

EXHIBIT

F

Allan Ratner
Vice President
Deputy General Counsel
(703) 903-2691

BY FACSIMILE AND COURIER

June 19, 2003

Stephen Blumenthal
Counsel to the Director
OFHEO
1700 G Street, NW
Washington, DC 20552

Freddie
Mac

Dear Mr. Blumenthal:

This letter responds to your letter of June 17, 2003, concerning the restrictions that OFHEO has directed to be placed on the transfer or other disposition by Messrs. Brendsel, Glenn and Clarke of several categories of stock.

As I have discussed with you, we have previously informed Salomon Smith Barney ("SSB"), our designated broker for stock plan accounts, and Bank of New York ("BONY"), our record keeper, of your prior oral instructions to prohibit the stock transactions described in your June 17 letter, and we have provided a copy of your letter to Citigroup Global Markets (for SSB) and to BONY, as evidenced by my attached letter to them of today. SSB and BONY have previously informed us that they have prohibited the transactions identified in your oral instructions and in your letter.

In the portion of your letter discussing Mr. Brendsel's request to transfer approximately [redacted] shares of stock from his employee stock purchase plan account, you indicate that I explained that stock in such an account is not available to an employee until Freddie Mac, at the direct request of the employee, directs SSB to release the shares. This does not correctly reflect the standard process or the description of it that I provided to you. In fact, in the absence of special instructions such as those that we transmitted to SSB at your direction, SSB routinely transfers stock from such an account in response to a direct request from an employee, without any need for intervention by Freddie Mac. This reflects the fact that the shares in such an account are owned by the employee. The same is true for shares in an employee's SSB plan account that result from the lapse of restrictions on restricted stock/units.

Your letter also instructs Freddie Mac to "reverse and cancel" what is described as "the sale [by Mr. Glenn] of previously restricted shares of stock on which the restrictions lapsed on June 5, 2003," and to "credit the shares back to his account." In fact, Mr. Glenn's shares of restricted stock on which the restrictions were scheduled to lapse on June 5 remain where they have been since they were issued to Mr. Glenn five years ago, in a pooled account at Freddie Mac's transfer agent that includes restricted stock issued to other Freddie Mac employees. Ordinarily, when the restrictions on employee restricted shares in that account lapse, the shares are transferred to the respective employee's stock plan account at

SSB. In compliance with your instructions, Mr. Glenn's shares of restricted stock, on which restrictions were scheduled to lapse on June 5, have not been transferred to Mr. Glenn's plan account at SSB.

The "sale" reported on Mr. Glenn's Form 4 of June 5, 2003, and referred to in your June 17th letter, reflected a bookkeeping entry by BONY concerning the manner in which Freddie Mac should satisfy its withholding obligation on the [REDACTED] shares on which the restrictions were scheduled to lapse on June 5. That entry documented the fact that Mr. Glenn elected to have Freddie Mac satisfy the obligation by withholding [REDACTED] of the shares, rather than to make a cash deposit with Freddie Mac. Upon a determination that the previously restricted shares are to be released to Mr. Glenn, those [REDACTED] shares would be transferred to Freddie Mac's treasury account to satisfy the withholding obligation, and the remaining [REDACTED] shares would be transferred to Mr. Glenn's plan account at SSB (an account from which transfers by Mr. Glenn have been prohibited in compliance with your instructions). However, no such transfers will occur until a determination has been made that the shares are to be released.

A similar, but not identical, situation exists with respect to Mr. Brendsel's [REDACTED] shares of restricted stock on which the restrictions were scheduled to lapse on June 5. As in the case of Mr. Glenn's restricted stock, those shares remain in the pooled account referred to above, with restricted stock issued to other Freddie Mac employees. Mr. Brendsel has not made a formal election concerning the manner in which the withholding obligation should be satisfied, which explains why no transaction corresponding to Mr. Glenn's "sale" has been reported on a Form 4 for Mr. Brendsel. In accordance with Freddie Mac's standard practice under the plan, if Mr. Brendsel does not deposit funds to satisfy the withholding obligation, BONY will designate an appropriate number of shares of Mr. Brendsel's restricted stock for withholding. As in the case of Mr. Glenn's shares, that action will not result in the transfer of any shares from the pooled Freddie Mac employee restricted stock account to Mr. Brendsel's plan account at SSB (an account from which transfers by Mr. Brendsel have been prohibited in compliance with your instructions), and no such transfer from the pooled account will be made until a determination is made to release the shares to Mr. Brendsel.

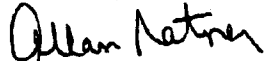
I also want to take this opportunity to point out to you that during their years of employment at Freddie Mac, Messrs. Brendsel, Glenn and Clarke have received other grants of restricted stock on which the restrictions lapsed. Despite the fact that the restrictions on those shares lapsed in 2002 and prior years, such stock would appear to fall within the literal meaning of the instruction in the third paragraph of your June 17th letter that neither Freddie Mac nor its agents take any action to effect or facilitate the transfer, sale or other disposition or encumbrance of previously restricted stock on which the restrictions have lapsed or will lapse. As the restrictions on those shares have lapsed over time, the executives have transferred, sold or otherwise disposed of the shares in a variety of ways, including placing them in retail accounts, converting them to certificated form, and selling or donating the shares, and the shares are no longer held either in a Freddie Mac account or in the executives' plan accounts at SSB. We do not believe that your instructions are intended to cover such shares, and we have taken no action of any kind with respect to those shares.

Stephen Blumental
June 19, 2003
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Finally, I want to confirm my understanding, from a prior conversation with you, that OFHEO does not object to the continued payment of salary to Messrs. Brendsel and Clarke through the effective dates of the termination of their employment relationships with Freddie Mac (July 6 for Mr. Brendsel and September 30 for Mr. Clarke). The next semi-monthly salary payment to those individuals is scheduled to be made shortly.

If you have any questions concerning any of the above, please contact me at (703) 903-2690.

Sincerely,



Allan Ratner

Enclosure

EXHIBIT

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

June 19, 2003

By FAX

John M. Dowd, Esq.
Akin Gump Strauss Hauer & Feld, LLP
1333 New Hampshire Avenue N.W.
Washington, 20036-1564

Dear Mr. Dowd:

In furtherance of our conversation yesterday afternoon regarding your letter of June 18, 2003, I am responding to your inquiry. On behalf of OFHEO, I am communicating our intention to retain the current status of our directions to Freddie Mac regarding compensation benefits for Leland C. Brendsel.

Communications regarding any legal matters relating to the subject of this letter should include a copy to Ms. Marcia Berman, Department of Justice, Federal Program Branch, 20 Massachusetts Avenue N.W., Washington, D.C. 20530; telephone 202 514 3330/fax 202 616 8470.

Sincerely,

Alfred M. Pollard
General Counsel
202 414 3788

cc: Allan Ratner, Esq.
John Dugan, Esq.

EXHIBIT

H

For Immediate Release

June 25, 2003

CONTACT: corprel@freddiemac.com

or (703) 903-3933

FREDDIE MAC REPORTS ON RESTATEMENT PROGRESS

McLean, VA - Freddie Mac (NYSE:FRE) today provided a progress update on issues relating to its previously announced restatement of prior year financial results.

Related Links[> Management Update](#)[> Investor Webcasts](#)

"The new management team of Freddie Mac, working closely with our Board of Directors, is determined to set high standards for candor and transparency in our financial reporting. Our investors and the public should expect and demand nothing less," said Gregory J. Parseghian, chief executive officer and president. "The information we are disclosing today reflects poorly on Freddie Mac's past accounting, control and disclosure practices. Management is aggressively addressing these issues. At the same time, we remain focused on our business and mission. Based on our current understanding, we expect the cumulative effect of the restatement to increase retained earnings as of December 31, 2002, by a range of \$1.5 billion to \$4.5 billion. Today we also are announcing that we expect to report a material increase in the fair value of shareholders' equity for year-end 2002 over 2001."

The corporation is working toward completing the restatement process and releasing its restated results during the third quarter of 2003.

"Freddie Mac is dedicating extraordinary resources to completing this labor intensive restatement process," said Martin F. Baumann, executive vice president—Finance and chief financial officer. "We are working closely with our independent auditor and other advisors to complete this job as quickly as possible."

Impact of Restatement on Financials and Business

As stated above, Freddie Mac continues to expect that the cumulative effect of the restatement will be to materially increase retained earnings for prior periods and materially increase its capital surplus under its regulatory minimum capital requirement as of December 31, 2002. Based on the information currently available, management believes that the expected cumulative effect of the restatement is to increase retained earnings as of December 31, 2002, by a range of \$1.5 billion to \$4.5 billion. Management cautions, however, that neither the restatement nor re-audit processes are complete and the final determination of the cumulative effect could therefore differ from this range. The expected cumulative increase to retained earnings will likely be driven primarily by gains on certain derivatives and mortgage securities that will be marked to fair value during periods in which interest rates were declining. In addition, the corporation continues to expect that adjustments affecting its income will relate substantially to changes in the timing of income recognition, and, as a result, cumulative increases related to these adjustments will have offsetting effects in future periods. These accounting policy changes will cause greater volatility in Freddie Mac's financial statements for prior periods. Freddie Mac believes there also will be significant volatility in its results in future periods.

Freddie Mac also expects a material increase in the fair value of shareholder equity in its fair value balance sheet as of year-end 2002 versus year-end 2001. This expected increase is subject to completion of the restatement and re-audit processes. Freddie Mac's economic hedges remain effective, as demonstrated by its consistently low levels of portfolio market value sensitivity ("PMVS") and narrow duration gap. The accounting policies that will be implemented in connection with the restatement will not adversely affect Freddie Mac's ability to invest in or securitize mortgages, or prudently manage the risks in its business.

Factors Contributing to Restatement

The accounting errors being corrected in the restatement arose from Freddie Mac's re-evaluation, in conjunction

with PricewaterhouseCoopers LLP ("PwC"), Freddie Mac's independent auditor, of certain accounting policies previously used by Freddie Mac. PwC was appointed in March 2002, replacing Arthur Andersen.

As previously announced, the outside directors of Freddie Mac's Board retained outside counsel ("Board Counsel") to review the facts and circumstances relating to certain of the principal accounting errors identified during the restatement process. Board Counsel has advised Freddie Mac that it expects to complete its review and present its written, final report to the Audit Committee and Board of Directors prior to the completion of the re-audit process and will issue a written, interim report during July 2003. Freddie Mac expects to make public Board Counsel's principal findings following those presentations.

Board Counsel has presented preliminary findings to the Audit Committee and the Board as to the factors contributing to the need for restatement. The principal factors thus far identified by Board Counsel are lack of sufficient accounting expertise and internal control and management weaknesses as a consequence of which Freddie Mac personnel made numerous errors in applying Generally Accepted Accounting Principles (GAAP). In addition, Board Counsel has noted that certain capital market transactions and accounting policies had been implemented with a view to their effect on earnings in the context of Freddie Mac's goal of achieving steady earnings growth, and that the disclosure processes and disclosure in connection with those transactions and policies did not meet standards that would have been required of Freddie Mac had it been an SEC registrant. The preliminary findings also note that certain reserve account and other adjustments, that were known departures from GAAP and that were not considered to be material at the time, were made with a view to their effect on earnings. In most cases, Freddie Mac believed at the time the accounting for the transactions, policies and adjustments being reviewed was appropriate and reached these conclusions after consultations with its previous independent auditor.

Board Counsel is continuing its investigation and is expected to present its findings to the Audit Committee and the Board when it presents its written reports. The Board and management will continue to conduct a rigorous review of these matters and take appropriate actions when determinations are made. As Freddie Mac previously has announced, the Board and management are fully cooperating with OFHEO, the SEC and the U.S. Attorney's office in the Eastern District of Virginia in connection with their respective investigations. The company believes that legal characterization of these matters is appropriately left to these agencies at this time.

"The Board's election of new management was made following in-depth consultation with Board Counsel and company's outside counsel," said Shaun F. O'Malley, chairman of Freddie Mac's Board of Directors. "We have every confidence that we have the right management team in place to lead the company and address these serious accounting and control issues."

Freddie Mac has taken numerous steps to date to enhance its internal accounting expertise and controls and will continue to implement remedial steps to address the deficiencies identified by the Board Counsel. Freddie Mac has previously announced its intention to voluntarily register with the SEC in order to become a reporting company under the Securities Exchange Act of 1934. Freddie Mac's new management reiterates its intention to resume the registration process once the restatement and re-audit are complete.

Actions to Address Factors Contributing to Restatement

Freddie Mac is aggressively addressing the factors contributing to the restatement and matters under review by Board Counsel and is committed to achieving high standards of accounting and financial controls. In March 2003, the Board established an ad hoc committee to oversee the restatement effort led by O'Malley. In May 2003, the Board directed its Governance Committee, composed of the presiding director and the chairs of all Board standing committees, to conduct weekly meetings with management regarding the progress of remediation efforts. These efforts are being led by EVP-Finance and Chief Financial Officer Baumann, who brings more than 30 years of experience as a partner, deputy chairman of the World Financial Services Practice and global banking leader for PricewaterhouseCoopers.

Freddie Mac has taken significant actions since the beginning of last year to address its internal control, accounting and financial reporting weaknesses, including the following:

- Added several senior level professionals possessing significant accounting and control expertise, particularly in the area of accounting policy.
- Increased its staff from 54 to 88 full-time employees within its largest accounting and reporting unit responsible for the mortgage, debt and derivative portfolios ("Retained Portfolio").

- Enhanced its control and operating risk oversight by establishing an Operating Risk Oversight function now reporting directly to Baumann.
- Strengthened the review and approval process for critical business transactions, new products and strategies.
- Improved accounting processes by strengthening reconciliation procedures, supervisory review controls, and accounting systems infrastructure.

In addition to these actions, the new executive management team is implementing a comprehensive remediation program with direct oversight by the Governance Committee of the Board. The program is effectuating broad changes in the finance function. This program includes initiatives around governance, human resources, corporate culture, financial reporting and disclosure, accounting policies, processes and controls, and compliance with the Sarbanes-Oxley Act. New management has shared this remediation program with OFHEO and will continue to provide ongoing updates.

"Freddie Mac is committed to strict compliance with GAAP and meeting fully the spirit and intent of all rules and regulations surrounding financial reporting. I am confident that we will emerge from this process stronger than ever, with high-quality accounting and financial reporting controls that match our world class risk management capabilities and powerful business fundamentals," Baumann said.

Summary of Accounting Corrections and Scope of Activities

As Freddie Mac announced in January 2003, the restatement will affect the corporation's financial statements for 2002, 2001 and 2000. These financial statements will be covered by the audit opinion of PwC. Freddie Mac's financial results for periods prior to 2000 will also be affected by the restatement as a result of accounting errors. The impact of these corrections for periods prior to 2000 will be reflected as an adjustment to the beginning balance of retained earnings as of January 1, 2000.

Correcting certain accounting errors will change significantly Freddie Mac's previously reported GAAP results for 2002 and prior years. Historically, a significant portion of Freddie Mac's mortgage securities were classified as held to maturity (HTM) and, accordingly, reported at cost adjusted for amortization of premiums and discounts. As a result, changes in those securities' fair value did not affect current period earnings or stockholders' equity. The restatement will shift all securities previously classified for accounting purposes as HTM to the available for sale (AFS) or trading classifications. All of Freddie Mac's mortgage securities will be marked to fair value, some through current period earnings (trading) and some directly to stockholders' equity (AFS).

In addition, as a result of the restatement, a majority of the corporation's derivatives in 2001 and 2002 will not qualify as accounting hedges. Gains and losses from the change in fair value of these derivatives will directly affect current period earnings as a result of removing previously recorded gains and losses related to certain hedged items and recognizing gains and losses previously deferred in shareholders' equity.

These accounting policy changes will cause greater volatility in Freddie Mac's GAAP financial statements for prior periods. Freddie Mac believes there also will be significant volatility in its GAAP results in future periods.

Based on the information currently available, the corrections the corporation is making fall primarily into the five categories described below. Management cautions, however, that because the restatement is not complete, additional issues may still arise.

Security Classification: During the period covered by the restatement, the corporation sold securities designated for accounting purposes as HTM in circumstances that would not permit the continued use of the HTM category. This means that the corporation must discontinue use of the HTM accounting classification for all securities in that category until at least 2004. Freddie Mac's entire portfolio of HTM securities will be reclassified for accounting purposes to the AFS category, with unrealized gains and losses on the HTM securities at the time of the reclassification recorded to the stockholders' equity section of the balance sheet. This reclassification will need to be recorded in each restatement period, involving up to \$260 billion of mortgage securities comprising in aggregate well over 100,000 individual security records.

The corporation also transferred certain mortgage securities designated for accounting purposes as "trading" into both HTM and AFS classifications when the securities should have remained classified as trading. This correction will require Freddie Mac to reclassify these HTM and AFS securities back to trading, with unrealized

gains and losses on the securities to be reported in current period earnings. These unrealized gains and losses previously had been deferred and not recognized.

Accounting for Derivative Instruments: As part of its ongoing risk management activities, Freddie Mac uses derivative instruments to manage the interest-rate risk associated with its assets and liabilities. Accounting issues associated with the restatement do not change the effectiveness of these derivative instruments from an economic risk management perspective. Notwithstanding the continued economic effectiveness of Freddie Mac's hedges, the restatement will require changes to accounting for derivative instruments in three main areas:

- Freddie Mac treated certain cash market instruments as derivatives that did not meet the GAAP accounting definition of a derivative and applied hedge accounting. Correction of this will require Freddie Mac to reverse from current period earnings gains and losses related to the hedged items (*i.e.*, debt securities issued by Freddie Mac) that were recorded in earnings as part of the hedge accounting relationship.
- Freddie Mac did not adequately document and test certain derivative instruments accounted for as hedges. As part of the restatement, Freddie Mac must reverse the hedge accounting entries related to certain of these accounting hedges. This will result in removing previously recorded gains and losses related to the hedged items from current period earnings for certain fair value hedges, and recording in current period earnings previously deferred gains and losses for certain cash flow hedges. This process involves several hundred thousand security records during the restatement period. Although these derivatives did not qualify for hedge accounting, they proved to be economically effective hedges of Freddie Mac's portfolio of assets and liabilities.
- Freddie Mac enters into forward commitments to acquire mortgage securities in the ordinary course of business. These commitments generally qualified as derivatives under GAAP, however, the changes in fair value of certain of these commitments to acquire mortgage securities were not recorded in current period earnings. In addition to recording the fair value of these commitments in earnings, Freddie Mac will be required to restate the initial premiums and discounts on the acquired mortgage securities and related amortization thereafter.

Asset Transfers and Securitizations: Freddie Mac accounted for certain transfers of mortgage securities to third parties as financings when they should have been accounted for as sales under GAAP. In addition, Freddie Mac did not record certain retained interests and credit obligations related to credit guarantees required when Freddie Mac sells mortgage securities. Freddie Mac will be required to record gains and losses on the sales transactions including the effects of retained interests and credit obligations, and reverse the effects of financing treatment.

Valuation of Financial Instruments: Freddie Mac has concluded that the reported fair values of certain option-related derivatives did not incorporate all applicable market pricing data. Therefore, fair values for these options will be changed to consider such data. These corrections will be recorded in current period earnings in the relevant restatement periods. The result of the re-valuation of these derivatives is expected to increase the net fair value presented in Freddie Mac's fair value balance sheet, which had previously been disclosed in Freddie Mac's Annual Report to Shareholders.

All Other: During the course of the restatement process, Freddie Mac has identified numerous other accounting policies, practices and entries requiring correction. These changes touch on many aspects of Freddie Mac's financial statements. In addition, Freddie Mac previously reported minor accounting corrections through earnings in the periods the errors were discovered. Freddie Mac's restated financial statements will reflect these corrections in the periods affected rather than the period in which the errors were discovered. Management believes that individually and in the aggregate these changes will have a smaller impact on cumulative retained earnings at December 31, 2002, relative to the categories discussed above.

"Given the number of accounting issues involved, the volume of Freddie Mac's securities and derivatives transactions, the number of years being restated, and the fact that the re-audit is being completed by auditors not previously involved with our prior years' financial statements, the time being taken to complete this restatement is entirely appropriate," said Baumann. "I am determined to do this job comprehensively and accurately so that investors and the public will have complete confidence in our financial reporting going forward."

O'Malley concluded, "Freddie Mac is moving forward aggressively and confidently. Our business fundamentals remain exceptionally strong. We expect the restatement to increase our assets, retained earnings and capital. And we are putting in place the accounting controls, people and processes equal to the excellence we expect of Freddie Mac."

Future Financial Performance Disclosures

Freddie Mac is committed to disclosing information that is useful to investors in understanding its financial performance. Previously, Freddie Mac has reported "Operating Earnings," a non-GAAP financial measure derived from GAAP financial statements. As a result of changes in its GAAP accounting policies occasioned by the restatement, particularly those affecting derivatives accounting, management has concluded that "Operating Earnings" no longer will be meaningful. Therefore Freddie Mac will neither restate nor provide this measure in its periodic financial reporting.

Freddie Mac expects to provide two supplemental disclosures later this year or beginning in 2004. This will include quarterly changes in Freddie Mac's fair value balance sheet and a new non-GAAP financial measure.

Announcement of Webcast and Live Telephone Conference

Freddie Mac will host a conference call discussing today's announcement at 8:30 a.m. eastern time on Wednesday, June 25, 2003. Domestic investors should call 1-888-428-4476 and international investors can access the call at 612-326-1003. The conference call will be Webcast live on Freddie Mac's Web site. A telephone recording of this conference call will be available continuously beginning at 10:30 a.m. eastern time on June 25 until midnight on July 10. To access this recording in the United States, call 1-800-475-6701 and use access code 689496. Outside of the United States, call 320-365-3844 and use code 689496.

Freddie Mac is a stockholder-owned corporation established by Congress in 1970 to support homeownership and rental housing. Freddie Mac purchases single-family and multifamily residential mortgages and mortgage-related securities, which it finances primarily by issuing mortgage passthrough securities and debt instruments in the capital markets. Over the years, Freddie Mac has opened the doors for one in six homebuyers and more than two million renters across America.

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EXHIBIT

I

**United States of America
Office of Federal Housing Enterprise Oversight**

In the Matter of
THE FEDERAL HOME LOAN MORTGAGE CORPORATION ("FREDDIE MAC")
December 9, 2003

STIPULATION AND CONSENT TO THE ISSUANCE OF A CONSENT ORDER

The Director of the Office of Federal Housing Enterprise Oversight ("OFHEO") has determined to initiate cease and desist proceedings and has determined to impose a civil money penalty against the Federal Home Loan Mortgage Corporation ("Freddie Mac" or "Enterprise") pursuant to 12 U.S.C. § 4631 and 12 U.S.C. § 4636.

The Enterprise, in the interest of compliance and cooperation, consents to the issuance of a Consent Order, dated December 9, 2003 ("Order"), before the filing of any notice and before the finding of any issues of fact or law.

In consideration of the above premises, the Director and the Enterprise, through its duly authorized representative, hereby stipulate and agree to the following:

ARTICLE I

Jurisdiction

(1) The Enterprise is a corporation chartered pursuant to the Federal Home Loan Mortgage Corporation Act of 1970, 12 U.S.C. §§ 1451 to 1459, and subject to supervision and regulation by OFHEO pursuant to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, 12 U.S.C. §§ 4501 *et seq.*

ARTICLE II

Agreement

(2) The Enterprise hereby consents and agrees to the issuance of the Order by the Director. In so doing, the Enterprise neither admits nor denies any wrongdoing or any asserted or implied finding or other basis for the Order. The

Enterprise further consents and agrees that said Order shall become effective upon its issuance and shall be fully enforceable by OFHEO under the provisions of 12 U.S.C. §§ 4635 and 4636.

ARTICLE III

Waivers

(3) The Enterprise, by signing this Stipulation and Consent, hereby waives:

(a) the issuance of a Notice of Charges pursuant to 12 U.S.C. § 4631(c)(1);

(b) written notice of the Director's determination to impose a penalty on the record pursuant to 12 U.S.C. § 4636(c)(1)(A);

(c) any and all procedural rights available in connection with the issuance of the Order;

(d) all rights to seek any type of administrative or judicial review of the Order; and

(e) any and all rights to challenge or contest the validity of the Order.

ARTICLE IV

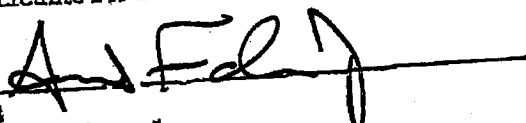
Other Action

(4) The Enterprise agrees that the provisions of this Stipulation and Consent shall not inhibit, estop, bar, or otherwise prevent the Director from taking any other action affecting the Enterprise in connection with OFHEO's ongoing regulatory oversight of the Enterprise with respect to matters occurring subsequent to the date of the Order or with respect to matters relating to third parties not affiliated with the Enterprise (including separated senior officers of the Enterprise) if, at any time, the

Director deems it appropriate to do so to fulfill the responsibilities placed upon him by the several laws of the United States of America.


(5) The Enterprise agrees that the provisions of this Stipulation and Consent shall not be construed to limit or otherwise affect regulatory actions by other federal regulatory agencies.

IN TESTIMONY WHEREOF, the undersigned, the Director of OFHEO, has hereunto set his hand on behalf of himself and OFHEO.


2003
Armando Falcon Jr.
Director, Office of Federal Housing Enterprise Oversight

DATED: December 9,

IN TESTIMONY WHEREOF, the undersigned, as the duly authorized representative of the Enterprise, has hereunto set his hand on behalf of the Enterprise.


2003
Shaun F. O'Malley
Chairman of the Board of Directors
Federal Home Loan Mortgage Corporation ("Freddie Mac")

DATED: December 9,

United States of America
Office of Federal Housing Enterprise Oversight

Order No. 2003-02

In the Matter of
The Federal Home Loan Mortgage Corporation

Consent Order

Whereas, the Director of the Office of Federal Housing Enterprise Oversight ("OFHEO") has determined to initiate cease and desist proceedings against the Federal Home Loan Mortgage Corporation (~~"Freddie-Mac" or "Enterprise"~~) pursuant to 12 USC § 4631.

Whereas, the Director has determined to initiate such proceedings based on his view that Freddie Mac engaged in conduct that does not conform with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("Safety and Soundness Act"), OFHEO rules, guidances and standards, and the Federal Home Loan Mortgage Corporation Act and that such conduct has resulted in harm to the Enterprise;

Whereas, the Director believes that the conduct involved provides sufficient grounds to initiate administrative or enforcement proceedings against the Enterprise, including a claim for the award of civil money penalties and other relief;

Whereas, the Enterprise has executed a "Stipulation and Consent to the Issuance of a Consent Order," dated December 9, 2003, that is accepted by the Director, and by such Stipulation and Consent the Enterprise has consented to the issuance of this Consent Order ("the Order") by the Director.

Whereas the Director believes that it would be in the public interest to enter into this Consent Order with the Enterprise,

Therefore, the Director, pursuant to the authority vested in him by the Safety and Soundness Act, 12 U.S.C. §§ 4631 and 4636, hereby orders that:

Article I Cooperation

1. The Enterprise shall use good faith reasonable efforts to cooperate with OFHEO in OFHEO's pursuit of administrative or enforcement proceedings with respect to other persons, including, upon reasonable prior notice and at reasonable times and places, in making Enterprise's documents and records relating to such proceeding available to OFHEO without subpoena (subject to any privilege or other protection available under applicable law), and, upon reasonable prior notice and at reasonable times and places, in making the Enterprise's personnel (including officers, directors and employees) available for interview and/or testimony without subpoena (subject to any privilege or other protection available under applicable law), provided that the duty to cooperate under this paragraph shall not require cooperation between the Enterprise and OFHEO in respect of claims or proceedings making any allegation that would, if proven, adversely affect the Enterprise, as determined by the Enterprise.

2. The Enterprise shall use good faith reasonable efforts to cooperate with OFHEO in OFHEO's pursuit of litigation with respect to other persons or in litigation involving other persons, including, upon reasonable prior notice and at reasonable times and places, in making the Enterprise's documents and records relating to such litigation available to OFHEO without subpoena (subject to any privilege or other protection available under applicable law), and, upon reasonable prior notice and at reasonable times and places, in making the Enterprise's personnel (including officers, directors and employees) available for interview and/or testimony without subpoena (subject to any privilege or other protection available under applicable law), provided that the duty to cooperate under this paragraph shall not require cooperation between the Enterprise and OFHEO in respect of claims or proceedings making any allegation that would, if proven, adversely affect the Enterprise, as determined by the Enterprise.

Article II Board of Directors and Senior Management

3. Within 120 days from the date of this Order, the Board shall cause to be conducted a review of the Enterprise's bylaws in light of the factors contributing to the restatement and revision of the Enterprise's financial statements for 2000, 2001 and 2002. Based on this review, the Board shall cause such revisions to be made in the Enterprise's bylaws as the Board determines to be appropriate.

The Enterprise shall report to OFHEO on the results of the review and on any revisions to be made to the Enterprise's bylaws.

4. Within 120 days from the date of this Order, the Board shall cause to be conducted a review of the Enterprise's codes of conduct for the Board and for employees in light of the factors contributing to the restatement and revision of the Enterprise's financial statements for 2000, 2001 and 2002, and shall cause such revisions to be made in those codes of conduct as the Board determines to be appropriate and such employee training programs to be developed and implemented as the Board determines to be appropriate.

Enterprise shall report to OFHEO on the results of the review of the Enterprise's codes of conduct for the Board and employees, on any revisions to be made in such codes of conduct and on any employee training programs to be developed and implemented.

In addition, for the first 24 months following the implementation of any employee training programs pursuant to this paragraph, the Enterprise shall submit to OFHEO at the end of each six-month period a report on the implementation of such training programs by the Enterprise.

5. Within 180 days from the date of this Order, the Board shall cause to be prepared a succession plan for the Enterprise's senior management. The Board shall consult with OFHEO in preparing this succession plan, and shall submit a copy of this succession

plan to OFHEO. (For purposes of this paragraph, senior management means the Enterprise's chief executive officer, chief operating officer, chief financial officer and general counsel, and the heads of the Investment & Capital Markets Division and the Mortgage Sourcing, Operations & Funding Division.)

6. Within 120 days from the date of this Order, the Board shall cause to be conducted a review of its committee structure and shall determine what changes, if any, are appropriate to make in such committee structure. This review shall take into account the need for effective Board oversight of essential Enterprise functions, including management implementation of internal controls and operational risk planning. The Board shall report to OFHEO any changes it determines to make in its committee structure as a result of this review.

7. Within 150 days from the date of this Order, the Board shall cause to be reviewed the frequency of regular Board meetings, the Board's process (including the amount of time allotted) for full Board consideration of Board committee reports, and the Board's processes for obtaining information from management with respect to both the Enterprise's ongoing operations and issues of special importance to the Enterprise.

Based on this review, the Board shall determine what revisions, if any, are appropriate to make in the frequency of regular Board meetings, in the Board's process (including the amount of time allotted) for full Board consideration of Board committee reports, and in the Board's processes for obtaining information from management with respect to both the Enterprise's ongoing operations and issues of special importance to the Enterprise.

The Board shall report to OFHEO any changes it determines to make as a result of this review with respect to the frequency of regular Board meetings, the Board's process (including the amount of time allotted) for full Board consideration of Board committee reports, and the Board's processes for obtaining information from management with

respect to both the Enterprise's ongoing operations and issues of special importance to the Enterprise.

8. Within 120 days from the date of this Order, the Board shall determine what limits, if any, to establish on the terms of members of the Board. The Board shall report to OFHEO any such term limits that are to be established and how such limits are to be implemented.

9. Within 120 days from the date of this Order, the Board shall develop required qualifications for service as a director of Enterprise. Such qualifications may include limits on service of Enterprise directors on boards of directors of other companies; standards for determining independence for outside directors that meet or exceed existing requirements of the New York Stock Exchange; and standards for the continuation of service as a director for executive officer directors who cease to be employees of Enterprise. The Board shall report to OFHEO any such qualifications that are to be established and how such qualifications are to be implemented.

10. At least once annually, the Board shall review, with appropriate professional assistance, the legal and regulatory requirements that are applicable to its activities and duties.

11. At least once annually, the Enterprise's senior management shall review, with appropriate professional assistance, the legal and regulatory requirements applicable to their activities and duties.

12. At least once annually, the Board shall meet with senior representatives of OFHEO to ensure that the Board is appropriately apprised regarding any significant regulatory issues relating to the Enterprise's operations and activities.

13. The Enterprise shall separate the position of Chairman and the position of Chief Executive Officer within a reasonable period of time.

14. Within 180 days from the date of this Order, Enterprise shall submit to OFHEO an acceptable plan setting forth specific actions that Enterprise will take to foster a management culture in which appropriate consideration is given to operational stability and legal and regulatory compliance throughout the Enterprise, as essential elements of a management approach that seeks properly to address all relevant risks and to maximize the Enterprise's long-term value. Such actions shall include appropriate training of the Enterprise's officers and employees, and steps to make the Enterprise's compensation system for executive officers consistent with fostering the management culture contemplated under this paragraph.

Article III Internal Controls

15. Within 60 days from the date of this Order, the Enterprise shall submit to OFHEO a report on the nature and status of PricewaterhouseCoopers' and any other consultant's review of the Enterprise's design, assessment and evaluation of controls with respect to financial reporting. Upon completion of such reviews, the Enterprise shall submit to OFHEO a report analyzing the results of such reviews and setting forth a plan for remedial steps to be taken by management.

16. (a) Within 60 days from the date of this Order, the Enterprise shall engage an independent consultant to conduct a review of the Enterprise's internal controls with respect to the following:

- (i) Reporting to the Enterprise's Board of Directors.
- (ii) Reporting to the Enterprise's senior management.

(b) Within 180 days from the date of its engagement, the consultant shall prepare a written report setting forth any recommended changes in the Enterprise's internal controls with respect to the following:

- (i) Reporting to the Enterprise's Board of Directors.
- (ii) Reporting to the Enterprise's senior management.

The consultant shall provide a copy of its report to OFHEO at the same time that the report is provided to the Enterprise.

(c) Within 60 days after receipt of the consultant's report, the Enterprise shall submit to OFHEO an acceptable written plan to address the recommendations of the consultant's report.

17. At least once annually, the Enterprise's senior management shall review the effectiveness of the internal controls that are the subject of paragraphs 15-16, and shall report to the Board, or an appropriate Board committee, on the results of its review. A copy of senior management's report shall be submitted to OFHEO.

18. The Enterprise shall have established the position of chief risk officer with responsibility for the Enterprise's risk oversight function. Within 60 days of the date of this Order, the Enterprise shall report to OFHEO on the functions of the chief risk officer and to whom such officer shall report.

19. The Enterprise shall have established the position of chief compliance officer. Within 60 days of the date of this Order, the Enterprise shall report to OFHEO on the functions of the chief compliance officer and to whom such officer shall report.

Article IV Internal Audit

20. Within 120 days from the date of this Order, the Enterprise shall submit to OFHEO an acceptable plan setting forth specific actions that the Enterprise will take in order to address the effectiveness of its internal audit function, including but not limited to:

- (a) The independence of the internal audit function;
- (b) The adequacy of information provided to the audit committee;
- (c) The adequacy of internal audit staffing;
- (d) The adequacy of internal audit planning;

- (e) The adequacy of internal audit work programs; and
- (f) The adequacy of formal management responses to audit findings.

Article V Internal Accounting

21. (a) Within 60 days of the date of this Order, the Enterprise shall engage an independent consultant to conduct a review of:
- (i) The current staffing of the Enterprise's internal accounting function in relation to Enterprise's accounting requirements.
 - (ii) Any plans to augment the staffing of the Enterprise's internal accounting function in relation to the Enterprise's accounting requirements.
 - (iii) The structure for ongoing management oversight of the internal accounting function, including with respect to ensuring timely implementation of new accounting standards and requirements.

(b) Within 90 days from the date of its engagement, the consultant shall prepare a written report setting forth any recommendations with respect to:

- (i) The staffing of the Enterprise's internal accounting function in relation to the Enterprise's accounting requirements.
- (ii) The structure for ongoing management oversight of the internal accounting function, including with respect to ensuring timely implementation of new accounting standards and requirements.

(c) Within 60 days of receipt of the consultant's report, the Enterprise shall submit to OFHEO an acceptable written plan to address the recommendations of the consultant's report.

Article VI Risk Management Transactions

22. (a) Within 90 days after the date of this Order, the Enterprise shall develop procedures with respect to:

(i) Appropriate management oversight that a business purpose exists for unique transactions relating to risk management or where a business purpose is required under generally accepted accounting principles for a transaction relating to risk management.

(ii) Maintaining appropriate records of the business purpose of unique transactions relating to risk management or where a business purpose is required under generally accepted accounting principles for a transaction relating to risk management.

(b) The Enterprise shall submit to OFHEO a copy of the procedures developed pursuant to paragraph 22(a).

Article VII Public Disclosures and Regulatory Reporting

23. Within 90 days from the date of this Order, the Enterprise shall submit to OFHEO an acceptable plan setting forth specific actions that the Enterprise will take to address the adequacy of its public disclosures practices and to have in place effective ongoing management oversight of its public disclosure practices.

24. Within 90 days from the date of this Order, the Enterprise shall review its procedures for ensuring that reports, including data, submitted to OFHEO meet all applicable legal and regulatory requirements, and shall submit to OFHEO a report setting forth those procedures, including any steps the Enterprise has made or has determined it should make to enhance those procedures.

Article VIII Oversight and Reporting

25. The Board shall designate a committee of the Board that shall be responsible for overseeing the Enterprise's compliance with the provisions of this Order.

26. Management shall prepare quarterly a report on the Enterprise's progress in complying with the provisions of this Order, and shall submit such quarterly progress report to the designated Board committee for its review and approval.

27. Following approval by the Board committee, a copy of such quarterly progress report shall be submitted to OFHEO.

28. The first quarterly progress report pursuant to paragraph 27 shall be submitted to the designated Board committee by no later than March 15, 2004.

Article IX. Civil Money Penalty

29. Within ten days from the date of this Order, the Enterprise shall transfer \$125 million, in the manner specified by the General Counsel of OFHEO, in the name of the United States Treasury. This amount shall constitute a civil money penalty imposed on the Enterprise pursuant to 12 U.S.C. § 4636.

It is so ordered, this 9th day of December, 2003.



Armando Falcon, Jr.

Director, Office of Federal Housing Enterprise Oversight

EXHIBIT

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

July 16, 2003

VIA FACSIMILE

Allan Ratner
Vice President and
Deputy General Counsel
Freddie Mac
8200 Jones Branch Drive
McLean, VA 22102-3107

Dear Mr. Ratner:

I have received your letters dated July 10 and 15, 2003, concerning certain compensation and benefit issues that we discussed in our telephone conversations on July 9 and 11. In your letters, you note several items that ensure Freddie Mac's continued compliance with instructions set forth in my letters of June 12 and 17, 2003. You also note the following items for which you are seeking guidance to ensure that Freddie Mac addresses them consistently with those instructions:

1. March 2003 dividends on Freddie Mac Stock of Mr. Brendsel
You stated that Mr. Brendsel exercised Freddie Mac stock options on March 13, 2003. Notwithstanding the exercise of the options on such date, the shares were not delivered to Mr. Brendsel's retail account at Salomon Smith Barney until after the dividend record date on March 17, 2003. As a result, Mr. Brendsel did not receive the first quarter dividend. (This same situation occurred with respect to some 30 - 40 other Freddie Mac employees who exercised stock options and whose shares were also "in transit" on the March dividend record date.) Mr. Brendsel did receive a dividend for the second quarter with respect to the shares he obtained by virtue of his exercise of the stock options on March 13. The Human Resources Department of Freddie Mac is in the process of having the missed March dividend payments included in affected employees' paychecks for the July 15 payroll, and Freddie Mac is proposing likewise to pay Mr. Brendsel the March dividend [REDACTED] on the shares he obtained by virtue of his March 13 exercise.

Please be advised that OFHEO does not object to Freddie Mac paying Mr. Brendsel the first quarter dividend [REDACTED] on the shares he obtained by virtue of his March 13, 2003 exercise.

2. David Glenn COBRA benefit

You stated that under COBRA, an employer may, but does not have to, deny standard health insurance coverage to an employee who has been terminated for gross misconduct. Notwithstanding that Mr. Glenn was terminated for gross misconduct, Freddie Mac proposes to offer Mr. Glenn and his family COBRA coverage to ensure that he and his family do not have a gap in health insurance coverage. Under COBRA, Mr. Glenn would pay █████ of the premiums for such coverage.

Please be advised that OFHEO does not object to Freddie Mac providing Mr. Glenn and his family the COBRA coverage.

3. Leland Brendsel 60 months of health care and life insurance

You summarized the health care and life insurance plans' coverage provided under section 6.2(v) of Mr. Brendsel's employment agreement (dated September 7, 1990) based on a termination "For Good Reason"(section 5.3).

Health Care Coverage

You stated that section 6.2(v) provides that Freddie Mac shall, at its expense, provide health care coverage for 60 months post-termination. Also, the section provides that Freddie Mac may either provide continued coverage for Mr. Brendsel and his family under the group health plan (medical/dental/vision) in effect on his termination date or afford him equivalent coverage. To meet this obligation, you advised that Freddie Mac is exploring several alternatives, including using the group health plan's retiree health coverage or purchasing individual health insurance policies. You noted that Freddie Mac estimates that, based on its current costs, retiree coverage for Mr. Brendsel and his spouse under Freddie Mac's group health plan would cost approximately █████ for 60 months coverage. You also noted that, to date, an equivalent individual policy has not been located.

Life Insurance Coverage

You stated that section 4.7 of Mr. Brendsel's employment agreement provides that during his employment (and during the 60 month post-termination period following termination under section 5.3), Mr. Brendsel's beneficiaries are entitled to company-paid death benefits in the amount that would apply pursuant to his elections under Freddie Mac's all-employee cafeteria plan, notwithstanding any salary caps that might apply under the group term life insurance plan. You also noted the following specific information regarding life insurance coverage by Freddie Mac for Mr. Brendsel under his employment agreement:

- Freddie Mac's cafeteria plan permits all employees to elect life insurance up to three times their annual salary, which is the amount that Mr. Brendsel elected (a total of [REDACTED]). The group term life insurance policy has a cap of [REDACTED], and three times Mr. Brendsel's salary exceeded that cap. Therefore, while Mr. Brendsel was an active employee, Freddie Mac met its obligation under section 4.7 through the group policy ([REDACTED]) and two individual term life policies ([REDACTED]) on which the company paid premiums. The remainder of Freddie Mac's contractual life insurance obligation was funded through a corporate life insurance policy.
- Section 6.2(v) of Mr. Brendsel's employment agreement provides that Freddie Mac shall, at its own expense, continue to provide life insurance coverage for 60 months post-termination at the same level as was being provided at the time of termination. That may be done either through Freddie Mac's group life insurance plans in effect at termination or through equivalent coverage. Freddie Mac plans to convert the group term policy described above to an individual policy whole life policy, and to continue to pay premiums on that policy plus the two individual term life policies mentioned above for the 60-month period. Those 3 policies will provide \$3 million in coverage, and Freddie Mac plans to use the corporate life insurance policy to pay the remainder of the death benefit.
- The estimated total premium for 60 months of coverage under the converted group life policy is [REDACTED]. The estimated total combined premium for 60 months' coverage under the two individual policies is [REDACTED]. No additional premium is related to that portion of the coverage provided by the corporate life insurance policy since such coverage is part of a single premium, group variable life insurance policy previously purchased by Freddie Mac.

Please be advised that OFHEO does not object to Freddie Mac providing Mr. Brendsel the health care coverage as set forth above. With respect to the life insurance coverage, based on the information noted above, OFHEO does not object to Freddie Mac providing Mr. Brendsel with continued coverage under the two existing individual term policies and the corporate life insurance policy. OFHEO also does not object to Freddie Mac finding and providing Mr. Brendsel with coverage under a comparable individual term insurance policy for the group term policy in effect at the date of his termination. A conversion by Freddie Mac of Mr. Brendsel's life insurance coverage from the group term policy to an individual whole life policy would constitute a new benefit that would be subject to the prior approval of OFHEO.

Allan Ratner
Vice President and
Deputy General Counsel
July 16, 2003
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4. Leland Brendsel and David Glenn deferred compensation

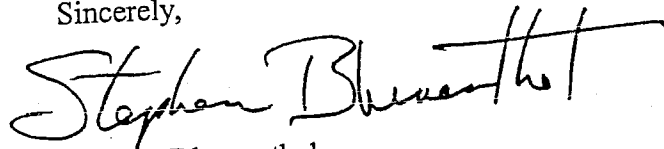
You stated that Freddie Mac believes that it is appropriate that payments under the deferred compensation plan be made to Mr. Brendsel and Mr. Glenn in accordance with the plan's terms. To that end, you provided specific information regarding the components of their deferred compensation plan accounts.

Please be advised that OFHEO does not agree to the payment of deferred compensation by Freddie Mac to either Mr. Brendsel or Mr. Glenn at this time. OFHEO believes that further discussions are appropriate.

Please be advised that the above actions by OFHEO do not represent an agency judgment or determination regarding the actions of Mr. Brendsel or Mr. Glenn in the performance of their duties and responsibilities during their employment with Freddie Mac. Notably, none of OFHEO's actions preclude, upon completion of its special examination, the pursuit of any course deemed appropriate with regard to Mr. Brendsel or Mr. Glenn, including the cessation of a compensation benefit or an order of recoupment.

If you have any questions, please contact me ((202) 414-3802).

Sincerely,



Stephen Blumenthal
Counsel to the Director

cc: David W. Roderer, Deputy General Counsel

EXHIBIT

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Office of Federal Housing Enterprise Oversight (OFHEO)
1700 G Street, NW 4th Floor
Washington, DC 20552
Phone: 202-414-3800
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FOR IMMEDIATE RELEASE
July 17, 2003

Contact: Corinne Russell
202.414.6921
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Statement of the Honorable Armando Falcon, Jr. Before the Committee on Banking, Housing and Urban Affairs, United States Senate, July 17, 2003

Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, I appreciate the opportunity to appear before you. My testimony today will focus on the Freddie Mac restatement process, OFHEO's role as a safety and soundness regulator, more specifically, the Agency's approach to examining accounting practices and financial controls at the Enterprises, and a status report on the related issues of Executive Compensation and Corporate Governance. In addition, I have attached some legislative recommendations for the Committee's consideration to enhance OFHEO's role as safety and soundness regulator.

Introduction

On January 22, 2003, Freddie Mac announced that it would reaudit and restate its financial statements for 2000 and 2001. The company also announced that its external auditor would delay certification of Freddie's year-end 2002 financial statements. Five months later, on June 7, the Board removed the company's top three officers. OFHEO, the SEC and a U.S. Attorney all have ongoing investigations of the company and its accounting practices. These extraordinary actions reflect the culmination of developments over several years. Given our ongoing investigation, I ask for the Committee's understanding if I am restrained in my testimony, as facts are still being verified and circumstances evaluated. I will begin by describing the major developments in chronological order.

Lead -Up to FAS 133 Preparation and Implementation -- 1999

First, the sequence of events begins with the preparation, in 1999, for implementation of Financial Accounting Standards Board (FASB) Statement No. 133 – Accounting for Derivative Instruments and Hedging Activities (FAS 133). FAS 133 is not the only accounting standard involved in this matter, but it plays the most important role. FAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities.

FAS 133 requires an entity to recognize all derivatives as either assets or liabilities in the financial statements and reflect those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as: a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment; b) a hedge of the exposure to variable cash flows of a forecasted transaction; or c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation.

Under FAS 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk.

I would now like to turn to OFHEO's examination strategy to cover FAS 133 preparation at the Enterprises in 1999. The routine 1999 examination work was conducted at the same time OFHEO's examiners were

expending considerable efforts to ensure that both Enterprises were prepared for, and all essential systems across the two companies would be fully compliant with Y2K goals. Because of the critical nature of Y2K readiness, examiners conducted extensive testing and validation of systems preparedness. Against this backdrop, the FAS 133 examination strategy required the examination team to maintain expertise and working knowledge of the accounting standard and its potential effects on each Enterprise; evaluate and assess the Enterprises' timelines for implementation; evaluate the strategy each Enterprise was pursuing for its implementation of the accounting pronouncement, and analyze the effects of FAS 133 on financial statements. In addition, our examiners would continue to evaluate the external accountant's position on the accounting policy guidance associated with implementing FAS 133; assess the systems enhancements to conduct hedging and financial reporting under FAS 133; and evaluate and monitor implementation readiness and event management, including contingency preparations for the transition.

In the second half of the year, FASB unexpectedly delayed the implementation date of FAS 133, from January 1, 2000 to January 1, 2001, so that companies could focus their attention on Y2K.

Transition Period to FAS 133 Readiness – 2000

In 2000, OFHEO's examiners assessed the development and implementation of Enterprise plans with respect to several new significant accounting standards, including FAS 133. At the same time, they reviewed the effectiveness of Y2K efforts and the effects on the financial safety and soundness of a 20 percent decline in the volume of originations; an increase in the proportion of Enterprise purchases of single-family mortgages evaluated through automated underwriting systems; and the increased use of sophisticated technology for risk management across the companies.

In evaluating preparations for the implementation of FAS 133, examiners were actively evaluating: Systems preparation, implementation strategies, impact analysis, documentation specifications, portfolio management strategies and the approvals from management, the Board and the internal and independent external accountants involving FAS 133 implementation. We recognized the substantial progress that had been made on the preparations and the considerable analysis that had been performed. Further, we noted the additional efforts that were underway to deal with the remaining systems and documentation challenges associated with implementing and operating with FAS 133.

In late 2000, the Audit Committee approved the Financial Reporting Controls Improvement Plan (FRCIP). The FRCIP was designed to address issues affecting financial accounting and financial reporting that had been identified by the company, its independent auditors and OFHEO. The goal of the FRCIP was to achieve the same level of controls in the financial accounting and financial reporting area that were present across the other areas of the company and in the operating business units.

OFHEO's examiners evaluated the FRCIP and Freddie Mac's progress in completing the FRCIP in a number of ways. In 2000, examiners evaluated and communicated with management about the FRCIP itself, ensuring if it was reasonably designed to address the root causes of the identified weaknesses. Also, in 2000, examiners assessed the design of the tools both management and the Board's Audit Committee intended to use to measure and report progress in implementing the FRCIP. On a regular basis, examiners were assessing the progress toward completion of the FRCIP and communicating our assessments to the company.

In the fourth quarter of 2000 and the first quarter of 2001, Freddie Mac entered into several transactions to minimize the impact of FAS 133. PwC later identified these FAS 133 transition transactions as accounting issues needing correction before the 2002 financial statements could be certified.

Implementation of FAS 133 – First Quarter 2001

In 2001, OFHEO's examiners continued their ongoing evaluation of the implementation of FAS 133 and its impact on the Enterprise, with respect to business activities, risk management strategies and portfolio management. Among the variety of features our examiners were reviewing, were the operational aspects associated with FAS 133 and the company's quarterly closing practices. When reviewing the quarterly closings, we noted the sign-offs and notations of the company's auditors. Our review found no reservations or qualifications associated with Arthur Andersen's certification of the quarterly and year-end 2001 financial

statements and the conformance of those financial statements and disclosures with GAAP.

FAS 133 was implemented in first quarter 2001. Arthur Andersen certified each quarter's financial statements under the new FAS 133 pronouncement as GAAP compliant. At this same time, extensive interpretations continued to be produced on FAS 133 by Financial Accounting Standards Board (FASB).

While OFHEO was conducting its FAS 133-related examination activities, we were also dedicating examiners to assess the impact of record levels of originations, new corporate governance standards and record volumes of purchases and securitization on both Enterprises' safety and soundness. OFHEO examiners were also evaluating the timeliness and effectiveness of the Enterprises' actions to meet the final Risk-Based Capital Rule.

Need to Strengthen Expertise and Controls -- 2001

After preparing for FAS 133, the actual implementation of this accounting standard further highlighted aspects of Freddie Mac's financial accounting and financial reporting areas that needed strengthening. It became more apparent to OFHEO and Freddie Mac that, while the overall control structure for the company was strong, in the financial accounting and financial reporting area there was an apparent need to strengthen expertise and reduce the reliance on manual systems. Strengthening expertise and reducing the reliance on manual systems were important aspects of the FRCIP introduced in 2000, and examiners continued in 2001 to evaluate the progress against this remediation plan. We continued to press management to ensure progress continued in implementing the FRCIP and maintaining the plan's implementation remained an important corporate priority.

OFHEO felt the control environment at that point in financial accounting and financial reporting was stable, but in need of strengthening. The FRCIP was designed to address the identified weaknesses and to strengthen the control environment in the financial control and financial reporting area to a level consistent with the control environments across the other parts of Freddie Mac. While there were weaknesses in the financial accounting and financial reporting area, the manual processes did mitigate those control weaknesses in the operating process and resulted in Freddie Mac's ability to produce reliable financial records. Upon completion of the work to re-engineer the financial accounting and financial reporting process, there would be a more timely, efficient and streamlined process that would not depend upon manual systems to ensure the reliability of financial information.

In context, Freddie Mac maintained effective internal controls in its various business areas. The area covered by FRCIP was the financial accounting and financial reporting area, which represents a subset within the larger finance area, and an even smaller subset within the overall company.

OFHEO's examiners continued in 2001 to evaluate progress on the FRCIP at least quarterly by, for example, analyzing and testing the quarterly progress reports to the Audit Committee, Internal Audit, senior management and Arthur Andersen, and evaluating the events reached or expected, major milestones, schedule overruns and the level of completion of each project. Examiners concluded that by mid-2001 approximately one-third of the FRCIP had been completed. As a result of a national search, Freddie Mac brought in a new Senior Vice President – Corporate Controller, charged with responsibility for the accounting and control function. This key milestone was achieved in October 2001, and by year-end 2001 Freddie Mac completed Phase I of the FRCIP, which included reconciliations, and deployment of integrated and automated cash management, bank account and transactional reconciliations and billings/receivables functionalities. In 2002, OFHEO's examiners continued their ongoing assessments of progress under the FRCIP, and determined that the new accountability model and Operation Risk Management Unit, when implemented, would strengthen Freddie Mac's financial accounting and reporting processes.

Also during this period, OFHEO was planning enhancements for its examination activities. In 2000, I had meetings with OFHEO's Chief Examiner, and we outlined plans for strengthening OFHEO's examination program. Among our discussions was an idea to create an examination team dedicated to accounting matters. In January 2001, the Chief Examiner delivered a plan designed to enhance OFHEO's examination program. A cornerstone of that plan was to more than double the size of the examination staff, adding depth and additional specialized skill sets to deal with complex issues associated involving the supervision of the Enterprises.

The plan to strengthen OFHEO's examination program included the formation of a group for specialized examination activities, including a team of accountants. After receiving this plan in January 2001, I began advocating within the Administration and with Congress the importance of OFHEO obtaining the resources to begin implementing this plan and enhancing our examination program. In the second half of 2002, we were able to start adding to our team of accountants with skilled technicians who would be dedicated to accounting matters at the Enterprises.

New Outside Auditor -- 2001

Late in 2001, Arthur Andersen was under public scrutiny because of its role as the audit firm of record in certain high-profile federal investigations and bankruptcy filings. Given these developments in late 2001 with Arthur Andersen, Freddie Mac's Board of Directors and executive management deliberated whether they should keep that firm or select a new, independent accounting firm. Freddie Mac solicited OFHEO's views concerning the retention of Arthur Andersen. OFHEO opined that given the circumstances, retention of the firm created a higher-risk situation for Freddie Mac.

The Audit Committee decided to change independent accountants and interviewed two potential firms in the first quarter of 2002. The Committee decided to switch to PwC for Freddie Mac's independent public accountants for the year ending December 31, 2002. Freddie Mac made a public announcement of this decision on March 6, 2002.

The audit opinions of Arthur Andersen on the consolidated financial statements of Freddie Mac for the fiscal years ending December 31, 2000 and 2001 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles. In separate management letters, Arthur Andersen shared its concern with senior management on a number of items that had also been independently noted by OFHEO.

Engagement of PwC -- 2002

OFHEO evaluated and tracked changes being made through its routine examination activities in 2002 regarding the engagement of PwC and the work of the Audit Committee. PwC began its audit engagement immediately after being selected by the Audit Committee. OFHEO examiners had an introductory meeting with PwC managers for the Freddie Mac audit on March 5, 2002. PwC was ratified as the independent public accountant at Freddie Mac's May 2, 2002 annual shareholders meeting.

In the course of its audit, PwC initiated a process of identifying various accounting policies and accounting issues to discuss with Freddie Mac's management. Both Freddie Mac management and PwC conveyed the nature of these discussions to the Audit Committee. In the normal course of business, PwC met with the Audit Committee in executive session on these matters.

Additional Expertise Added at Freddie Mac -- 2002

Consistent with OFHEO's concerns, some important staffing decisions in the finance area were announced at Freddie Mac during 2002, adding necessary expertise. In June, a new Senior Vice President for Operational Risk Oversight was hired. On June 18, the Board announced the creation of a new senior level executive position and national search, for an Executive Vice President of Finance, consistent with the goals outlined in the FRCIP. The newly created position would be responsible for the overall finance, accounting, corporate planning, tax, shareholder relations, and market risk and operating risk oversight functions of the company. The CFO and the Corporate Controller would continue in their respective roles and they would report to the new Executive Vice President -- when hired. Until the new position was filled, the Corporate Controller had a direct administrative reporting line to the COO and a direct communication line with the Audit Committee, similar to the CFO's reporting line. The current EVP and CFO -- Mr. Vaughn Clarke - no longer had the Corporate Controller reporting through him, and notified the company of his intentions to leave Freddie Mac. On March 19, 2003, Freddie Mac announced that Mr. Martin Baumann had filled the newly created EVP of Finance position.

ALLL Accounting Matter Identified -- 2002

OFHEO was actively involved in the discussions that were taking place between PwC and Freddie Mac regarding the Allowance for Loan and Lease Losses (ALLL). The ALLL was identified in July 2002 by PwC as a critical accounting matter that needed to be resolved as they worked toward certifying Freddie Mac's financial statements.

A special Audit Committee meeting was held on July 16, 2002 where PwC raised the ALLL issue for Freddie Mac – it was too conservative in its loss estimates and coverage per PwC's determination under GAAP. PwC said this matter on the ALLL needed to be resolved before Freddie Mac's release of second quarter financial statements on July 23, 2002.

OFHEO and Freddie Mac representatives met on July 22, 2002 to gather information about the final size of the adjustments being made to Freddie Mac's financial statements. The adjustment was a \$246 million reduction in the ALLL. On the same day, the Audit Committee had a special meeting to review the final analysis and approve the adjustment for release to the public in the July 23, 2002 release of financial statements.

Accounting policies and issues continued to be worked on by PwC, management and the Board throughout 2002. Progress appeared on track for the certification of fiscal year 2002 financial statements. As of fourth quarter 2002, the ALLL was the only accounting issue that had risen to the level of PwC expressing reservations to the Audit Committee relating to that firm's ability to certify Freddie Mac's statements and that had been resolved in July 2002.

OFHEO continued to evaluate and monitor the status of the accounting policies under discussion between PwC and Freddie Mac during 2002, as well as the actions and decision-making by the Audit Committee. Examiners continued in 2002 to evaluate progress on the FRCIP at least quarterly. This included examiners testing selected work products and evaluating project management and reporting.

Unresolved Accounting Matters under FAS 133 -- 2003

PwC came to the Freddie Mac Board in mid-January 2003 and informed the Audit Committee they would be meeting with representatives from PwC's national office about unresolved accounting policy matters, related to FAS 133 implementation. On Monday, January 20, 2003, PwC notified the Audit Committee that they were uncomfortable with certain accounting treatments applied during the FAS 133 transition. Furthermore, until its concerns were resolved, it would not be able to certify the company's 2002 fiscal financial statements using the accounting policies from prior periods, even though the policies had been approved by Arthur Andersen as GAAP compliant. OFHEO was made aware of these developments on that day and met with Freddie Mac officials the following day.

The nature of the major accounting issues identified through the restatement process include:

1. The erroneous accounting treatment of the company's Securities Sales and Trading Group (SS&TG) as a third-party broker dealer;
2. Inadequate documentation and testing of certain derivative instruments and their valuations accounted for as hedge instruments for accounting purposes;
3. The erroneous transfer of mortgage securities out of the "held-to-maturity" and trading accounts;
4. The treatment of mortgage sales transactions as financings;
5. Accounting for certain cash transactions used to manage interest rate risk as if they were derivatives; and
6. Omitting the recognition of the guarantee fee and credit obligations embedded within sold PCs. These transactions are the subject of our investigation, and I will have more to say about them in my final report.

Because Arthur Andersen was no longer an operating firm at this point, PwC could not undertake a normal

transition pursuant to the American Institute of Certified Public Accountants (AICPA) guidance for successor/predecessor accountants. Instead, PwC would have to undertake additional substantive testing. The Board of Directors determined that PwC should conduct a reaudit of the prior period financial statements.

OFHEO, PwC, and the Audit Committee evaluated the nature of the accounting issues. Among the factors considered was the cumulative effect of the adjustments flowing from the change in accounting treatments. The net cumulative effect of the new accounting treatments was an increase to income in prior periods, thus increasing the amount of capital on a cumulative basis. This would also result in considerable volatility in those prior periods. Further, OFHEO, PwC, and the Audit Committee considered the effects from the accounting policy changes for any potential effect on the fair value statements of Freddie Mac. All concluded there was no meaningful impact on the fair value statements, which meant the underlying economics for Freddie Mac's risk positions were materially unaffected by the timing changes in recognizing income for the GAAP statements being restated.

Examiners were on-site at Freddie Mac gathering more information about the issues and the action plan that were being formed to address the reaudit. Freddie Mac announced the reaudit and the delay in 2002 certified financial statements on January 22, 2003.

Based upon the reaudit of prior periods, Freddie Mac said it would be restating 2000 and 2001 annual results and quarterly financial results for 2001. Along with delays in issuing certified 2002 financial results and prior period restatements, there would be delays in issuing certified quarterly financial statements for the first and second quarter of 2003. The timeline was to have the restatements done in approximately six months.

The restatement process has involved the reevaluation of over 100 accounting policies, which resulted in the identification of approximately 20 major issues that will affect the financial statements.

These accounting changes will result in about half of the company's derivatives being marked to market through current period earnings as opposed to being deferred and recorded into earnings over time. In addition, all mortgage securities will be marked to market either through OCI or current period earnings. In addition, previously off-balance sheet guarantee fees and obligations relating to approximately one-half of the guarantee business will now be recorded on balance sheet at fair value, with changes reported in current period earnings. These changes will most likely result in increased volatility and decreased future earnings.

Heightened Focus -- January 2003 to Present

In mid-January 2003, it was clear that a forensic review of selected accounting issues raised by PwC would be appropriate. The law firm of Baker Botts was retained by the Audit Committee to perform diagnostic and forensic work associated with the restatement process. The scope of Baker Botts' engagement is to conduct a review of the facts and circumstances surrounding certain transactions and other matters related to the restatement process. OFHEO's plans were to monitor and consider the work of Baker Botts, while concentrating the Agency's efforts on the re-audit and restatement process. When the restatement process neared its completion, OFHEO would consider the progress and adequacy of the counsel's review and determine whether the Agency would need to undertake its own forensic review.

At this point, OFHEO focused on its mission -- safety and soundness -- and emphasized to Freddie Mac the importance of properly concluding the reaudit and publishing certified financial statements. In addition, OFHEO concurred with the Board's decision to engage outside counsel for forensic and related work.

OFHEO's accounting team began continuous surveillance of the restatement process on January 22, 2003, focusing on: The accounting issues surrounding the transactions that triggered the reaudit; the accounting policies/issues under consideration -- being changed or affirmed; the organization and staffing of the project; the analysis of the cumulative effect of the restatement process; the preparation of adjustments; the methodology for establishing value estimates; the process for running ledgers and analyzing results; the quality control process; the plan for rolling out the revised financial statements; and the status of controls being embedded into the new processes as they are being built. In addition to the ongoing work of the accounting team, there were periodic updates and evaluations on the restatement process from January on.

February - In February, OFHEO continued its close evaluation of the restatement process. Specifically,

OFHEO's accounting team scrutinized the organizational structure of the effort, the plan of action, and the resources and the timeline associated with the work on the restatement process.

March - OFHEO met with the Board and its Audit Committee on March 6. In that meeting, there was considerable discussion relating to the restatement process, the reaudit, and OFHEO's posture toward completing the restatement process. Also in March, as noted earlier, Freddie Mac announced the hiring of Mr. Baumann as Executive Vice President for Finance. Mr. Baumann was given full responsibility for the restatement process by the Board of Directors and for formulating a plan of action for the post-restatement environment. Mr. Baumann is reporting directly to the Board of Directors until the restatement process is completed.

OFHEO remained engaged during the period the Board considered a delay in the release of first quarter financial results to coincide with the restated financials for prior periods. On March 25, Freddie Mac announced the restatement process remained on track. The company's expectation was still to have the restatement concluded as soon after the close of second quarter 2003 as practical – expecting to restate financials by mid-July 2003. Freddie Mac also notified the market they would not be releasing first quarter financials, rather, they would provide operating statistics and risk measures. The decision to delay first quarter financials was to provide those 2003 results consistent with the basis upon which the restated financials will be presented. In the March 25th release, Freddie Mac also identified additional accounting issues.

April - In April, Freddie Mac was moving toward the final stages of a complete review and affirmation of all the accounting policies. OFHEO continued to evaluate the work being conducted and the progress against the established timeline. Some additional accounting items were adding to the complexity of the task. Freddie Mac brought in third-party vendors to expedite the process after PwC approved the use of such vendors. On April 29th, PwC informed the Audit Committee that they might not be able to accept the representations of top management.

May - In May, OFHEO observed slippage in the restatement process against established time frames. PwC and Freddie Mac had more than 500 people working on the process six days a week and this work had been continuous since January 2003. They were beginning to complete some of the adjustments. There was considerable work that needed to be done between production of statements and producing the tables and disclosure to accompany those statements. On May 8th, PwC informed Senior Board members and counsel that PwC would not accept the representations of Vaughn Clarke and David Glenn.

On May 13, the Board's Governance Committee at its weekly meeting approved the Finance Function Governance Plan (FFGP) presented by Mr. Baumann. This plan, superceding the FRCIP, addressed the considerable work that has been done to re-engineer the process and enhance the controls for financial accounting and financial reporting. This plan, some of which will take almost two years to complete, is intended to build a finance environment incorporating a high level of professional standards and compliance that delivers comprehensive and understandable financial information. The objectives included addressing findings which had arisen during the restatement process and the work of Baker Botts and PwC.

In late May, OFHEO again observed the challenges against achieving the timeline with the additional accounting issues that were added in April. However, Freddie Mac continued to work toward the mid-July target. There were no new issues since April. Freddie Mac continued to work through all the adjustments and calculated the valuation estimates for prior periods. Some opportunities to strengthen controls noted during the restatement process continue being implemented by Freddie Mac.

On May 27, OFHEO was briefed on the Baker Botts work for the Audit Committee. The briefing covered the scope of the project, the nature of their forensic work and perspective on the status of their findings to-date. In response to a direct question, Baker Botts expressed no concerns regarding the management team of inappropriate or improper management behavior. Subsequent to this meeting, OFHEO learned of very troubling information regarding the conduct and integrity of management in matters related to the restatement process, indicating the Board's counsel had not been fully forthcoming. This lack of candor contributed to my decision on June 7th to initiate an OFHEO investigation.

Events of June 4 through June 7

Mr. Chairman, I will begin a discussion of the key events of June 4-7, that have drawn so much attention. First, I would note that the Freddie Mac Board of Directors was holding a regularly scheduled meeting on Thursday, June 5th and Friday, June 6th.

On Wednesday, June 4th, Mr. David Glenn met with the Board's outside law firm—Baker Botts—and informed them that he had altered parts and had removed pages from a document that had been requested by the firm. That evening, counsel from Baker Botts informed the lead outside Director of Mr. Glenn's admission.

On Thursday, June 5th, Freddie Mac's Board was informed of Mr. Glenn's admissions and determined that actions were required. The morning of June 5th, OFHEO was alerted that the Board would have an urgent communication to discuss with us when the Board's deliberations were concluded. The Board's deliberations continued into Friday, June 6th.

On Friday June 6th, during the day, the Board made decisions on the separation from the firm of Brendsel, Glenn, and Clarke and on the appointment of O'Malley, Parseghian, Petersen and Baumann. The Board communicated to OFHEO immediately its actions regarding the management changes. Later that evening, I was informed about the circumstances surrounding Mr. Glenn. I instructed Board counsel to appear at OFHEO's offices on Saturday, June 7th, to advise us on all the matters surrounding management changes.

On the morning of June 7th, OFHEO senior staff and I met with representatives of Freddie Mac's Board to learn the details of recent events. I would note that much of what was addressed that day was known to OFHEO and had been the subject of the restatement. However, new issues relating to Mr. Glenn and the termination and replacement of senior management were also presented; particularly the lack of confidence in Mr. Glenn expressed a month earlier by PwC. I considered the information regarding Mr. Glenn a clear signal of a breakdown in the integrity of the Freddie Mac's control environment at the highest levels and sent a letter to the Board that day initiating an OFHEO investigation.

Following this meeting, as occurred after the meeting on May 27, additional matters came to light and, again, reflected a lack of candor that concerned me deeply.

In the June 7 letter, I formalized with the Board certain actions with respect to the restatement process. In addition, I tasked a special investigative team to explore and review accounting practices relevant to the restatement process at Freddie Mac and, in addition, management's progress in implementing an action plan that OFHEO directed the Board to provide for the Agency's formal approval. The investigative team has also undertaken an investigation of employee misconduct. OFHEO is moving expeditiously on this review.

The Role of a Federal Financial Safety and Soundness Regulator

Having discussed our specific regulatory role over the restatement process at Freddie Mac, I would now like to put it in a more general context. First, the role of a financial safety and soundness regulator and second, and more specifically, the Agency's regulatory approach in examining accounting practices and controls.

OFHEO uses a safety and soundness approach in supervising the Enterprises that is analogous to the Federal Reserve System's and the Office of the Comptroller of the Currency's approach to supervising large-and-complex banking organizations. The foundation of these approaches is that the management of these firms should be held responsible for monitoring and managing the institution's exposure to risk. By looking at the firm's risk management procedures and internal controls, the safety and soundness regulator assesses whether the firm's ability to manage risk matches the level of risk it assumes. In addition, the supervisory process also reviews the firm's performance in complying with the company's own internal policies, as well as other prescriptive requirements. In short, safety and soundness supervision is directed toward identifying material problems or emerging problems and seeing they are appropriately corrected before the company's financial solvency is threatened.

During the past decade, financial safety and soundness regulators and OFHEO have endeavored to continuously enhance the examination process to make it more risk-focused and to make greater use of technological innovations. Increasingly, safety and soundness supervision stresses the need for financial firms to implement sound risk management practices for: Active oversight of management by the Board;

clearly defined policies, procedures and authority; comprehensive risk measurement and reporting systems; and adequate audits and systems of internal controls.

OFHEO's supervisory activities are designed to assess the Enterprises' risk profiles and require remedies where and when they are appropriate. They encompass evaluations of each Enterprise's asset quality, management of interest rate risk, liquidity management, capital adequacy, and their risk management strategies and risk management practices -- including their internal controls and governance.

Safety and soundness regulators do not attempt to prescribe "regulatory accounting principles" for financial reporting. In fact, when accounting principles were prescribed in the 1980s by financial regulators, many of those standards were criticized after numerous financial institutions failed. Congress subsequently expressed its desire for financial safety and soundness regulators to rely upon established accounting principles (GAAP) for financial reporting standards (Section 121 of FDICIA). In OFHEO's 1992 Act, Congress directed OFHEO to do the same, i.e., to pursue GAAP in their regulatory reporting requirements.

Safety and soundness regulators do not review accounting policies for conformance with GAAP, nor do we certify that a company's financial statements are consistent with GAAP. We expect an independent auditor to certify that a company's financial statements are in conformance with GAAP. We review transactions to ensure that they are consistent with sound risk management. The work of the independent auditor is to conduct its audit and report on the company's annual financial statements. The scope of the independent auditor's engagement must be sufficient to permit the auditing firm to determine and report upon whether the financial statements are presented fairly and in accordance with GAAP.

The internal and external auditors routinely work together in establishing the scope and frequency of audits to be performed. The independent auditor reviews the scope and adequacy of the internal auditing program.

Safety and soundness supervision does not replace an internal audit function for the Enterprises' Boards of Directors. Internal audits are a governance/management control question. That is, the Board of Directors and executive management need to have the internal controls tested and assessed by units without business-line operating responsibilities, such as an internal audit group. Internal audit provides the Board and the CEO, along with other members of senior management, with assurances concerning the effectiveness of controls.

Safety and soundness regulators do not perform forensic work (investigative work on what has occurred) unless a need arises. In fact, safety and soundness regulators frequently cause the Board of Directors to engage forensic professionals to investigate irregularities and share the results of their findings with the regulator. Subsequent to the findings from the forensic work, the regulator holds the Board accountable for ensuring there are appropriate remediation plans and action items to address the issues that are identified.

OFHEO's Approach to Examining Accounting Practices and Controls Over Financial Reporting

The process of examining an Enterprise's accounting practices and related internal controls for financial reporting begins with a thorough study of the strategies and the techniques the Board of Directors has adopted to set the company's course, and to measure and evaluate management's performance in implementing the Board's strategies. This step includes, for example, an evaluation of the Board's committee structure, oversight practices and reporting conventions, and an assessment of the effectiveness of the overall control framework at the Board level. The examination process also includes a "mapping" of the corporate structure management has adopted to facilitate the implementation of the Board's strategies and the achievement of its objectives pertinent to financial reporting. The objective of the mapping process is to establish a roadmap of management's assigned responsibilities, duties, and functions that can then be used to identify key risk points in the internal control framework for financial reporting that warrant targeted evaluation and attention due to their potential impact on financial safety and soundness.

Having established an appropriate understanding of the overall control framework and its risk points by, for example, reviewing relevant policies, procedures, systems, tools, and management reporting, and by interviewing Enterprise management and personnel, examiners then sample selected transactions in order to test whether the framework actually functions as designed and intended. Depending on the nature of the examiners' focus, these sampling activities may include evaluations of the actions of a variety of different participants and their respective roles in the control framework, including management, technical staff,

internal auditors, and independent auditors. During the course of their evaluations, examiners apply evaluative standards that reflect the professional standards appropriate for the actions under review, and reach conclusions that address the Enterprises' financial safety and soundness.

OFHEO's approach to examining accounting practices and internal controls for financial reporting should be familiar to the Committee, given that our approach is built on the same well-established concepts that form the core of applicable provisions of the Sarbanes-Oxley Act of 2002 and the SEC's regulations implementing the control-related provisions of that Act. Our examination approach also embraces fundamental precepts found in widely-recognized control frameworks such as the Internal Control—Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (more familiarly known as "COSO"), the Guidance on Assessing Control published by the Canadian Institute of Chartered Accountants, and the Turnbull Report published by the Institute of Chartered Accountants in England & Wales. Moreover, we regularly consider practices adopted by other financial safety and soundness regulators, generally accepted auditing standards, and control-related methodologies and standards propounded by professional associations such as the Institute of Internal Auditors and the American Institute of Certified Public Accountants, and we enhance our evaluative techniques as necessary to maintain a position on the leading edge of this evolving field of expertise.

The Committee has requested information on OFHEO's role with respect to approving termination agreements for the executive officers of the Enterprises, including involvement in the recent termination agreements of Freddie Mac's executive officers. In addition, you sought information on OFHEO's corporate governance rule. Details on both follow.

Executive Compensation

OFHEO has broad authority to consider executive compensation, both as a specific matter of excessive compensation as well as a factor in the operational integrity of the Enterprises.

OFHEO draws authority from the explicit and implied authorities of its statute, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, PL 102-550, Title XIII; 106 Stat. 3672 (October 28, 1992). At the same time, other OFHEO authorities are delineated in certain sections of the chartering acts for the Enterprises.

Excessive Compensation. OFHEO is directed by statute to prohibit the payment of "excessive compensation" to executive officers; 12 USC 4513(b)(8). The prohibition on excessive compensation is tied to compensation that is "...not reasonable and comparable with compensation for employment in other similar businesses..."; 12 USC 4518(a). At the same time, OFHEO may not set or prescribe or set a specific level or range of compensation for such executives; 12 USC 4518(b).

Termination Benefits. OFHEO has authority to review and provide approval for "termination benefits." This authority is contained in the charter acts of the two Enterprises.

For example, in the Freddie Mac charter (Federal Home Loan Mortgage Corporation Act, 12 USC 1451 et seq.), Section 303(h)(2) provides that the Corporation may not enter into any agreement or contract to provide money or other things of current or potential value in connection with the termination of employment of any executive officer unless the agreement or contract is approved in advance by OFHEO; 12 USC 1452 (h)(2). The statute provides for OFHEO to make such determination based on comparability of such agreements with officers at comparable companies. The statute covers contracts entered after the date of enactment, but provides that any "renegotiation, amendment, or change" after such date of enactment to any contract entered into before or after the date of enactment shall be considered entering into a new agreement or contract that OFHEO should review and provide its opinion.

In regards to Freddie Mac, OFHEO has undertaken certain actions relating to executive compensation. Specifically, I wrote to the Board of Directors on June 7, 2003 indicating it must explain its rationale for any termination packages for the individuals leaving the firm, specifically for Brendsel, Glenn and Clarke. Further, I directed the Board to inform these individuals that their termination packages are subject to OFHEO review and approval and, for any employee discharged for misconduct, that OFHEO could direct indemnification of Freddie Mac for losses incurred.

We have directed Freddie Mac not to transfer funds, stock or options to these three individuals and Freddie Mac is complying. OFHEO is reviewing now the termination packages for Brendsel, Glenn and Clarke.

I want to reiterate what I noted regarding OFHEO's authority in this area. First, we review executive compensation as a stand-alone matter, that is: Is such compensation excessive? And, second, as we proceed with the investigation, we look to the behavior of management and whether it comports with the standards of the corporation, violates any corporate governance rules or otherwise harms or threatens the safety and soundness of the corporation. If so, OFHEO would consider actions that would involve compensation, such as ordering restitution.

Corporate Governance

OFHEO has had in place for some time an active program of review for corporate governance at the Enterprises. Corporate governance is considered a major component of risk management and a fundamental ingredient in the safe and sound operation of the firms. Corporate governance under the examination program is composed of separate programs entitled Board Governance, Management Processes Program, Audit Program and Management Information Program.

While OFHEO has strong statutory support for its corporate governance regime, in 2000, the Agency began a program of building up its regulatory infrastructure, putting in place rules to support its various functions and to strengthen its legal position. This program included a corporate governance rule.

The rule generated a great deal of interest and OFHEO issued a Final Rule on June 2, 2002, effective on August 5, 2002. The rule made clear that corporate governance is a key area of safety and soundness and it directed each of the Enterprises to elect a state law for the purposes of adhering to a body of corporate law. Both have done so. The rule required the companies to have committees and that they meet the highest applicable standards; both have such committees. A quorum of the board is required to transact business and no proxy voting is allowed; both have such policies. The rule required conflict of interest policies; both have such policies. The rule mandated that the Board meet its responsibilities and described the areas of key concern for Board oversight of senior management. Finally, the rule noted the authority of OFHEO to limit or restrict indemnification of current or former Board members as part of its safety and soundness authority.

OFHEO's examination team has worked with the Enterprises to see that changes that were required have been put in place and that the Enterprises continue to address other requirements, such as changes mandated in the Sarbanes-Oxley Act.

Legislative Enhancements

I would like to submit for the Committee's consideration a series of legislative recommendations to add to OFHEO's broad authorities and to fill in a number of gaps between OFHEO's authorities and those of other financial regulators.

Paramount among these is permanent funding for the Agency. Other financial safety and soundness regulators are funded through assessments on the institutions they regulate; so is OFHEO. Only OFHEO, however, must move through the annual appropriations process. The budget process has had a limiting effect on the Agency's resources and may affect our ability to effectively address regulatory issues on a timely basis.

OFHEO must have more flexibility to respond to important issues, such as Freddie Mac's restatement of income, without stretching thin our ability to continually monitor the significant credit and interest rate risks being managed by the two Enterprises. The amount of resources needed to address the issues surrounding Freddie Mac's restatement is straining our resources. Permanent funding is needed to ensure that OFHEO can continue to effectively regulate the Enterprises. I am pleased that the Administration has endorsed this needed change.

The other recommendation I would like to highlight relates to charter compliance. I believe that the regulatory responsibility for ensuring that the Enterprises remain in compliance with their charters more properly resides

with the safety and soundness regulator. Mission regulation would continue to reside in HUD in the form of affordable housing goals and fair lending enforcement.

OFHEO has the authority and responsibility for taking an enforcement action when an Enterprise violates any applicable law or regulation. In fact, under the current scheme, if HUD found that a new program was not permissible, HUD would turn to OFHEO to take any necessary enforcement action. In addition, OFHEO would take appropriate action if we independently determined that an Enterprise was in clear violation of its charter. OFHEO should have full authority, including in areas of ambiguity, for interpreting and enforcing charter compliance.

Without casting any doubt on HUD's abilities, I simply believe that public policy would be better served if OFHEO, with its active examination and oversight of the Enterprises, had full responsibility for charter compliance.

The draft proposal, attached with a summary, strengthens OFHEO with explicit receivership authority, removal authority, greater facility in hiring examiners, adds criminal penalties for certain violations of law, provides independent litigation authority and addresses certain gaps in OFHEO's enabling statute that have been addressed previously by regulation.

Notes on Recent Events and the OFHEO June 2003 Annual Report to Congress

Turning now to the OFHEO Report to Congress, we reported that Freddie Mac's overall internal control framework, and the management of the internal control framework, are effective. We stated, however, that Freddie Mac's release of audited financial statements was being delayed pending a reaudit of past financial statements, and that Freddie Mac had agreed that certain accounting treatments applied in the past were incorrect. We informed Congress at the time, of our opinion regarding the reaudit. We further advised Congress that Freddie Mac's Board of Directors had undertaken efforts to enhance expertise and controls in the area of financial accounting and operational control, that we had evaluated the Board's and management's plans in that regard, and that we were satisfied that these actions were appropriate steps to address the situation. In my view, these statements clearly indicate that, although the overall framework is effective, OFHEO is ensuring that the Board and management devote serious attention and remedial efforts to the area of financial reporting and related controls. OFHEO's activities in this regard are highlighted in this testimony.

With regard to internal controls, our examination program is consistent with applicable professional standards in that it addresses each Enterprise's overall internal control framework; that is, the framework that includes the following categories: (1) the effectiveness and efficiency of operations; (2) the reliability of financial reporting; (3) compliance with applicable laws and regulations; (4) and safeguarding the assets of the company. Consider that the term "internal control" encompasses five interrelated components—the control environment; risk assessment activities; control activities; information/communication; and monitoring. As you might imagine, companies as complex as Fannie Mae and Freddie Mac develop equally complex internal control frameworks. These frameworks encompass hundreds, perhaps thousands, of separate controls, including approvals, authorizations, verifications, reconciliations, segregation of duties, systems access limitations, and a myriad of others. In short, the integrity of the overall internal control framework is determined by considering the total picture, and when viewed in its entirety, a framework may exceed safety and soundness standards even though there are observed weaknesses or deficiencies in particular controls.

Examples of the application of this principle include practices adopted under standards established by the American Institute of Certified Public Accountants, and guidance provided by the SEC in recent rules implementing provisions in the Sarbanes-Oxley Act that pertain to assessments of internal controls over financial reporting. Specifically, it is common for an independent auditor to provide an unqualified opinion on management's reports of financial condition even though the auditor is aware of certain "reportable conditions." In the vernacular of the independent auditor, a reportable condition is a significant deficiency in the design or operation of the internal control structure that could adversely affect a company's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The common practice is for the auditor to communicate such deficiencies to management in the form of a management letter, while at the same time allowing its unqualified opinion to stand. As a separate example, under SEC rules, significant deficiencies that do not rise to the level of a

material weakness do not preclude management from characterizing its internal controls over financial reporting as "effective." The SEC guidance prohibits management from deeming its controls effective if there are one or more material weaknesses; however, the SEC also observes that a material weakness constitutes a greater deficiency than a significant deficiency. In sum, I believe the standards we have applied in reaching our examination conclusions on internal controls are consistent with those established by both the AICPA and the SEC.

Before I move on, I would like to emphasize a point or two about information flow and the environment that preceded the publication of our Annual Report to Congress. The results and conclusions of the 2002 annual examination were based on the information gathered and evaluated during the course of our work during 2002. That information was supplemented by information obtained by OFHEO during 2003, from early January up to the time of the publication of the Annual Report to Congress. As I discussed earlier, OFHEO has devoted considerable effort and resources to this matter, and our efforts continue to yield new information. One should also consider that the Board of Directors' internal investigation is being conducted during 2003 as well, and that the Board's investigation may yield new information. In addition, the Committee is aware that I initiated OFHEO's own special examination on June 7, little more than one week before the statutory delivery date for the Report to Congress; and it is possible that our special examination could give rise to new findings as well. I raise these facts to emphasize that the date on which the Report was due fell in the midst of a very fluid environment; nevertheless, I believe that the examination results and conclusions expressed in the Report to Congress regarding the overall internal control and framework at Freddie Mac are appropriate. Certainly, we will have more to say about the controls over financial reporting, improper earnings management, and corporate governance practices after the special examination has concluded. I assure you that I will provide the Committee with a timely notification and description of any substantive changes in our view of the internal control framework and corporate governance practices once I have the benefit of the results under the various investigations currently underway.

Supplemental Appropriations

Finally, I would like to bring to the committee's attention an urgent funding matter. Earlier this week I submitted an FY 2003 supplemental funding request of \$4.5 million to the Senate and House Appropriations Committees.

The requested funds will support two critical objectives: First, the funds will support the ongoing special investigation of Freddie Mac. The investigation is already well underway and is building on information gathered over the course of the restatement process. The requested resources are necessary to obtain contract services for investigative support and forensic accounting experts. Second, OFHEO intends to conduct a special accounting review of Fannie Mae. The special review would independently evaluate the accounting policies at Fannie and examine whether their implementation is resulting in a high level of conformance to GAAP. While I do not have a specific concern about Fannie Mae's accounting practices, such a review would be most prudent under the circumstances.

OFHEO's goal of concluding the investigation of Freddie Mac expeditiously is dependent on receiving these funds as soon as possible. I would like to ask for the Committee's support in obtaining the additional funds.

Conclusion

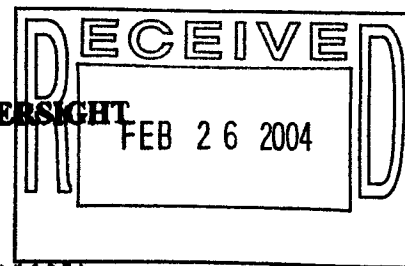
In summary, Mr. Chairman, is this a serious matter? Yes. Is there a crisis? No. While challenges remain, Freddie Mac remains safe and sound. At the end of our investigation, we will present all the facts, conclusions, and recommendations for the Committee's consideration. Mr. Chairman, thank you for the opportunity to testify. I would be pleased to answer any questions you or Committee Members may have.

Attachment: OFHEO's Legislative Enhancements

EXHIBIT

L

**UNITED STATES OF AMERICA
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**



In the Matter of:

LELAND C. BRENDEL,

Respondent.

HUDALJ 04-056-NA
Notice No. 2003-2

Chief Judge Arthur A. Liberty

SCHEDULING ORDER

The Office of Federal Housing Enterprise Oversight ("OFHEO") and Leland C.

Brendel, respondent, have jointly proposed the following schedule for this proceeding:

Preliminary Motions

- Deadline for response to Brendel's motion to compel: February 25, 2004
- Deadline for reply briefs to Brendel's motion to disqualify Director Falcon: February 27, 2004
- Deadline for reply briefs to Brendel's motion to disqualify Crowell Moring LLP: February 27, 2004
- Deadline for reply brief to motion to consolidate: February 27, 2004
- Deadline for OFHEO's opposition to motions to dismiss: March 31, 2004
- Deadline for Brendel's reply memoranda: April 20, 2004
- Arguments on motions (if any): TBD

Document Discovery

- Rolling production began (protective order is in place): February 18, 2004
- Close of discovery: October 29, 2004
- Deadline for parties to bring motions to compel (if any): November 29, 2004
- Deadline for response dates: TBD

Experts

Deadline for service of expert reports by OFHEO:	February 28, 2005
Deadline for service of expert reports by Brendsel:	April 29, 2005
Deadline for service of rebuttal expert reports by OFHEO:	June 30, 2005

Dispositive Motions

Deadline for filing of dispositive motions:	August 31, 2005
Deadline for filing responses to dispositive motions:	October 31, 2005
Deadline for replies in support of dispositive motions:	December 5, 2005

Pretrial and Trial Schedules

TBD

Having considered the parties' proposed schedule, and appearing to the Court that the parties have reached an agreement, it is this 26th day of February 2004 hereby

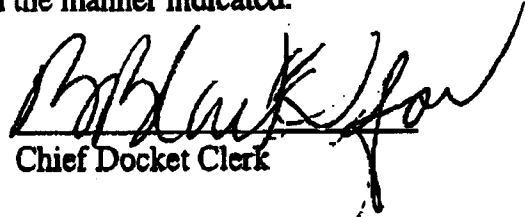
ORDERED that proceedings in this matter shall conform to the schedule proposed by the parties.



Chief Judge Arthur A. Liberty
Office of Administrative Law and Judges
U.S. Department of Housing and
Urban Development

CERTIFICATE OF SERVICE

I hereby certify that copies of this SCHEDULING ORDER issued by ARTHUR A. LIBERTY, Chief Administrative Law Judge, HUDALJ 04-056-NA, were sent to the following parties on this 26th day of February 2004, in the manner indicated:


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