved in the process for establishing limits and monitoring performance against risk limits, including derivatives. (Examiners verify and evaluate.)
• Derivatives activities are subject to regular and frequent coverage by Internal Audit. (Examiners test, verify, and evaluate.)</td></tr>
</table>

BOX 3.1.
DERIVATIVES - FANNIE MAE

WHAT OFHEO DOES	OBSERVATIONS ON FANNIE MAE
3.1.d. Topic: Derivatives strategies and positions are appropriate and well-documented.	
• OFHEO evaluates hedging strategies, derivatives transactions, risk exposures, and analysis of hedge effectiveness. • OFHEO evaluates the process and actions employed to rebalance the portfolio. • OFHEO evaluates the funding strategies and the use of derivatives to implement those funding strategies. • OFHEO evaluates the appropriateness of GAAP accounting for derivatives.	• Derivatives are not used for speculative purposes. (Examiners verify and evaluate.) • Interest rate risk, changes in that risk, and the funding environment are continuously monitored. Management takes prompt action to rebalance and remain within desirable risk tolerances and be in adherence with risk limits. (Examiners verify and evaluate.) • Strategies are formal and regularly re-evaluated and refined or altered to effectively manage risk positions, including how derivatives are used. (Examiners verify and evaluate.) • Management considers multiple scenarios, interest rate environments, and market conditions when performing its analyses, and develops comprehensive contingency plans. (Examiners verify and evaluate.) • Hedge performance and hedge strategies are tracked and compared to expected performance. (Examiners verify and evaluate.) • Management augments its analyses with 'stress-testing' and 'back-testing' and considers the results of these tests in its planning. (Examiners verify and evaluate.) • All derivatives are included in risk and sensitivity analyses and cash management forecasts. (Examiners test and verify.) • The methodology employed in performing valuations for derivatives is sound, and the controls surrounding that independent methodology produces reliable values. (Examiners test, verify, and evaluate.) • Derivatives are regularly marked-to-market. (Examiners test and verify.) • FAS 133 implementation has been deliberate and well-documented with the necessary investments made to provide systems needed to ensure ongoing compliance. (Examiners test, verify, and evaluate.)

<table>
<tr><th colspan="2">BOX 3.1.
DERIVATIVES - FANNIE MAE</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FANNIE MAE</th></tr>
<tr><td colspan="2">3.1.e. Topic: The Enterprise is an end-user of derivatives. Derivatives instruments are used exclusively for risk management purposes and not for speculative purposes.</td></tr>
<tr><td>• OFHEO evaluates the types, maturities, and amounts of derivative transactions.
• OFHEO evaluates policies and procedures and patterns of derivatives transactions.
• OFHEO evaluates management's timing and rationale associated with use of certain derivative instruments and transactions.
• OFHEO evaluates how derivatives are being used.</td><td>• The use of derivatives is limited to end-use. (Examiners verify and evaluate.)
• The derivatives being used are limited to those instruments that are common in the financial markets to conduct risk management activities. (Examiners verify and evaluate.)
• The derivatives used are not exotic instruments. (Examiners verify and evaluate.)
• Corporate policies prohibit speculative positions in derivatives. (Examiners test and verify)
• Hedge records and accounting records reflect how derivatives are used. (Examiners test, verify, and evaluate.)
• Derivatives are used in a manner consistent with formally approved risk management policies and procedures. (Examiners verify and evaluate.)
• Automated systems, operating procedures, controls and management oversight safeguard against unauthorized derivatives transactions. (Examiners test and verify.)
• Metrics, management reports, and follow-up analyses demonstrate and confirm the appropriateness of derivatives transactions when evaluated in context with the hedging strategies and the risk management objectives. (Examiners verify and evaluate.)
• The specific types, the terms, and the volume of derivative transactions are consistent with the approved hedging strategies and comport with the nature and level of risk being managed – and are consistent with the prevailing conditions and liquidity in the marketplace. (Examiners verify and evaluate.)</td></tr>
</table>

BOX 3.1. DERIVATIVES - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.1.f. Topic: A meaningful methodology is employed to quantify and monitor the risks associated with derivatives.	
• OFHEO evaluates the quality and appropriateness of valuation methodologies for derivatives. • OFHEO evaluates the quality of analyses and tools to gauge the future value of derivatives instruments and positions under alternate scenarios.	• Systems for data capture, processing, settlement, and management reporting are prudent and provide accurate and reliable information. (Examiners verify and evaluate.) • Model assumptions and parameters are independently validated and continuously reviewed for reasonableness. (Examiners test, verify, and evaluate.) • Changes to model assumptions are thoroughly reviewed, monitored for reasonableness, and revalidated. (Examiners test, verify and evaluate.) • Management has effective processes and controls to detect and report changes to the model assumptions or operations. Changes to the model's assumptions or operations are documented and tracked. (Examiners verify and evaluate.) • Robust tools are employed for pricing and evaluating the effect of changes to interest rates or changes in the shape of the yield curve that cover all categories of the balance sheet, including derivatives. (Examiners verify and evaluate.) • Robust prepayment models consider a wide variety of factors that can affect prepayment speeds. Performance of prepayment models is regularly evaluated and tracked. (Examiners test, verify, and evaluate.) • Valuations produced by the model are validated using actual market quotes where appropriate. (Examiners verify and evaluate.)

Box 3.2.
AUDIT PROGRAM – FANNIE MAE

Central to an effective internal control system and the safe and sound operation of any financial organization is an independent and professional audit program. When properly structured and conducted, an audit program provides the directors and senior management with important information about weaknesses in the system of internal controls. An effective audit program positions a company's board of directors and senior officers to take prompt, remedial action when necessary, and enables a company's board of directors and senior officers to meet their responsibilities to ensure that the system of controls operates effectively resulting in: (a) assets being safeguarded, (b) financial reports being reliable, and (c) compliance with laws, regulations, policies and procedures.

OFHEO, like the banking regulators, reviews and evaluates Fannie Mae's audit program and when necessary, makes recommendations for needed improvements. In evaluating the audit program, examiners test the work conducted by the internal auditors and the external auditors and evaluate: (a) the level of independence, (b) the appropriateness of the scope, (c) the quality of the work and its documentation, (d) the quality of communications associated with the results, and (e) the quality of board and senior management action and follow-up.

The following table highlights selected observations from OFHEO's testing and verification work that is regularly conducted on Fannie Mae's internal and external audit programs. The information in this table augments the overall opinions on the audit programs that are expressed on page 23.

<table>
<tr><th colspan="2">BOX 3.2.
AUDIT PROGRAM - FANNIE MAE</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FANNIE MAE</th></tr>
<tr><td colspan="2">3.2.a. Topic: Audit activities are directed and governed by the Board of Directors and supervised on an ongoing basis by a qualified Board Audit Committee.</td></tr>
<tr><td>• OFHEO evaluates the level of expertise in the Board and on each of the Board Committees.
• OFHEO evaluates the agendas, information packages, presentations and minutes of the Board and its Committees, including the Audit Committee.
• OFHEO's evaluations reflect, among other things, the perspective gained from years of examination experience, comparisons with practices at other large financial intermediaries, best practices identified by groups such as the National Association of Corporate Directors (NACD), Blue Ribbon Commission, the New York Stock Exchange (NYSE), and the Business Roundtable.</td><td>• Audit Committee adopted and Board approved a comprehensive charter for the Audit Committee. (Examiners verify the process and evaluate the content of the charter.)
• Audit Committee charter is reviewed at least annually and ratified/revised as warranted. (Examiners verify the process and evaluate the quality and appropriateness of revisions.)
• Each Audit Committee member is an independent outside director. (Examiners verify.)
• Audit Committee members meet the Blue Ribbon Commission/NYSE standards, including those for independence, financial literacy and expertise. (Examiners verify.)
• Audit Committee appropriately reports its views to the entire Board, and keeps the entire Board informed of significant matters raised or considered by the Committee. (Examiners test and verify.)
• Materials provided to the Audit Committee in advance of its meetings permit the members to conduct the oversight prescribed by the Audit Committee charter and identified by the Blue Ribbon Commission as best practice. (Examiners verify, test and evaluate.)
• Audit Committee approves the annual audit plan for both the internal and external audit activities. (Examiners test and verify the process and evaluate the plan.)
• Audit Committee is kept informed about the progress of the audit activities against the approved audit plan. (Examiners test and verify the process and evaluate the follow-up.)
• Results of all internal audit activities are provided to the Audit Committee on a timely basis, and the level of detail provided to the Audit Committee about specific internal audit activities appropriately reflects the findings and impact on the corporate risk profile. (Examiners test and verify.)
• Audit Committee meets regularly in executive session with the head of Internal Audit. (Examiners verify.)
• Results and observations of external audit activities are routinely shared with the Audit Committee. (Examiners test and verify the process and evaluate the materials provided to the Audit Committee.)
• Audit Committee, comprised of independent outside directors, meets regularly in executive session with the External Auditor. (Examiners verify.)</td></tr>
</table>

BOX 3.2. AUDIT PROGRAM - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.2.b. Topic: The Board and Audit Committee are regularly apprised of OFHEO's view of the quality of the internal and external audit programs, and the quality and effectiveness of management's follow-up on issues identified through the audit process.	
• OFHEO regularly communicates with the Board of Directors to share its results, conclusions, recommendations and follow-up for all areas of the examination. • OFHEO's communications specifically address the quality of both the internal and external audit functions, and the level of reliance OFHEO believes is appropriate for the Board and Audit Committee to place on those functions. • OFHEO's communications are directed to both the Audit Committee, comprised entirely of independent outside Directors, and to all members of the Board. • OFHEO conducts meetings with outside Directors.	• OFHEO's regular communications about examination activities, including those related to internal and external audit functions, are provided to each Board member and are included in the Board packages and official Board records. (Examiners verify.) • Fannie Mae management shares specific examination observations directed to management with the Board, including observations related to internal and external audit functions. (Examiners test and verify.) • The Board and Audit Committee discuss and consider OFHEO's communications about examination activities. (Examiners verify.) • The Audit Committee, comprised solely of independent outside directors, meets with OFHEO's Chief Examiner and the substance of the communications are documented. (Examiners verify.)

BOX 3.2. AUDIT PROGRAM - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.2.c. Topic: The nationally recognized CPA firm that certifies Fannie Mae's financial statements adheres to prescribed auditing standards, including those that relate to the scope of audit activities required to be conducted before the CPA firm can opine on the financial statements.	
• OFHEO evaluates the external auditor's annual audit plan against best practices, AICPA standards, and other relevant standards, including those established by regulators for Federally insured financial institutions. • OFHEO evaluates the qualifications, experience and expertise of the individuals assigned to conduct the external audit. • OFHEO tests the results and conclusions of the external auditor's work against the annual audit plan, and against professional standards. • OFHEO evaluates the quality of the products produced by the external auditor, and tests the sufficiency of work and workpapers that support the external auditor's conclusions.	• The external auditor's audit plan includes all activities and operations necessary to opine on Fannie Mae's financial statements and the quality of the company's controls. (Examiners verify and evaluate.) • The external auditor's audit plan appropriately reflects the complexity of Fannie Mae's corporate structure, operations and the volume of transactions. (Examiners test, verify and evaluate.) • The engagement team possesses significant auditing experience of large complex financial intermediaries and technology dependent companies. (Examiners verify.) • Individual assignments for external audit activities appropriately take into consideration each auditor's qualifications, experience and expertise. Auditors with specialized expertise are appropriately assigned to specific audit activities. (Examiners verify.) • The communications from the external auditor to the Audit Committee are comprehensive, clear, direct and effective. (Examiners test, verify and evaluate.) • The communications from the external auditor to the Audit Committee address all matters required by among others, the AICPA, the SEC and recognized best practices. (Examiners test, verify and evaluate.) • The communications from the external auditor to the Audit Committee tie directly to the approved audit plan. (Examiners test and verify.) • The external auditor's individual and overall conclusions are supported by workpapers that comport with established standards and among other things, demonstrate the extent of testing and verification performed by the external auditor. (Examiners test and evaluate.)

BOX 3.2. AUDIT PROGRAM - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.2.d. Topic: The external audit firm is independent.	

• OFHEO verifies and tests the practice of hiring individuals from the external auditor into positions of influence at Fannie Mae.
• OFHEO evaluates the nature and extent of non-audit services provided by the external audit firm.
• OFHEO verifies the composition of the teams that perform each of the non-audit services.
• OFHEO evaluates the quality of audit services provided by the external auditor, including the communications from the external auditor to the Board and its Audit Committee about its findings and observations.
	• External Auditor does not perform internal audit functions. (Examiners verify.)
	  ▪ February 2002 policy amendment which formalized existing practice prohibits use of external auditor to perform internal audit functions.
	• External Auditor discloses any relationships that might bear on independence. (Examiners verify.)
	• Independence is a factor in the decision to appoint the External Auditor. (Examiners verify and test.)
	• Engagement of External Auditor is negotiated at arms length. (Examiners verify and evaluate.)
	• External Auditor's engagement partner changes more frequently than required by SEC. (Examiners verify.)
	• External auditor meets regularly in executive session with Audit Committee. (Examiners verify.)
	• Examiners tested a three-year period (1999-2001) and during that period no one from the External Auditor was hired at or above the Vice President level. (Examiners verify and test.)
	  ▪ February 2002 policy amendment which formalized existing practices precludes Fannie Mae from hiring any member or employee of the external audit firm who worked on the Fannie Mae account within the preceding three-year period, or assisted in the evaluation of Fannie Mae external reporting systems, or provided consulting services related to external financial reporting systems.
	• External Auditor tests management reports and information to evaluate their reliability. (Examiners test, verify and evaluate.)
	• External Auditor maintains complete supporting workpapers for 7 audit cycles. (Examiners test.)
	• Nature and extent of non-audit services provided by External Auditor consistent with statements of SEC Chairman Pitt and emerging best practices guidance. (Examiners test, verify and evaluate.)
	  ▪ February 2002 policy amendment precludes External Auditor from performing information system design and implementation work.
	• Audit Committee assesses and reviews the full range of services provided by the External Auditor, including the non-audit services its provides. (Examiners verify.)

BOX 3.2. AUDIT PROGRAM - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.2.e. Topic: The qualified Fannie Mae professionals who perform the internal audit function report, through the head of Internal Audit, to the Board's Audit Committee.	
• OFHEO evaluates the structure and reporting relationship of the Internal Audit unit against, among others, the Institute of Internal Auditors (IIA) and other professional standards, best practices and guidance provided by regulators of Federally insured financial institutions. • OFHEO evaluates the qualifications, experience and expertise of the Internal Audit staff and management • OFHEO evaluates the quality of the management of the Internal Audit function, including the appropriateness and effectiveness of the annual audit plan. • OFHEO evaluates the quality of the audit reports generated by the Internal Audit staff • OFHEO evaluates the quality and sufficiency of the Internal Audit workpapers	• Head of Internal Audit regularly meets in executive session with Audit Committee and separately with the Chair of Audit Committee prior to each Audit Committee meeting. (Examiners verify.) • Audit Committee oversees and evaluates the performance of the head of Internal Audit. (Examiners verify and evaluate.) • Internal Audit Reports contain the weaknesses and control deficiencies identified in audit activities. (Examiners test and verify.) • Internal Audit informs senior management and the Board about the weaknesses and control deficiencies identified in audit activities. (Examiners test and verify.) • Management's views about the Internal Audit findings are documented and shared with Audit Committee. (Examiners test, verify and evaluate.) • Internal Audit follows up on and tracks management's actions to address control deficiencies and weaknesses, and routinely provides this information to the Audit Committee. (Examiners test, verify and evaluate.) • Internal audit practices adhere to IIA standards. (Examiners test and verify.) • Internal Audit's risk assessment process covers all business units and processes. (Examiners verify and evaluate.) • Business units do not control ordirect the timing or scope of audit work. (Examiners test and verify.) • Fannie Mae budgets sufficient resources to complete all planned internal audit activities, and to conduct significant additional, unanticipated audit activities. (Examiners verify and evaluate.)

Box 3.3.
BOARD GOVERNANCE – FANNIE MAE

Central to the safe and sound operation of any financial organization is an independent and effective board of directors. Fannie Mae's directors are placed in positions of trust either by the shareholders or by the President of the United States. Responsibility for the prudential operations of the company rests squarely with the board of directors. The board should delegate the day-to-day conduct of business to the Enterprise's officers and employees, but the board cannot delegate its responsibility for the consequences of unsound or imprudent policies and practices.

Recognizing the importance of an independent and effective board of directors, OFHEO reviews and evaluates the way and means by which the directors discharge their duties and responsibilities. Examiners review and evaluate the processes employed by the board and its committees including: (a) the communication flows between senior management and the board, (b) the communications with the auditors or consultants engaged by the board, (c) the information and presentations that are provided to the board, (d) the planning and execution of board agendas, and (e) the documentation materials and follow-up process for open items. In evaluating the effectiveness of the board of directors, examiners consider a variety of governance features, including but not limited to: the process for director recruitment, training and selection; the independence exercised by the board and its committees; the process for selecting executive officers and the process and measures for how these officers are compensated and held accountable for performance; the process and tools used to supervise Fannie Mae's affairs; the role and involvement of the board in adopting, monitoring and enforcing adherence to sound policies and objectives; the methods employed to identify and proctor ethical conduct; and the efforts to ensure the maintenance of a sound system of internal controls.

The following table highlights selected observations covering OFHEO's routine examination activities of Fannie Mae's board governance. The information in this table augments the overall opinion on board governance that is expressed on pages 23 – 24.

BOX 3.3.
BOARD GOVERNANCE - FANNIE MAE

WHAT OFHEO DOES	OBSERVATIONS ON FANNIE MAE
3.3.a. Topic: Board governance is performed by a capable and knowledgeable group of Directors.	
• OFHEO evaluates the processes used to identify and nominate potential shareholder elected Directors. • OFHEO evaluates the Nominating and Corporate Governance Committee's charter. • OFHEO evaluates the actions of the Nominating and Corporate Governance Committee and the support and rationale for its recommendations. • OFHEO assesses the experience, expertise and capabilities of the Board as a whole, of each of the Board committees, and of each Director.	• The Nominating and Corporate Governance Committee is comprised solely of outside directors. (Examiners verify.) • The Nominating and Corporate Governance Committee appropriately considers the current make up of the Board, Fannie Mae's current operations and its future plans when identifying potential nominees to the Board. (Examiners verify and evaluate.) • The Board and each of its committees are comprised of individuals with appropriate experience and expertise, including expertise in housing, finance, control, audit and board governance. (Examiners verify and evaluate.)
3.3.b. Topic: Fannie Mae's Board of Directors is appropriately informed of the company's condition, activities and operations.	
• OFHEO evaluates the scope, quality and timeliness of materials provided to the Board and to its Committees. • OFHEO evaluates the agendas, information packages, presentations and minutes of the meetings of the Board and its committees. • OFHEO evaluates the Board's opinion about the scope, quality and timeliness of materials provided to the Board and its Committees.	• Comprehensive, yet meaningful and manageable materials about Fannie Mae's condition, activities and operations are provided sufficiently in advance of all Board and Committee meetings. (Examiners verify and evaluate.) • Information provided to the Board and its committees comes from appropriate sources within the company, and from appropriate external sources. (Examiners verify.) • The Board and its committees are provided point-in-time, trend and forecasted information. (Examiners verify, test and evaluate.) • The Board and its committees are provided both financial and non-financial information about Fannie Mae's condition, activities, operations and controls. (Examiners verify and evaluate.) • Materials provided to the Board and its committees include information and metrics related to risks and risk management within particular business units and/or processes as well as to risks and risk management across the company. (Examiners verify, test and evaluate.) • The Board is appropriately informed about progress against annual and multi-year plans. (Examiners verify and test.) • OFHEO's Chief Examiner communicates regularly with the Board and meets with the Directors.

BOX 3.3. BOARD GOVERNANCE - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.3.c. Topic: Fannie Mae's Board of Directors is appropriately informed about compliance with the company's Code of Business Conduct.	
• OFHEO evaluates the Code of Business Conduct and compares it to best practices. • OFHEO evaluates the processes surrounding the administration of the Code of Business Conduct, including the type, frequency and effectiveness of communications about the Code of Business Conduct and its provisions. • OFHEO evaluates the reporting processes related to the Code of Business Conduct . • OFHEO evaluates the number and nature of violations of the Code of Business Conduct. • OFHEO evaluates the quality and timeliness of information provided to the Board about compliance with the Code of Business Conduct.	• Fannie Mae has a comprehensive and rigorous Code of Business Conduct that embodies best practices and includes strong and comprehensive restrictions on actual and potential conflicts of interest. (Examiners verify, test and evaluate.) • The Code of Business Conduct is supported by effective administrative processes that reinforce the specific provisions of the Code as well as its general intent. (Examiners verify and evaluate.) • Actual and potential conflicts of interest are reported accurately and in a timely manner. (Examiners verify and test.) • Appropriate restrictions are placed on individuals with actual or potential conflicts. (Examiners verify and test.) • Violations of the Code of Business Conduct are infrequent, but are dealt with quickly and seriously. (Examiners verify, test and evaluate management and Board actions.) • The Audit Committee regularly receives accurate reports about compliance with the Code of Business Conduct and about violations, including management's response to violations. (Examiners verify and test.) • The Audit Committee appropriately reports to the full Board significant matters relating to: the Code of Business Conduct and its administration; compliance with the Code of Business Conduct; and violations of the Code of Business Conduct. (Examiners verify and test.)

<table>
<tr><th colspan="2">BOX 3.3.
BOARD GOVERNANCE - FANNIE MAE</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FANNIE MAE</th></tr>
<tr><td colspan="2">3.3.d. Topic: Fannie Mae's Board of Directors and the Board committees are independent and empowered to operate independently from management.</td></tr>
<tr><td>• OFHEO evaluates the nature and extent of the relationship(s) each Director has with Fannie Mae.
• OFHEO evaluates the nature and extent of the relationship(s) each Director on every committee has with Fannie Mae.
• OFHEO evaluates the charter for each Board committee.
• OFHEO evaluates the process available to the Board and its committees to independently marshal monies and contract resources to assist them in fulfilling their duties and responsibilities.</td><td>• Three of the 18 Directors are Fannie Mae employees. (Examiners verify.)
• Three of the 15 outside Directors are or have been associated with companies or institutions that have business dealings with Fannie Mae. (Examiners verify and evaluate.)
• The full Board meets regularly in executive session (without management present), as do the Audit, Compensation, and Nominating and Corporate Governance committees. (Examiners verify.)
• All members of the Compensation, Audit, and the Nominating and Corporate Governance committees are outside directors, and all meet the definition of independence of the Blue Ribbon Commission/NYSE. (Examiners verify.)
• Agendas for meetings of the Board of Directors and its committees are under the direction of the Directors and committee chairs. (Examiners verify.)
• Board committees have the authority to undertake investigations and engage independent resources they deem necessary. (Examiners verify.)</td></tr>
<tr><td colspan="2">3.3.e. Topic: Fannie Mae's Board of Directors and its committees have formal processes, independent of management, to hire, compensate and replace the executive management team.</td></tr>
<tr><td>• OFHEO evaluates the composition of the Board's Compensation Committee.
• OFHEO evaluates the charter for the Board's Compensation Committee.
• OFHEO evaluates the information provided to and considered by the Compensation Committee when it considers hiring executive management.
• OFHEO evaluates the information provided to and considered by the Compensation Committee when it establishes compensation for the executive management team.
• OFHEO reviews and approves the compensation packages for Fannie Mae's executives.
• OFHEO evaluates the process by which the Compensation Committee assesses the performance of each member of the executive management team.
• OFHEO evaluates the quality of communications from the Compensation Committee to the full Board concerning the hiring, compensation and performance of executive management.</td><td>• The Compensation Committee is comprised solely of outside directors, each of whom meets the Blue Ribbon Commission/NYSE standards for independence. (Examiners verify and evaluate.)
• The Compensation Committee has access to, and receives assistance from qualified independent compensation and executive placement experts. (Examiners verify.)
• The Compensation Committee evaluates the knowledge, skills and abilities of existing management, as well as the direction the Board envisions for the company when considering individuals for executive management positions. (Examiners verify and review.)
• The Compensation Committees employs appropriate, formal metrics and measures when evaluating the performance of the executive management team. (Examiners verify.)
• The recommendations from the Compensation Committee to the Board are well supported and timely. (Examiners verify, test and review.)
• The Board in executive session makes final decisions about executive management's performance-based compensation. (Examiners verify.)</td></tr>
</table>

BOX 3.3. BOARD GOVERNANCE - FANNIE MAE	
WHAT OFHEO DOES	**OBSERVATIONS ON FANNIE MAE**
3.3.f. Topic: Fannie Mae has a comprehensive, formal orientation program for new directors and a process for any director to obtain more information or knowledge about any topic.	
• OFHEO evaluates the orientation process and materials for new directors. • OFHEO evaluates the opportunities Fannie Mae provides its directors to enhance their knowledge about matters related to their duties and responsibilities as directors.	• Orientation for new directors is comprehensive and includes information about directors' roles and responsibilities – including their ethical and legal responsibilities – as well as information about Fannie Mae's activities, condition and operating environment. (Examiners verify and evaluate.) • The materials provided during director orientation are comprehensive and current, and serve as a valuable reference tool. (Examiners verify and evaluate.) • The orientation programs for new directors are the same, whether the directors are shareholder-elected or Presidential appointees. (Examiners test and verify.) • 'Continuing education' opportunities are provided for all directors. Board members have easy access to additional information and/or Fannie Mae personnel about any aspect of Fannie Mae's operations or any aspect of board governance. (Examiners verify.)

Freddie Mac Examination Results and Conclusions

Freddie Mac's credit risk management and credit risk management framework exceed safety and soundness standards, and they have resulted in a high-quality portfolio and manageable credit exposure. The portfolio is diversified and the credit risk profile is in compliance with the internally prescribed limits that examiners have deemed to be appropriate. Policies, procedures, internal controls and management reporting for the credit function are effective. Freddie Mac is adequately compensated for the credit risk it assumes and its credit risk models produce reliable results. Management prudently manages counterparty exposure. New products and initiatives are well researched prior to implementation. The process for determining the reserve for credit losses, the credit risk sharing strategies, and the credit risk management tools all are effective. Freddie Mac effectively identifies, quantifies and tracks its credit risk exposures. Management has an effective means for following up on credit-related issues. The technology and controls supporting the credit risk management function are effective. Management effectively reconciles differences between actual and expected credit portfolio performance.

Freddie Mac's interest rate risk management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to interest rate risk are appropriate and effective. Management has a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk. Freddie Mac's management effectively follows up on issues related to interest rate risk. Freddie Mac appropriately researches and controls the extent to which new products and initiatives may impact the interest rate risk profile. The technology and controls supporting the interest rate risk management function are effective. The tools used to model interest rate risk and the strategies to alter the exposures to interest rates are prudent and effective. Management effectively incorporates tactical and strategic issues into the management of interest rate risk. The responsibilities for the strategy and the analytics functions are appropriately separated from those for the execution functions. Derivative instruments are used prudently for hedging risks and in accordance with the standards used by other large financial intermediaries. **(Box 3.4.)**

Freddie Mac's liquidity management framework exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to liquidity management are deemed to be appropriate and effective. Management has an effective methodology for quantifying and monitoring liquidity, and management appropriately evaluates the impact of various events and alternative environments when developing and updating contingency plans. The planning process for liquidity management is effective. Freddie Mac appropriately considers the impact new products and initiatives may have on liquidity. Management effectively follows up on issues and initiatives that influence liquidity. Technology and controls for liquidity management are prudent and effective. The quality of tools Freddie Mac uses to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are comprehensive and effective. An appropriate separation of duties exists between the strategy and analytics functions and the execution function. Freddie Mac effectively analyzes and is well positioned to respond to trends and anomalies in market and funding spreads. Liquidity management is appropriately integrated with other management and with financial performance issues.

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Operating processes are in place to ensure secure, effective and efficient data center processing and problem management. There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users and that the conduct of E-commerce is secure. There are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster and these are routinely tested and enhanced. Management has processes in place to ensure information technology plans effectively address business unit and corporate objectives. Effective processes are in place to ensure appropriate controls are implemented and maintained. Documentation for system development and maintenance is complete. The controls over end-user computing are effective and there are controls that secure networks and firewalls from inappropriate or unauthorized actions with an appropriate level of testing conducted on these controls. Freddie Mac has processes in place to ensure data and information are processed accurately and in a timely manner.

The internal control framework and the management of that framework exceed safety and soundness standards. Management has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. Implemented controls properly address risks assessed by management. Management has a reliable process for ensuring the timely resolution of control related issues. Internal Audit appropriately identifies and communicates control deficiencies to management and the Board of Directors. There are established policies and procedures that delineate internal control process and standards resulting in a sound control environment. Management routinely tests and ensures compliance with established internal controls.

Business process controls exceed safety and soundness standards. Freddie Mac's corporate environment fosters the introduction of new ideas and values intellectual capital. The process and control environment used when considering or developing new or substantially revised business initiatives is effective. The criteria Freddie Mac uses to subject a business initiative to review as new or substantially revised are comprehensive and appropriate. The analysis and review of new or substantially revised business initiatives are effective. Pilot programs are effectively used and the analysis and review conducted after the launch of a new or substantially revised business initiative is thorough and appropriate. The communications associated with new or substantially revised business initiatives are effective. Freddie Mac appropriately balances risk management, internal controls and the pressure to deliver new or substantially revised business initiatives.

The audit functions exceed safety and soundness standards. **(Box 3.5.)** The Internal and External Audit functions have the appropriate independence. Auditors performing the work possess appropriate professional proficiency. The scope of Internal and External Audit work performed is appropriate and comprehensive, and the audit work is documented and complete. The management of the Internal Audit department is effective. Executive management and the Board of Directors are appropriately involved with and follow up on identified audit issues. The auditor's risk assessment process is effective. Internal Audit is appropriately involved in new products and new initiatives.

The Board discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. **(Box 3.6.)** In discharging its duties and responsibilities, the Board of Directors operates with the appropriate independence. The Board is appropriately engaged in the development of a strategic direction for the company and ensures that management appropriately defines the operating parameters and risk tolerances of the Enterprise in a manner consistent with the strategic direction; legal standards; and ethical standards. The Board has an effective process for hiring and maintaining a quality executive management team, and has processes in placed designed to hold the executive management team accountable for achieving the defined goals and objectives. The Board is appropriately informed of the condition, activities and operations of the Enterprise, and has sufficient, well-organized time to carry out its responsibilities.

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Management and the Board of Directors receive complete and comprehensive reports on Freddie Mac's performance relative to established goals and objectives. Management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively. Management reporting permits management to evaluate and gauge the quality of their decisions. Information systems are linked to Freddie Mac's overall strategy, and are developed and refined consistent with the strategic direction and plan. The reports management uses for decision making are accurate. There are communications across the company and management communicates Enterprise strategy, roles and responsibility. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements.

Key management processes that influence corporate-wide behaviors exceed safety and soundness standards. The strategic planning process is comprehensive and dynamic. Business unit goals are effective and implementation efforts reflect changing priorities. Management has the ability to monitor and manage change. Key performance measures are appropriate, effective and align with strategy. The behavior management programs are effectively designed to achieve corporate goals and objectives. Freddie Mac has programs for career and management development, and for identifying and recruiting competent people. Freddie Mac's proprietary risk management programs and systems are effective. Management effectively conveys an appropriate message of integrity and ethical values. Management's philosophy and operating style have a pervasive effect on the company. The organizational structure and the assignment of responsibility provide for accountability and sound controls.

Box 3.4.
DERIVATIVES – FREDDIE MAC

Freddie Mac is an end-user of derivatives to manage its business more effectively and mitigate financial risks. Its goals for using derivatives are: to lower debt costs associated with the purchase of mortgage assets; to reduce market risks associated with the issuance of debt; and to effectively match the Enterprise's funding composition with changes occurring in the interest-rate characteristics of its mortgage assets that results from changes occurring in the overall interest rate environment. In pursuing these goals, Freddie Mac enters into derivative contracts that are common in the financial markets and widely used for risk management activities – both OTC derivatives and exchange-traded options. Management does not speculate with derivatives. Derivative activities are transacted in accordance with approved policies and procedures and closely supervised and scrutinized by senior management and the Board of Directors.

Derivatives are important instruments for Freddie Mac's management of its business and risk exposures. The volume of derivatives increased from $474.5 billion notional amount on December 31, 2000 to $1,052.4 billion notional amount on December 31, 2001. Notional principal amount is a commonly used measure for the volume of derivatives, but it does not accurately reflect the market and credit risk associated with derivatives. A better measure for the exposure to risk in derivatives is the "replacement cost" for the economic value of contracts. Replacement cost for derivatives positions will regularly fluctuate along with changes in the market. On December 31, 2001, Freddie Mac had a replacement cost of $69 million for its $1,052.4 billion notional principal amount in derivatives.

OFHEO carefully scrutinizes Freddie Mac's use of derivatives. Derivative exposures are incorporated into regulatory capital requirements, both minimum and risk-based, and OFHEO conducts on-site examinations that include a review of derivatives activity. Examiners verify and evaluate a variety of risk management strategies and practices during on-site examinations, which includes: (a) testing transactions and controls; (b) evaluating strategies and their implementation; (c) evaluating the quality of tools used to identify, measure, and monitor risk – including the tools and methodology for valuing derivatives and the off-setting cash positions; (d) testing for the level of compliance with limit structures and for the quality of analyses that forms and defines the limit structure; (e) testing the integrity of the audit program and the accuracy of financial records; (f) evaluating the quality of technology that supports the business and the integrity of the security framework for that technology; (g) evaluating the quality of personnel, management, and board oversight; (h) evaluating the quality of policies and procedures and testing for adherence to these policies and procedures; (i) critiquing the quality of counterparty credit risk analysis and maintenance of the ongoing analysis; (j) proctoring the implementation of FAS 133 and ongoing compliance; (k) making recommendations that can strengthen systems, processes and practices; and (l) requiring remedial actions to address weaknesses, where appropriate.

The following table highlights selected observations from OFHEO's testing and verification work that is regularly conducted on Freddie Mac's derivative activities. The information in this table augments the overall opinions on derivatives that are expressed on page 43.

<table>
<tr><th colspan="2">BOX 3.4.
DERIVATIVES – FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ABOUT FREDDIE MAC</th></tr>
<tr><td colspan="2">3.4.a. Topic: Derivatives activities are governed by sound policies, procedures and effective internal controls and consistent with the prescribed purpose.</td></tr>
<tr><td>• OFHEO evaluates the appropriateness of policies, procedures, internal controls, and reports.
• OFHEO evaluates the process for establishing limits, the appropriateness of limit structures, and the appropriateness of prescribed practices.
• OFHEO evaluates the level of directorate and management oversight and reporting.
• OFHEO's evaluations reflect, among other things, the perspective gained from years of examination and market experience, comparisons with practices at other large financial intermediaries and end-users, and emerging best practices.</td><td>• Management operates with policies and procedures that cover the use of derivatives. (Examiners verify and evaluate.)
• Responsibility and accountability, including independent risk oversight, are clearly communicated. (Examiners verify and evaluate.)
• The integrity of data used for models, reporting and decision-making are safeguarded with appropriate controls. (Examiners test, verify, and evaluate.)
• Models are independently validated, subject to formal change management, and controlled to preclude unauthorized & untested changes to the models. (Examiners verify and evaluate.)
• Contingency plans and business continuity plans provide for disaster recovery and enable continued monitoring of risk positions in the event of business interruption. (Examiners verify and evaluate.)
• The Enterprise documents, analyzes and monitors risk positions and risk limit compliance through effective technology, tracking systems, and reliable records. (Examiners verify and evaluate.)
• Comprehensive derivative reporting is tailored appropriately to meet the respective audience's needs. (Examiners test, verify, and evaluate.)
• Management systems and reporting for derivatives are comprehensive and capture the risks and other important attributes for consideration. (Examiners test, verify, and evaluate.)
• Compliance with policies, procedures, limits, strategies and internal controls for derivatives activities and transactions are policed through effective compliance programs and audit coverage. (Examiners verify and evaluate.)
• Appropriate separation of duties exists among derivatives personnel. Derivatives activities and compliance with policies and limits are monitored by a qualified and independent risk oversight function. (Examiners test and verify.)
• The enterprise has a framework for evaluating the impact of new initiatives. The framework requires detailed tracking, reporting and analysis of performance and/or unexpected outcomes. (Examiners verify and evaluate.)</td></tr>
</table>

<table>
<tr><th colspan="2">BOX 3.4.
DERIVATIVES – FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ABOUT FREDDIE MAC</th></tr>
<tr><td colspan="2">3.4.b. Topic: Risk management techniques are employed to effectively manage risk.</td></tr>
<tr><td>• OFHEO evaluates the quality of the process and the results of credit analyses and limit setting for derivatives counterparty.
• OFHEO evaluates the documents, philosophy, methods and practices employed in netting exposures for derivatives.
• OFHEO evaluates the policy, practices, and approaches employed in managing collateral for derivatives.</td><td>• Measurement and monitoring of credit risk and fair market value for derivatives is independent and separate from any influence of portfolio management activities. (Examiners verify and evaluate.)
• Collateral is independently marked-to-market based on actual market prices and prudent modeling techniques & practices. (Examiners test, verify, and evaluate.)
• Comprehensive credit analyses of derivatives counterparties are performed by credit specialists who are separate from portfolio operations. Credit limits and procedures are prescribed along with collateral requirements. (Examiners verify and evaluate.)
• Counterparties are required to meet credit ratings that exceed minimum investment grade as determined by leading outside credit rating agencies and management has procedures to ensure the creditworthiness of its counterparties in the event there is a material adverse change. (Examiners test and verify.)
• Prudent credit limits, procedures, and collateral requirements are clearly delineated, and consistently implemented. (Examiners test, verify, and evaluate)
• An independent risk management function monitors and tracks the credit exposure for derivatives counterparties, including collateral positions. (Examiners verify and evaluate.)
• Derivatives activities are conducted with an appropriately diverse set of derivatives counterparties. The credit quality of these counterparties is routinely monitored with corrective measures employed when needed or warranted. (Examiners test, verify, and evaluate)
• Collateral posting requirements are clearly delineated, and consistently implemented. (Examiners verify and evaluate.)
• Derivative transactions are governed by master agreements. (Examiners verify and evaluate.)
• Netting is employed to mitigate counterparty exposure levels. (Examiners verify and evaluate.)
• Derivative positions are regularly revalued with net exposures effectively managed, including the requirement additional collateral when required under credit policies. (Examiners verify and evaluate.)
• Counterparties are recognized, reputable, and creditworthy with substantial presence in the derivatives market. (Examiners verify and evaluate.)</td></tr>
</table>

BOX 3.4. DERIVATIVES – FREDDIE MAC	
WHAT OFHEO DOES	**OBSERVATIONS ABOUT FREDDIE MAC**
3.4.c. Topic: Derivatives activities are governed by and implemented through qualified and experienced professionals and subject to effective limits and reporting.	
• OFHEO evaluates the qualifications and expertise of individuals and groups charged with planning, implementing, and overseeing the use of derivatives. • OFHEO evaluates the appropriateness and effectiveness of limit structures and due diligence process.	• Personnel with the requisite knowledge, qualifications, and experience are involved in executing, managing, and overseeing derivatives activities. (Examiners verify and evaluate.) • Appropriate separation of duties between transactors, operations, analytics, and risk governance personnel exists. (Examiners test and verify.) • There is a comprehensive and effective risk oversight framework staffed with qualified individuals representing the appropriate disciplines. (Examiners verify and evaluate.) • The enterprise has dedicated the appropriate human and financial resources that support the development and implementation of quality technology and tools that enable effective management of interest rate risk, hedging, and derivatives activities. (Examiners verify and evaluate.) • The risk management function is staffed with specialists. (Examiners verify and evaluate.) • Analyses are comprehensive, including evaluations performed under multiple & different scenarios. (Examiners verify and evaluate.) • Staff performing analysis, accounting and operations functions are qualified and experienced. • Effective and timely systems enable management to monitor compliance with limits and determine intra-day risk exposures and changes in risk and risk positions. (Examiners verify and evaluate.) • Risk limits are routinely evaluated and updated with timely reporting of compliance with those limits. (Examiners verify and evaluate.) • Individuals are precluded from taking risk positions that go undetected by management and the risk oversight function by effective risk management systems, practices, and controls. (Examiners verify and evaluate.) • The board of directors and senior management are appropriately involved in the process for establishing limits and monitoring performance against risk limits. (Examiners verify and evaluate.) • Derivatives activities are subject to regular and frequent coverage by the Internal Audit. (Examiners test, verify, and evaluate.)

BOX 3.4.
DERIVATIVES – FREDDIE MAC

WHAT OFHEO DOES	OBSERVATIONS ABOUT FREDDIE MAC
3.4.d. Topic: Derivatives strategies and positions are appropriate and well-documented.	
• OFHEO evaluates hedging strategies, derivatives transactions, risk exposures, and analysis of hedge effectiveness. • OFHEO evaluates the process and actions employed to rebalance the portfolio. • OFHEO evaluates the funding strategies and the use of derivatives to implement those funding strategies. • OFHEO evaluates the appropriateness of GAAP accounting for derivatives.	• Derivative instruments are not used for speculative purposes. (Examiners verify and evaluate.) • Management continuously monitors interest rate risk, changes in that risk and the funding environment and takes prompt action to rebalance and remain within desired risk tolerances and risk limits. (Examiners verify and evaluate.) • Strategies are formal and regularly re-evaluated and refined or altered to effectively manage risk positions, including how derivatives are used. (Examiners verify and evaluate.) • A variety of market conditions, interest rate environments and scenarios are considered, analyzed and used to develop comprehensive contingency plans. (Examiners verify and evaluate.) • Hedge performance and hedge strategies are tracked and compared to expected performance. (Examiners verify and evaluate.) • 'Stress-testing' and 'back-testing' augments regular analyses with results considered in management's plans and strategies. (Examiners verify and evaluate.) • All derivatives are included in risk and sensitivity analyses and cash management forecasts. (Examiners test and verify.) • The methodology employed in performing independent valuations of derivatives is sound and that methodology is surrounded with the appropriate controls. (Examiners test, verify, and evaluate.) • Derivatives are marked-to-market regularly. (Examiners test and verify). • FAS 133 implementation has been deliberate and well-documented. The appropriate investments were made, and continue to be made, to the infrastructure that ensures ongoing compliance with FAS 133. (Examiners test, verify, and evaluate.)

BOX 3.4. DERIVATIVES – FREDDIE MAC	
WHAT OFHEO DOES	**OBSERVATIONS ABOUT FREDDIE MAC**
3.4.e. Topic: The Enterprise is an end-user of derivatives. Derivatives instruments are used exclusively for risk management purposes and not for speculative purposes.	
• OFHEO evaluates the types, maturities, and amounts of derivative transactions. • OFHEO evaluates policies and procedures and patterns of derivatives transactions. • OFHEO evaluates management's timing and rationale associated with use of certain derivative instruments and transactions. • OFHEO evaluated how derivatives are being used.	• The derivatives being used are limited to those instruments that are common in the financial markets to conduct risk management activities. (Examiners verify and evaluate.) • The derivatives being used are not exotic instruments. (Examiners verify and evaluate.) • The use of derivatives is limited to end-use. (Examiners verify and evaluate.) • Corporate policies prohibit speculative positions in derivatives. (Examiners test and verify) • Derivatives are used in a manner consistent with the formally approved risk management policies and procedures. (Examiners verify and evaluate.) • Hedge records and accounting records reflect how derivatives are used. (Examiners test, verify, and evaluate.) • Automated systems, operating procedures, controls and management oversight safeguard against unauthorized derivatives transactions. (Examiners test and verify.) • Metrics, management reports, and follow-up analyses demonstrate and confirm the appropriateness of derivatives transactions when evaluated in context with the hedging strategies and the risk management objectives. (Examiners verify and evaluate.) • The specific types, the terms, and the volume of derivative transactions are consistent with the approved hedging strategies and comport with the nature and level of risk being managed – and are consistent with the prevailing conditions and liquidity in the marketplace. (Examiners verify and evaluate.)

BOX 3.4. DERIVATIVES – FREDDIE MAC	
WHAT OFHEO DOES	**OBSERVATIONS ABOUT FREDDIE MAC**
3.4.f. Topic: A meaningful methodology is employed to quantify and monitor the risks associated with derivatives.	
• OFHEO evaluates the quality and appropriateness of valuation methodologies for derivatives. • OFHEO evaluates the quality of analyses and tools to gauge the future value of derivatives instruments and positions under alternate scenarios.	• Systems for data capture, processing, settlement and management reporting are prudent and provide accurate and reliable information. (Examiners verify and evaluate.) • Independent validation of model assumptions and parameters is performed with these assumptions and parameters continuously reviewed for reasonableness and regularly revalidated. • Changes to model assumptions are thoroughly reviewed, monitored for reasonableness, and revalidated. (Examiners test, verify, and evaluate.) • Management has effective processes and controls to detect and report changes to the model assumptions or operations. Changes to the model's assumptions or operations are documented and tracked. (Examiners verify and evaluate.) • Actual market prices are used to validate model pricing where appropriate. (Examiners verify and evaluate.) • Robust tools are employed for pricing and evaluating the effect of changes to interest rates or changes in the shape of the yield curve that cover all categories of the balance sheet, including derivatives. (Examiners verify and evaluate.) • Robust prepayment models consider a wide variety of factors that can affect prepayment speeds. Performance of prepayment models is regularly evaluated and tracked. (Examiners test, verify, and evaluate.)

Box 3.5.
AUDIT PROGRAM – FREDDIE MAC

Central to an effective internal control system and the safe and sound operation of any financial organization is an independent and professional audit program. When properly structured and conducted, an audit program provides the directors and senior management with important information about weaknesses in the system of internal controls. An effective audit program positions a company's board of directors and senior officers to take prompt, remedial action when necessary, and enables a company's board of directors and senior officers to meet their responsibilities to ensure that the system of controls operates effectively resulting in: (a) assets being safeguarded, (b) financial reports being reliable, and (c) compliance with laws, regulations, policies and procedures.

OFHEO, like the banking regulators, reviews and evaluates Freddie Mac's audit program and when necessary, makes recommendations for needed improvements. In evaluating the audit program, examiners test the work conducted by the internal auditors and the external auditors and evaluate: (a) the level of independence, (b) the appropriateness of the scope, (c) the quality of the work and its documentation, (d) the quality of communications associated with the results, and (e) the quality of board and senior management action and follow-up.

The following table highlights selected observations from OFHEO's testing and verification work that is regularly conducted on Freddie Mac's internal and external audit programs. The information in this table augments the overall opinions on the audit programs that are expressed on page 44.

<table>
<tr><th colspan="2">BOX 3.5.
AUDIT PROGRAM - FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FREDDIE MAC</th></tr>
<tr><td colspan="2">3.5.a. Topic: Audit activities are directed and governed by the Board of Directors and supervised on an ongoing basis by a qualified Board Audit Committee.</td></tr>
<tr><td>• OFHEO evaluates the level of expertise in the Board and on each of the Board Committees.
• OFHEO evaluates the agendas, information packages, presentations and minutes of the Board and its Committees, including the Audit Committee.
• OFHEO's evaluations reflect, among other things, the perspective gained from years of examination experience, comparisons with practices at other large financial intermediaries, best practices identified by groups such as the National Association of Corporate Directors (NACD), Blue Ribbon Commission, the New York Stock Exchange (NYSE), and the Business Roundtable.</td><td>• Audit Committee adopted and Board approved a comprehensive charter for the Audit Committee. (Examiners verify the process and evaluate the content of the charter.)
• Audit Committee charter is reviewed at least annually and ratified/revised as warranted. (Examiners verify the process and evaluate the quality and appropriateness of revisions.)
• Each Audit Committee member is an outside director. (Examiners verify.)
• Audit Committee members meet the Blue Ribbon Commission/NYSE standards for financial literacy, expertise and independence. (Examiners verify.)
• Audit Committee appropriately reports its views to the entire Board, and keeps the entire Board informed of significant matters raised or considered by the Committee. (Examiners test and verify.)
• Materials provided to the Audit Committee in advance of its meetings permit the members to conduct the oversight prescribed by the Audit Committee charter and identified by the Blue Ribbon Commission as best practice. (Examiners test, verify and evaluate the quality of materials.)
• Audit Committee approves the annual audit plan for both the internal and external audit activities. (Examiners test and verify the process and evaluate the plan.)
• Audit Committee is kept informed about the progress of the audit activities against the approved audit plan. (Examiners test and verify the process and evaluate the follow-up.
• Results of all internal audit activities are provided to the Audit Committee on a timely basis, and the level of detail provided to the Audit Committee about specific internal audit activities appropriately reflects the findings and impact on the corporate risk profile. (Examiners test and verify.)
• Audit Committee meets regularly in executive session with the Senior Vice President – General Auditor. (Examiners verify.)
• Results and observations of external audit activities are routinely shared with the Audit Committee. (Examiners test and verify the process and evaluate the materials provided to the Audit Committee.)
• Audit Committee meets regularly in executive session with the External Auditor. (Examiners verify.)</td></tr>
</table>

BOX 3.5. AUDIT PROGRAM - FREDDIE MAC	
WHAT OFHEO DOES	**OBSERVATIONS ON FREDDIE MAC**
3.5.b. Topic: The Board and Audit Committee are regularly apprised of OFHEO's view of the quality of the internal and external audit programs, and the quality and effectiveness of management's follow-up on issues identified through the audit process.	
• OFHEO regularly communicates with the Board of Directors to share its results, conclusions, recommendations and follow-up for all areas of the examination. • OFHEO's communications specifically address the quality of both the internal and external audit functions, and the level of reliance OFHEO believes is appropriate for the Board and Audit Committee to place on those functions. • OFHEO's communications are directed to both the Audit Committee comprised entirely of outside directors, and to all members of the Board. • OFHEO conducts meetings with outside Directors.	• OFHEO's regular communications about examination activities, including those related to internal and external audit functions, are provided to each Board member and are included in the Board packages and official Board records. (Examiners verify.) • Freddie Mac management shares specific examination observations directed to management with the Board, including observations related to internal and external audit functions. (Examiners test and verify.) • The Board and Audit Committee discuss and consider OFHEO's communications about examination activities. (Examiners verify.) • The Audit Committee, comprised solely of outside directors, meets with OFHEO's Chief Examiner.

<table>
<tr><th colspan="2">BOX 3.5.
AUDIT PROGRAM - FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FREDDIE MAC</th></tr>
<tr><td colspan="2">3.5.c. Topic: The nationally recognized CPA firm that certifies Freddie Mac's financial statements adheres to prescribed auditing standards, including those that relate to the scope of audit activities required to be conducted before the CPA firm can opine on the financial statements.</td></tr>
<tr><td>• OFHEO evaluates the external auditor's annual audit plan against best practices, AICPA standards, and other relevant standards, including those established by regulators for Federally insured financial institutions.
• OFHEO evaluates the qualifications, experience and expertise of the individuals assigned to conduct the external audit.
• OFHEO tests the results and conclusions of the external auditor's work against the annual audit plan, and against professional standards.
• OFHEO evaluates the quality of the products produced by the external auditor, and tests the sufficiency of work and workpapers that support the external auditor's conclusions.</td><td>NOTE: The following comments relate to the external audit activities conducted through the conclusion of the 2001 audit.
• The external auditor's audit plan includes all activities and operations necessary to opine on Freddie Mac's financial statements and the quality of the company's controls. (Examiners verify and evaluate.)
• The external auditor's audit plan appropriately reflects the complexity of Freddie Mac's corporate structure, operations and the volume of transactions. (Examiners test, verify and evaluate.)
• The engagement team possesses significant auditing experience of large complex financial intermediaries and technology dependent companies. (Examiners verify.)
• Individual assignments of external audit activities appropriately take into consideration each auditor's qualifications, experience and expertise. Auditors with specialized expertise are appropriately assigned to specific audit activities. (Examiners verify.)
• The communications from the external auditor to the Audit Committee are comprehensive, clear, direct and effective. (Examiners test, verify and evaluate.)
• The communications from the external auditor to the Audit Committee address all matters required by among others, the AICPA, the SEC and recognized best practices. (Examiners test, verify and evaluate.)
• The communications from the external auditor to the Audit Committee tie directly to the approved audit plan. (Examiners test and verify.)
• The external auditor's individual and overall conclusions are supported by workpapers that comport with established standards and among other things, demonstrate the extent of testing and verification performed by the external auditor. (Examiners test and evaluate.)</td></tr>
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AUDIT PROGRAM - FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FREDDIE MAC</th></tr>
<tr><td colspan="2">3.5.d. Topic: The external audit firm is independent.</td></tr>
<tr><td>• OFHEO verifies and tests the practice of hiring individuals from the external auditor into positions of influence at Freddie Mac.
• OFHEO evaluates the nature and extent of non-audit services provided by the external audit firm.
• OFHEO verifies the composition of the teams that perform each of the non-audit services.
• OFHEO evaluates the quality of audit services provided by the external auditor, including the communications from the external auditor to the Board and its Audit Committee about its findings and observations.</td><td>NOTE: The following comments relate to the external audit firm that conducted audits through 2001.
• External Auditor does not perform internal audit functions. (Examiners verify.)
• External Auditor discloses any relationships that might bear on independence. (Examiners verify.)
• Independence is a factor in the decision to appoint the External Auditor. (Examiners verify and test.)
• Engagement of External Auditor is negotiated at arms length. (Examiners verify.)
• External Auditor's engagement partner changes consistent with SEC requirements. (Examiners verify.)
• External auditor meets regularly in executive session with Audit Committee. (Examiners verify.)
• Examiners tested a three year period (1999 – 2001) and during that period no one from the External Auditor was hired at or above the Vice President level. (Examiners verify and test.)
    ▪ An employee of Freddie Mac's previous external auditor was hired in April 2002 as SVP Control and Accounting.
• External Auditor tests management reports and information to evaluate their reliability. (Examiners test, verify and evaluate.)
• External Auditor maintains complete supporting workpapers for 7 audit cycles. (Examiners test.)
• Nature and extent of non-audit services provided by External Auditor consistent with statements of SEC Chairman Pitt and emerging best practices guidance. (Examiners test, verify and evaluate.)
• Audit Committee assesses and reviews the full range of services provided by the External Auditor, including the non-audit services its provides. (Examiners verify.)</td></tr>
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<tr><th colspan="2">BOX 3.5.
AUDIT PROGRAM - FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FREDDIE MAC</th></tr>
<tr><td colspan="2">3.5.e. Topic: The qualified Freddie Mac professionals who perform the internal audit function report, through the head of Internal Audit, to the Board's Audit Committee.</td></tr>
<tr><td>• OFHEO evaluates the structure and reporting relationship of the Internal Audit unit against, among others, the Institute of Internal Auditors (IIA) and other professional standards, best practices and guidance provided by regulators of Federally insured financial institutions.
• OFHEO evaluates the qualifications, experience and expertise of the Internal Audit staff and management.
• OFHEO evaluates the quality of the management of the Internal Audit function, including the appropriateness and effectiveness of the annual audit plan.
• OFHEO evaluates the quality of the audit reports generated by the Internal Audit staff.
• OFHEO evaluates the quality and sufficiency of the Internal Audit workpapers</td><td>• Senior Vice President – General Auditor regularly meets in executive session with Audit Committee and separately with the Chair of Audit Committee prior to each Audit Committee meeting. (Examiners verify.)
• Audit Committee oversees and evaluates the performance of the Senior Vice President – General Auditor. (Examiners verify and evaluate.)
• Internal Audit Reports contain the weaknesses and control deficiencies identified in audit activities. (Examiners test and verify.)
• Internal Audit informs senior management and the Board about the weaknesses and control deficiencies identified in audit activities. (Examiners test and verify.)
• Management's views about the Internal Audit findings are documented and shared with Audit Committee. (Examiners test, verify and evaluate.)
• Internal Audit follows up on and tracks management's actions to address control deficiencies and weaknesses, and routinely provides this information to the Audit Committee. (Examiners test, verify and evaluate.)
• Internal audit practices adhere to IIA standards. (Examiners test and verify.)
• Internal Audit's risk assessment process covers all business units and processes. (Examiners verify and evaluate.)
• Business units do not control or direct the timing or scope of audit work. (Examiners test and verify.)
• Freddie Mac budgets sufficient resources to complete all planned internal audit activities, and to conduct significant additional, unanticipated audit activities. (Examiners verify and evaluate.)</td></tr>
</table>

Box 3.6.
BOARD GOVERNANCE – FREDDIE MAC

Central to the safe and sound operation of any financial organization is an independent and effective board of directors. Freddie Mac's directors are placed in positions of trust either by the shareholders or by the President of the United States. Responsibility for the prudential operations of the company rests squarely with the board of directors. The board should delegate the day-to-day conduct of business to the Enterprise's officers and employees, but the board cannot delegate its responsibility for the consequences of unsound or imprudent policies and practices.

Recognizing the importance of an independent and effective board of directors, OFHEO reviews and evaluates the way and means by which the directors discharge their duties and responsibilities. Examiners review and evaluate the processes employed by the board and its committees including: (a) the communication flows between senior management and the board, (b) the communications with the auditors or consultants engaged by the board, (c) the information and presentations that are provided to the board, (d) the planning and execution of board agendas, and (e) the documentation materials and follow-up process for open items. In evaluating the effectiveness of the board of directors, examiners consider a variety of governance features, including but not limited to: the process for director recruitment, training and selection; the independence exercised by the board and its committees; the process for selecting executive officers and the process and measures for how these officers are compensated and held accountable for performance; the process and tools used to supervise Freddie Mac's affairs; the role and involvement of the board in adopting, monitoring and enforcing adherence to sound policies and objectives; the methods employed to identify and proctor ethical conduct; and the efforts to ensure the maintenance of a sound system of internal controls.

The following table highlights selected observations covering OFHEO's examination activities of Freddie Mac's board governance. The information in this table augments the overall opinion on board governance that is expressed on page 45.

BOX 3.6. BOARD GOVERNANCE - FREDDIE MAC	
WHAT OFHEO DOES	**OBSERVATIONS ON FREDDIE MAC**
3.6.a. Topic: Board governance is performed by a capable and knowledgeable group of Directors.	
• OFHEO evaluates the processes used to identify and nominate potential shareholder elected Directors. • OFHEO evaluates the Human Resources Committee's charter. • OFHEO evaluates the actions of the Human Resources Committee and the support and rationale for its recommendations. • OFHEO assesses the experience, expertise and capabilities of the Board as a whole, of each of the Board committees, and of each Director.	• The Human Resources Committee (whose responsibilities include board nominations) is comprised solely of outside directors. (Examiners verify.) • The Human Resources Committee appropriately considers the current make up of the Board, Freddie Mac's current operations and its future plans when identifying potential nominees to the Board. (Examiners verify and evaluate.) • The Board and each of its committees are comprised of individuals with appropriate experience and expertise, including expertise in housing, finance, control, audit and board governance. (Examiners verify and evaluate.)
3.6.b. Topic: Freddie Mac's Board of Directors is appropriately informed of the company's condition, activities and operations.	
• OFHEO evaluates the scope, quality and timeliness of materials provided to the Board and to its Committees. • OFHEO evaluates the agendas, information packages, presentations and minutes of the meetings of the Board and its committees. • OFHEO evaluates the Board's opinion about the scope, quality and timeliness of materials provided to the Board and its Committees.	• Comprehensive yet manageable and meaningful materials about Freddie Mac's condition, activities and operations are provided sufficiently in advance of all Board and Committee meetings. (Examiners verify and evaluate.) • Information provided to the Board and its committees comes from appropriate sources within the company, and from appropriate external sources. (Examiners verify.) • The Board and its committees are provided point-in-time, trend and forecasted information. (Examiners verify, test and evaluate.) • The Board and its committees are provided both financial and non-financial information about Freddie Mac's condition, activities, operations and controls. (Examiners verify and evaluate.) • Materials provided to the Board and its committees include information and metrics related to risks and risk management within particular business units and/or processes as well as to risks and risk management across the company. (Examiners verify, test and evaluate.) • The Board is appropriately informed about progress against annual and multi-year plans. (Examiners verify and test.) • OFHEO's Chief Examiner communicates regularly with the Board and meets with Directors.

<table>
<tr><th colspan="2">BOX 3.6.
BOARD GOVERNANCE - FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FREDDIE MAC</th></tr>
<tr><td colspan="2">3.6.c. Topic: Freddie Mac's Board of Directors is appropriately informed about compliance with the company's Codes of Conduct.</td></tr>
<tr><td>• OFHEO evaluates the Codes of Conduct and compares them to best practices.
• OFHEO evaluates the processes surrounding the administration of the Codes of Conduct, including the type, frequency and effectiveness of communications about the Codes of Conduct and their provisions.
• OFHEO evaluates the reporting processes related to the Codes of Conduct.
• OFHEO evaluates the number and nature of violations of the Codes of Conduct.
• OFHEO evaluates the quality and timeliness of information provided to the Board about compliance with the Codes of Conduct.</td><td>• Freddie Mac has comprehensive and rigorous Codes of Conduct for its employees and for the Board that embody best practices and include strong and comprehensive restrictions on actual and potential conflicts of interest. (Examiners verify, test and evaluate.)
• The Codes of Conduct are supported by effective administrative processes that reinforce the specific provisions of the Codes as well as their general intent. (Examiners verify and evaluate.)
• Actual and potential conflicts of interest are reported accurately and in a timely manner. (Examiners verify and test.)
• Appropriate restrictions are placed on individuals with actual or potential conflicts. (Examiners verify and test.)
• Violations of the Codes of Conduct are infrequent, but are dealt with quickly and seriously. (Examiners verify and test, and evaluate management and Board actions.)
• The Human Resources Committee regularly receives accurate reports about compliance with the Codes of Conduct and about violations, including management's response to violations. (Examiners verify and test.)
• The Human Resources Committee appropriately reports to the full Board significant matters relating to: the Codes of Conduct and their administration; compliance with the Codes of Conduct; and violations of the Codes. (Examiners verify and test.)</td></tr>
</table>

BOX 3.6. BOARD GOVERNANCE - FREDDIE MAC	
WHAT OFHEO DOES	**OBSERVATIONS ON FREDDIE MAC**
3.6.d. Topic: Freddie Mac's Board of Directors and the Board committees are independent and empowered to operate independently from management.	
• OFHEO evaluates the nature and extent of the relationship(s) each Director has with Freddie Mac. • OFHEO evaluates the nature and extent of the relationship(s) each Director on every committee has with Freddie Mac. • OFHEO evaluates the charter for each Board committee. • OFHEO evaluates the processes available to the Board and its committees to independently marshal monies and contract resources to assist them in fulfilling their duties and responsibilities.	• Two of the 18 Directors are Freddie Mac employees. (Examiners verify.) ▪ Note, for part of 2001 a third Freddie Mac employee filled the vacancy caused by the resignation of an outside director and served only until a new outside director was named. • Three of the 16 outside Directors are or have been associated with companies or institutions that have business dealings with Freddie Mac. (Examiners verify and evaluate.) • The full Board meets regularly in executive session, as do the Audit and Human Resources committees. (Examiners verify.) • All members of the Audit and Human Resources committees are outside directors and meet the Blue Ribbon Commission/NYSE requirements. (Examiners verify.) • Agendas for meetings of the Board of Directors and its committees are under the direction of the Directors and committee chairs. (Examiners verify.) • Board committees have the authority to undertake investigations and engage independent resources they deem necessary. (Examiners verify.)

<table>
<tr><th colspan="2">BOX 3.6.
BOARD GOVERNANCE - FREDDIE MAC</th></tr>
<tr><th>WHAT OFHEO DOES</th><th>OBSERVATIONS ON FREDDIE MAC</th></tr>
<tr><td colspan="2">3.6.e. Topic: Freddie Mac's Board of Directors and its committees have formal processes, independent of management, to hire, compensate and replace the executive management team.</td></tr>
<tr><td>• OFHEO evaluates the composition of the Board's Human Resources Committee.
• OFHEO evaluates the charter for the Board's Human Resources Committee.
• OFHEO evaluates the information provided to and considered by the Human Resources Committee when it considers hiring executive management.
• OFHEO evaluates the information provided to and considered by the Human Resources Committee when it establishes compensation for the executive management team.
• OFHEO reviews and approves the compensation packages for Freddie Mac's executives.
• OFHEO evaluates the process by which the Human Resources Committee assesses the performance of each member of the executive management team.
• OFHEO evaluates the quality of communications from the Human Resources Committee to the full Board concerning the hiring, compensation and performance of executive management.</td><td>• The Human Resources Committee is comprised solely of outside directors, each of whom meets the Blue Ribbon Commission/NYSE standards for independence. (Examiners verify and evaluate.)
• The Human Resources Committee has access to, and receives assistance from qualified independent compensation and executive placement experts. (Examiners verify and review.)
• The Human Resources Committee evaluates the knowledge, skills and abilities of existing management, as well as the direction the Board envisions for the company when considering individuals for executive management positions. (Examiners verify and review.)
• The Human Resources Committees employs appropriate formal metrics and measures when evaluating the performance of the executive management team. (Examiners verify.)
• The recommendations from the Human Resources Committee to the Board are well supported and timely. (Examiners verify, test and review.)
• The Board in executive session (without management present) makes final decisions about executive management's performance-based compensation. (Examiners verify.)</td></tr>
<tr><td colspan="2">3.6.f. Topic: Freddie Mac has a comprehensive, formal orientation program for new directors and a process for any director to obtain more information or knowledge about any topic.</td></tr>
<tr><td>• OFHEO evaluates the orientation process and materials for new directors.
• OFHEO evaluates the opportunities Freddie Mac provides its directors to enhance their knowledge about matters related to their duties and responsibilities as directors.</td><td>• Orientation for new directors is comprehensive and includes information about directors' roles and responsibilities – including their ethical and legal responsibilities – as well as information about Freddie Mac's activities, condition and operating environment. (Examiners verify and evaluate.)
• The materials provided during director orientation are comprehensive and current, and serve as a valuable reference tool. (Examiners verify and evaluate.)
• The orientation programs for new directors are the same, whether the directors are shareholder-elected or Presidential appointees. (Examiners test and verify.)
• 'Continuing education' opportunities are provided for all directors. Board members have easy access to additional information and/or Freddie Mac personnel about any aspect of Freddie Mac's operations or any aspect of board governance. (Examiners verify.)</td></tr>
</table>

CHAPTER FOUR – Financing OFHEO's Operations

OFHEO'S BUDGET

OFHEO's operations are not financed by taxpayer funds. OFHEO's annual operating budget is, however, subject to the Federal appropriations process and is based on the amount appropriated by Congress and signed into law by the President. The amounts provided for by the appropriations process are collected from Fannie Mae and Freddie Mac in the form of an annual assessment paid semi-annually.

The President's Budget for Fiscal Year 2003 includes a proposal to remove OFHEO from the appropriations process. OFHEO Director Armando Falcon has continuously stated that the lengthy appropriations process may not allow OFHEO the flexibility necessary to address evolving, dynamic issues before those issues impact the financial safety and soundness of the Enterprises or funding for the housing market. The Administration is seeking the authority for OFHEO to operate like all other financial safety and soundness regulators, such as the Office of the Comptroller of the Currency and the Office of Thrift Supervision. OFHEO's operations would remain subject to the oversight of Congress, but its budget would be free from the unpredictability of the annual appropriations process.

For fiscal year 2001, OFHEO's budgetary resources totaled $22,605,000. Budgetary resources represent $22 million appropriated to OFHEO for fiscal year 2001 plus recovery of $605,000 prior year funds. The fiscal year 2001 operating budget supported the completion of a long awaited milestone by publishing the Final Risk-Based Capital regulation. The office continued to conduct comprehensive annual risk-based examinations of Fannie Mae and Freddie Mac, reviewed and classified the capital adequacy of each Enterprise quarterly, and performed other safety and soundness related regulatory activities.

For fiscal year 2002, OFHEO received its full budget request of $27,000,000. OFHEO will use these resources to maintain existing staffing levels, continue current examination and oversight programs and upgrade OFHEO's computing capacity which is critical to the efficient implementation of the risk-based capital regulation and to support needed research and analysis on the ever-changing risk profiles of the Enterprises.

OFHEO's fiscal year 2003 budget request totals $30,843,000. These resources will maintain existing oversight activities plus two initiatives. The first initiative is to strengthen OFHEO's safety and soundness programs. This will be done by bolstering OFHEO's capacity to oversee Enterprise risk management activities, by improving OFHEO's capacity to analyze stress test outputs, and by improving OFHEO's capacity to analyze developments in the mortgage and securities markets. In addition, OFHEO will expand its data warehouse and improve the efficiency of using these data to improve the productivity of regulatory staff. The second initiative is to strengthen OFHEO's infrastructure. This will be done primarily by creating an integrated administrative and financial management system.

OFHEO CONTINUES TO RECEIVE UNQUALIFIED AUDIT OPINION IN FY 2001

In conjunction with the government's goal of improved accountability, OFHEO voluntarily prepared financial statements for fiscal year 2001 and subjected these statements and underlying processes to an independent audit. The certified public accounting firm of Dembo, Jones, Healy, Pennington and Marshall audited the statements. The firm issued an unqualified audit opinion on OFHEO's fiscal year 2001 Financial Statements. The complete audit report follows.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

FINANCIAL REPORT

September 30, 2001

Office of Federal Housing Enterprise Oversight

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

FISCAL YEAR 2001

MANAGEMENT'S DISCUSSION AND ANALYSIS

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.

Overview

The Office of Federal Housing Enterprise Oversight (OFHEO) was established by Title XIII of the Housing and Community Development Act of 1992, Public Law Number 102-550, known as the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (1992 Act). OFHEO is an independent office within the Department of Housing and Urban Development (HUD) with responsibility for examining and regulating the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) (collectively, the Enterprises) and ensuring that they are adequately capitalized.

A Director appointed by the President and confirmed by the Senate for a five-year term heads OFHEO. In October 1999, Armando Falcon, Jr. was sworn in as OFHEO's second Director. Under Director Falcon's leadership, during FY 2001, OFHEO continued to effectively regulate the Enterprises through an integrated program of ensuring that the Enterprises were adequately capitalized and operating in a safe and sound manner, promoting an efficient secondary mortgage market through an independent and balanced approach of oversight of the Enterprises and ensuring that the Enterprises comply with all laws under OFHEO's jurisdiction.

To ensure that the Enterprises are adequately capitalized, OFHEO is required by law to develop a stress test to determine risk-based capital requirements. During FY 2001, Director Falcon devoted considerable resources to the critical task of completing the Risk-Based Capital Rule and readying the stress test for implementation. OFHEO issued a final Risk-Based Capital Rule in September 2001.

OFHEO is required by law to conduct on-site comprehensive examinations at Fannie Mae and Freddie Mac to determine the overall safety and soundness of the two companies. The examinations are designed to identify the risks in the business activities of the Enterprises, and to determine if those risks are being prudently managed, controlled, and monitored. Director Falcon has maintained focus on OFHEO's examination and oversight function and plans to add resources in this area over a three-year period beginning in FY 2003. These additional resources are required to keep pace with the tremendous growth in the size and complexity of the Enterprises' operations.

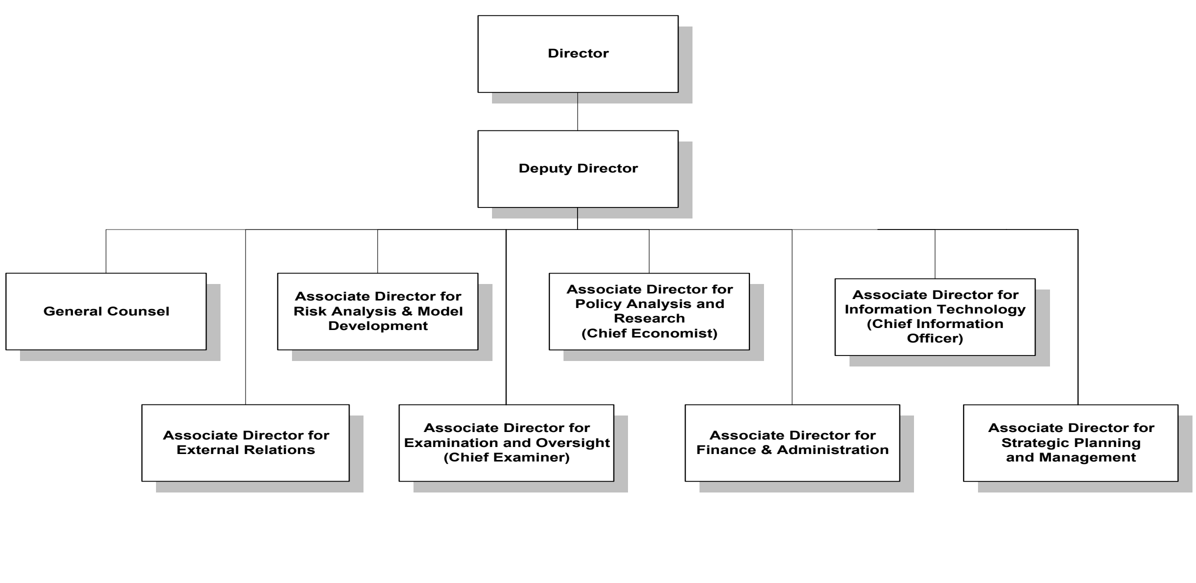
Since OFHEO began operations in 1993, the Enterprises have more than doubled in size and fundamentally shifted their business mix from guarantors of mortage-backed securities to asset managers. In response to more ambitious affordable housing goals and the shift in business strategy, the Enterprises have also expanded business products and structured programs to purchase high loan-to-value mortgages to support the drive to higher rates of homeownership, to promote the expansion of reverse mortgages for elderly homeowners, and to develop the means to reach less credit worthy borrowers. To fund their expanded portfolios, the Enterprises issued innovative debt instruments, including instruments denominated in foreign currencies and a program of regular issuances that frequently serves as an alternative to U.S. Treasury securities. The Enterprises have also increased their use of derivative instruments from a notional amount of $72 billion at year-end 1993 to $1.6 trillion on September 30, 2001, representing 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.

At the same time, dramatic advances in technology represent the foundation for the Enterprises new 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. These technologies carry with them operational challenges that not only permit the Enterprises to leverage their resources but also heighten their operational risks. These developments and trends have challenged the resources of OFHEO in its oversight role.

An increase in staffing is imperative to ensure that OFHEO has the capability to assess the consequences of further growth and innovation by Fannie Mae and Freddie Mac. OFHEO also must share a commitment to technology that will permit OFHEO to leverage the expertise and skills of its staff. Consequently, the Director's budget strategy includes the enhancement of OFHEO's computing capacity in FY 2002 followed by integration of commercial automated analytic tools into OFHEO's regulatory and oversight systems in FY 2003. The phased expansion in staffing is targeted to begin in FY 2003 with the addition of 24 positions.

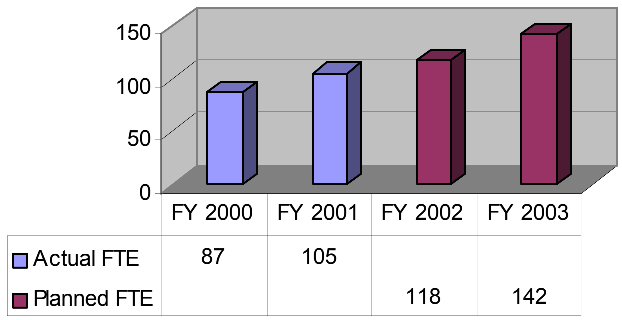
OFHEO IS GROWING BUT REMAINS FLEXIBLE AND EFFICIENT

OFHEO is located at 1700 G Street NW in the District of Columbia. The Director and Deputy Director carry out OFHEO's mission through the coordinated efforts of eight offices. These offices are: (1) General Counsel, (2) Risk Analysis and Model Development, (3) Policy Analysis and Research, (4) Information Technology, (5) External Relations, (6) Examination and Oversight, (7) Finance and Administration, and (8) Strategic Planning and Management.



During FY 2001, OFHEO finalized the Risk-Based Capital Rule and strengthened examination and oversight by employing about 105 full time equivalent (FTE) workyears, up 21 percent from FY 2000. The nature of OFHEO's mission requires a highly skilled, motivated, and diverse workforce to provide institutional capacity in mission-critical areas at all times. The Director's long-term strategy would continue to increase staffing through FY 2006 and strengthen OFHEO's capacity to perform oversight of the evolving risk profiles of the Enterprises.

63% Staffing Increases Planned from FY 2000 - 2003



OFHEO OPERATIONS ARE NOT FINANCED BY TAXES

While OFHEO's budget is currently subject to the annual congressional appropriations process, it is not funded by tax dollars. Fannie Mae and Freddie Mac bear the full cost of OFHEO's operations through an annual assessment based on OFHEO's annual operating budget as appropriated. Each Enterprise pays a pro rata share of the annual assessment. The combined assets and off-balance sheet obligations of each Enterprise determine the pro rata shares. OFHEO receives the annual assessment in semi-annual payments each fiscal year. By statute these payments are due to OFHEO October 1, and April 1, of each fiscal year, excluding years when the Enterprises must also pay based on temporary funding resolutions.

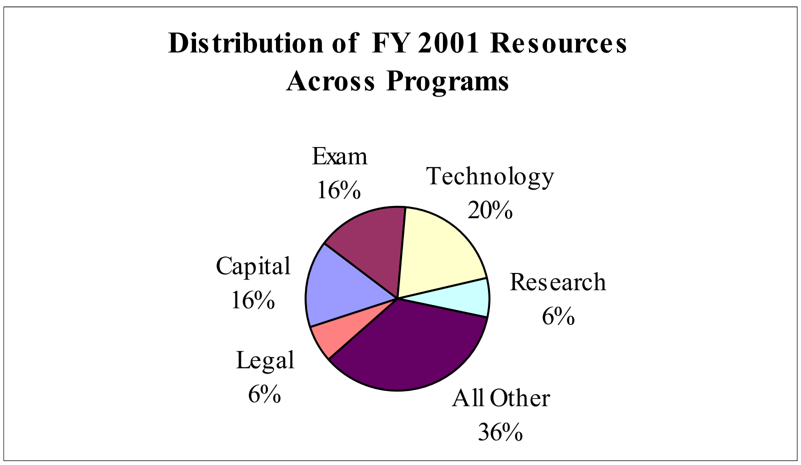
The President's FY 2003 budget contains an administrative provision that would provide direct funding to OFHEO eliminating the appropriations requirement. Without passage of this provision, OFHEO, unlike most other federal financial regulators, must submit a request for an annual operating budget to the Office of Management and Budget (OMB) and the Congress. This process diminishes the efficiency and effectiveness of OFHEO's programs by requiring the Office to predict in advance the resources that it may need to respond to external events that will not arise for over two years. OFHEO has no operating funds for a fiscal year until appropriation legislation is enacted by Congress and signed by the President. OFHEO's budget is bundled with the Department of Veterans Affairs (VA), HUD, and a variety of independent agencies such as the National Science Foundation. When the Congress and the Administration are unable to reach timely budget agreements, it results in OFHEO's not having an enacted budget until after the fiscal year has commenced. The appropriations process has forced OFHEO to trim operations until large, unrelated budget issues are resolved between the executive and legislative branches.

Director Falcon has repeatedly voiced concern about the potential impacts of OFHEO's current funding strategy and has asked Congress to remove OFHEO from the appropriations process. He is concerned that the appropriations process constrains OFHEO's ability to respond appropriately to new unanticipated developments that could impair the financial safety and soundness of the Enterprises and prohibit the Enterprises from performing their important public missions. Removal from the appropriations process would put OFHEO on par with bank and thrift regulatory agencies and would allow the office to operate more efficiently and effectively while maintaining vigorous congressional oversight.

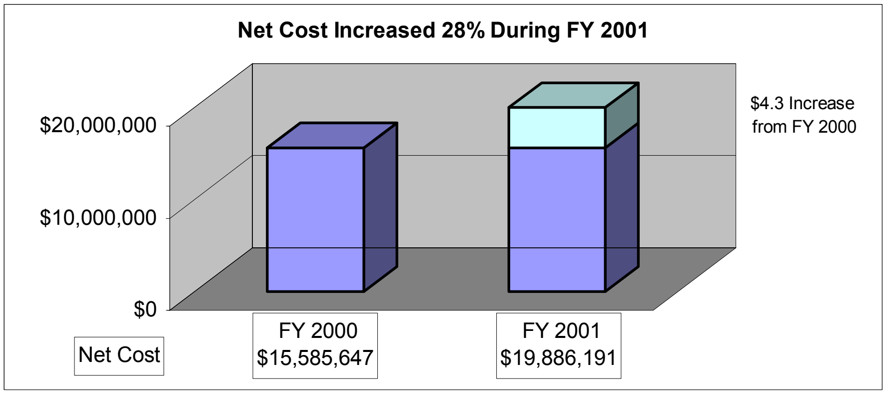
KEY FINANCIAL INFORMATION

OFHEO had $22.6 million available for obligation during FY 2001. Obligations represent monies awarded to specific contractors, payroll costs for FY 2001, and other expenses such as equipment purchases and employee travel costs for the fiscal year. All but $6,713 was obligated by the end of the year on September 30, 2001. As required by law, the $6,713 was credited against the FY 2002 annual assessment to be paid by the Enterprises.

Of the $22.6 million obligated during FY 2001, over $14 million (64%) were obligated for purchases that directly support mission activities such as examination and oversight, capital adequacy, and financial research related to housing finance. This is up 2% over the funds obligated in FY 2000 for direct mission activities. The balance of funds were obligated for activities supporting the accomplishment of the mission such as rent, internal financial and administrative management, external relations to the Congress and the public, and non-mission legal support.

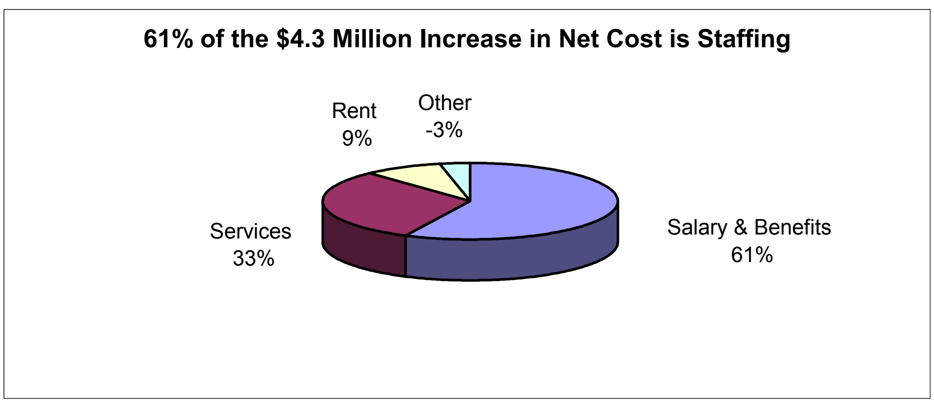


As OFHEO matures and staffing levels expand to meet the demand of regulating the Enterprises, the net cost of OFHEO's operations is rising. Net cost represents assessment collections, from Fannie Mae and Freddie Mac, that have been expensed for salaries and operating expenses, including retirement benefits financed by the Office of Personnel Management, to support OFHEO during the fiscal year. The net cost of operations for FY 2001 was over $19.9 million, up about 28% from FY 2000.



The nearly $4.4 million increase in net cost is associated with staffing, rent and contract services. Over 61% of the increase is in salary and benefits largely attributable to hiring vacancies to support examination, capital, information technology (IT) and legal programs. The second largest category in the net cost increase is contract services at 33%. The components included in the contract services increase are direct, risk-based capital expenses, the redesign of space, improvements to the IT infrastructure, and miscellaneous support services.

The small increase of net cost associated with rent resulted from advance payments of rent necessary to secure additional space for a growing staff required in the 1700 G Street location. In addition, OFHEO required more space to house its computer systems required to implement the risk-based capital stress test.



FINANCIAL MANAGEMENT ACHIEVEMENTS AND IMPROVEMENTS

Financial Statement Audit. OFHEO has received ***unqualified audit opinions*** for the last three years on it's financial statements, internal controls and compliance with laws and regulations.

Federal Managers' Financial Integrity Act (FMFIA). In letters dated December 13, 2001, Director Falcon advised the President and the Congress that OFHEO was in compliance with FMFIA as of the end of FY 2001 (September 30, 2001). During FY 2001, OFHEO's managers continued to monitor internal controls and reported on the effectiveness of controls to the Director. No reportable material weaknesses were identified.

Compliance with Prompt Payment Act. OFHEO maintains excellent compliance with the Prompt Payment Act and OMB circular A-125, which focus on improving the cash management practices of the government. OMB defines "on time as those payments made 23 to 30 days after receipt of the invoice, earlier payments where discounts were taken, and earlier payments made in accordance with management guidance." This means that OFHEO must pay its bills within a narrow window – not too early and not late.

During FY 2001, OFHEO further reduced the amount it paid for interest penalties to a miniscule $445 in relation to a growing amount of disbursements, over $6.5 million, covered by the Prompt Payment Act. This reduction follows an outstanding performance in FY 2000 when OFHEO paid only $517 in interest penalties relating to nearly $5 million in disbursements. OFHEO accomplished this reduction in interest penalties by reducing the number of invoices paid late through enhanced tracking procedures for credit card statement payments.

Federal Financial Management Information Act (FFMIA) of 1996

The FFMIA codified in law certain financial management system requirements that were already in place by Executive Branch policies and added one new requirement. The Act established new requirements for auditors to report on agency compliance with system requirements and for agency heads and agency management to correct deficiencies within a reasonable time period.

OFHEO contracts certain administrative and financial services from other government agencies. Since OFHEO is small, these cross servicing arrangements with larger agencies provide a cost-effective means for the use of systems, which are generally expensive to purchase and maintain. OFHEO maintains its financial accounting on a system owned by VA. The National Finance Center (NFC), operated by the Department of Agriculture, provides OFHEO with payroll systems and services. HUD provides personnel action processing services and systems and a human resources data interface with the NFC systems.

FY 2001 MARKS KEY PERFORMANCE ACCOMPLISHMENTS FOR OFHEO

OFHEO's FY 2001 Annual Performance Plan and its operations were designed to achieve the Office's three strategic goals, described in the FY 1998-2003 Strategic Plan:

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

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

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

Through the FY 2001 Annual Performance Plan, OFHEO set its performance goals for the year and outlined means and strategies to achieve them. Highlights of the goals and accomplishments that relate to each of these strategic goals are described below. In accordance with the Government Performance and Results Act, the FY 2001 Annual Performance Report will contain a more detailed description of OFHEO's performance, and will be issued by March 29, 2002.

OFHEO's ACCOMPLISHMENTS

At year-end, two of OFHEO's major criteria for achieving the mission have been satisfied. OFHEO has classified the Enterprises as adequately capitalized each quarter and determined through examinations that they meet or exceed safety and soundness standards. OFHEO has also achieved a long-awaited milestone by publishing a Final Risk-Based Capital Rule on September 13, 2001.

OFHEO established three strategic goals and 22 performance goals in the FY 2001 Performance Plan that it presented to Congress in February 2000 with the budget request. As FY 2001 began the following October, the enacted budget was less than the requested level, and OFHEO was revising the schedule for promulgating the Risk-Based Capital Rule. While recognizing that the Office would be unable to meet five performance goals as originally set, OFHEO did not revise the performance plan. The year concluded with these expectations met. OFHEO published the capital rule later in the year to achieve one of the goals. Achieving three goals related to the rule's implementation would be deferred to FY 2002. The last of these five goals may be considered in a future year, as resources are available.

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

During FY 2001, OFHEO completed its comprehensive annual risk-based examinations. Through these examinations for calendar year 2000, OFHEO determined that both Enterprises were financially sound and well managed. As in prior years, before conducting the examinations, the Office established and shared with the Enterprises safety and soundness standards that reflect various components of risk and risk management. For these examinations, OFHEO considers four major areas–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 over 100 factors are assessed at the start of the year and updated quarterly to reflect changes. The examination process and results are described in more detail in OFHEO's 2001 Report to Congress. Both examinations were completed on schedule and both Enterprises responded appropriately to examination issues. For the calendar year 2001 examination, which OFHEO initiated in FY 2001, OFHEO began implementation of an additional 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. OFHEO accomplished its performance goals in these examination areas.

The Enterprises met applicable capital standards quarterly, and OFHEO met its goal in this area. Each quarter, OFHEO applied the minimum capital standard to each Enterprise's financial position and determined that they met the standards. OFHEO also continues to monitor the Enterprises' minimum capital levels on a monthly basis. OFHEO is planning to update the minimum capital regulation, and will seek public comments on the proposed amendments during FY 2002.

In September 2001, OFHEO published a final Risk-Based Capital rule, although later than the target date originally set in the performance plan. By law, OFHEO cannot enforce compliance with the risk-based capital regulation until one year after it was issued in final. Until then, the minimum capital standard is the only one used to classify the Enterprises for capital adequacy. Once the Risk-Based Capital Rule is enforceable, OFHEO will calculate Risk-Based Capital levels for each Enterprise on at least a quarterly basis. In FY 2001, after the final rule was announced, OFHEO established a Risk-Based Capital Task Force to facilitate the rule's implementation. As part of that effort, OFHEO began working with the Enterprises to ensure that they can run the stress test and have an opportunity to integrate the rule into their risk management framework. OFHEO also began work in FY 2001 to ensure that the Risk-Based Capital Model and Rule are updated and enhanced. In the first quarter of FY 2002, OFHEO published a notice of proposed rulemaking to make improvements that better tie capital to risk. OFHEO's performance goals related to implementation of the capital rule are being deferred to FY 2002.

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

OFHEO continued to strengthen its independent capacity to analyze the Enterprises and mortgage markets by continuing to bolster its staffing levels in key mission-related areas. OFHEO met its performance goals by continuing to issue internal reports analyzing Enterprise risks throughout FY 2001. The Office met its goals for maintaining the examination cadre's objectivity and expertise. Examination staff participated in professional development and training programs, and interagency assignments and forums. Because OFHEO's FY 2001 budget was enacted at a lower level than requested, and available resources were diverted to the Risk-Based Capital project, the Office did not meet its performance goal to develop the automated Surveillance and Monitoring System as originally planned.

During FY 2001, OFHEO initiated several research projects, including a study of the systemic risk in the financial markets and the housing markets that the Enterprises may pose and/or mitigate. At the onset of the study, OFHEO sought public comment through its web site and the *Federal Register*, and then posted on the web site the comments received. During FY 2001, OFHEO developed a preliminary research agenda that it is refining in FY 2002, and established an interdisciplinary Research Council to coordinate research plans and activities. In future years, OFHEO anticipates undertaking additional research and analysis, including exploring issues that arose in comments on the proposed risk-based capital rule and using the risk-based capital stress test to assess alternative stress scenarios to continue to analyze the Enterprises.

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

During FY 2001, OFHEO found no violations of the Enterprises' Charter Acts or other applicable laws. As part of OFHEO's responsibility to prohibit excessive executive compensation at the Enterprises, OFHEO reviewed four termination agreements of executives who left the Enterprises, and found them satisfactory. During FY 2002, OFHEO will conduct a study of executive compensation at the Enterprises by comparing their executives' compensation with executive compensation at peer firms. OFHEO met its performance goals in this area.

FY 2002 and the Future

Beginning with FY 2002, OFHEO's Annual Performance Plans tie to OFHEO's new FY 2000-2005 Strategic Plan. This Plan was developed during the last quarter of FY 2000, in accordance with the Government Performance and Results Act. This plan provides a framework for OFHEO's future Annual Performance Plans and operations. Taking OFHEO to its next stage, the plan details OFHEO's mission, goals and objectives for the five-year period and provides a blueprint for achieving them.

The new plan reflects OFHEO's congressional mandate to ensure the safety and soundness of Fannie Mae and Freddie Mac and emphasizes the need to foster the strength and vitality of the nation's housing finance system. It also recognizes that success in carrying out this mission promotes a robust housing sector and a strong economy. The strategic objectives continue OFHEO's focus on ensuring the Enterprises are adequately capitalized and that they comply with safety and soundness standards and other legal requirements. The objectives also place increased emphasis on enhancing public understanding of the nation's housing finance system and contributing to Federal efforts to promote efficient and effective financial markets and homeownership. OFHEO's three primary regulatory responsibilities are incorporated in the plan: Ensuring that the Enterprises are adequately capitalized, conducting safety and soundness examinations, and undertaking research and analysis on emerging Enterprise-related matters.

LIMITATIONS OF THE FINANCIAL STATEMENTS

While OFHEO is not specifically covered by the requirements in the CFO Act, the Office has prepared financial statements to report the financial position and results of operations of OFHEO, pursuant to the requirements of 31 U.S.C. 3515(b). The statements have been prepared from the books and records of OFHEO in the format prescribed by OMB. These statements supplement the periodic financial reports used to monitor and control budgetary resources that were prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government.

The following principal statements present the financial position of OFHEO, an independent office within HUD, as of September 30, 2001, and September 30, 2000. The statements are in conformity with the instructions provided for federal entities by the OMB and comply with Statements of Federal Financial Accounting Standards effective as of September 30, 2001.

Dembo, Jones, Healy, Pennington & Marshall, P.C.
Certified Public Accountants and Consultants

Independent Auditors' Opinion on the Financial Statements

Mr. Armando Falcon
Director
Office of Federal Housing Enterprise Oversight

We have audited the accompanying Principal Statements and related notes of the Office of Federal Housing Enterprise Oversight as of September 30, 2001 and 2000, and for the years then ended. These Principal Statements (hereinafter referred to as "financial statements") comprised of the balance sheets, the statements of net cost, changes in net position, budgetary resources and financing, and their related notes, are the responsibility of the agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements." These standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net position; net costs; changes in net position; budgetary resources; and reconciliation of net costs to budgetary obligations of the Office of Federal Housing Enterprise Oversight as of September 30, 2001 and 2000, and for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis and the Required Supplemental Information sections are not required parts of the basic financial statements of the Office of Federal Housing Enterprise Oversight but are supplementary information required by the Federal Financial Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the Management Discussion and Analysis and the Required Supplementary Information. However, we did not audit the information and express no opinion on it.

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In accordance with Governmental Auditing Standards, we have also issued a report dated February 14, 2002, on our consideration of the Office of Federal Housing Enterprise Oversight's internal control over financial reporting and a report dated February 14, 2002 on our tests of the Office of Federal Housing Enterprise Oversight's compliance with certain provisions of laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of the audits.

This report is intended solely for the information and use of the management of the Office of Federal Housing Enterprise Oversight, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Dembo, Jones, Healy, Pennington + Marshall, P.C.

February 14, 2002

Dembo, Jones, Healy, Pennington & Marshall, P.C.
Certified Public Accountants and Consultants

Report of Independent Auditors on Internal Control

Mr. Armando Falcon
Director
Office of Federal Housing Enterprise Oversight

We have audited the Principal Statements (hereinafter referred to as "financial statements") of the Office of Federal Housing Enterprise Oversight as of and for the years ended September 30, 2001 and 2000, and have issued our report thereon dated February 14, 2002. We conducted our audits in accordance with: auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audits, we considered the Office of Federal Housing Enterprise Oversight's internal control over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audits was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving

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the internal control and its operation that we considered to be material weaknesses as defined above. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the Office of Federal Housing Enterprise Oversight in a separate letter dated February 14, 2002.

Finally, with respect to internal control related to performance measures reported in the annual performance plan, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

This report is intended solely for the information and use of the management of the Office of Federal Housing Enterprise Oversight, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Dembo, Jones, Healy, Pennington & Marshall, P.C.

February 14, 2002

Dembo, Jones, Healy, Pennington & Marshall, P.C.
Certified Public Accountants and Consultants

Report of Independent Auditors on Compliance with Laws and Regulations

Mr. Armando Falcon
Director
Office of Federal Housing Enterprise Oversight

We have audited the Principal Statements (hereinafter referred to as "financial statements") of the Office of Federal Housing Enterprise Oversight as of and for the years ended September 30, 2001 and 2000, and have issued our report thereon dated February 14, 20002. We conducted our audits in accordance with: auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of the Office of Federal Housing Enterprise Oversight is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test all laws and regulations applicable to the Office of Federal Housing Enterprise Oversight.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02. OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements", as amended, defines the form and content of financial statements of the executive departments and agencies listed in the attachment to the Bulletin. The Office of Federal Housing Enterprise Oversight is not required to follow OMB Bulletin No. 97-01 but has voluntarily adopted the Bulletin's requirements.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

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The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audits and, accordingly, we do not express such an opinion.

This report is intended solely for the information of the management of the Office of Federal Housing Enterprise Oversight, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Dembo, Jones, Healy, Pennington & Marshall, P.C.

February 14, 2002

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
BALANCE SHEETS
AS OF SEPTEMBER 30, 2001 AND 2000

	2001	2000
ASSETS		
Intragovernmental Assets		
Fund Balance with Treasury - Note 2	$ 4,628,495	$ 5,939,763
Accounts Receivable	46,459	-
Advances/Prepayments - Note 3	575,339	460,142
Total Intragovernmental Assets	5,250,293	6,399,905
Accounts Receivable	2,871	-
Property, Plant and Equipment, Net - Note 4	15,176,690	10,935,914
TOTAL ASSETS	**$ 20,429,854**	**$ 17,335,819**
LIABILITIES		
Liabilities Covered by Budgetary Resources:		
Intragovernmental Liabilities		
Accrued Liabilities	$ 157,304	$ 146,555
Total Intragovernmental Liabilities	157,304	146,555
Other Payables and Liabilities		
Accounts Payable	1,433,217	1,349,098
Other Liabilities	859,872	688,166
Total Other Payables and Liabilities - Note 5	2,293,089	2,037,264
Total Liabilities Covered by Budgetary Resources	**2,450,393**	**2,183,819**
Liabilities Not Covered by Budgetary Resources:		
Governmental		
Accrued Annual Leave	890,745	673,519
Total Liabilities Not Covered by Budgetary Resources - Note 6	**890,745**	**673,519**
TOTAL LIABILITIES	**$ 3,341,138**	**$ 2,857,338**
NET POSITION		
Unexpended Appropriations	$ 2,212,149	$ 3,754,738
Cumulative Results of Operations	14,876,567	10,723,743
Total Net Position - Note 7	**17,088,716**	**14,478,481**
TOTAL LIABILITIES AND NET POSITION	**$ 20,429,854**	**$ 17,335,819**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF NET COST
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2001 AND 2000

	2001	2000
Program Costs		
Production Costs		
Public Production	$ 16,775,503	$ 13,263,439
Federal Production	2,387,275	2,173,453
Total Production Costs - Note 8	19,162,778	15,436,892
Non-Production Costs		
Imputed Financing Sources - Note 9	506,187	389,794
Financing Sources Yet to be Provided - Note 10	217,226	(241,039)
Total Non-Production Costs	723,413	148,755
Total Program Costs	**19,886,191**	**15,585,647**
Net Cost of Operations	**$ 19,886,191**	**$ 15,585,647**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF CHANGES IN NET POSITION
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2001 AND 2000

	2001	2000
Net Cost of Operations	**$ (19,886,191)**	**$ (15,585,647)**
Financing Sources		
Appropriations Used	23,534,034	18,067,103
Imputed Financing Sources - Note 9	506,187	389,794
Total Financing Sources	24,040,221	18,456,897
Net Change in Cumulative Results of Operations	**4,154,030**	**2,871,250**
Increase / (Decrease) in Unexpended Appropriations	(1,543,795)	1,415,116
Changes in Net Position	**2,610,235**	**4,286,366**
Net Position - Beginning of Period	**14,478,481**	**10,192,115**
Net Position - End of Period - Note 7	**$ 17,088,716**	**$ 14,478,481**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF BUDGETARY RESOURCES
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2001 AND 2000

	2001	2000
Budgetary Resources		
Appropriations	$ 22,000,000	$ 19,493,000
Unobligated Balance Brought Forward October 1	9,762	10,780
Adjustments		
Recoveries of Prior Year Obligations - Note 11	605,000	133,203
Permanently not available Pursuant to Public Law 102-550	(9,762)	(10,780)
Total Budgetary Resources	**$ 22,605,000**	**$ 19,626,203**
Status of Budgetary Resources		
Obligations Incurred	$ 22,598,287	$ 19,616,441
Unobligated Balance Not Available	6,713	9,762
Total Status of Budgetary Resources	**$ 22,605,000**	**$ 19,626,203**
Outlays		
Obligations Incurred	$ 22,598,287	$ 19,616,441
Less: Spending Authority from Collections/Adjustments		
Receivable from Federal Sources	34,047	-
Actual Recoveries of Prior Year Obligations - Note 11	(605,000)	(133,203)
	22,027,334	**19,483,238**
Obligated Balance, Net - Beginning of Period	**5,930,001**	**4,354,541**
Obligated Balance, Net - End of Period		
Undelivered Orders	(2,205,436)	(3,746,183)
Accounts Payable	(2,450,393)	(2,183,818)
Total Obligated Balance, Net - End of Period	**(4,655,829)**	**(5,930,001)**
Total Outlays	**$ 23,301,506**	**$ 17,907,778**
Disbursements	$ 23,306,279	$ 17,923,953
Collections	(4,773)	(16,175)
Total Outlays	**$ 23,301,506**	**$ 17,907,778**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF FINANCING
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2001 AND 2000

	2001	2000
Obligations and Nonbudgetary Resources		
Obligations Incurred	**$ 22,598,287**	**$ 19,616,441**
Less: Spending Authority from Offsetting Collections/Adjustments		
Earned Reimbursements		
Receivables from Federal Sources	(12,412)	-
Recoveries of Prior Year Obligations - Note 11	(605,000)	(133,203)
Other - Imputed Financing Sources - Note 9	506,187	389,794
Exchange Revenue Not in the Entity's Budget	(2,871)	1,206
Total Obligations as Adjusted and Nonbudgetary Resources	**22,484,191**	**19,874,238**
Resources That Do Not Fund Net Cost of Operations		
Change in Goods/Services/Benefits Ordered but not Provided (Increases)	1,425,550	(1,877,483)
Costs Capitalized on the Balance Sheet (Increases)		
General Property, Plant and Equipment	(4,240,776)	(2,170,069)
Total Resources That Do Not Fund Net Costs of Prior Periods	**(2,815,226)**	**(4,047,552)**
Financing Sources Yet to be Provided		
Annual Leave	217,226	188,971
Future Workers' Compensation	-	(430,010)
Total Financing Sources Yet to be Provided - Note 10	**217,226**	**(241,039)**
Net Cost of Operations	**$ 19,886,191**	**$ 15,585,647**

The accompanying notes are an integral part of these statements.

<u>NOTES TO FINANCIAL STATEMENTS</u>

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- ***Reporting Entity***

The Office of Federal Housing Enterprise Oversight (OFHEO) was established as an independent office within the Department of Housing and Urban Development (HUD) by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (title XIII of P.L. 102-550).

Since 1993, Congress has enacted no-year appropriations, which are available for obligation by OFHEO until expended. The appropriation is funded by an annual assessment from two government sponsored enterprises, Fannie Mae and Freddie Mac (the "Enterprises") and not with taxpayer funds. Beginning with the FY 1998 appropriation, OFHEO receives an appropriation from the U.S. Treasury General Fund each year. OFHEO fully offsets the General Fund appropriation with collections from the assessments of the Enterprises and ensures that taxpayer funds are not used for OFHEO's operations.

OFHEO's enabling statute requires that OFHEO return to the Enterprises, in the form of a credit against the next year's annual assessment, any unobligated assessment funds at the end of the fiscal year. This effectively makes OFHEO operate like a hybrid annual appropriation with no-year authority -- OFHEO's annual resources are available for obligation and expenditure without regard to any fiscal year limitation. OFHEO reduces the current year's assessment by the amount of the unobligated balance from the previous year. Consequently, there is no carry over of budget authority from one year to the next and the annual assessment is adjusted by the credit given to the Enterprises each year.

The accompanying financial statements reflect the activities of OFHEO. OFHEO has only entity activities and the financial statements reflect those activities, which include the appropriation received to conduct operations. OFHEO does not perform custodial activities on behalf of other federal agencies.

- ***Basis of Presentation***

OFHEO is not covered by the Chief Financial Officer's (CFO) Act and is not required to follow the Office of Management and Budget (OMB) Bulletin 97-01, as amended on form and content. However, OFHEO adopted OMB's requirements for CFO Act financial statements. The principal statements were prepared from the official financial records and general ledger of OFHEO in accordance with Generally Accepted Accounting Principles (GAAP) as established through the Federal Accounting Standards Advisory Board (FASAB) standards.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- ***Basis of Accounting***

Transactions are recorded on both an accrual accounting basis and on a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements and controls over the use of Federal funds. OFHEO complies with the U.S. Standard General Ledger and conforms to the hierarchy of the American Institute of Certified Public Accountants (AICPA) through Statement on Auditing Standards (SAS) No. 69, as amended by SAS No.91, *Federal GAAP Hierarchy*, of accounting principles for the Federal Government:

> Federal Accounting Standards Advisory Board (FASAB) Statements and Interpretations plus AICPA and Financial Accounting Standards Board (FASB) pronouncements if made applicable to the Federal governmental entities by a FASAB Statement or Interpretation;
>
> FASAB Technical Bulletins and the following pronouncements if specifically made applicable to Federal governmental entities by the AICPA and cleared by the FASAB: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position;
>
> AICPA Accounting Standards Executive Committee (ACSEC) Practice Bulletins if specifically made applicable to Federal governmental entities and cleared by the FASAB and Technical Releases of the Accounting and Auditing Policy Committee of the FASAB;
>
> Implementation guides published by the FASAB staff and practices that are widely recognized and prevalent in the Federal government; and
>
> Accounting policy and procedures established by OFHEO to enhance consistency or to provide guidance in the absence of government-wide standards.

- ***Funds with the U.S. Treasury***

OFHEO cash receipts and disbursements are processed by the United States Department of the Treasury (Treasury). The funds with Treasury are primarily assessment funds that are available to pay current liabilities and to finance authorized purchase commitments. OFHEO does not have monetary assets held outside OFHEO's fund balance at Treasury. OFHEO does not have an advance from Treasury to maintain an Imprest Fund and does not hold any marketable or non-marketable securities. OFHEO does not operate a direct loan or loan guarantee program.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- ***Property and Equipment***

OFHEO's property and equipment is recorded at cost and is depreciated using the straight-line method over the estimated service lives of the assets. Service lives have been established as three years for computer related systems and up to 20 years for other equipment. Leasehold improvements are depreciated over the remaining term of the lease agreement. OFHEO has an established capitalization threshold of $5,000 to conform with the materiality approach for the accounting that supports OFHEO's independent financial statements. Other property items, normal repairs, and maintenance are charged to expense as incurred.

At present, internally developed software is being created at OFHEO. This asset is software under development to support the oversight of the Enterprises. The software supports the development of risk-based capital standards and will be used to implement the final risk-based capital standards. It also supports the examination of the Enterprises. The software is being developed internally. The asset had not been placed in service as of September 30, 2001 and no depreciation has been recorded.

OFHEO has no capitalized leases, no real property holdings, and no heritage assets.

- ***Prepaid and Deferred Charges***

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and are recognized as expenditures/expenses when the related goods and services are received.

- ***Accounts Receivable***

OFHEO's Accounts Receivable consists of receivables and reimbursements due from others. No account is estimated as uncollectable.

- ***Liabilities***

Liabilities represent the amount of funds that are likely to be paid by OFHEO as the result of a transaction or event that has already occurred.

OFHEO reports its liabilities under two categories: Liabilities covered by Budgetary Resources and Liabilities Not Covered by Budgetary Resources.

OFHEO's Liabilities Covered by Budgetary Resources are liabilities that are funded by a current appropriation or other funding source. Both intragovernmental (payable to other federal entities) and governmental liabilities, consist of accounts payable and accrued liabilities. Accounts payable reflect invoices processed for payment during the fiscal year which are yet unpaid as of the end of the fiscal year due to scheduling of payments to reflect prompt payment guidelines. Accrued liabilities consist of both estimates of accounts payable for the value of services received during the fiscal year for which OFHEO had not been billed as of the end of the fiscal year and payroll accruals

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- ***Liabilities (continued)***

reflecting payroll costs earned by employees during the fiscal year which are not paid until the next fiscal year.

OFHEO's Liabilities Not Covered by Budgetary Resources are liabilities that are not funded by any current appropriation or other funding source. These liabilities consist of accrued annual leave at the end of the fiscal year. Reimbursements owed to the Department of Labor for claims already paid under the Federal Employees Compensation Act would also be reported under this liability category: however, OFHEO has no claims outstanding in FY 2001 and 2000. In addition, a liability for any future claims (future worker's compensation) would be reported in this category. The agency's methodology for estimating this future worker's compensation liability determined that the liability would be negligible and therefore no liability is recorded for fiscal years 2001 or 2000.

- ***Retirement Plans***

OFHEO participates in the retirement plans offered by the Office of Personnel Management (OPM) and does not maintain any private retirement plans. The majority of OFHEO's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). OFHEO expenses its contributions to the retirement plans of covered employees as the expenses are incurred. OFHEO is reporting imputed financing with respect to retirement plans, health benefits and life insurance pursuant to guidance received from OPM. These costs are paid by OPM and not by OFHEO. Disclosure is intended to provide information regarding the full cost of OFHEO's program in accordance with GAAP.

- ***Net Position***

OFHEO's net position is comprised of the following components:

1. Undelivered orders and unobligated balances of OFHEO's funds.

2. Invested capital represents U.S. Government resources invested in OFHEO's property and equipment and inventory not held for sale. Increases to invested capital are recorded when assets are acquired with direct appropriations, and decreases are recorded as a result of the depreciation, disposition of capital assets, or consumption of inventory.

3. Future funding requirements represent accumulated annual leave earned but not taken as of the financial statement date. The expense for these accruals is not funded from current assessments, but will be funded from future assessments as the expenses are incurred.

4. Prepayments and advances of OFHEO's funds.

NOTE 2 - FUND BALANCE WITH TREASURY

Fund Balance with Treasury consists of the following as of September 30, 2001 and 2000:

		Unobligated			
	Obligated	Available	Unavailable	2001	2000
General Funds	$4,621,782		$6,713	$4,628,495	$5,939,763

The FY 2001 Fund Balance with Treasury reflects an erroneous OPAC that was charged by OTS in error, in the amount of $34,047.

NOTE 3 – ADVANCES/PREPAYMENTS

The Advances/Prepayments are payments made to the Office of Thrift Supervision (OTS) for additional occupancy space contracted for in fiscal year 2000 but not occupied until fiscal year 2001 and for additional occupancy space contracted for in fiscal year 2001 but not to be occupied until fiscal year 2002.

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment balances as of September 30, 2001 and 2000 are as follows:

Asset Type	Acquisition Cost	Accumulated Depreciation	2001 Net Book Value	2000 Net Book Value
Equipment	$ 1,501,724	$796,600	$ 705,124	$ 725,619
Leasehold Improvements	474,997	9,200	465,797	-
Information Technology Software	14,005,769	-	14,005,769	10,210,295
Total	$15,982,490	$805,800	$15,176,690	$10,935,914

NOTE 5 – OTHER PAYABLES AND LIABILITIES

	2001	2000
Accounts Payable in Process	$ 190,090	$ 263,479
Accrued Accounts Payable	1,243,127	1,085,619
Sub-Total Other Payables and Liabilities	$1,433,217	$1,349,098
Accrued Payroll and Benefits	859,872	688,166
Total Other Payables and Liabilities	$2,293,089	$2,037,264

NOTE 6 – LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities Not Covered by Budgetary Resources consists of Accrued Annual Leave earned but not used as of September 30, 2001. The accrued annual leave liability is adjusted as leave is earned and used through out the year. The expense for these accruals will be funded from future assessments as the expenses are incurred.

NOTE 7 - NET POSITION

Net Position consists of the following as of September 30, 2001 and 2000:

	2001	2000
Unobligated – Available	$ 6,713	$ 9,762
Undelivered Orders	2,205,436	3,746,182
Refund – Collection	-	(1,206)
Total Unexpended Appropriations	$ 2,212,149	$ 3,754,738
Invested Capital	$15,176,690	$10,935,914
Future Funding Requirements	(890,745)	(673,519)
Advances/Prepayments	575,339	460,142
Accounts Receivable	15,283	1,206
Total Cumulative Results of Operations	$14,876,567	$10,723,743
Total Net Position	$17,088,716	$14,478,481

NOTE 8 - PRODUCTION COSTS

OFHEO is a single program providing financial safety and soundness oversight of Fannie Mae and Freddie Mac. OFHEO does not have any stewardship responsibilities for federal lands. Production Costs represent assessment collections, from Fannie Mae and Freddie Mac, that have been expensed for salaries and operating expenses to support OFHEO during the fiscal years ended September 30, 2001 and 2000. Production Costs are distributed into two categories: Public and Federal. Public costs result from contracts with the private sector for goods or services. Federal costs are a result of OFHEO contracting with other federal agencies for goods and/or services (e.g. purchase of supplies from the General Services Administration).

	2001	2000
Public Production Costs Paid	$15,228,681	$11,907,319
Accrued Accounts Payable Public	1,243,127	1,085,619
Depreciation Expense	303,695	270,501
Total Public Production Costs	$16,775,503	$13,263,439
Federal Production Costs Paid	$ 2,229,971	$ 2,026,898
Accrued Accounts Payable Federal	157,304	146,555
Total Federal Production Costs	$ 2,387,275	$ 2,173,453
Total Production Costs	$19,162,778	$15,436,892

NOTE 9 - IMPUTED FINANCING

Imputed Financing represents the post retirement benefits funded by OPM for OFHEO employees.

	2001	2000
CSRS Imputed	$244,098	$198,115
FERS Imputed	(5,141)	(14,985)
CSRS Offset Imputed	14,913	5,776
Life Insurance Imputed	1,630	1,189
Health Insurance Imputed	250,687	199,699
Total Imputed Financing – Post Employment	$506,187	$389,794

NOTE 10 - FINANCING SOURCES YET TO BE PROVIDED

Financing Sources Yet to be Provided reflects potential future costs for accrued annual leave and future worker's compensation (FWC), which are not funded by current budgetary resources. The amounts reported are the net change of the accrued annual leave and the FWC liability from the prior year.

	2001	2000
Annual Leave Expense	$217,226	$ 188,971
Future Worker's Compensation	-	(430,010)
Total Financing Sources Yet To Be Provided	$217,226	($241,039)

NOTE 11 - RECOVERIES OF PRIOR YEAR OBLIGATIONS

Recoveries of prior year obligations consist of the reapportionment of prior year funds by OMB. OFHEO requested and received the authority to re-obligate these prior year funds in FY 2001 and also in FY 2000.

NOTE 12 – PENSION EXPENSE

OFHEO recognizes the full cost of providing future pension benefits to eligible employees while they are working. The excess of total pension expense over the amounts contributed by OFHEO and its employees must be financed by OPM. OFHEO recognizes an imputed financing source equal to this excess amount. Pension expense in FY 2001 and 2000 consisted of the following:

	Employer Contributions	Accumulated Costs Imputed to OPM	2001 Total Pension Expense	2000 Total Pension Expense
Civil Services Retirement	$ 268,766	$259,011	$ 527,777	$ 417,551
Federal Employee's Retirement	841,929	(5,141)	836,788	634,174
Thrift Savings Plan	317,749	-	317,749	228,722
Total Pension Expense	$1,428,444	$253,870	$1,682,314	$1,280,447

NOTE 13 – OPERATING LEASE

OFHEO has an occupancy lease with the Office of Thrift Supervision (OTS) that covers office space and building services which include utilities, security guards, janitorial services, mail delivery, use of the loading dock, garage parking and building operation and maintenance. The initial term of the lease was for five years beginning in 1993, with the option to renew for three 5-year terms. OFHEO has exercised the first of the three option terms. Total rent expense for years ending September 30, 2001 and 2000 was approximately $1.8 million and $1.7 million respectively.

OFHEO may terminate the lease agreement in whole or in part. In the event of a termination at OFHEO's discretion, OFHEO would be required to pay two months rent, at an approximate cost of $300,000 (based on September 2001 rate). OFHEO's obligation to make payments ceases on the date that the space is rented. If either party ceases to exist or merge with another entity by operation of law, either party may terminate the rental agreement. In the event of termination under this provision, neither party is liable for further costs, fees, damages or other monies due to the termination, except for payments through the date of termination. During FY 2000 OFHEO rented additional space from OTS, which was not ready for occupancy until FY 2001, also during FY 2001 OFHEO rented additional space from OTS, which will not be ready for occupancy until FY 2002, therefore, OFHEO is reflecting these rental payments as Advances/Prepayments.

Office of Federal Housing Enterprise Oversight
Required Supplementary Information
Intra-governmental Trading Partners
As of September 30, 2001 and 2000

Trading Partner Agency	Intra-governmental Assets 2001	2000
Department of Treasury[1]	$ 4,628,495	$ 5,939,763
National Finance Center[2]	12,412	-
Office of Thrift Supervision [3, 4]	609,386	460,142
	$ 5,250,293	$ 6,399,905

[1] Fund balance with Treasury consists of assessment funds that are available to pay current liabilities and to finance authorized purchase commitments.

[2] During FY 2001, duplicate award payments to OFHEO employees were processed by the National Finance Center (NFC) and charged to OFHEO. Employees receiving the duplicate payments have submitted checks to NFC for repayment. However, OFHEO is awaiting refund from NFC for the duplicate charge.

[3] During FY 2001 OFHEO rented additional space from OTS, this space will not be occupied until FY 2002, therefore, OFHEO reflected this rental payment for additional space as a Prepayment. This amount also includes an erroneous OPAC charge of $34,047, that was rejected on October 1, 2001.

[4] During FY 2000 OFHEO rented additional space from OTS, this space was not ready for occupancy until FY 2001. OFHEO began expensing this prepayment during FY 2001 when OFHEO took possession of the additional space.

Trading Partner Agency	Intra-governmental Liabilities 2001	2000
Comptroller of the Currency	$ 100	$ -
Federal Deposit Insurance Corp	46,000	3,248
Department of Treasury	1,592	9,305
Office of Thrift Supervision	15,902	-
Department of Veteran's Affairs	44,196	27,397
Department of Housing and Urban Development	40,827	95,827
Federal Reserve Board	-	3,500
Department of Commerce	8,507	3,500
Office of Personnel Management	-	3,112
Department of State	180	-
Department of Agriculture	-	666
	$ 157,304	$ 146,555

OFHEO's intra-governmental liabilities consist of accrued liabilities for the value of services received during the fiscal year for which OFHEO had not been billed as of the end of the fiscal year.

CHAPTER FIVE - HISTORICAL DATA TABLES

Table 1. Fannie Mae Mortgage Purchases

Business Activity ($ in Millions)				
	Purchases			
Period	Single-Family ($)	Multifamily ($)	Total [1] ($)	Mortgage Securities[2] ($)
4Q01	177,446	4,366	181,812	59,668
3Q01	150,044	4,846	154,890	47,411
2Q01	151,873	5,484	157,357	49,179
1Q01	88,310	4,435	92,745	48,242
Annual Data				
2001	567,673	19,131	586,804	204,500
2000	227,069	10,377	237,446	126,034
1999	316,136	10,012	326,148	166,431
1998	354,920	11,428	366,348	144,461
1997	159,921	6,534	166,455	48,848
1996	164,456	6,451	170,907	45,016
1995	126,003	4,966	130,969	34,036
1994	158,229	3,839	162,068	24,552
1993	289,826	4,135	293,961	6,275
1992	248,603	2,956	251,559	4,930
1991	133,551	3,204	136,755	2,384
1990	111,007	3,180	114,187	977
1989	80,510	4,325	84,835	Not Applicable Before 1990
1988	64,613	4,170	68,783	
1987	73,942	1,733	75,675	
1986	77,223	1,877	79,100	
1985	42,543	1,200	43,743	
1984	27,713	1,106	28,819	
1983	26,339	140	26,479	
1982	25,929	10	25,939	
1981	6,827	2	6,829	
1980	8,074	27	8,101	
1979	10,798	9	10,807	
1978	12,302	3	12,305	
1977	4,650	134	4,784	
1976	3,337	295	3,632	
1975	3,646	674	4,320	
1974	4,746	2,273	7,019	
1973	4,170	2,082	6,252	
1972	2,596	1,268	3,864	
1971	2,742	1,298	4,040	

Source: Fannie Mae

1 Cash purchases plus securitizations; excludes non-Fannie Mae securities and repurchased Fannie Mae MBS.

2 Not included in total purchases.

Table 2. Fannie Mae MBS Issuances

Business Activity ($ in Millions)				
	MBS Issuances			
Period	Single-Family MBS ($)	Multifamily MBS ($)	Total MBS ($)	Multiclass MBS[1] ($)
4Q01	159,387	2,955	162,342	81,551
3Q01	135,964	3,452	139,416	26,349
2Q01	138,983	4,376	143,359	18,191
1Q01	80,287	3,018	83,305	13,312
Annual Data				
2001	514,621	13,801	528,422	139,403
2000	204,066	7,596	211,662	39,544
1999	292,192	8,497	300,689	55,160
1998	315,120	11,028	326,148	84,147
1997	143,615	5,814	149,429	85,415
1996	144,201	5,668	149,869	30,780
1995	106,269	4,187	110,456	9,681
1994	128,385	2,237	130,622	73,365
1993	220,485	959	221,444	210,630
1992	193,187	850	194,037	170,205
1991	111,488	1,415	112,903	112,808
1990	96,006	689	96,695	68,291
1989	66,489	3,275	69,764	41,715
1988	51,120	3,758	54,878	17,005
1987	62,067	1,162	63,229	9,917
1986	60,017	549	60,566	2,400
1985	23,142	507	23,649	Not Issued Before 1986
1984	13,087	459	13,546	
1983	13,214	126	13,340	
1982	13,970	Not Issued Before 1983	13,970	
1981	717		717	
	Not Issued Before 1981		Not Issued Before 1981	

Source: Fannie Mae

1 The majority qualify as Real Estate Mortgage Investment Conduits (REMICs) and are also known as structured securitizations.

Table 3. Fannie Mae Earnings

Earnings ($ in Millions)						
Period	Operating Net Interest Income[1] ($)	Guarantee Fee Income ($)	Average Guarantee Fee Rate (BasisPoints)	Administrative Expenses ($)	Credit-related Expenses[2] ($)	Operating Net Income[3] ($)
4Q01	2,165	398	18.9	251	16	1,438
3Q01	1,892	384	19.2	273	15	1,377
2Q01	1,800	357	18.9	254	18	1,314
1Q01	1,643	343	19.1	239	29	1,238
Annual Data						
2001	7,500	1,482	19.0	1,017	78	5,367
2000	5,674	1,351	19.5	905	94	4,448
1999	4,894	1,282	19.3	800	127	3,912
1998	4,110	1,229	20.2	708	261	3,418
1997	3,949	1,274	22.7	636	375	3,056
1996	3,592	1,196	22.4	560	409	2,725
1995	3,047	1,086	22.0	546	335	2,144
1994	2,823	1,083	22.5	525	378	2,132
1993	2,533	961	21.3	443	305	1,873
1992	2,058	834	21.2	381	320	1,623
1991	1,778	675	21.0	319	370	1,363
1990	1,593	536	21.1	286	310	1,173
1989	1,191	408	21.3	254	310	807
1988	837	328	21.6	218	365	507
1987	890	263	22.1	197	360	376
1986	384	175	23.8	175	306	105
1985	139	112	25.6	142	206	(7)
1984	(90)	78	26.2	112	86	(71)
1983	(9)	54	26.3	81	48	49
1982	(464)	16	27.2	60	36	(192)
1981	(429)	0	25.0	49	(28)	(206)
1980	21	Not Applicable Before 1981	Not Applicable Before 1981	44	19	14
1979	322			46	35	162
1978	294			39	36	209
1977	251			32	28	165
1976	203			30	25	127
1975	174			27	16	115
1974	142			23	17	107
1973	180			18	12	126
1972	138			13	5	96
1971	49			15	4	61

Source: Fannie Mae

1 Interest income net of interest expense, nominal basis, adjusted to remove FAS 133 effects starting in 2001.
2 Credit-related expenses are mortgage loan loss provision plus real estate owned expenses.
3 Net income adjusted to remove FAS 133 starting in 2001.

Table 3a. Fannie Mae Earnings

Period	Net Income ($)	Purchased Option (Income) Expense ($)	Purchased Option Amortization Expense ($)	Cumulative Gain on Adoption of FAS 133 ($)	Tax Effects of Adjustments ($)	Operating Net Income[1] ($)	Return on Adjusted Common Equity[2] (%)
Earnings ($ in Millions)							
4Q01	1,969	(578)	(239)	0	286	1,438	25.4
3Q01	1,229	413	(186)	0	(79)	1,377	25.5
2Q01	1,403	(36)	(100)	0	47	1,314	25.5
1Q01	1,293	238	(65)	(258)	30	1,238	25.3
Annual Data							
2001	5,894	37	(590)	(258)	284	5,367	25.4
2000	4,448	Not	Not	Not	Not	4,448	25.2
1999	3,912	Applicable	Applicable	Applicable	Applicable	3,912	25.0
1998	3,418	Before	Before	Before	Before	3,418	25.2
1997	3,056	2001	2001	2001	2001	3,056	24.6
1996	2,725					2,725	24.1
1995	2,144					2,144	20.9
1994	2,132					2,132	24.3
1993	1,873					1,873	25.3
1992	1,623					1,623	26.5
1991	1,363					1,363	27.7
1990	1,173					1,173	33.7
1989	807					807	31.1
1988	507					507	25.2
1987	376					376	23.5
1986	105					105	9.5
1985	(7)					(7)	(0.7)
1984	(71)					(71)	(7.4)
1983	49					49	5.1
1982	(192)					(192)	(18.9)
1981	(206)					(206)	(17.2)
1980	14					14	0.9
1979	162					162	11.3
1978	209					209	16.5
1977	165					165	15.3
1976	127					127	13.8
1975	115					115	14.1
1974	107					107	14.7
1973	126					126	20.3
1972	96					96	18.8
1971	61					61	14.4

Source: Fannie Mae

1 Reported net income adjusted for net effect of the reconciliation.

2 Operating net income divided by average adjusted common equity (common stock, retained earnings additional paid-in capital, and common stock in treasury) -- non-GAAP basis.

Table 4. Fannie Mae Balance Sheet

Balance Sheet ($ in Millions)							Mortgage Backed Securities Outstanding ($ in Millions)	
End of Period	Total Assets ($)	Retained Mortgage Portfolio[1] ($)	Non-Mortgage Investments[2] ($)	Debt Outstanding ($)	Shareholders' Equity[3] ($)	Core Capital [4] ($)	Total MBS Outstanding[5] ($)	Multiclass MBS Outstanding[6] ($)
4Q01	799,791	705,372	74,554	763,467	18,118	25,182	858,867	392,457
3Q01	766,650	687,002	57,875	726,992	13,778	23,778	816,724	349,727
2Q01	737,151	663,199	58,259	702,334	19,431	22,978	773,836	333,468
1Q01	700,977	640,934	44,102	666,592	16,086	21,482	725,685	335,918
Annual Data								
2001	799,791	705,372	74,554	763,467	18,118	25,182	858,867	392,457
2000	675,072	607,602	54,982	642,682	20,838	20,827	706,684	334,508
1999	575,167	522,977	39,751	547,619	17,629	17,876	679,169	335,514
1998	485,014	415,434	58,515	460,291	15,453	15,465	637,143	361,613
1997	391,673	316,592	64,596	369,774	13,793	13,793	579,138	388,360
1996	351,041	286,527	56,606	331,270	12,773	12,773	548,173	339,798
1995	316,550	252,868	57,273	299,174	10,959	10,959	513,230	353,528
1994	272,508	220,815	46,335	257,230	9,541	9,541	486,345	378,733
1993	216,979	190,169	21,396	201,112	8,052	8,052	471,306	381,865
1992	180,978	156,260	19,574	166,300	6,774	Not Applicable Before 1993	424,444	312,369
1991	147,072	126,679	9,836	133,937	5,547		355,284	224,806
1990	133,113	114,066	9,868	123,403	3,941		288,075	127,278
1989	124,315	107,981	8,338	116,064	2,991		216,512	64,826
1988	112,258	100,099	5,289	105,459	2,260		170,097	26,660
1987	103,459	93,665	3,468	97,057	1,811		135,734	11,359
1986	99,621	94,123	1,775	93,563	1,182		95,568	Not Issued Before 1987
1985	99,076	94,609	1,466	93,985	1,009		54,552	
1984	87,798	84,135	1,840	83,719	918		35,738	
1983	78,383	75,247	1,689	74,594	1,000		25,121	
1982	72,981	69,356	2,430	69,614	953		14,450	
1981	61,578	59,629	1,047	58,551	1,080		717	
1980	57,879	55,589	1,556	54,880	1,457		Not Issued Before 1981	
1979	51,300	49,777	843	48,424	1,501			
1978	43,506	42,103	834	40,985	1,362			
1977	33,980	33,252	318	31,890	1,173			
1976	32,393	31,775	245	30,565	983			
1975	31,596	30,820	239	29,963	861			
1974	29,671	28,666	466	28,168	772			
1973	24,318	23,589	227	23,003	680			
1972	20,346	19,652	268	19,239	559			
1971	18,591	17,886	349	17,672	460			

Source: Fannie Mae

1 Gross retained portfolio net of unamortized purchase premium, discounts and deferred price adjustments.
2 Prior to 1982 balances primarily composed of U.S. government and agency securities.
3 GAAP basis.
4 The sum of common stock, noncumulative preferred stock, paid-in capital and retained earnings.
5 Total MBS outstanding net of MBS in portfolio.
6 The majority qualify as REMICs and are also known as structured securitizations.

Table 5. Fannie Mae Retained Mortgage Portfolio Detail

($ in Millions)[1]				
End of Period	Whole Loans ($)	Fannie Mae Securities ($)	Other Mortgage-Related Securities ($)	Total Retained Mortgage Portfolio ($)
4Q01	165,957	431,484	110,035	707,476
3Q01	161,858	411,407	116,283	689,548
2Q01	157,362	390,142	118,231	665,735
1Q01	154,241	373,364	115,775	643,380
Annual Data				
2001	165,957	431,484	110,035	707,476
2000	152,505	351,066	106,551	610,122
1999	149,105	281,714	93,122	523,941
1998	155,779	197,375	61,361	414,515
1997	160,102	130,444	26,132	316,678
1996	167,891	102,607	16,554	287,052
1995	171,481	69,729	12,301	253,511
1994	170,909	43,998	7,150	225,057
1993	163,149	24,219	3,493	190,861
1992	134,597	20,535	2,987	158,119
1991	109,251	16,700	3,032	128,983
1990	101,797	11,758	3,073	116,628
1989	95,729	11,720	3,272	110,721
1988	92,220	8,153	2,640	103,013
1987	89,618	4,226	2,902	96,746
1986	94,167	1,606	2,060	97,833
1985	97,421	435	793	98,649
1984	87,205	477	427	88,109
1983	77,983		273	78,256
1982	71,777		37	71,814
1981	61,411		1	61,412
1980	57,326		1	57,327
1979	51,096		1	51,097
1978	43,315			43,315
1977	34,377			34,377
1976	32,937			32,937
1975	31,916			31,916
1974	29,708			29,708
1973	24,459			24,459
1972	20,326			20,326
1971	18,515			18,515

Source: Fannie Mae

1 Gross retained portfolio (total unpaid principal balance).

Table 6. Fannie Mae Derivatives

Financial Derivatives - Notional Amount Outstanding ($ in Millions)							
End of Period	Interest Rate Swaps ($)	Interest Rate Caps, Floors, and Corridors ($)	Foreign Currency ($)	OTC Futures, Options and Forward Rate Agreements ($)	Exchange-Traded Futures, Options, and Other Derivatives ($)	Other ($)	Total ($)
4Q01	299,953	75,893	8,493	148,800	0	0	533,139
3Q01	295,990	66,193	8,470	116,165	0	0	486,818
2Q01	285,103	59,443	8,477	101,765	262	600	455,650
1Q01	246,822	53,413	8,526	60,215	2,000	3,335	374,311
Annual Data							
2001	299,953	75,893	8,493	148,800	0	0	533,139
2000	227,651	33,663	9,511	48,865	0	0	319,690
1999	192,032	28,950	11,507	41,081	0	1,400	274,970
1998	142,846	14,500	12,995	13,481	0	3,735	187,557
1997	149,673	100	9,968	0	0	1,660	161,401
1996	158,140	300	2,429	0	0	350	161,219
1995	125,679	300	1,224	29	0	975	128,207
1994	87,470	360	1,023	0	0	1,465	90,317
1993	49,458	360	1,023	0	0	1,425	52,265
1992	24,130	0	1,177	0	0	1,350	26,658
1991	9,100	0	Not Available Before 1992	50	0	1,050	10,200
1990	4,800	0		25	0	1,700	6,525

Source: Fannie Mae

Table 7. Fannie Mae Non-Mortgage Investments

Non-Mortgage Investments ($ in Millions)						
End of Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total[1] ($)
4Q01	16,089	20,941	9,380	23,837	4,343	74,590
3Q01	6,359	20,484	5,436	15,550	10,043	57,872
2Q01	5,271	19,387	7,435	15,458	10,705	58,256
1Q01	1,172	17,703	7,677	8	17,540	44,100
Annual Data						
2001	16,089	20,941	9,380	23,837	4,343	74,590
2000	7,539	17,512	2,722	8,893	18,316	54,982
1999	4,837	19,207	2,574	1,723	11,410	39,751
1998	7,926	20,993	7,556	5,155	16,885	58,515
1997	19,212	16,639	6,715	11,745	10,285	64,596
1996	21,734	14,635	4,667	6,191	9,379	56,606
1995	19,775	9,905	10,175	8,629	8,789	57,273
1994	17,593	3,796	9,006	7,719	8,221	46,335
1993	4,496	3,557	4,684	0	8,659	21,396
1992	6,587	4,124	3,189	0	5,674	19,574
1991	2,954	2,416	2,195	0	2,271	9,836
1990	5,329	1,780	951	0	1,808	9,868
1989	5,158	1,107	0	0	2,073	8,338
1988	4,125	481	0	0	683	5,289
1987	2,559	25	0	0	884	3,468
1986	1,530	0	0	0	245	1,775
1985	1,391	0	0	0	75	1,466
1984	1,575	0	0	0	265	1,840
1983	1,462	0	0	0	227	1,689
1982	1,799	0	0	0	631	2,430
1981	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	1,047
1980						1,556
1979						843
1978						834
1977						318
1976						245
1975						239
1974						466
1973						227
1972						268
1971						349

Source: Fannie Mae

1 Prior to 1982, the majority of non-mortgage investments was comprised of U.S. government securities and agency securities.

Table 8. Fannie Mae Asset - Liability Mix

Asset - Liability Ratios				
	Asset Mix		Liability Mix	
End of Period	Retained Portfolio / Total Assets (%)	Non-Mortgage Investments / Total Assets (%)	Callable Debt / Total Effective Long-Term Debt[1] (%)	Total Effective Long-Term Debt / Total Debt[2] (%)
4Q01	88.2	9.3	37.1	82.2
3Q01	89.6	7.5	36.1	80.3
2Q01	89.9	7.9	36.1	80.2
1Q01	91.4	6.3	35.3	77.4
Annual Data				
2001	88.2	9.3	37.1	82.2
2000	90.0	8.1	42.9	84.6
1999	90.9	6.9	43.4	87.1
1998	85.7	12.1	42.9	76.4
1997	80.8	16.5	46.4	79.4
1996	81.6	16.1	47.5	80.5
1995	79.9	18.1	48.0	73.9
1994	81.0	17.0	54.6	72.6
1993	87.6	9.9	58.1	80.0
1992	86.3	10.8	48.8	77.9
1991	86.1	6.7	36.0	85.5
1990	85.7	7.4	21.9	82.6
1989	86.9	6.7	10.1	80.1
1988	89.2	4.7	3.6	78.7
1987	90.5	3.4	Not Available Before 1988	Not Available Before 1988
1986	94.5	1.8		
1985	95.5	1.5		
1984	95.8	2.1		
1983	96.0	2.2		
1982	95.0	3.3		
1981	96.8	1.7		
1980	96.0	2.7		
1979	97.0	1.6		
1978	96.8	1.9		
1977	97.9	0.9		
1976	98.1	0.8		
1975	97.5	0.8		
1974	96.6	1.6		
1973	97.0	1.0		
1972	96.6	1.3		
1971	96.2	1.8		

Source: Fannie Mae

1 Callable debt includes derivative financial instruments that provide interest-rate protection similar to callable debt.

2 Total effective long-term debt represents debt with an effective repricing date greater than one year.

Table 9. Fannie Mae Mortgage Asset Quality

Mortgage Asset Quality					
End of Period	Single-Family Delinquency Rate[1] (%)	Multifamily Delinquency Rate[2] (%)	Credit Losses /Total MBS Outstanding plus Retained Portfolio[3] (%)	REO / Total MBS Outstanding plus Retained Portfolio[4] (%)	Credit-Enhanced Outstanding / Total MBS Outstanding plus Retained Portfolio[5] (%)
4Q01	0.49	0.32	0.01	0.04	15.5
3Q01	0.45	0.10	0.01	0.04	17.0
2Q01	0.43	0.07	0.01	0.04	17.8
1Q01	0.44	0.05	0.01	0.05	19.3
Annual Data					
2001	0.49	0.32	0.01	0.04	15.5
2000	0.45	0.05	0.01	0.05	20.3
1999	0.48	0.12	0.01	0.06	20.9
1998	0.58	0.29	0.03	0.08	17.5
1997	0.62	0.37	0.04	0.10	12.8
1996	0.58	0.68	0.05	0.11	10.5
1995	0.56	0.81	0.05	0.08	10.6
1994	0.47	1.21	0.06	0.10	10.2
1993	0.48	2.34	0.04	0.10	10.6
1992	0.53	2.65	0.04	0.09	15.6
1991	0.64	3.62	0.04	0.07	22.0
1990	0.58	1.70	0.06	0.09	25.9
1989	0.69	3.20	0.07	0.14	Not Available Before 1990
1988	0.88	6.60	0.11	0.15	
1987	1.12	Not Available Before 1988	0.11	0.18	
1986	1.38		0.12	0.22	
1985	1.48		0.13	0.32	
1984	1.65		0.09	0.33	
1983	1.49		0.05	0.35	
1982	1.41		0.01	0.20	
1981	0.96		0.01	0.13	
1980	0.90		0.01	0.09	
1979	0.56		0.02	0.11	
1978	0.55		0.02	0.18	
1977	0.46		0.02	0.26	
1976	1.58		0.03	0.27	
1975	0.56		0.03	0.51	
1974	0.51		0.02	0.52	
1973	Not Available Before 1974		0.00	0.61	
1972			0.02	0.98	
1971			0.01	0.59	

Source: Fannie Mae

1 Includes conventional loans for which Fannie Mae has primary risk of loss that are 90 or more days delinquent or are in the process of foreclosure. Data prior to 1992 includes loans in relief or bankruptcy, even if they are less than 90 days delinquent.

2 Includes loans that are two or more months delinquent based on the dollar amount of such loans in the portfolio and underlying MBS.

3 Credit losses are charge-offs plus real estate owned expense; average balances used to calculate ratios subsequent to 1994; quarterly data are annualized.

4 Real Estate Owned balances reflect end-of-period amounts. Beginning with 1995, data reflect adoption of SFAS 114.

5 The proportion of loans that has additional recourse from a third party to accept some or all of the expected losses on defaulted mortgages.

Table 10. Fannie Mae Capital

Capital ($ in Millions)							
End of Period	**Core Capital ($)**	**Regulatory Minimum Capital Requirement[1] ($)**	**Regulatory Capital Surplus (Deficit)[2] ($)**	**Market Capitalization[3] ($)**	**Core Capital / Total Assets (%)**	**Core Capital / Outstanding MBS plus Total Assets (%)**	**Common Share Dividend Payout Rate[4] (%)**
4Q01	25,182	24,182	1,000	79,281	3.15	1.52	21.4
3Q01	23,778	23,130	648	80,055	3.10	1.50	22.4
2Q01	22,978	22,177	801	85,239	3.12	1.52	23.5
1Q01	21,482	21,033	448	79,628	3.06	1.51	24.9
Annual Data							
2001	25,182	24,182	1,000	79,281	3.15	1.52	23.0
2000	20,827	20,294	533	86,643	3.09	1.51	26.0
1999	17,876	17,770	106	63,651	3.11	1.43	28.8
1998	15,465	15,334	131	75,881	3.19	1.38	29.5
1997	13,793	12,703	1,090	59,167	3.52	1.42	29.4
1996	12,773	11,466	1,307	39,932	3.64	1.42	30.4
1995	10,959	10,451	508	33,812	3.46	1.32	34.6
1994	9,541	9,416	126	19,882	3.50	1.26	30.8
1993	8,052	7,864	176	21,387	3.70	1.17	26.8
1992	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	20,874	Not Applicable Before 1993	Not Applicable Before 1993	23.2
1991				18,836			21.3
1990				8,490			14.7
1989				8,092			12.8
1988				3,992			11.2
1987				2,401			11.7
1986				3,006			8.0
1985				1,904			30.1
1984				1,012			Not Applicable
1983				1,514			13.9
1982				1,603			Not Applicable
1981				502			Not Applicable
1980				702			464.2
1979				Not Available Before 1980			45.7
1978							30.3
1977							31.8
1976							33.6
1975							31.8
1974							29.6
1973							18.1
1972							15.2
1971							18.7

Source: Fannie Mae and OFHEO

1 Minimum capital requirement in accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.
2 The difference between Core Capital and Minimum Regulatory Capital Requirement.
3 Stock price multiplied by number of outstanding common shares.
4 Common dividends paid as a percentage of net income available to common shareholders.

Table 11. Freddie Mac Mortgage Purchases

Business Activity ($ Millions)				
	Purchases			
Period	Single-Family ($)	Multifamily ($)	Total Mortgages[1] ($)	Mortgage Securities[2] ($)
4Q01	123,151	4,068	127,219	63,791
3Q01	109,665	2,048	111,713	56,853
2Q01	104,935	1,955	106,890	54,985
1Q01	55,404	1,438	56,842	55,285
Annual Data				
2001	393,155	9,509	402,664	230,914
2000	168,013	6,030	174,043	91,896
1999	232,612	7,181	239,793	101,898
1998	263,490	3,910	267,400	128,446
1997	115,160	2,241	117,401	35,385
1996	122,850	2,229	125,079	36,824
1995	89,971	1,565	91,536	39,292
1994	122,563	847	123,410	19,817
1993	229,051	191	229,242	Not Available Before 1994
1992	191,099	27	191,126	
1991	99,729	236	99,965	
1990	74,180	1,338	75,518	
1989	76,765	1,824	78,589	
1988	42,884	1,191	44,075	
1987	74,824	2,016	76,840	
1986	99,936	3,538	103,474	
1985	42,110	1,902	44,012	
1984	Not Available Before 1985	Not Available Before 1985	21,885	
1983			22,952	
1982			23,671	
1981			3,744	
1980			3,690	
1979			5,716	
1978			6,524	
1977			4,124	
1976			1,129	
1975			1,716	
1974			2,185	
1973			1,334	
1972			1,265	
1971			778	

Source: Freddie Mac

1 Loans purchased from lenders; excluding non-Freddie Mac mortgage securities and repurchased Freddie Mac MBS.

2 Not included in total purchases.

Table 12. Freddie Mac MBS Issuances

Business Activity ($ in Millions)				
MBS Issuances				
Period	Single-Family MBS ($)	Multifamily MBS ($)	Total MBS ($)	Multiclass MBS[1] ($)
4Q01	119,306	1,830	121,136	70,074
3Q01	110,920	253	111,173	50,521
2Q01	102,964	58	103,022	48,250
1Q01	54,065	215	54,280	23,592
Annual Data				
2001	387,255	2,356	389,611	192,437
2000	165,115	1,786	166,901	48,202
1999	230,986	2,045	233,031	119,565
1998	249,627	937	250,564	135,162
1997	113,758	500	114,258	84,366
1996	118,932	770	119,702	34,145
1995	85,522	355	85,877	15,372
1994	116,901	209	117,110	73,131
1993	208,724	0	208,724	143,336
1992	179,202	5	179,207	131,284
1991	92,479	0	92,479	72,032
1990	71,998	1,817	73,815	40,479
1989	72,931	587	73,518	39,754
1988	39,490	287	39,777	12,985
1987	72,866	2,152	75,018	0
1986	96,798	3,400	100,198	2,233
1985	37,583	1,245	38,828	2,625
1984	Not Available Before 1985	Not Available Before 1985	18,684	1,805
1983			19,691	1,685
1982			24,169	Not Issued Before 1983
1981			3,526	
1980			2,526	
1979			4,546	
1978			6,412	
1977			4,657	
1976			1,360	
1975			950	
1974			46	
1973			323	
1972			494	
1971			65	

Source: Freddie Mac

1 The majority qualify as Real Estate Mortgage Investment Conduits (REMICs), and are also known as structured securitizations. In years 1983 - 1986, data consist of collateralized mortgage obligations (CMOs) and mortgage cash flow obligations (MCFs).

Table 13. Freddie Mac Earnings

Earnings ($ in Millions)						
Period	Operating Net Interest Income[1, 2, 3] ($)	Guarantee Fee Income [2,3] ($)	Average Guarantee Fee [2,3] (basis points)	Administrative Expenses ($)	Credit-related Expenses[4] ($)	Operating Net Income [5] ($)
4Q01	1,194	297	18.6	259	24	853
3Q01	1,015	287	18.5	201	18	813
2Q01	904	274	18.8	194	18	769
1Q01	819	272	19.0	190	24	719
Annual Data						
2001	3,932	1,130	18.7	844	84	3,154
2000	3,270	1,057	19.3	713	106	2,547
1999	2,926	1,019	19.8	655	159	2,223
1998	2,215	1,019	21.4	578	342	1,700
1997	1,847	1,082	22.9	495	529	1,395
1996	1,705	1,086	23.4	440	608	1,243
1995	1,396	1,087	23.8	395	541	1,091
1994	1,112	1,108	24.4	379	425	983
1993	772	1,009	23.8	361	524	786
1992	695	936	24.7	329	457	622
1991	683	792	23.7	287	419	555
1990	619	654	22.4	243	474	414
1989	517	572	23.4	217	278	437
1988	492	465	21.5	194	219	381
1987	319	472	24.2	150	175	301
1986	299	301	22.4	110	120	247
1985	312	188	22.1	81	79	208
1984	213	158	24.7	71	54	144
1983	125	132	26.2	53	46	86
1982	30	77	24.5	37	26	60
1981	34	36	19.5	30	16	31
1980	54	23	14.3	26	23	34
1979	55	18	13.2	19	20	36
1978	37	14	14.9	14	13	25
1977	31	9	18.9	12	8	21
1976	18	3	13.6	10	(1)	14
1975	31	3	24.8	10	11	16
1974	42	2	25.5	8	33	5
1973	31	2	32.4	7	15	12
1972	10	1	39.4	5	4	4
1971	10	1	Not Available Before 1972	Not Available Before 1972	Not Available Before 1972	6

Source: Freddie Mac

1 Interest income net of interest expense, nominal basis, adjusted to remove FAS 133 effects starting in 2001.

2 Effective 1/1/96, Freddie Mac reports guarantee fees on retained MBS as guarantee fee income. However, in these data, fees on retained MBS have been estimated and reclassified as interest income for comparability with Fannie Mae.

3 In 1993, Freddie Mac adopted a change in reporting of uncollectible interest on single-family mortgages. Pre-1993 amounts do not reflect this change.

4 Credit-related expenses are mortgage loan loss provision plus real estate owned expense. From 1988 to 1990, data include real estate owned disposition loss provisions instead of expense, and before 1988, only mortgage loan loss provision.

5 Net income adjusted to remove FAS 133 effects starting in 2001.

Table 13a. Freddie Mac Earnings

	Earnings ($ in Millions)							
Period	Net Income ($)	Remove Certain FAS 133 Hedged Item Amortization ($)	Include Straight-line Option Premium Amortization ($)	Remove FAS 133 "Fair Value Gains (Losses)" ($)	Tax Effects of Preceeding Adjustments ($)	Cumulative Gain on Adoption of FAS 133 ($)	Operating Net Income[1] ($)	Return on Adjusted Common Equity[2] (%)
4Q01	1,364	(316)	(366)	(105)	276	-	853	22.5
3Q01	1,032	(118)	(305)	85	119	-	813	23.2
2Q01	914	(68)	(218)	64	77	-	769	23.5
1Q01	837	(17)	(140)	(17)	61	(5)	719	23.4
Annual Data								
2001	4,147	(519)	(1,029)	27	533	(5)	3,154	23.1
2000	2,547	Not	Not	Not	Not	Not	2,547	23.7
1999	2,223	Applicable	Applicable	Applicable	Applicable	Applicable	2,223	25.5
1998	1,700	Before	Before	Before	Before	Before	1,700	22.6
1997	1,395	2001	2001	2001	2001	2001	1,395	23.1
1996	1,243						1,243	22.6
1995	1,091						1,091	22.1
1994	983						983	23.3
1993	786						786	22.3
1992	622						622	21.2
1991	555						555	23.6
1990	414						414	20.4
1989	437						437	25.0
1988	381						381	27.5
1987	301						301	28.2
1986	247						247	28.5
1985	208						208	30.0
1984	144						144	52.0
1983	86						86	44.5
1982	60						60	21.9
1981	31						31	13.1
1980	34						34	14.7
1979	36						36	16.2
1978	25						25	13.4
1977	21						21	12.4
1976	14						14	9.5
1975	16						16	11.6
1974	5						5	4.0
1973	12						12	9.9
1972	4						4	3.5
1971	6						6	5.5

Source: Freddie Mac

1 Reported net income adjusted for net effect of the reconciliation.

2 Annual computation reflects the simple average of quarterly returns. Calculated as annualized operating earnings available for common shareholders divided by average realized common stockholders' equity (common stockholders' equity excluding "Accumulated other comprehensive income, net of taxes").

Table 14. Freddie Mac Balance Sheet

Balance Sheet ($ in Millions)							Mortgage-Backed Securities Outstanding ($ in Millions)	
End of Period	Total Assets ($)	Retained Mortgage Portfolio[1] ($)	Non-Mortgage Investments[2] ($)	Debt Outstanding ($)	Shareholders' Equity[3] ($)	Core Capital[4] ($)	Total MBS Outstanding[5] ($)	Multiclass MBS Outstanding[6] ($)
4Q01	617,340	494,585	77,444	565,071	15,373	19,336	646,448	373,552
3Q01	571,907	475,214	61,344	534,434	14,506	17,743	635,844	350,932
2Q01	537,590	442,878	58,953	496,712	13,980	16,870	604,057	329,866
1Q01	497,839	422,085	45,745	461,338	12,821	15,770	572,328	312,246
Annual Data								
2001	617,340	494,585	77,444	565,071	15,373	19,336	646,448	373,552
2000	459,297	385,451	43,521	426,899	14,837	14,380	576,101	309,185
1999	386,684	322,914	34,152	360,711	11,525	12,692	537,883	316,168
1998	321,421	255,670	42,160	287,396	10,835	10,715	478,351	260,504
1997	194,597	164,543	16,430	172,842	7,521	7,376	475,985	233,829
1996	173,866	137,826	22,248	156,981	6,731	6,743	473,065	237,939
1995	137,181	107,706	12,711	119,961	5,863	5,829	459,045	246,366
1994	106,199	73,171	17,808	93,279	5,162	5,169	460,656	264,152
1993	83,880	55,938	18,225	49,993	4,437	4,437	439,029	265,178
1992	59,502	33,629	12,542	29,631	3,570	Not Applicable Before 1993	407,514	218,747
1991	46,860	26,667	9,956	30,262	2,566		359,163	146,978
1990	40,579	21,520	12,124	30,941	2,136		316,359	88,124
1989	35,462	21,448	11,050	26,147	1,916		272,870	52,865
1988	34,352	16,918	14,607	26,882	1,584		226,406	15,621
1987	25,674	12,354	10,467	19,547	1,182		212,635	3,652
1986	23,229	13,093	Not Available Before 1987	15,375	953		169,186	5,333
1985	16,587	13,547		12,747	779		99,909	5,047
1984	13,778	10,018		10,999	606		70,026	3,214
1983	8,995	7,485		7,273	421		57,720	1,669
1982	5,999	4,679		4,991	296		42,952	Not Issued Before 1983
1981	6,326	5,178		5,680	250		19,897	
1980	5,478	5,006		4,886	221		16,962	
1979	4,648	4,003		4,131	238		15,316	
1978	3,697	3,038		3,216	202		12,017	
1977	3,501	3,204		3,110	177		6,765	
1976	4,832	4,175		4,523	156		2,765	
1975	5,899	4,878		5,609	142		1,643	
1974	4,901	4,469		4,684	126		780	
1973	2,873	2,521		2,696	121		791	
1972	1,772	1,726		1,639	110		444	
1971	1,038	935		915	107		64	

Source: Freddie Mac

1 Gross retained portfolio net of unamortized purchase premium, discounts and deferred fees.

2 Excludes mortgage-related securities held for trading purposes.

3 GAAP basis.

4 The sum of common stock, noncumulative preferred stock, paid-in capital and retained earnings.

5 Total MBS outstanding net of repurchased MBS in retained portfolio.

6 The majority qualify as REMICs and are also known as structured securitizations. In years 1983 - 1999, data also include original issue CMOs and MCFs, and structured securitizations and PCs with mandatory purchase obligations.

Table 15. Freddie Mac Retained Mortgage Portfolio Detail

($ in Millions)				
End of Period	Whole Loans ($)	Freddie Mac Securities ($)	Other Mortgage-Related Securities ($)	Total Retained Mortgage Portfolio ($)
4Q01	62,792	301,961	129,832	494,585
3Q01	59,639	291,646	123,929	475,214
2Q01	61,542	269,693	111,643	442,878
1Q01	60,111	261,288	100,686	422,085
Annual Data				
2001	62,792	301,961	129,832	494,585
2000	59,240	246,209	80,002	385,451
1999	56,676	211,198	55,040	322,914
1998	57,084	168,108	30,478	255,670
1997	48,454	103,400	12,689	164,543
1996	46,504	81,195	11,127	137,826
1995	43,753	56,006	7,947	107,706
1994	Not Available Before 1995	30,670	Not Available Before 1995	73,171
1993		15,877		55,938
1992		6,394		33,629
1991		Not Available Before 1992		26,667
1990				21,520
1989				21,448
1988				16,918
1987				12,354
1986				13,093
1985				13,547
1984				10,018
1983				7,485
1982				4,679
1981				5,178
1980				5,006
1979				4,003
1978				3,038
1977				3,204
1976				4,175
1975				4,878
1974				4,469
1973				2,521
1972				1,726
1971				935

Source: Freddie Mac

Table 16. Freddie Mac Financial Derivatives

Financial Derivatives - Notional Amount Outstanding ($ in Millions)								
End of Period	Interest Rate Swaps ($)	Interest Rate Caps, Floors, and Corridors ($)	Treasury-Based Contracts ($)	Foreign Currency ($)	OTC Futures, Options, Forward Rate Agreements ($)	Exchange-Traded Futures, Options, and Other Derivatives ($)	Other ($)	Total ($)
4Q01	442,769	12,178	13,468	23,995	187,487	369,695	2,802	1,052,394
3Q01	507,976	12,454	8,087	19,606	172,862	369,295	535	1,090,815
2Q01	373,516	12,517	5,986	19,293	151,675	124,471	5,239	692,697
1Q01	355,147	12,610	4,040	14,859	122,332	65,590	1,608	576,186
Annual Data								
2001	442,769	12,178	13,468	23,995	187,487	369,695	2,802	1,052,394
2000	277,888	12,819	2,200	10,208	113,064	22,517	35,839	474,535
1999	126,580	19,936	8,894	1,097	172,750	94,987	0	424,244
1998	57,555	21,845	11,542	1,464	63,000	157,832	0	313,238
1997	54,172	21,995	12,228	1,152	6,000	0	0	95,547
1996	46,646	14,095	651	544	0	0	0	61,936
1995	45,384	13,055	24	0	0	0	0	58,463
1994	21,834	9,003	0	0	0	0	0	30,837
1993	17,888	1,500	0	0	0	0	0	19,388

Source: Freddie Mac

Table 17. Freddie Mac Non-Mortgage Investments

Non-Mortgage Investments[1] ($ in Millions)						
End of Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total ($)
4Q01	15,846	26,253	5,531	21,424	8,390	77,444
3Q01	12,930	25,966	4,918	13,840	3,690	61,344
2Q01	6,421	24,107	6,173	14,365	7,887	58,953
1Q01	6,150	21,373	6,204	9,545	2,473	45,745
Annual Data						
2001	15,846	26,253	5,531	21,424	8,390	77,444
2000	2,267	19,063	7,488	7,302	7,401	43,521
1999	10,545	10,305	4,961	3,916	4,425	34,152
1998	20,524	7,124	1,756	7,795	4,961	42,160
1997	2,750	2,200	6,982	3,203	1,295	16,430
1996	9,968	2,086	6,440	1,058	2,696	22,248
1995	110	499	9,217	1,201	1,684	12,711
1994	7,260	0	5,913	1,234	3,401	17,808
1993	9,267	0	4,198	1,438	3,322	18,225
1992	5,632	0	4,060	53	2,797	12,542
1991	2,949	0	4,437	0	2,570	9,956
1990	1,112	0	9,063	0	1,949	12,124
1989	3,527	0	5,765	0	1,758	11,050
1988	4,469	0	9,107	0	1,031	14,607
1987	3,177	0	5,859	0	1,431	10,467

Source: Freddie Mac

1 Excludes mortgage-related securities held for trading purposes.

Table 18. Freddie Mac Asset Mix

Asset Ratios		
End of Period	Total Retained Mortgage Portfolio / Total Assets (%)	Non-Mortgage Investments / Total Assets (%)
4Q01	80.1	12.5
3Q01	83.1	10.7
2Q01	82.4	11.0
1Q01	84.8	9.2
Annual Data		
2001	80.1	12.5
2000	83.9	9.5
1999	83.5	8.8
1998	79.5	13.1
1997	84.6	8.4
1996	79.3	12.8
1995	78.5	9.3
1994	68.9	16.8
1993	66.7	21.7
1992	56.5	21.1
1991	56.9	21.2
1990	53.0	29.9
1989	60.5	31.2
1988	49.2	42.5
1987	48.1	40.8
1986	56.4	Not Available Before 1987
1985	81.7	
1984	72.7	
1983	83.2	
1982	78.0	
1981	81.9	
1980	91.4	
1979	86.1	
1978	82.2	
1977	91.4	
1976	86.1	
1975	82.2	
1974	91.5	
1973	87.7	
1972	97.4	
1971	90.1	

Source: Freddie Mac

Table 19. Freddie Mac Mortgage Asset Quality

Mortgage Asset Quality					
End of Period	Single-Family Delinquency Rate[1] (%)	Multifamily Delinquency Rate[2,3] (%)	Credit Losses / Total MBS Outstanding plus Retained Portfolio[4] (%)	REO / Total MBS Outstanding plus Retained Portfolio[5] (%)	Credit-Enhanced Outstanding / Total MBS Outstanding plus Retained Portfolio[6] (%)
4Q01	0.41	0.15	0.01	0.04	29.3
3Q01	0.38	0.03	0.01	0.03	30.4
2Q01	0.36	0.02	0.01	0.03	32.3
1Q01	0.36	0.05	0.01	0.04	32.6
Annual Data					
2001	0.41	0.15	0.01	0.04	29.3
2000	0.37	0.04	0.01	0.04	31.8
1999	0.39	0.14	0.02	0.05	29.9
1998	0.50	0.37	0.04	0.08	27.3
1997	0.55	0.96	0.08	0.11	15.9
1996	0.58	1.96	0.10	0.13	10.0
1995	0.60	2.88	0.11	0.14	9.7
1994	0.55	3.79	0.08	0.18	7.2
1993	0.61	5.92	0.11	0.16	5.3
1992	0.64	6.81	0.09	0.12	Not Available Before 1993
1991	0.61	5.42	0.08	0.14	
1990	0.45	2.63	0.08	0.12	
1989	0.38	2.53	0.08	0.09	
1988	0.36	2.24	0.07	0.09	
1987	0.36	1.49	0.07	0.08	
1986	0.42	1.07	Not Available Before 1987	0.07	
1985	0.42	0.63		0.10	
1984	0.46	0.42		0.15	
1983	0.47	0.58		0.15	
1982	0.54	1.04		0.12	
1981	0.61	Not Available Before 1982		0.07	
1980	0.44			0.04	
1979	0.31			0.02	
1978	0.21			0.02	
1977	Not Available Before 1978			0.03	
1976				0.04	
1975				0.03	
1974				0.02	

Source: Freddie Mac

1 Based on number of mortgages 90 days or more delinquent. 1994 - 2001 data include only loans for which Freddie Mac has assumed primary default risk (“at-risk”); includes foreclosures and in process. Excludes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies or subject to subordination agreements. Pre-1994 calculations include both at-risk and non-at-risk loans.

2 1982 - 1987 data based on the number of loans delinquent 60 days or more; calculations subsequent to 1987 based on unpaid principal balance of loans 60 days or more.

3 Pre-1991 amounts do not reflect change in reporting of multifamily in-substance foreclosures pursuant to adoption of SFAS 114.

4 Credit losses equal to charge-offs plus REO operations expense. Average balances used to calculate ratios subsequent to 1994; quarterly data are annualized.

5 Beginning with 1992, data reflect adoption of SFAS 114.

6 Includes loans for which the lender or third-party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default. Also includes securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender’s or third party’s risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

Table 20. Freddie Mac Capital

Capital ($ in Millions)							
End of Period	Core Capital ($)	Regulatory Minimum Capital Requirement[1] ($)	Regulatory Capital Surplus (Deficit)[2] ($)	Market Capitalization[3] ($)	Core Capital / Total Assets (%)	Core Capital / Total MBS Outstanding plus Total Assets (%)	Common Share Dividend Payout Rate[4] (%)
4Q01	19,336	18,515	821	45,462	3.13	1.53	17.5
3Q01	17,743	17,335	408	45,179	3.10	1.47	18.4
2Q01	16,870	16,303	567	47,221	3.10	1.48	19.4
1Q01	15,770	15,164	606	44,963	3.17	1.47	20.6
Annual Data							
2001	19,336	18,515	821	45,462	3.13	1.53	19.0
2000	14,380	14,178	202	47,702	3.13	1.39	20.0
1999	12,692	12,287	405	32,713	3.28	1.37	20.1
1998	10,715	10,333	382	44,797	3.33	1.34	20.7
1997	7,376	7,082	294	28,461	3.79	1.10	21.0
1996	6,743	6,517	226	19,161	3.88	1.04	21.3
1995	5,829	5,584	245	14,932	4.25	0.98	21.1
1994	5,169	4,884	285	9,132	4.87	0.91	20.5
1993	4,437	3,782	655	9,005	5.29	0.85	21.6
1992	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	8,721	Not Applicable Before 1993	Not Applicable Before 1993	23.1
1991				8,247			21.6
1990				2,925			23.2
1989				4,024			24.3
				Not Applicable Before 1989			Not Available Before 1989

Source: Freddie Mac and OFHEO

1 Minimum capital requirement in accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.

2 The difference between Core Capital and Minimum Regulatory Capital Requirement.

3 Stock price multiplied by number of outstanding common shares.

4 Common dividends paid as a percentage of operating net income available to common shareholders.
Annual computations reflect the simple average of quarterly ratios. Quarterly ratios are computed as dividends paid by operating net income available to common stockholders.

Table 21. Aggregate Purchases

Business Activity ($ in Millions)				
Purchases				
Period	Single-Family ($)	Multifamily ($)	Total ($)	Mortgage Securities[1] ($)
4Q01	300,597	8,434	309,031	123,459
3Q01	259,709	6,894	266,603	104,264
2Q01	256,808	7,439	264,247	104,164
1Q01	143,714	5,873	149,587	103,527
Annual Data				
2001	960,828	28,640	989,468	435,414
2000	395,082	16,407	411,489	217,930
1999	548,748	17,193	565,941	268,329
1998	618,410	15,338	633,748	272,907
1997	275,081	8,775	283,856	84,233
1996	287,306	8,680	295,986	81,840
1995	215,974	6,531	222,505	73,328
1994	280,792	4,686	285,478	44,369
1993	518,877	4,326	523,203	Not Available Before 1994
1992	439,702	2,983	442,685	
1991	233,280	3,440	236,720	
1990	185,187	4,518	189,705	
1989	157,275	6,149	163,424	
1988	107,497	5,361	112,858	
1987	148,766	3,749	152,515	
1986	177,159	5,415	182,574	
1985	84,653	3,102	87,755	
1984	Not Available Before 1985	Not Available Before 1985	50,704	
1983			49,431	
1982			49,610	
1981			10,573	
1980			11,791	
1979			16,523	
1978			18,829	
1977			8,908	
1976			4,761	
1975			6,036	
1974			9,204	
1973			7,586	
1972			5,129	
1971			4,818	

Sources: Fannie Mae and Freddie Mac

[1] Not included in total purchases.

Table 22. Aggregate MBS Issuances

Business Activity ($ in Millions)				
MBS Issuances				
Period	Single-Family MBS ($)	Multifamily MBS ($)	Total MBS ($)	Multiclass MBS ($)
4Q01	278,693	4,785	283,478	151,625
3Q01	246,884	3,705	250,589	76,870
2Q01	241,947	4,434	246,381	66,441
1Q01	134,352	3,233	137,585	36,904
Annual Data				
2001	901,876	16,157	918,033	331,840
2000	369,181	9,382	378,563	87,746
1999	523,178	10,542	533,720	174,725
1998	564,747	11,965	576,712	219,309
1997	257,373	6,314	263,687	169,781
1996	263,133	6,438	269,571	64,925
1995	191,791	4,542	196,333	25,053
1994	245,286	2,446	247,732	146,496
1993	429,209	959	430,168	353,966
1992	372,389	855	373,244	301,489
1991	203,967	1,415	205,382	184,840
1990	168,004	2,506	170,510	108,770
1989	139,420	3,862	143,282	81,469
1988	90,610	4,045	94,655	29,990
1987	134,933	3,314	138,247	9,917
1986	156,815	3,949	160,764	4,633
1985	60,725	1,752	62,477	2,625
1984	Not Available Before 1985	Not Available Before 1985	32,230	1,805
1983			33,031	1,685
1982			38,139	Not Issued Before 1983
1981			4,243	
1980			2,526	
1979			4,546	
1978			6,412	
1977			4,657	
1976			1,360	
1975			950	
1974			46	
1973			323	
1972			494	
1971			65	

Sources: Fannie Mae and Freddie Mac

Table 23. Aggregate Earnings[1]

Period	Earnings ($ in Millions) Operating Net Interest Income ($)	Guarantee Fee Income ($)	Administrative Expenses ($)	Credit-Related Expenses ($)	Operating Net Income ($)	Net Income ($)
4Q01	3,359	695	510	40	2,291	3,333
3Q01	2,907	671	474	33	2,190	2,261
2Q01	2,704	631	448	36	2,083	2,317
1Q01	2,462	615	429	53	1,957	2,130
Annual Data						
2001	11,432	2,612	1,861	162	8,521	10,041
2000	8,944	2,408	1,618	200	6,995	6,995
1999	7,820	2,301	1,455	286	6,135	6,135
1998	6,325	2,248	1,286	603	5,118	5,118
1997	5,796	2,356	1,131	904	4,451	4,451
1996	5,297	2,282	1,000	1,017	3,968	3,968
1995	4,443	2,173	941	876	3,235	3,235
1994	3,935	2,191	904	803	3,115	3,115
1993	3,305	1,970	804	829	2,659	2,659
1992	2,753	1,770	710	777	2,245	2,245
1991	2,461	1,467	606	789	1,918	1,918
1990	2,212	1,190	529	784	1,587	1,587
1989	1,708	980	471	588	1,244	1,244
1988	1,329	793	412	584	888	888
1987	1,209	735	347	535	677	677
1986	683	476	285	426	352	352
1985	451	300	223	285	201	201
1984	123	236	183	140	73	73
1983	116	186	134	94	135	135
1982	(434)	93	97	62	(132)	(132)
1981	(395)	36	79	(12)	(175)	(175)
1980	75	23	70	42	48	48
1979	377	18	65	55	198	198
1978	331	14	53	49	234	234
1977	282	9	44	36	186	186
1976	221	3	40	24	141	141
1975	205	3	37	27	131	131
1974	184	2	31	50	112	112
1973	211	2	25	27	138	138
1972	148	1	18	9	100	100
1971	59	1	Not Available Before 1972	Not Available Before 1972	67	67

Sources: Fannie Mae and Freddie Mac

[1] See notes to Tables 3 and 13.

Table 24. Aggregate Balance Sheet[1]

Balance Sheet ($ in Millions)							Mortgage-Backed Securities Outstanding ($ in Millions)	
End of Period	Total Assets ($)	Total Retained Mortgage Portfolio ($)	Non-Mortgage Investments ($)	Debt Outstanding ($)	Stockholders' Equity ($)	Core Capital ($)	Total MBS Outstanding ($)	Multiclass MBS Outstanding ($)
4Q01	1,417,131	1,199,957	151,998	1,328,538	33,491	44,518	1,505,315	766,009
3Q01	1,338,557	1,162,216	119,219	1,261,426	28,284	41,521	1,452,568	700,659
2Q01	1,274,741	1,106,077	117,212	1,199,046	33,411	39,848	1,377,893	663,334
1Q01	1,198,816	1,063,019	89,847	1,127,930	28,907	37,252	1,298,013	648,164
Annual Data								
2001	1,417,131	1,199,957	151,998	1,328,538	33,491	44,518	1,505,315	766,009
2000	1,134,369	993,053	98,489	1,069,581	35,675	35,207	1,282,785	643,693
1999	961,851	845,891	73,903	908,330	29,154	30,568	1,217,052	651,682
1998	806,435	671,104	100,675	747,687	26,288	26,180	1,115,494	622,117
1997	586,270	481,135	81,026	542,616	21,314	21,169	1,055,123	622,189
1996	524,907	424,353	78,854	488,251	19,504	19,516	1,021,238	577,737
1995	453,731	360,574	69,984	419,135	16,822	16,788	972,275	599,894
1994	378,707	293,986	64,143	350,509	14,703	14,710	947,001	642,885
1993	300,859	246,107	39,621	251,105	12,489	12,489	910,335	647,043
1992	240,480	189,889	32,116	195,931	10,344	Not Available Before 1993	831,958	531,116
1991	193,932	153,346	19,792	164,199	8,113		714,447	371,784
1990	173,692	135,586	21,992	154,344	6,077		604,434	215,402
1989	159,777	129,429	19,388	142,211	4,907		489,382	117,691
1988	146,610	117,017	19,896	132,341	3,844		396,503	42,281
1987	129,133	106,019	13,935	116,604	2,993		348,369	15,011
1986	122,850	107,216	Not Available Before 1987	108,938	2,135		264,754	5,333
1985	115,663	108,156		106,732	1,788		154,461	5,047
1984	101,576	94,153		94,718	1,524		105,764	3,214
1983	87,378	82,732		81,867	1,421		82,841	1,669
1982	78,980	74,035		74,605	1,249		57,402	Not Available Issued
1981	67,904	64,807		64,231	1,330		19,897	
1980	63,357	60,595		59,766	1,678		16,962	
1979	55,948	53,780		52,555	1,739		15,316	
1978	47,203	45,141		44,201	1,564		12,017	
1977	37,481	36,456		35,000	1,350		6,765	
1976	37,225	35,950		35,088	1,139		2,765	
1975	37,495	35,698		35,572	1,003		1,643	
1974	34,572	33,135		32,852	898		780	
1973	27,191	26,110		25,699	801		791	
1972	22,118	21,378		20,878	669		444	
1971	19,629	18,821		18,587	567		64	

Sources: Fannie Mae and Freddie Mac

[1] See notes to Tables 4 and 14.

Table 25. Aggregate Retained Mortgage Portfolio Detail

($ in Millions)				
End of Period	Aggregate Whole Loans ($)	Aggregate Repurchased Enterprise Securities ($)	Aggregate Other Mortgage-Related Securities ($)	Aggregate Total Retained Mortgage Portfolio ($)
4Q01	228,749	733,445	239,867	1,202,061
3Q01	221,497	703,053	240,212	1,164,762
2Q01	218,904	659,835	229,874	1,108,613
1Q01	214,352	634,652	216,461	1,065,465
Annual Data				
2001	228,749	733,445	239,867	1,202,061
2000	211,745	597,275	186,553	995,573
1999	205,781	492,912	148,162	846,855
1998	212,863	365,483	91,839	670,185
1997	208,556	233,844	38,821	481,221
1996	214,395	183,802	27,681	424,878
1995	215,234	125,735	20,248	361,217
1994	Not Available Before 1995	74,668	Not Available Before 1995	295,228
1993		40,096		246,799
1992		26,929		191,748
1991		Not Available Before 1992		155,650
1990				138,148
1989				132,169
1988				119,931
1987				109,100
1986				110,926
1985				112,196
1984				98,127
1983				85,741
1982				76,493
1981				66,590
1980				62,333
1979				55,100
1978				46,353
1977				37,581
1976				37,112
1975				36,794
1974				34,177
1973				26,980
1972				22,052
1971				19,450

Sources: Fannie Mae and Freddie Mac

Table 26. Aggregate Financial Derivatives

Financial Derivatives ($ in Millions)								
End of Period	Interest Rate Swaps ($)	Interest Rate Caps, Floors, and Corridors ($)	Treasury-Based Contracts ($)	Foreign Currency ($)	OTC Futures, Options, and Forward Rate Agreements ($)	Exchange-Traded Futures, Options, and Other Derivatives ($)	Other ($)	Total ($)
4Q01	742,722	88,071	13,468	32,488	336,287	369,695	2,802	1,585,533
3Q01	803,966	78,647	8,087	28,076	289,027	369,295	535	1,577,633
2Q01	658,619	71,960	5,986	27,770	253,440	124,733	5,839	1,148,347
1Q01	601,969	66,023	4,040	23,385	182,547	67,590	4,943	950,497
Annual Data								
2001	742,722	88,071	13,468	32,488	336,287	369,695	2,802	1,585,533
2000	505,539	46,482	2,200	19,719	161,929	22,517	35,839	794,225
1999	318,612	48,886	8,894	12,604	213,831	94,987	1,400	699,214
1998	200,401	36,345	11,542	14,459	76,481	157,832	3,735	500,795
1997	203,845	22,095	12,228	11,120	6,000	0	1,660	256,948
1996	204,786	14,395	651	2,973	0	0	350	223,155
1995	171,063	13,355	24	1,224	29	0	975	186,670
1994	109,304	9,363	0	1,023	0	0	1,465	121,154
1993	67,346	1,860	0	1,023	0	0	1,425	71,653

Sources: Fannie Mae and Freddie Mac

Table 27. Aggregate Non-Mortgage Investments

Non-Mortgage Investments ($ in Millions)						
End of Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total ($)
4Q01	31,935	47,194	14,911	45,261	12,733	152,034
3Q01	19,289	46,450	10,354	29,390	13,733	119,216
2Q01	11,692	43,494	13,608	29,823	18,592	117,209
1Q01	7,322	39,076	13,881	9,553	20,013	89,845
Annual Data						
2001	31,935	47,194	14,911	45,261	12,733	152,034
2000	9,806	36,575	10,210	16,195	25,717	98,503
1999	15,382	29,512	7,535	5,639	15,835	73,903
1998	28,450	28,117	9,312	12,950	21,846	100,675
1997	21,962	18,839	13,697	14,948	11,580	81,026
1996	31,702	16,721	11,107	7,249	12,075	78,854
1995	19,885	10,404	19,392	9,830	10,473	69,984
1994	24,853	3,796	14,919	8,953	11,622	64,143
1993	13,763	3,557	8,882	1,438	11,981	39,621
1992	12,219	4,124	7,249	53	8,471	32,116
1991	5,903	2,416	6,632	0	4,841	19,792
1990	6,441	1,780	10,014	0	3,757	21,992
1989	8,685	1,107	5,765	0	3,831	19,388
1988	8,594	481	9,107	0	1,714	19,896
1987	5,736	25	5,859	0	2,315	13,935

Sources: Fannie Mae and Freddie Mac

Table 28. Aggregate Capital

Capital ($ in Millions)				
End of Period	Core Capital ($)	Minimum Regulatory Capital Requirements ($)	Regulatory Capital Surplus (Deficit) ($)	Market Capitalization ($)
4Q01	44,518	42,697	18,21	124,743
3Q01	41,521	40,465	1,056	125,234
2Q01	39,848	38,480	1,368	132,460
1Q01	37,252	36,197	1,054	124,591
Annual Data				
2001	44,518	42,697	1,821	124,743
2000	35,207	34,472	735	134,345
1999	30,568	30,057	511	96,364
1998	26,180	25,667	513	120,678
1997	21,169	19,785	1,384	87,628
1996	19,516	17,983	1,533	59,093
1995	16,788	16,035	753	48,744
1994	14,710	14,300	411	29,014
1993	12,489	11,658	831	30,392
1992	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	29,595
1991				27,083
1990				11,415
1989				12,116
1988				3,992
1987				2,401
1986				3,006
1985				1,904
1984				1,012
1983				1,514
1982				1,603
1981				502
1980				702

Sources: Fannie Mae, Freddie Mac, and OFHEO

Table 29. Loan Limits

Single-Family Conforming Loan Limits[1] ($)				
Year	1-unit	2-units	3-units	4-units
1970 - 1976	33,000	Not Applicable	Not Applicable	Not Applicable
1977 - 1978	60,000	Not Applicable	Not Applicable	Not Applicable
1979	67,500	Not Applicable	Not Applicable	Not Applicable
1980	93,750	120,000	145,000	180,000
1981	98,500	126,000	152,000	189,000
1982	107,000	136,800	165,100	205,300
1983	108,300	138,500	167,200	207,900
1984	114,000	145,800	176,100	218,900
1985	115,300	147,500	178,200	221,500
1986	133,250	170,450	205,950	256,000
1987	153,100	195,850	236,650	294,150
1988	168,700	215,800	260,800	324,150
1989	187,600	239,950	290,000	360,450
1990	187,450	239,750	289,750	360,150
1991	191,250	244,650	295,650	367,500
1992	202,300	258,800	312,800	388,800
1993	203,150	259,850	314,100	390,400
1994	203,150	259,850	314,100	390,400
1995	203,150	259,850	314,100	390,400
1996	207,000	264,750	320,050	397,800
1997	214,600	274,550	331,850	412,450
1998	227,150	290,650	351,300	436,000
1999	240,000	307,100	371,200	461,350
2000	252,700	323,400	390,900	485,800
2001	275,000	351,950	425,400	528,700
2002	300,700	384,900	465,200	578,150

Sources: Department of Housing and Urban Development (HUD), Federal Housing Finance Board, Freddie Mac

[1] Conforming Loan Limits are 50% higher in Alaska, Hawaii, Guam, and the U.S. Virgin Islands.

FHA Single-Family Insurable Limits ($)								
	1-unit		2-units		3-units		4-units	
Year	Low Cost Area Max	High Cost Area Max	Low Cost Area Max	High Cost Area Max	Low Cost Area Max	High Cost Area Max	Low Cost Area Max	High Cost Area Max
1997	81,546	170,362	104,310	205,875	126,103	248,888	156,731	309,338
1998	109,032	197,621	139,512	252,866	168,624	305,631	209,568	379,842
1999	115,200	208,800	147,408	267,177	178,176	322,944	221,448	401,375
2000	121,296	219,849	155,232	281,358	187,632	340,083	233,184	422,646
2001	132,000	239,250	168,936	306,196	204,192	370,098	253,766	459,969
2002	144,336	261,609	184,752	334,863	223,296	404,724	277,512	502,990

Table 30. Mortgage Interest Rates

Period	Average Commitment Rates on Loans[1]		Effective Rates on Closed Loans[2]	
	Conventional		Conventional	
	30-Year Fixed Rate (%)	One-Year ARMs (%)	Fixed Rate (%)	Adjustable Rate (%)
4Q01	6.8	5.2	6.8	6.1
3Q01	7.0	5.7	7.2	6.4
2Q01	7.1	5.9	7.2	6.5
1Q01	7.0	6.5	7.3	6.6
Annual Data				
2001	7.0	5.8	7.1	6.4
2000	8.1	7.0	8.3	7.0
1999	7.4	6.0	7.5	6.5
1998	6.9	5.6	7.2	6.5
1997	7.6	5.6	7.9	7.0
1996	7.8	5.7	8.0	7.2
1995	7.9	6.1	8.2	7.4
1994	8.4	5.3	8.1	6.6
1993	7.3	4.6	7.5	5.9
1992	8.4	5.6	8.5	6.9
1991	9.2	7.1	9.7	8.4
1990	10.1	8.4	10.4	9.2
1989	10.3	8.8	10.5	9.3
1988	10.3	7.9	10.4	8.5
1987	10.2	7.8	9.9	8.5
1986	10.2	8.4	10.5	9.4
1985	12.4	10.0	12.4	10.8
1984	13.9	11.5	13.2	12.1
1983	13.2	Not Available Before 1984	13.0	12.3
1982	16.1		15.2	15.4
1981	16.6		Not Available Before 1982	Not Available Before 1982
1980	13.8			
1979	11.2			
1978	9.6			
1977	8.8			
1976	8.9			
1975	9.0			
1974	9.2			
1973	8.0			
1972	7.4			

Average Commitment Rates Source: Freddie Mac
Effective Rates Source: Federal Housing Finance Board

1 Commitment rates do not reflect points.
2 Effective rates reflect points.

Table 31. Housing Market Activity

Period	Housing Starts units in thousands			Home Sales units in thousands	
	Single-Family Housing Starts	Multifamily Housing Starts	Total Housing Starts	New Single-Family Home Sales	Existing Single-Family Home Sales
4Q01*	1,285	286	1,571	928	5,240
3Q01*	1,313	288	1,601	867	5,267
2Q01*	1,330	294	1,624	890	5,330
1Q01*	1,312	313	1,660	950	5,327
Annual Data					
2001	1,309	292	1,602	906	5,296
2000	1,298	295	1,593	898	5,031
1999	1,367	300	1,667	907	5,197
1998	1,314	303	1,617	886	4,970
1997	1,179	296	1,474	804	4,382
1996	1,206	271	1,477	757	4,196
1995	1,110	244	1,354	667	3,888
1994	1,233	224	1,457	670	3,916
1993	1,155	133	1,288	666	3,786
1992	1,061	139	1,200	510	3,479
1991	876	138	1,014	509	3,186
1990	932	260	1,193	534	3,219
1989	1,059	318	1,376	650	3,325
1988	1,140	348	1,488	676	3,513
1987	1,212	409	1,621	671	3,436
1986	1,263	542	1,805	750	3,474
1985	1,166	576	1,742	688	3,134
1984	1,206	544	1,750	639	2,829
1983	1,181	522	1,703	623	2,697
1982	743	320	1,062	412	1,991
1981	796	288	1,084	436	2,419
1980	962	331	1,292	545	2,973
1979	1,316	429	1,745	709	3,827
1978	1,558	462	2,020	817	3,986
1977	1,573	414	1,987	819	3,650
1976	1,248	289	1,538	646	3,064
1975	956	204	1,160	549	2,476
1974	956	382	1,338	519	2,272
1973	1,250	795	2,045	634	2,334
1972	1,451	906	2,357	718	2,252
1971	1,271	781	2,052	656	2,019

Components may not add to totals due to rounding.
*Adjusted Annual Rates
Housing Starts Source and New Single-Family Home Sales Source: Bureau of the Census
Existing Single-Family Home Sales Source: National Association of Realtors

Table 32. Weighted Repeat Sales House Price Index

Weighted Repeat Sales House Price Index (Annual Data)[1]										
	USA	New England	Mid-Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific
1Q02	6.05	9.57	7.88	6.26	4.76	6.53	3.58	3.21	4.28	6.64
4Q01	7.41	10.60	8.68	8.17	4.98	7.16	5.22	5.90	6.43	8.73
3Q01	8.89	12.04	9.91	9.18	6.22	8.46	6.10	6.90	8.26	11.63
2Q01	9.01	12.10	9.51	8.90	6.45	8.17	6.25	7.38	8.47	12.57
1Q01	9.33	12.92	9.84	8.81	6.81	8.41	6.29	7.75	8.82	13.24
Annual Data										
2001	7.41	10.60	8.68	8.17	4.98	7.16	5.22	5.90	6.43	8.73
2000	8.61	13.42	9.10	7.58	6.86	8.28	4.77	5.84	7.95	12.43
1999	5.93	10.41	5.71	4.84	5.81	7.74	3.12	5.04	5.17	6.47
1998	5.19	6.70	4.38	4.77	4.15	4.69	5.03	5.21	4.28	7.62
1997	4.62	4.70	3.31	4.52	5.23	5.01	4.84	3.87	4.95	5.23
1996	2.57	1.70	0.26	2.22	5.03	4.12	4.05	2.29	4.31	0.92
1995	4.45	4.09	3.13	4.27	6.01	5.23	5.47	4.07	7.42	2.77
1994	0.89	-2.89	-3.19	0.11	5.14	5.48	4.91	1.61	9.30	-3.40
1993	2.01	0.36	1.33	1.90	3.55	3.80	3.99	3.98	7.85	-1.95
1992	1.86	-1.07	1.70	2.11	3.88	3.02	3.30	3.42	5.35	-1.39
1991	2.56	-2.25	1.50	3.04	4.58	3.81	4.08	3.69	4.73	1.36
1990	0.15	-7.64	-2.88	0.12	3.73	0.54	0.69	0.42	1.81	2.86
1989	6.06	0.73	2.33	5.08	6.04	3.20	3.07	2.84	2.78	19.48
1988	6.22	3.68	6.08	6.86	6.74	2.42	2.64	-2.15	0.28	17.47
1987	6.79	13.23	16.03	6.81	8.00	2.42	3.94	-8.67	-2.83	9.57
1986	8.23	20.93	17.87	6.05	7.26	4.19	5.81	-0.57	3.23	7.25
1985	6.69	24.95	14.34	5.56	4.89	4.38	4.59	-1.23	2.33	4.89
1984	5.46	17.64	13.50	4.26	2.75	4.63	4.40	-0.06	1.88	5.19
1983	4.14	16.28	9.91	3.39	4.35	4.61	4.55	0.72	-2.62	1.14
1982	2.29	4.14	4.74	4.69	-5.04	0.04	4.03	5.91	7.36	0.79
1981	4.39	5.49	0.18	5.60	2.48	0.33	-0.43	12.00	6.37	5.96
1980	6.77	5.82	9.14	8.40	1.50	3.60	7.17	7.53	6.76	11.32
1979	11.93	10.91	15.49	11.11	9.31	9.34	5.31	13.48	15.92	16.34
1978	13.07	17.76	6.51	10.71	13.77	12.74	11.41	16.82	17.67	15.62
1977	13.13	8.81	11.41	7.41	13.28	14.72	11.28	11.20	17.74	25.66
1976	7.66	3.31	2.34	5.02	8.06	6.31	5.39	9.75	9.80	20.21

Regional Divisions:
New England: CT, MA, ME, NH, RI, VT
Mid-Atlantic: NJ, NY, PA
South Atlantic: DC, DE, FL, GA, MD, NC, SC, VA, WV
East North Central: IL, IN, MI, OH, WI, ND, SD, NE
East South Central: AL, KY, MS, TN
West South Central: AR, LA, OK, TX
Mountain: AZ, CO, ID, MT, NM, NV, UT, WY
Pacific: AK, CA, HI, OR, WA

[1] All data are measured based on percentage change over the previous four quarters. Data from 1976 - 2001 are measured based on fourth quarter to fourth quarter percentage change.