

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Legislative Proposal

It is expected that all resources available to the Office of Federal Housing Enterprise Oversight (OFHEO) would be transferred to a new strengthened housing GSE regulator upon enactment of the proposal announced by the Secretaries of the Departments of Housing and Urban Development and the Treasury on September 10, 2003 and October 16, 2003. The Administration continues to support direct funding of these activities with mandatory assessment on Fannie Mae and Freddie Mac.

Salaries and Expenses

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992, (P. L. 102-550, Section 1313(a)), Title XIII of the Housing and Community Development Act of 1992 (1992 Act), established OFHEO as an independent office in the Department of Housing and Urban Development (HUD) to supervise the two largest government-sponsored enterprises - Fannie Mae and Freddie Mac. The Act mandates annual examinations of Fannie Mae and Freddie Mac by OFHEO to determine the condition of each Enterprise for the purpose of ensuring financial safety and soundness. The statute also requires OFHEO to develop and administer capital requirements for the Enterprises and to conduct other research and financial analysis necessary for effective regulatory oversight. In so doing, OFHEO helps ensure the Enterprises are able to provide liquidity to the mortgage markets and promote homeownership.

OFHEO's Mission and Strategic Goals

OFHEO promotes housing and a strong economy by ensuring the safety and soundness of Fannie Mae and Freddie Mac and fostering the strength and vitality of the nation's housing finance system.

OFHEO developed three strategic goals to achieve its mission.

Strategic Goal 1: Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements.

Strategic Goal 2: Enhance public understanding of the nation's housing finance system.

Strategic Goal 3: Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.

OFHEO's operating costs of \$39.9 million estimated for fiscal year 2004 remains modest in comparison with the trillions of dollars at stake at the Enterprises and the importance of public confidence in the Enterprises. The number of corporate accounting fraud cases and subsequent corporate failures in the past few years has eroded the public's confidence in business practices and shaken the U.S. economy. The accounting failures and management control weaknesses made public this past year at Freddie Mac served to underscore the importance of maintaining a strong, flexible regulator of the Enterprises. In the first quarter of fiscal year 2004, OFHEO has collected over \$125.1 million in civil money penalties from Freddie Mac and a corporate official having management responsibility during the time period that the accounting failure occurred.

The Enterprises engage in two principal lines of business: the buying and holding of residential mortgages and mortgage-backed securities, and the guaranteeing of securities backed by residential mortgages. The Enterprises' business decisions reflect their understanding, interpretation and management of risk. It is OFHEO's responsibility to understand and interpret the Enterprises' risk management strategies as well as how risks may evolve over time and what potential ramifications these risks may have within the housing sector and economy in general. For example, the Enterprises have increased their use of derivative instruments from a notational amount of \$72 billion at year-end 1993 to \$1.8 trillion on September 30, 2003 representing over a twenty-fold increase.

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At the same time, dramatic advances in technology represent the foundation of these business initiatives. The Enterprises employ cutting-edge risk management techniques, build on quantitative models, to manage the many alternations of their risk profile. These technologies carry with them operational challenges that not only permit Fannie Mae and Freddie Mac to leverage their resources but also expand their operational risks.

Just as the Enterprises continually evaluate their operating processes and initiate new activities, OFHEO must continually evaluate its capability to oversee these new processes and risks. OFHEO must be nimble in order to respond quickly to developments at the Enterprises, and must have adequate resources to deploy quickly to address emerging activities.

BUDGET HIGHLIGHTS

The following table summarizes the funding and staffing levels for OFHEO for fiscal year 2003 and the estimate for fiscal year 2004.

	<u>ACTUAL</u> <u>2003</u>	<u>ENACTED</u> <u>2004</u>
	(Dollars in Thousands)	
<u>From Appropriation:</u>		
Budget Authority (Assessed To GSE's)	\$30,000	\$39,915
Interagency Agreements ... <u>a/</u>	29	...
Prior Year Recovery <u>b/</u>	<u>68</u>	<u>...</u>
Subtotal	30,097	39,915
Total Obligations	30,095	39,915
Unobligated Balance EOY	0	...
Outlays (net)	27,742	39,000
Full-Time Equivalents	126	167

a/ The \$29,353 in 2003 represents an extension of the 2002 Economy Act Agreement between OFHEO and the Small Business Administration (SBA). OFHEO is assisting SBA in the development of an econometric equation-based computer model. The Office of Management and Budget (OMB) apportioned this amount to OFHEO for obligation during 2003.

b/ OMB approved OFHEO's request to recover prior year obligations for re-obligation during fiscal year 2003. OMB reapportioned \$67,884 to OFHEO as an increase in budgetary resources available to OFHEO during fiscal year 2003.

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Funding

The following table summarizes obligations for OFHEO by object class.

	ACTUAL 2003 a/ (Dollars in Thousands)	ENACTED 2004 b/
Personal Services	\$18,211	\$26,821
Travel and Transportation Of Persons	137	377
Transportation of Things	7	11
Rent, Communications, and Utilities	3,481	3,699
Printing and Reproduction	45	60
Other Services	5,484	7,275
Supplies and Materials	239	278
Furniture and Equipment	2,030	1,394
Land & Structure	<u>461</u>	<u>...</u>
Total Obligations	30,095	39,915

a/ Fiscal year 2003 includes \$29,353 for an extension to the 2002 Interagency Agreement with SBA and an anticipated recovery of \$67,884.

b/ Includes budget amendment requested by the President on September 12, 2003.

1. CHANGES FROM ESTIMATES INCLUDED IN 2004 BUDGET

Since the fiscal year 2004 Budget was submitted, the regulatory environment of the Enterprises has changed dramatically, and OFHEO's funding requirements have likewise changed. The events at Freddie Mac that led to the announcement that it would need to re-state its financial statements, underscored serious internal management control issues and accounting weaknesses at the Enterprise, and led the Director to order the special investigation of Freddie Mac.

The Director testified before the Committee on Banking, Housing and Urban Affairs on July 17, 2003, and advised the Committee that OFHEO would expand its supervisory programs over the Enterprises. In order to enhance OFHEO's supervisory program as requested by Congress, OFHEO requested and received \$7.5 million in supplemental resources for fiscal year 2004, adding to the \$32.4 million contained in the President's fiscal year 2004 budget, for a total of \$39.9 million. The \$7.5 million funding received through the supplemental request is allocated to three supervisory initiatives.

Firstly, \$1.5 million is allocated to the litigation of enforcement actions against Leland Brendsel, former CEO and Chairman of the Board, and Vaughn Clarke, former Chief Financial Officer. In December 2003, OFHEO filed a "Notice of Charges" against Freddie Mac; Leland Brendsel, former CEO and Board Chairman; and Vaughn A. Clarke, former Chief Financial Officer. The enforcement actions involving Leland Brendsel and Vaughn A. Clarke are being litigated, requiring increasing amounts of internal and external resources for legal support and litigation management.

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Secondly, \$3 million is allocated to commence a special examination of accounting practices at Fannie Mae. OFHEO expects to award a contract during the second quarter of fiscal year 2004 for this examination. The report of the special investigation at Freddie Mac concluded that OFHEO must ensure that Freddie Mac establish an adequate remediation plan and allocate the necessary resources to establish a new corporate culture that rewards integrity and the acceptance of responsibility while penalizing failure to meet appropriate standards of conduct. OFHEO will oversee corrective actions taken by Freddie Mac during fiscal year 2004, and evaluate their operational effectiveness.

Thirdly, \$3 million is allocated to strengthen and add capacity to OFHEO's supervisory program of the Enterprises. These funds will be used to secure additional personnel required for OFHEO's re-structured, focused program of supervision.

Fiscal year 2004 marks the commencement of a targeted re-structuring of OFHEO to enhance the focus on supervision of the Enterprises. In the Director's statement before the House Financial Services Subcommittee on Capital Markets, Insurance, and GSEs on January 24, 2004, OFHEO discussed the findings and recommendations of the Freddie Mac report. OFHEO made a commitment to implement the recommendations. In doing so OFHEO has created two new offices to provide more focused supervision over areas discussed in the Freddie Mac report: The Office of Compliance, and the Office of The Chief Accountant. Capital adequacy evaluations are also being fortified and linked with other supervisory actions for a more holistic approach. All organizational activities pertaining to supervisory functions will be coordinated under the broad oversight of the Deputy Director.

PROGRAM PERFORMANCE OVERVIEW

OFHEO's Strategic Plan for fiscal year 2003-2008 describes the Office's mission and three Strategic Goals to achieve it. OFHEO's means and strategies are the key activities, actions, processes and technologies that describe how OFHEO will use its fiscal year 2005 resources to achieve each performance goal. The Office provides regulation, supervision, guidance, review and a variety of products that influence the Enterprises and the financial markets. As for all regulators, the outcomes or results of OFHEO's work are achieved through the actions of others.

2003 - 2004 Resource Allocation Estimates a/

Dollars in Millions

Year	Strategic Goal 1		Strategic Goal 2		Strategic Goal 3		Total Dollars
	Dollars	Percent	Dollars	Percent	Dollars	Percent	
2004	31.8	79.7	6.0	15.0	2.1	5.3	39.9
2003	24.2	80.4	4.0	13.3	1.9	6.3	30.1

FTE

Year	Strategic Goal 1		Strategic Goal 2		Strategic Goal 3		Total FTE
	FTE	Percent	FTE	Percent	FTE	Percent	
2004	128	76.6	28	16.8	11	6.6	167
2003	95	75.4	20	15.9	11	8.7	126

a/ Strategic Goal 1: Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements.

Strategic Goal 2: Enhance public understanding of the nation's housing finance system.

Strategic Goal 3: Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.

Strategic Goal 1: Ensure the Enterprises Comply with Safety and Soundness Standards, are adequately capitalized, and comply with other Legal Requirements.

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

Performance Goal 1.1: Ensure the Enterprises comply with safety and soundness standards.

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

Means and Strategies:

On a calendar year cycle, OFHEO conducts risk-based examinations annually at each Enterprise. An integral part of the examination program is identifying risks, developing risk-focused examination strategies and updating those strategies as risk profiles change. OFHEO bases the examination strategies on an analysis of the risk profiles of each Enterprise combined with a comprehensive and systematic review of the assessment factors and the corresponding evaluation criteria for each of the examination program areas. In advance of the examination, OFHEO completes and communicates the Examination Strategies for each Enterprise and updates these strategies quarterly, as necessary, as risk profiles change.

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

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

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

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

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

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

OFHEO's planned database expansion and improved retrieval and reporting tools will provide enriched information for the examiners to better evaluate risks. The Examiner Workstation investment will provide examiners with a comprehensive tool to access information necessary to assess risk from a single software application on their computer, both onsite and off-site (at the Enterprises). The Examiner Workstation is similar in concept to initiatives being developed at the Federal Reserve and the OCC. During fiscal year 2005, OFHEO will continue the Examiner Workstation project.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Ensure the Enterprises comply with safety and soundness standards. Each Enterprise responds appropriately to 100% of OFHEO's safety and soundness concerns.
2004	The Enterprises meet or exceed safety and soundness standards. Each Enterprise responds appropriately to 100% of OFHEO's safety and soundness concerns. (Fiscal year 2004 Performance Goal 1.1)
2003	Both Enterprises were financially sound, however, OFHEO identified unsafe and unsound practices at Freddie Mac and undertook remedial actions. OFHEO continues its review and remedial steps into the 2004 fiscal year.
2002	Both Enterprises were financially sound and well managed.
2001	Both Enterprises were financially sound and well managed.
2000	Both Enterprises were financially sound and well managed.

Performance Goal 1.2: Ensure the Enterprises are adequately capitalized.

Performance Measure 1.2(1): Each Enterprise meets the minimum capital standard at least quarterly.

Performance Measure 1.2(2): Each Enterprise meets the risk-based capital standard at least quarterly.

Performance Measure 1.2(3): Continually review the capital standards and risk-based capital model and change them as needed to reflect new risk measurement techniques and new Enterprise risks.

Performance Measure 1.2(4): Using the capital standards, a variety of analytics, environmental scans and early warning indicators, each Enterprise is determined by the OFHEO Director to be adequately capitalized on at least a quarterly basis.

Performance Measure 1.2(5): Whenever an Enterprise does not comply with the OFHEO Director's determination of capital adequacy, OFHEO receives an acceptable capital plan.

Means and Strategies:

OFHEO seeks to ensure the Enterprises remain adequately capitalized. Capital compliance with the statutory prescriptions is achieved through quarterly measurements, routine updates about the Enterprises' financial condition and operating environment, the Agency's examinations, scenario analyses, economic analysis, alternative modeling tools, and research. Collectively, these assessments position OFHEO to make informed decisions about the Enterprise's capital adequacy.

OFHEO's assessment of the Enterprises' capital adequacy is multifaceted. The qualitative assessment of capital occurs through OFHEO's continuous and comprehensive examination of each Enterprise.

The two key quantitative assessments of capital are OFHEO's minimum and risk-based standards. The minimum capital standard, as with other financial regulators, is a ratio-based capital cushion relative to the size of the company. It represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. The risk-based capital requirement is based directly on the risks inherent in the Enterprises' portfolios and other obligations, particularly the risks related to credit extended and to changes in interest rates. OFHEO uses a 10-year stress test to determine the amount of total capital that each Enterprise must hold to absorb projected losses from future adverse interest-rate and credit-risk conditions, plus an additional 30 percent to cover unspecified management and operations risk.

OFHEO will continue to determine, at least quarterly, if each Enterprise meets the quantifiable capital requirements on the basis of OFHEO's minimum capital and risk-based capital (RBC) standards, as required by law. The complete classification program includes the calculation, analysis, and review of the minimum and risk-based capital results, other measures of risk and capital, and qualitative assessments of Enterprise capital adequacy. When final, capital classifications are made public.

Fiscal year 2005 will be the third full year that the risk-based capital standard will be used for capital classification. To calculate and apply minimum and risk-based capital standards, OFHEO performs a series of ongoing tasks that verify every aspect of the capital classification process, and ensure its continued integrity and accuracy. OFHEO verifies Enterprise data used in the stress test and analyzes stress test results, sensitivity analysis, and new Enterprise products and activities. These activities, taken together, ensure the results are as expected based on changes in the Enterprises' balance sheets.

In fiscal year 2005, OFHEO will continue its broadened focus to provide a more comprehensive evaluation of the Enterprises' capital adequacy and assessment of risks that affect capital. OFHEO will pursue analysis of additional perspectives of risk that may not be reflected in the stress test and develop alternative models and measurements of risk and capital adequacy. The Office will research topics that have a direct impact on the effectiveness of the minimum and risk-based capital calculations and the other capital adequacy measures. Initiatives will include the development of additional risk measures and analysis using a new portfolio risk metrics model to evaluate the risks embedded in the Enterprises' derivatives portfolios, including interest rate, basis, and credit risks. This model will allow analysis of stochastic market value and earnings, in contrast to the stress test cash flow model.

OFHEO will also explore alternative approaches to assessing the capital of the Enterprises. This analysis will examine all aspects of regulation, modeling, data and data sources, the reliance or use of counterparties and third party vendors. The goal is to objectively evaluate various methods for assessing capital adequacy and risk and to ensure OFHEO is well positioned through tools and

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analysis to monitor and assess the Enterprises' capital positions in the future. In fiscal year 2005, OFHEO will continue to review stress test assumptions and explore enhancements to aspects of the stress test model, such as considering alternative treatments of subprime mortgages and adding credit scores or other explanatory variables to the model.

As the financial markets and mortgage finance industry evolve, the Enterprises regularly adapt their business activities and products. OFHEO will ensure that new Enterprise activities and accounting treatments are assessed timely and thoroughly to determine their affect on the Enterprises' capital adequacy. OFHEO is committed to continually reviewing the capital standards and risk-based capital model, and changing them as needed to reflect new risk measurement techniques and new Enterprise risks. The conclusions of these projects and initiatives may result in proposed modifications to the risk-based capital regulation.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Ensure the Enterprises are adequately capitalized.
2004	Ensure the Enterprises are adequately capitalized. (Fiscal year 2004 Performance Goal 1.2)
2003	Each Enterprise is adequately capitalized. Quarterly minimum capital classification ratios Fannie Mae: 1.032 to 1.052 Freddie Mac: 1.170 to 1.298* Quarterly risk-based capital classification ratios Fannie Mae: 1.204 to 1.831 Freddie Mac: 5.100 to 21.597 Made technical amendments to the final rule and initiated projects to consider future changes.
2002	Each Enterprise is adequately capitalized. Quarterly minimum capital classification ratios Fannie Mae: 1.028 to 1.05 Freddie Mac: 1.051 to 1.310* Third Quarter CY 2002 risk-based capital ratios (first enforceable application of the risk-based capital standard) Fannie Mae: 1.332 Freddie Mac: 4.696
2001	Each Enterprise is adequately capitalized. Quarterly minimum capital classification ratios Fannie Mae: 1.02 to 1.03 Freddie Mac: 1.068 to 1.103*
2000	Each Enterprise is adequately capitalized. Quarterly minimum capital classification ratios Fannie Mae: 1.00 to 1.03 Freddie Mac: 1.025 to 1.086*

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* The capital data for Freddie Mac for 2000, 2001 and 2002 are based on restatement of previously issued consolidated financial statements and reflect adjustments to previously reported results. The capital data for 2003 are based upon financial information and application of accounting policies currently involved in the Freddie Mac restatement process. The 2003 numbers are subject to change.

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

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

Means and Strategies:

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

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

OFHEO, with the assistance of an executive compensation consulting firm, conducted an extensive study of executive compensation at the Enterprises in fiscal year 2002. The study identified an updated peer group of comparable firms. Using that peer group and other publicly available information, OFHEO will continue to monitor changes in executive compensation at the Enterprises in fiscal year 2005 to ensure that such compensation is not excessive. Also, when an Enterprise submits for OFHEO's approval an agreement or amendment to an agreement that provides termination benefits to an executive, OFHEO will review and act upon the Enterprise's request. OFHEO will also monitor the Enterprises' compliance with the executive compensation regulation and, if necessary, take appropriate steps to assure their compliance. OFHEO also reviews termination benefits when an executive officer leaves an Enterprise.

Should a violation of law be determined by another regulator or by a judicial body under a statute not within OFHEO's direct enforcement authority, OFHEO may take such supervisory action as deemed necessary within its authorities relating to safety and soundness and the charter acts.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure.
2004	Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure. (Fiscal year 2004 Performance Goal 1.3)
2003	OFHEO identified instances of unsafe and unsound practices at Freddie Mac, undertook supervisory actions, and required remedial steps.
2002	No instances of violation identified during fiscal year 2002.
2001	No instances of violation identified during fiscal year 2001.
2000	No instances of violation identified during fiscal year 2000.

Strategic Goal 2: Enhance public understanding of the nation's housing finance system.

Enhancing the public's understanding of the nation's housing finance system, including the roles and activities of the Enterprises and OFHEO, contributes directly to the strength and vitality of that system. The public—borrowers, investors, market participants, policymakers and other stakeholders—will make better decisions about the allocation of their resources if they are well informed. OFHEO, with its expertise in housing finance, is uniquely positioned to provide the public with information and analysis, leading to more informed decision-making by the public.

Performance Goal 2.1: Enhance awareness and understanding of housing and mortgage market developments and Enterprise risks and activities.

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

Performance Measure 2.1(2): Report on OFHEO activities, examination results and conclusions, and the secondary mortgage market in the OFHEO annual Report to Congress.

Means and Strategies:

OFHEO provides information about house prices, mortgage markets, and the Enterprises on a regular basis through several vehicles. OFHEO's quarterly House Price Index (HPI) documents changes in house prices for the nation, each state, the nine census regions, and metropolitan statistical areas (MSAs). OFHEO posts the HPI on its web site each quarter. Many researchers, analysts and practitioners rely on OFHEO's HPI. In fiscal year 2005 OFHEO will continue research to refine the HPI and assess the implications of changes in house prices.

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OFHEO publishes an annual review of housing finance market developments, including the financial performance and activities of the Enterprises, as well as comprehensive historical Enterprise data. OFHEO also issues publicly its annual Report to Congress, available by June 15th each year, which summarizes the results and conclusions of OFHEO's annual risk-based examinations of the Enterprises and describes OFHEO's activities in the preceding calendar year.

OFHEO provides valuable information to the public regarding the Enterprises and developments in housing finance through published reports, staff studies, and other analyses. On a quarterly basis, OFHEO will disclose appropriate information about each Enterprise's compliance with both the minimum and risk-based capital standards. The information will include non-proprietary details relating to the calculation of the minimum capital requirement and a description of the Enterprise's performance in the risk-based capital stress test. In fiscal year 2005, OFHEO will continue analyses of appropriate disclosure of information about Enterprise risks and activities to expand public awareness of the financial health of the Enterprises. OFHEO will focus in particular on interest rate risk measurement and management, including review and evaluation of the Enterprises' models and methodologies.

Related Fiscal Year 2004 Goal and Prior Year Performance Information:

2005	Enhance awareness and understanding of housing and mortgage market developments and Enterprise risk and activities.
2004	Enhance awareness and understanding of housing and mortgage market developments and Enterprise risk and activities. (Performance Goal 2.1)
2003	Annual Report on OFHEO activities and examination results and conclusions sent to Congress June 4, 2003. House Price Index (HPI) Report issued quarterly.
2002	Analysis of the secondary mortgage market issued September 2002. Annual Report on OFHEO activities and examination results and conclusions sent to Congress June 15, 2002. House Price Index (HPI) Report issued quarterly.
2001	Annual Report sent to Congress June 15, 2001. HPI Report issued quarterly. Analysis of secondary mortgage market issued separately, July 2001.
2000	Annual Report sent to Congress June 15, 2000. HPI Report issued quarterly.

Performance Goal 2.2: Undertake research and analysis of risks and emerging issues.

Performance Measure 2.2(1): Meet the Director's priorities for research as identified in the fiscal year 2005 research plan.

Performance Measure 2.2(2): Prepare special reports on topical issues.

Means and Strategies:

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OFHEO's research enables the Office to understand how changes in the market impact the Enterprises and conversely how changes in Enterprise operations impact the market. OFHEO's research is designed to support the Office's supervisory efforts in fostering safety and soundness through examinations, capital standards, and the regulatory regime, which falls under the first strategic goal: "Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements." Some research also presents the opportunity to improve the public's understanding of the housing finance system. OFHEO's seven broad objectives for its research and analysis describe the areas in which additional investigation will be crucial to keeping OFHEO's supervisory structure pro-active and at pace with the dynamics of the markets and the Enterprises. The objectives are:

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

The fiscal year 2005 research plan will identify the topics on which OFHEO plans to conduct empirical research and policy analysis during the fiscal year. OFHEO will select topics based on knowledge of current issues, the most recent research, and available data and resources. The plan will establish goals for the preparation of reports, staff studies, professional papers, or other analyses or publications, reflecting priorities set by the OFHEO Director. OFHEO will revise the plan as needed during fiscal year 2005 to take into account research priorities that emerge during the year.

Because of the proprietary nature of certain information, some of the projects will be for internal use only and others will be available for public dissemination. Reports, staff studies, and other analyses released by OFHEO will provide valuable information to the public and enhance understanding of the housing finance system, the Enterprises, and related policy issues. In accord with the objectives described above, OFHEO's fiscal year 2005 research will continue to focus on subprime lending and affordable housing, refining the HPI, as well as issues associated with systemic risk, competition in the secondary mortgage market, and various measures of capital adequacy.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Undertake research and analysis of risks and emerging issues. Meet the Director's priorities for research as identified in the fiscal year 2005 research plan. Prepare special reports on topical issues.
2004	Undertake research and analysis of risks and emerging issues. Meet the Director's priorities for research as identified in the fiscal year 2004 research plan. Prepare special reports on topical issues. (Fiscal year 2004 Performance Goal 2.2)
2003	Research and analysis of emerging issues have been ongoing. OFHEO made progress on its research agenda.
2002	Research and analysis of emerging issues have been ongoing. OFHEO made progress on its research agenda.
2001	Research and analysis have been ongoing. Additional research priorities have been developed.
2000	Research and analysis have been ongoing.

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

Performance Measure 2.3(1): The majority of survey respondents attending OFHEO's symposium find it valuable.

Performance Measure 2.3(2): Consider and respond appropriately to all Congressional inquiries within 14 days.

Performance Measure 2.3(2): Consider and respond appropriately to all public inquiries within 21 days.

Means and Strategies:

OFHEO will continue the practice, begun in fiscal year 2003, of hosting a Symposium, open to the public, on significant emerging issues or trends. The Symposium will focus on matters of importance related to the Enterprises and to the public policy considerations related to their mission and regulation.

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

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

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

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Communicate effectively with stakeholders on regulatory issues. The majority of survey respondents attending OFHEO's symposium find it valuable. Consider and respond appropriately to all Congressional and inquiries within 14 days. Consider and respond appropriately to all public inquiries within 21 days.
2004	Communicate effectively with stakeholders on regulatory issues. Consider and respond appropriately to all Congressional and inquiries within 14 days. Consider and respond appropriately to all public inquiries within 21 days. (Fiscal year 2004 Performance Goal 2.3)
2003	Responded to nearly all inquiries from Congress and the public within 7 days.
2002	Responded to all inquiries from Congress and the public within 7 days.
2001	Responded to all inquiries from Congress and the public within the 15-day goal.
2000	Responsive to Congress and the public. Data not collected.

Strategic Goal 3: Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.

The secondary mortgage market and the diverse capital markets have experienced dramatic growth and have become increasingly complex. The Enterprises' role in several of these markets is a dominant one, and in others, their role has grown. To ensure that these dynamics are recognized, OFHEO must work with other Federal agencies to ensure a strong and vital housing finance system and efficient and effective capital markets. In addition, OFHEO will contribute to Federal efforts to promote homeownership and affordable housing as reflected in the Office's mission statement.

Performance Goal 3.1: Cooperate with other Federal financial agencies on regulatory issues.

Performance Measure 3.1(1): Participate in on-going task forces and forums with other regulatory agencies.

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Performance Measure 3.1(2): Respond within 30 days to requests from other Federal agencies for information about housing finance markets and the Enterprises.

Means and Strategies:

In fiscal year 2005, OFHEO will continue to support interagency efforts to identify and analyze emerging trends and policy issues related to housing finance, homeownership, and affordable housing, as well as broad public policy issues affecting the Enterprises. OFHEO will participate in and host seminars, brown-bag lunch presentations, and other informal meetings of Federal and non-federal researchers, analysts, and examiners, and may sponsor more formal meetings.

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

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

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

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Cooperate with other Federal financial agencies on regulatory issues.
2004	Cooperate with other Federal financial agencies on regulatory issues. (Fiscal year 2004 Performance Goal 3.1)
2003	Worked with other Federal financial agencies on regulatory issues.
2002	Worked with other Federal financial regulators on regulatory issues.
2001	Worked with HUD on regulatory issues of a common interest. Cooperation has been ongoing.
2000	Cooperation has been ongoing.

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

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

Means and Strategies:

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

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

Related Fiscal Year 2004 and Prior Year Performance Information

2005	Ensure there is sufficient meaningful disclosure of information regarding Enterprise operations to allow market participants to trade their obligations efficiently and effectively in the financial markets.
2004	Ensure there is sufficient disclosure of information regarding Enterprise operations to allow market participants to trade their obligations efficiently and effectively in the financial markets. (Performance Goal 3.2 a new performance goal in fiscal year 2004)
2003	Issued final disclosure regulation. Completed joint staff review with the Securities and Exchange Commission and the Treasury Department on disclosure related to Mortgage-Backed Securities. Initiated a special examination of Freddie Mac (and issued a report in FY 2004). (Not a fiscal year 2003 performance goal)
2002	Drafted proposed disclosure regulation. Participated in joint staff review with the Securities and Exchange Commission and the Treasury Department on disclosure related to Mortgage-Backed Securities. (Not a fiscal year 2002 performance goal)
2001	No related performance goal.
2000	No related performance goal.

Resource Management Strategy: Manage OFHEO resources effectively to enable the office to fulfill its mission.

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

OFHEO's management philosophy reflects the Administration's governmentwide management goals. OFHEO focuses on human capital management, effective information technology resource management, and strong program controls, including integrating financial systems, through the achievement of the following performance goals.

Performance Goal 4.1: Ensure the staff have the knowledge and skills to fulfill the goals of the agency.

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

Means and Strategies:

OFHEO's staff are its most valuable resources. The Office relies on those with cutting-edge professional skills and a breadth and depth of knowledge in their fields. Their technical competence, skills, and effective teamwork are crucial to ensuring the successful completion of its goals. Due to the small size of OFHEO, all staff members must possess a depth and breadth of skill and knowledge that is a combination of several positions at a larger agency. OFHEO hires staff with highly technical skills and oftentimes must provide training to enhance and maintain knowledge and skills.

OFHEO invests in staff development by providing appropriate training for achievement of OFHEO's performance goals. This investment ensures that staff not only stay abreast of changes in the Enterprises, but also in the financial, regulatory, and technological environments in which the Enterprises and OFHEO operate.

Individual Development Plans (IDPs) provide a systematic way to ensure proper skill maintenance and development. In fiscal year 2002, OFHEO staff and managers established Individual Development Plans (IDPs) for each staff member, and have continued to update them on an annual basis. In fiscal year 2005, managers and staff will review the strategic plan and annual performance plan and determine what skill enhancements are needed to carry out the tasks to achieve the agency goals and update their IDPs as appropriate.

OFHEO will also institute new outreach efforts to continue to attract and maintain a high performance workforce.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Ensure the staff have the knowledge and skills to fulfill the goals of the agency. Revise Individual Development Plans for each staff member annually to ensure OFHEO staff maintains and enhances the expertise and skills necessary to achieve the Office's goals.
2004	Ensure the staff have the knowledge and skills to fulfill the goals of the agency. Revise Individual Development Plans for each staff member annually to ensure OFHEO staff maintains and enhances the expertise and skills necessary to achieve the Office's goals. (Fiscal year 2004 Performance Goal 4.1)
2003	Completed annual revision of individual development plans for 95% of staff members. Training and development have been ongoing.
2002	Individual Development Plans were established for all employees. Training and development have been ongoing.
2001	Training and development have been ongoing.
2000	Training and development have been ongoing.

Performance Goal 4.2: Provide effective information resources management services to OFHEO managers and staff.

Performance Measure: Implement the fiscal year 2005 component of OFHEO's 5-Year IT Strategic Plan.

Means and Strategies:

OFHEO's regulation of the Enterprises is highly dependent upon the strategic use of technology. The use of information technology is an integral part of OFHEO's mission and of the operation of the Enterprises that the Office regulates. Without technologies comparable to those used by other organizations with similar risk assessment and analytical requirements, OFHEO would not be able to provide independent analysis of safety and soundness issues to accomplish its mission. OFHEO examiners use technology to analyze the performance of the Enterprises and the mortgage markets in order to update the risk profiles of the Enterprises. The Enterprises' risk-based capital requirements are calculated using a large and complex computer model that simulates the cash flows of the Enterprises' assets and obligations under stressful conditions. Research projects often depend on large and well-maintained databases, advanced software, and very high-speed computational facilities. OFHEO also relies heavily on technology to implement its

administrative processes. To maintain the technological capability to perform these functions effectively and efficiently so that OFHEO can accomplish its fiscal year 2003-2008 Strategic Plan, OFHEO will review its 5-year IT Strategic Plan each year, and ensure that the annual component of the plan ties to the Office's Annual Performance Plan. The fiscal year 2005 component of OFHEO's 5-Year IT Strategic Plan contains the following goals:

- Continue the Examiner Workstation project.
- Manage the data supporting OFHEO's analysis and research through the data warehouse.
- Continue to enhance the security, reliability and capacity of OFHEO's IT infrastructure.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Implement fiscal year 2005 Component of 5-Year IT Strategic Plan.
2004	Implement fiscal year 2004 Component of 5-Year IT Strategic Plan. (Fiscal year 2004 Performance Goal 4.2)
2003	Implemented four projects from the fiscal year 2003 Component of 5-Year IT Strategic Plan, made substantial progress on two others, and suspended one project.
2002	5-Year IT Strategic Plan Approved.
2001	Not Applicable.
2000	Not Applicable.

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

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

Means and Strategies:

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

In addition to maintaining strong internal controls, in fiscal year 2005 OFHEO will improve its ability to manage its resources by completing the implementation of an integrated administrative, human resources and financial management system. Currently OFHEO uses separate systems, with different service providers or requiring manual data entry. During fiscal year 2004, OFHEO will begin the conversion and implementation to a new integrated administrative and financial system. This will facilitate enhanced capability to report planned budget resources and actual expenses in concert with OFHEO's strategic goals. The integration of administrative, human resources and finance functions into a single financial system will provide OFHEO management with improved financial information to support agency resource decisions and strengthen OFHEO's internal control and risk management program.

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OFHEO's information security program provides for the protection of its information assets, including the hardware and software used to create and maintain the information. Information security at OFHEO is a shared responsibility among the Information Systems Security Officer, several information technology professionals, and everyone in OFHEO. During fiscal year 2005, OFHEO will continue its program of information security monitoring and staff training, and will update risk assessments of its systems to ensure the associated risks have been mitigated. OFHEO will also continue its internal review program, and follow up with its fourth independent review of its information security program.

To ensure that OFHEO continues to function in the event of an emergency, OFHEO will continue to update its "Continuity of Operations Plan" (COOP) and perform periodic disaster recovery testing at a remote site during fiscal year 2005.

Related Fiscal Year 2004 Goal and Prior Year Performance Information

2005	Maintain a strong internal control and risk management program.
2004	Maintain a strong internal control and risk management program. (Fiscal year 2004 Performance Goal 4.3)
2003	Received an unqualified audit opinion on financial statements, internal controls and compliance with laws and regulations from an independent, external auditor. No material weaknesses were reported during the independent review of OFHEO's information security program. The HUD IG issued a report with two findings: improve oversight of the travel program and implement a space utilization policy (which OFHEO satisfied by early FY 2004).
2002	Received an unqualified audit opinion on financial statements, internal controls and compliance with laws and regulations from an independent, external auditor. Contracted for an independent review of IT security and found no material weaknesses.
2001	OFHEO received a clean audit opinion on its financial statements. OFHEO conducted its first independent review of its IT security program. No material weaknesses were found.
2000	OFHEO received a clean audit opinion on its financial statements.

Verification and Validation of Performance Information

The Office is systematically monitoring and tracking progress in achieving its performance goals. OFHEO maintains information, as described in the performance measures themselves, so that the Office's performance can be validated. OFHEO's managers report ongoing performance and progress against the performance goals, and can rely on this information as they manage their operations. Most of

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OFHEO's performance indicators reflect data and outputs internal to the Office. The data used as input to the capital calculations are an exception. For the minimum capital and risk-based capital calculations, senior officers of each Enterprise transmit their data and attest to their completeness and accuracy. OFHEO is able to validate the minimum capital data through comparison with published Enterprise data, and has been satisfied with the data received. For the risk-based capital standard, OFHEO uses data validation protocols to ensure consistency and integrity of the data received. This allows ready identification of data issues, which OFHEO resolves with the Enterprises. OFHEO will continue to improve the sophistication of its validation checks. OFHEO had the financial simulation model used in the risk-based capital calculation independently tested during fiscal year 2001 and continuously tests any changes made to the software model to ensure accuracy. OFHEO and the Enterprises work in concert to ensure the replication of model results by OFHEO and the Enterprises.

Freddie Mac's capital calculation is based on financial information and the application of accounting policies currently involved in the accounting restatement process. The accounting changes reflected in the 2003 statements will impact the minimum capital surpluses and, to a lesser degree, the risk based capital surpluses. The \$5 billion increase reflected in Freddie Mac's 2002 financials is not yet reflected in the FY 2003 numbers. The risk-based capital stress test utilizes cash flows and the economics of the individual transactions. OFHEO will determine the need for recalculation of regulatory capital after Freddie Mac publishes financial results for 2003. OFHEO anticipates that Freddie Mac's FY 2005 financial information will be reliable.

Monitoring and Reporting on Performance

During fiscal year 2005, OFHEO will evaluate its performance internally, make appropriate adjustments, and continue to analyze and reallocate its budgetary resources to enable the Office to achieve its annual performance goals. OFHEO will continue using the systems in place to monitor actual performance against the Performance Plan, and will enhance these systems by implementing the integrated financial and administrative management system in fiscal year 2004. On a quarterly basis, OFHEO's progress in meeting its performance goals is discussed among senior management and disseminated to OFHEO staff. Because OFHEO's appropriation is for a single account, and management has access to real time budget information, management will be able to redirect resources timely, if necessary, to accomplish the Office's goals.

As required by the Government Performance and Results Act of 1993 and the Reports Consolidation Act of 2000, OFHEO will submit a performance report for fiscal year 2005 to Congress by February 27, 2006, to discuss the Office's actual performance as compared with the fiscal year 2005 Annual Performance Plan.