

OFHEO

FY 2007 Performance Budget



December 28, 2006

**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
FY 2007 Performance Plan**

INTRODUCTION

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

Fannie Mae and Freddie Mac engage in two principal lines of business: the guaranteeing of securities backed by residential mortgages, and the buying and holding of residential mortgages and mortgage-backed securities. Those activities expose the Enterprises to interest rate, market, prepayment, credit, liquidity, operational and systemic risks. When OFHEO started operating in 1993, the Enterprises owned or guaranteed slightly over \$1.1 trillion in mortgages and mortgage backed securities. Of their total mortgage business, about 21 percent were portfolio investments and 79 percent were guaranteed mortgage-backed securities.

Thirteen years of tremendous growth later, the Enterprises now own or guarantee over \$4 trillion in mortgages and guaranteed mortgage-backed securities. Mortgage portfolio investments now comprise 36 percent of their mortgage business while mortgage-backed securities account for 64 percent. This growth has resulted in the Enterprises having over a 40 percent share of the residential mortgage market. Today, because of their absolute size and their interdependencies with other financial markets, the Enterprises pose systemic risk to the financial system. It is therefore more important than ever for OFHEO to have the resources, tools, and authorities to be an effective regulator.

Recent OFHEO examinations of both Enterprises have confirmed gross mismanagement, fraud, and significant violations of accounting rules resulting in their combined earnings being misstated by \$11.3 billion, fines exceeding one-half billion dollars, and remedial costs exceeding \$2 billion. Both Enterprises have substantially increased permanent staff and contractors working to resolve their accounting and systems problems. Both Enterprises have entered into written consent agreements with OFHEO to improve, among other things, their internal controls, accounting systems, operational and other risk management practices and systems, and data quality.

During FY 2007, OFHEO will monitor and enforce compliance with these consent agreements, continue enforcement actions taken with respect to the Fannie Mae investigation, and strengthen the agency's regulatory infrastructure and regular examination and supervisory programs. In addition to our efforts to help the Enterprises recover from their serious missteps and deficiencies, OFHEO will intensify its review of the risk-based capital standard to improve its ability to measure risk and therefore capital adequacy of the Enterprises. OFHEO will also continue to support the legislation proposed by the Administration and the Congress to strengthen the regulatory oversight of Fannie Mae and Freddie Mac.

Program Performance Overview

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

The OFHEO 2006-2011 Strategic Plan describes OFHEO's mission and three Strategic Goals to achieve it. This is the starting point for the performance goals that OFHEO plans to achieve in fiscal year 2007. The means and strategies of OFHEO are the key activities, actions, processes and technologies that describe how OFHEO will use its fiscal year 2007 resources to achieve each performance goal. The agency provides regulation, supervision, guidance, review and a variety of products designed to provide oversight of the Enterprises and to benefit the financial markets. As for all regulators, internal and external factors may impact the ability of OFHEO to achieve its goals.

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

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

Performance Goal 1.1:

The Enterprises comply with safety and soundness standards.

<u>Measure</u>	<u>Target</u>
1.1(1) The percentage of Enterprises with CAMELSO ratings of 1, 2, or 3.	100% Note: PART Measure
1.1(2): For both Enterprises, the percentage of OFHEO's five risk assessment categories (Governance, Market, Credit, Operational, Model) with a risk profile <u>not</u> rated high risk quantity and weak risk management quality.	80% for both Enterprises Note: PART Measure
1.1(3): Average number of days to issue annual report of examinations to Enterprise Boards of Directors and meet with them after field work is complete.	120 days Note: PART Measure

Means & Strategies:

OFHEO conducts risk-based supervision and examinations at each Enterprise with a primary goal of ensuring that they operate in a safe and sound manner and influencing positive changes at the Enterprises when necessary. Throughout the examination process, OFHEO works with the Enterprises to resolve issues identified as quickly as possible by requiring a corrective action plan and monitoring its implementation. The findings from these examinations are presented to Enterprise management and/or to their Boards of Directors so that they can ensure that changes are made. OFHEO also makes the conclusions of these examinations about the condition of the Enterprises public through its annual Report to Congress.

- OFHEO will continue to use a continuous supervision process that includes on-site examination and off-site monitoring and analysis.
- OFHEO will continue to consider five broad categories of risk and evaluate the Enterprises on both the level of risk and the quality of risk management for these categories (governance, operational, credit, market and model risk).
- When risk or risk management issues are identified that warrant further investigation, OFHEO will conduct targeted examinations that focus in depth on a specific topic.

- OFHEO will reassess the risk profile of each Enterprise continuously to focus its resources appropriately on the areas of most concern.
- OFHEO will continue to provide conclusions to Enterprise management and/or Enterprise Boards of Directors in an ongoing way to ensure that corrections and improvements are made timely.
- OFHEO will issue a numerical rating summarizing the condition of the Enterprises based on a CAMELSO approach. A rating of 1 indicates strong performance, while 5 indicates severe financial distress with a likelihood of failure. (CAMELSO stands for Capital adequacy, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk, and Operational risk.)
- When circumstances warrant, OFHEO will use the enforcement authorities at its disposal, including entering into agreements with the Enterprises and issuing directives and guidances.
- OFHEO will issue to the Enterprises' Boards of Directors the Annual Report of Examination, which consolidates findings and presents a comprehensive assessment of the Enterprise, and will meet with the Board to discuss their concerns. OFHEO anticipates issuing the Annual Report of Examination to the Boards and meeting with the Boards in April.
- OFHEO will focus closely in FY 2007 on operational, accounting and model risks, given the issues each Enterprise has faced in these areas in the last several years and the change or evolution of standards in these fields.
- Through ongoing supervision efforts, OFHEO will continue to monitor Enterprise disclosures and review key areas of executive compensation, including compliance with the executive compensation regulation on a case-by-case basis.
- OFHEO will continue to monitor the early-alert triggers described in the Prompt Supervisory Response regulation so that any needed regulatory response would be timely.

Performance Goal 1.2:

The Enterprises are adequately capitalized.

<u>Measure</u>	<u>Target</u>
1.2(1): The Enterprises meet OFHEO's determination of capital adequacy.	Meet capital requirement quarterly
	Note: PART Measure

- 1.2(2): Complete planned enhancements to the capital standards against which the Enterprises are measured. Meet quarterly milestones

Means & Strategies:

Capital adequacy is an essential component of Enterprise safety and soundness and their continued financial viability. OFHEO uses a multi-faceted approach to ensure that the Enterprises remain adequately capitalized: application of minimum and risk-based capital requirements, continuous monitoring and examination of each Enterprise's financial condition and operating environment, and market and industry research and analysis. In recent years, both Enterprises have been required to hold 30% more capital than the minimum amount to account for the accounting and internal control issues each Enterprise is in the process of correcting. OFHEO will continue to strengthen and enhance its capital supervision of the Enterprises.

- Throughout FY 2007, OFHEO will continue the timely, accurate assessment and reporting of the capital adequacy of each Enterprise, and will continue to make the capital classifications available on its web site.
- The Director will make a determination of capital adequacy at least quarterly based on the minimum and risk-based capital requirements, as required by law. The minimum capital standard is ratio-based and represents a statutorily-determined amount of capital needed to protect an Enterprise against broad categories of business risk. The risk-based capital requirement is based directly on the risks inherent in the Enterprises' portfolios and other obligations assessed against simulated stressful economic conditions in a stress test.
- OFHEO will continue to augment the required minimum and risk-based capital calculations with evaluation of factors that impact the Enterprises' capital, such as the effects of alternative interest rate scenarios and the Enterprises' performance on key capital assessment factors that cover a broad range of risks, such as capital projections, earnings, and access to markets.
- OFHEO will continue to evaluate other risk measures such as credit risk, liquidity risk, operational risk, counterparty risk, and concentration risk using publicly-disclosed and proprietary data provided by the Enterprises to identify and evaluate potential risks to the Enterprises' portfolios and capital. In FY 2007, OFHEO will continue to develop these risk measures and assessments with plans to incorporate them in its capital classification process to achieve a comprehensive evaluation of the Enterprises' capital adequacy.

- In FY 2007, OFHEO will continue to make improvements to the capital regulation within OFHEO's current statutory authority, by updating the data, methodologies and components in the risk-based capital stress test, and by including new measures of risk and new capital treatments that better capture risk.
- In FY 2007, OFHEO will work to develop a fair value measure of Enterprise equity that addresses the trend in accounting standards toward the full fair value measurements.
- In FY 2007, OFHEO will begin to use an asset-liability management (ALM) model to supplement and enhance financial analysis of the Enterprises. OFHEO will develop measurements of duration and convexity, market value and earnings analyses.
- OFHEO will work toward assessing and measuring the capital implications of operational risk at the Enterprises and systemic risk based on the growth and size of the Enterprises.
- OFHEO will continue to review the impact of trends in market interest rates, house prices, mortgage product originations, and asset-liability management actions on the Enterprises' portfolio composition and capital requirements.
- OFHEO will continue the ongoing data validation examination to further OFHEO's evaluation and oversight of the Enterprises capital planning and management practices.

Performance Goal 1.3:

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

<u>Measure</u>	<u>Target</u>
1.3(1): Any identified instances of non-compliance with laws and regulations are being addressed to OFHEO's satisfaction.*	100%
1.3(2): The percentage of actions required by formal regulatory agreements with the Enterprises that are resolved as planned.	85% Note: PART Measure
1.3(3) The percentage of Matters Requiring Attention (MRA) and items related to	95%

OFHEO guidances and directives in non-compliance that are being addressed to OFHEO's satisfaction.

Compliance indicates that the Enterprise has submitted the required item and OFHEO has validated it and finds it acceptable and sustainable. Compliance with consent orders and agreements does not indicate that the Enterprise has fully resolved the underlying problem.

Means & Strategies:

Compliance with applicable laws and regulations, as well as formal agreements and directives, is paramount to the safety and soundness of each Enterprise. OFHEO seeks an enforcement and compliance regime that is prompt, reasonable, effective and transparent. In FY 2007 OFHEO will continue to actively monitor and review compliance of the Enterprises through its supervision processes and follow through on enforcement actions, including litigation, stemming from the special examinations of Fannie Mae and Freddie Mac and undertake additional supervisory actions if new or additional violations of law or regulation are discovered at either Enterprise.

- In recent years, OFHEO examinations have identified problems at each of the Enterprises related to financial reporting, accounting, internal controls and operational risk, and the Enterprises have agreed to address these issues through specific changes outlined in agreements with OFHEO.
- OFHEO expects these changes to take some time to implement and will continue to monitor the Enterprises efforts to make these improvements during FY 2007, tracking the Enterprises' progress against their implementation plans.
- In FY 2007, OFHEO will continue enforcement actions focused on several executives at Fannie Mae during the time period covered by the special examination. To be successful, OFHEO must secure litigation support, including expert witnesses, outside counsel, discovery attorneys and other temporary employees, document management and control and Administrative Law Judge expenses. These litigation activities assist OFHEO in preparing charges against executives, prosecuting the charges, developing arguments to counter those made by the defendants, conducting discovery, and responding in third-party actions.
- In FY 2007, OFHEO will conduct targeted examinations of the Enterprises to assess compliance with applicable laws, including the Enterprises' charters, regulations, directives, and other safety and soundness standards. Such examinations are focused on issues, transactions, or events identified through the supervision process within OFHEO or from other sources.

- OFHEO will require the Enterprises to resolve all non-compliance issues, including those that do not rise to the level of a formal agreement. When Enterprise non-compliance is identified, OFHEO may initiate appropriate enforcement actions to correct it and ensure satisfactory compliance on a continuous basis.
- Should another regulator or a judicial body determine a violation of law under a statute not within direct OFHEO enforcement authority, OFHEO may take supervisory action as necessary within its authorities relating to safety and soundness and the charter acts.

Performance goal 1.4:

Strengthen regulatory infrastructure to enhance the supervision of the Enterprises.

<u>Measure</u>	<u>Target</u>
1.4(1): Revise and implement policies, guidances and regulations for the Enterprises to augment current regulatory infrastructure.	Meet quarterly milestones
1.4(2): Develop a quality assurance function and implement other planned initiatives to strengthen supervision of the Enterprises.	Meet quarterly milestones for planned initiatives
1.4(3) Develop an Enterprise call report.	Meet quarterly milestones for development of the call report.

Means & Strategies:

OFHEO will enhance its regulatory infrastructure in 2007 to provide for more comprehensive and in-depth supervision of the Enterprises to prevent problems from arising or worsening and to facilitate quick resolutions. OFHEO is building on lessons learned from the special examinations to improve its external guidance and internal operations.

- OFHEO will develop and expand its published regulations, policy statements, guidances and directives on a variety of topics to improve the transparency of the supervision process to augment its current regulatory infrastructure.

- OFHEO will complete a plan for its efforts in this area and will hold itself accountable for achieving this plan. It will include new or updated policy guidance on current compliance issues, consistent application of updated accounting standards and interpretations, and guidances or policies on operational and model risk.
- OFHEO will develop a quantifiable measure and assessment of operational risk to apply to the Enterprises, and will provide additional focus on assessing the Enterprises' model risk.
- OFHEO will issue the first version of a supervisory handbook to provide clear information to both Enterprises about OFHEO expectations for Enterprise performance and to ensure that the same standards are known by and applied to each. OFHEO expects to expand and revise the handbook as the agency further develops the regulatory infrastructure.
- OFHEO will continue to expand the implementation of its automated supervisory tool to enhance the planning, organization, management, and documentation of its enforcement and supervision activities in an integrated way.
- OFHEO will develop a quality assurance function that will be responsible for ensuring internal policies and procedures are followed, and will also implement a centralized function that will be responsible for supervision policy, guidelines, procedures, supervisory handbook development and oversight.
- During FY 2007, OFHEO will make other enhancements to its supervisory function, focusing on integrating the various supervisory processes to ensure consistency and timely flow of information.
- In 2007, OFHEO will develop a uniform call report for the Enterprises to provide for consistent reporting and disclosure of information by the Enterprises, with implementation in 2008. The call report may include limited release of certain report items, but will primarily be used to facilitate OFHEO's monitoring and analysis of the Enterprises. OFHEO also plans to conduct comparative analysis of key financial performance and risk measurement factors related to the Enterprises using this and other data.
- OFHEO will further enhance its supervision of the Enterprises by incorporating applied research and analysis of a wide range of safety and soundness issues, including systemic risk. This applied research informs all aspects of the supervision function, including capital requirements and examination processes, and assists OFHEO in determining where more in-depth evaluation is needed.

- OFHEO will enhance its knowledge and understanding of GSE mission and affordable housing requirements as they relate to the business operations of the Enterprises and their safety and soundness. This will give OFHEO a stronger ability to validate claims by the Enterprises of a need to engage in certain business activities.
- As part of enhancement of policies related to the risks the Enterprises face, OFHEO will perform analysis and research of new products, activities and operations and develop benchmarks based on the best practices of other institutions with similar products and activities.

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

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

Performance Goal 2.1:

Support efforts to strengthen OFHEO’s authorities.

<u>Measure</u>	<u>Target</u>
2.1(1): Conduct and disseminate research and analysis to identify issues and areas requiring legislative change.	As needed
2.1(2): Make recommendations to Congress about legislative changes OFHEO needs to accomplish its mission.	At least annually
2.1(3): Respond to all Congressional inquiries.	Within 10 business days

Means & Strategies:

To accomplish its mission, OFHEO needs legislation that strengthens its regulatory powers. Since OFHEO’s inception, the agency has not had the authorities and

resources to match the responsibility assigned to it. Together, the Enterprises represent more than a 40 percent share of the residential mortgage market, a share that has doubled since 1990. This unconstrained growth led to significant operational problems, mismanagement and earnings manipulation. A key reason that these companies have continued to grow is that the credit markets have not provided normal market discipline to offset shareholders' pressure to grow. Another way to look at this growth is that during the last 15 years, the nation's GDP doubled, the mortgage market tripled, the Enterprises' guarantees quadrupled and their portfolios grew nine-fold. Unconstrained growth has caused market, credit and operational risks and, most importantly, systemic risk due to the level of interdependencies between the Enterprises and the market.

Given these issues OFHEO, as the regulator of Fannie Mae and Freddie Mac, must have stronger powers. Using as a guide Basel II, the proposed international regulatory rules for banks, there are three pillars for ensuring sound financial institutions. They are: 1) strong capital rules; 2) a strong regulator; and 3) market discipline. Unfortunately, with the Enterprises, the market discipline pillar doesn't exist and the other two are weak. The weakness of the regulatory framework helped contribute to the Enterprises' problems, and it is why the current statutory framework needs to be reformed.

- In FY 2007, OFHEO will continue to have ongoing interaction with Members of Congress, congressional staff, and with staff and policy officials at federal agencies, with respect to what authorities are needed to ensure stronger regulation of the Enterprises.
- The agency will continue to conduct public outreach and public speaking with relevant groups in order to inform and educate them. OFHEO staff will meet with industry stakeholders to discuss and receive input from the industry.
- OFHEO will conduct historical, financial and comparative analysis and research on the products, activities and operations of the Enterprises, and develop benchmarks based on other institutions with similar responsibilities, including bank regulators.
- OFHEO will continue to rely on the results of its research and analysis conducted for its ongoing supervision of the Enterprises to clarify where legislative change is necessary to achieve its mission.
- In order to educate the public, relevant stakeholders and the Congress, OFHEO staff will research issues relating to the Enterprises, including those surrounding current GSE reform legislative proposals such as issues pertaining to independence and removal from the appropriations process; receivership; portfolio limits; flexible capital requirements and safety and soundness powers equivalent to other federal financial regulators.

- OFHEO will also make recommendations on legislation in tandem with this research at least annually through its Annual Report to Congress. These recommendations are called for in OFHEO's enabling legislation and are important to ensuring that OFHEO has the powers and authorities it needs to ensure the safety and soundness of the Enterprises.
- The key to providing support to Congress for statutory reform is to be proactive in anticipating requests and respond in a timely manner to all Congressional inquiries. OFHEO has a goal of responding to Congressional inquiries within 10 business days.

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

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

Performance Goal 3.1:

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

<u>Measure</u>	<u>Target</u>
3.1(1): Report about house price trends through the House Price Index (HPI) report.	Each quarter
3.1(2): Report on OFHEO activities, examination results and conclusions, and housing, mortgage market development, and secondary mortgage market in the OFHEO annual Report to Congress.	March 31, 2007
3.1(3): Publish reports to enhance understanding of mortgages, mortgage markets and the nation's housing finance system.	At least 5 per year

- 3.1(4): Create a housing statistics section on the OFHEO web site. By the end of the fiscal year

Means & Strategies:

In FY 2008, OFHEO will continue to provide information to promote an efficient secondary mortgage market. The presentation of accurate and timely information is critical to understanding mortgages, mortgage markets and the Enterprises' risks and activities. OFHEO is uniquely positioned to serve as a resource to the public about these issues. As in previous years, OFHEO will publish a variety of data and reports throughout the year in order to increase the transparency of mortgage market developments, as well as Enterprise risks and activities.

- OFHEO will continue to calculate and release its quarterly Housing Price Index (HPI), which documents changes in house prices for the nation, the states, the nine census regions, and the metropolitan statistical areas (MSAs), and post this information on OFHEO's web site.
- In FY 2007, OFHEO will undertake research to enhance the HPI and related products by increasing the coverage and analysis of geographical areas (e.g. rural areas) and specific markets to enhancing the industry's understanding of changes in house prices and to draw inferences on many aspects of the housing finance market and the safety and soundness of the Enterprises.
- OFHEO will issue earlier in the year the Annual Report to Congress, which summarizes the results and conclusions of OFHEO's annual examinations of the Enterprises and provides information on the agency's activities, housing markets and developments in the secondary mortgage market, including a comprehensive set of supporting historical data on Enterprise-related activities.
- In FY 2007, OFHEO will expand the Annual Report to Congress to include selected abstracts of OFHEO's research and analysis products.
- OFHEO will also publish, in FY 2007, a number of reports aimed at developing an improved public understanding of mortgages, mortgage markets and the nation's housing financial system, covering topics related to the economic environment, measuring risks and supervisory policies. Generally, these reports are created in support of OFHEO's supervision of the Enterprises.
- OFHEO will continue its research on issues related to OFHEO's house price index, operational risk measurement, the assessment and measurement of capital adequacy, recent improvements in fair value balance sheets or analysis of the retained mortgage portfolios of the Enterprises. OFHEO

purchases external data on subprime loans and operational risk to conduct this research.

Performance Goal 3.2:

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

<u>Measure</u>	<u>Target</u>
3.2(1): Percentage of survey respondents visiting OFHEO’s website who find it a useful resource.	Greater than prior year Note: PART Measure
3.2(2): Respond to all public inquiries.	Within 15 business days
3.2(3): Meet with industry stakeholders to address current topics and receive input from the industry.	Quarterly

Means & Strategies:

Communication with stakeholders is key to OFHEO’s support of an efficient secondary mortgage market. Through its web site, OFHEO provides the public with information on the Enterprises, the risks they face, the economic environment in which they operate, and policy issues facing OFHEO. The OFHEO web site features detailed information about the OFHEO House Price Index (HPI), including an HPI calculator, speeches and testimony, policies and guidelines that apply to the Enterprises, Enterprise capital classifications, research and working papers, and news releases.

- During FY 2007, OFHEO will revise its web site to make it more user-friendly and make the information more accessible. OFHEO conducted a user survey in FY 2006 and is considering comments from web site users as it makes the revisions.
- OFHEO will continue to include a comprehensive range of OFHEO products on its website to ensure that members of the public find it a valuable resource.
- In FY 2007, OFHEO will continue to expand its outreach and educational efforts to the industry and stakeholders by holding meetings with industry stakeholders, Congress and the news media on mortgage market developments and the policy positions and activities of the agency to ensure that stakeholders develop an improved understanding of the financial

condition of the Enterprises, as well as the agency's operations, proposals, and regulatory activities.

- OFHEO's representatives will continue to speak at industry forums and to participate in meetings with regulatory groups, interagency groups and industry organizations, providing information about the secondary mortgage market, the Enterprises, and OFHEO's regulatory role.
- OFHEO will continue to participate in panel discussions that enhance the awareness and understanding of developments in the nation's housing finance system, and facilitates the sharing of information that identifies issues and trends important to the industry as a whole.
- OFHEO will continue to respond to inquiries from the public in a consistent, courteous, accurate, and timely manner and will seek to ensure appropriate transparency in its responses to public inquiries regarding the Enterprises, as well as to those inquiries that relate to OFHEO's operations, its proposals and regulatory activities.

Performance Goal 3.3:

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

<u>Measure</u>	<u>Target</u>
3.3(1): Meet with HUD to discuss issues related to the regulation of the Enterprises, including affordable housing goals.	At least quarterly
3.3(2): Respond to requests from other Federal agencies for information about housing finance markets and the Enterprises.	Within 30 days

Means & Strategies:

Another important way OFHEO will work to promote an efficient secondary mortgage market is by working with other Federal agencies and stakeholders to share information and discuss issues of common interest. OFHEO promotes regular liaison among regulators and will work with them as they develop regulatory standards that are aimed at improving financial safety and soundness. OFHEO considers coordination with HUD, the Enterprises' mission regulator, a critical link in meeting OFHEO's safety and soundness mission and ensuring an efficient secondary mortgage market.

- OFHEO will continue its cooperative working relationship with HUD and will work with the Secretary of HUD to raise any safety and soundness implications of proposed changes to the Secretary's goals regarding Enterprise purchases of mortgages that finance affordable housing.
- As a member of the HUD GSE Working Group, OFHEO will continue to actively participate in policy discussions with HUD regarding other safety and soundness issues impacting the Enterprises, such as charter and affordable housing issues.
- In FY 2007, OFHEO will maintain a dialogue with the Federal Reserve Board, the Treasury Department, the Securities and Exchange Commission, and other appropriate agencies about broad public policy issues affecting housing finance markets and the Enterprises.
- OFHEO will keep other financial regulators informed about OFHEO's regulatory activities and solicit their views about issues related to the Enterprises. OFHEO will evaluate this information and take it into account when making decisions consistent with its mission.
- OFHEO will enter formal agreements with other financial regulators to share resources, information, ideas and draft documents while maintaining the integrity, examiner privilege and confidentiality of the information.
- OFHEO will contribute to Federal efforts to address policy issues such as systemic risk, adequate financial disclosure, consistent supervisory standards, the development of capital requirements for other Federally-regulated financial institutions, and the security and emergency preparedness of the nation's financial system.
- As described under Strategic Goal 2, OFHEO will also work with the Congress to provide information on the effect of any proposed legislation relating to the Enterprises or the markets in which they operate.
- OFHEO will continue to participate in a number of interagency task forces, forums and groups such as the Interagency Task Force on Fair Lending, the Interagency Task Force on Predatory Lending, the Ad Hoc Credit Scoring Group, the HUD GSE Working Group, the Working Group on Mortgage Fraud, the GSE Examination Council, the Federal Financial Regulators Results Act Working Group, the Financial and Banking Information Infrastructure Committee, and the Federal Financial Institutions Examination Council (FFIEC) Information Systems Subcommittee.

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

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

Performance Goal 4.1:

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

<u>Measure</u>	<u>Target</u>
4.1(1) Develop a workforce plan that is focused on aligning human capital with OFHEO’s strategic goals.	By the end of the third quarter.
4.1(2): Conduct an OFHEO-wide competency analysis review.	By the end of the fiscal year
4.1(3) Develop a succession plan to address OFHEO’s future workforce needs.	By the end of the fiscal year
4.1(4): Conduct first annual employee survey to establish a baseline.	Acquire baseline survey results in 2007
4.1(5): Develop draft changes to the performance management system to incorporate office and individual work plans and identify a specific connection between the employee’s work plan and OFHEO’s performance goals.	By the end of the fiscal year

Means and Strategies:

OFHEO's workforce is its most valuable resource. OFHEO relies on those with a diverse background, cutting-edge professional skills and a breadth and depth of knowledge in their fields. Their technical competence, skills, and effective teamwork are crucial to ensuring the successful achievement of OFHEO's goals.

To ensure OFHEO effectively manages its most valuable resources, OFHEO has adopted the President's Management Agenda on Human Capital, focusing on six areas: strategic alignment, workforce planning, leadership knowledge, results-oriented performance culture, talent management and accountability. In FY 2007, OFHEO will complete its Human Capital Strategic Plan, which will address these six areas in the context of OFHEO's workforce and operating environment. OFHEO will continue to review its supervisory program and organization and make adjustments to improve effectiveness. OFHEO will also continue to explore opportunities for competitive sourcing by reviewing whether commercial activities performed by the government can be more efficiently obtained by private sector service providers or Federal employees.

- OFHEO will develop a workforce planning strategy to assess the skills and competencies of the workforce and develop an effective succession plan based on the needs identified to achieve OFHEO strategic goals in FY 2007.
- OFHEO will hire a training officer to begin to develop an agency-wide training plan that incorporates online, in-house and external opportunities to address skill gaps, skill enhancements, refresher courses and new learning to ensure an effective workforce. This more centralized training function will ensure a more efficient use of limited training resources.
- OFHEO will survey its staff to measure employees' perceptions of conditions that characterize successful organizations, such as leadership quality, performance culture and talent capacity, at OFHEO. The results will be a baseline for future employee surveys.
- To maintain a diverse and skilled workforce, OFHEO will continue to advertise our mission-critical jobs in print or electronic publications frequented by relevant professionals and attend minority job fairs and professional conventions of under-represented groups in order to attract and acquire qualified staff.

Performance Goal 4.2:

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

<u>Measure</u>	<u>Target</u>
4.2(1) Publish the IT 5-Year Strategic Plan	By the end of the third quarter.
4.2(2): Implement the fiscal year 2007 component of the OFHEO 5-Year IT Strategic Plan.	By the end of the fiscal year
4.2(3): Percent of time OFHEO's IT systems are available for use by the OFHEO staff.	97%
4.2(4): Certification and Accreditation of all major OFHEO systems completed.	100%

Means & Strategies:

OFHEO's supervision of the Enterprises is highly dependent upon the strategic use of technology. The use of information technology (IT) is an integral part of achieving OFHEO's mission and of the Enterprise operations that the agency regulates. Without technology comparable to that used by other organizations with similar risk assessment and analytical requirements, OFHEO would not be able to provide independent analysis of safety and soundness issues to accomplish its mission. OFHEO has a Five-Year Information Technology Strategic Plan that outlines the goals and deliverables needed to support the mission and functions of OFHEO, and carries out the e-Gov goals of the President's Management Agenda. Each year, OFHEO reviews the plan to ensure that the annual component of the plan ties to the annual performance budget and positions the agency in achieving its long term goals.

- In FY 2007, OFHEO will continue to use the IT Investment Review Board (IRB) first implemented in FY 2006 to make effective IT decisions. The IRB review ensures a cost-effective allocation of resources for IT capital investments that are consistent with OFHEO's Strategic Plan.
- OFHEO will develop an agency process to use the System Development Life Cycle methodology by the end of FY 2007 to minimize the long term costs of supervisory and administrative systems at the agency. OFHEO will begin to implement this process for all agency systems the following year...
- In FY 2007, OFHEO will develop a 5-year plan for the automated supervisory tool that facilitates the examination process and coordinates activities throughout the Office of Supervision, promoting information sharing and documenting the risk rating process.
- OFHEO will continue to support and maintain the risk-based capital stress test application, a large and complex computer model that simulates the cash

flows of the assets and obligations of each Enterprise under stressful conditions.

- OFHEO will continue to support and maintain data sets and advanced technology needed to conduct research and financial analysis, including the asset-liability model.
- To ensure maximum availability of OFHEO information resources, OFHEO will continue to enhance the security, reliability and capacity of OFHEO's IT infrastructure, consistent with the Federal Information Security Management Act (FISMA).

Performance Goal 4.3:

Maintain a strong internal control and risk management program.

<u>Measure</u>	<u>Target</u>
4.3(1): Percent of OFHEO's external audits or external reviews with a clean opinion and no material weaknesses.	100%

Means & Strategies:

To ensure that its resources are managed effectively and efficiently, OFHEO will continue to expand its use of financial and performance information in managing program operations, integrating its budget and performance development, and making program improvements. OFHEO must continue to maintain a strong internal control and risk management program. This includes financial management, information security and other management and operating processes. These efforts continue to support the President's Management Agenda initiatives of improved financial performance and budget and performance integration.

- OFHEO will seek an independent audit of its financial statements for FY 2007, as it has in prior years, and will revise its policies and procedures as necessary to ensure that the agency's resources are used to achieve its strategic and performance goals.
- OFHEO will seek an independent Federal Information Security Management Act (FISMA) review of its information security program during FY 2007. The OFHEO information security program provides for the protection of its information assets, including the hardware and software used to create and maintain the information.

- During FY 2007, OFHEO will continue its program of information security monitoring and staff training, and will update risk assessments of its systems to ensure that the associated risks have been mitigated. Information security at OFHEO is a shared responsibility among the Chief Information Security Officer, information technology professionals, and the entire OFHEO staff.
- To ensure that OFHEO maintains its independent hiring authority and is appropriately recruiting the talent needed to accomplish its mission, OFHEO will have its Delegated Examining Unit (DEU) audited in FY 2007.

Performance Goal 4.4:

Ensure the continuity of OFHEO’s business functions.

<u>Measure</u>	<u>Target</u>
4.4(1): Complete continuity of operations plan as outlined by Federal Preparedness Circular 65.	By year end

Means & Strategies:

OFHEO is committed to the good business practice of business continuity planning, ensuring that the agency can continue to perform its essential functions during an unplanned event that would prevent normal business operations.

- OFHEO will revise and update its continuity of operations (COOP) plan that identifies essential functions and alternate plans in case of an emergency, including alternative work sites. The plan will follow Federal Preparedness Circular 65, which provides guidance to Federal agencies about business continuity planning and outlines requirements for agency plans.
- As part of the COOP plan, OFHEO will include a regular schedule of testing to assess and validate the plan and proactively identify any gaps or operational problem areas. This testing will include alert and notification procedures, recovery plans for vital systems and data, and infrastructure systems such as computer systems.

Program Evaluation

OFHEO has not conducted a program evaluation in recent years. OFHEO has made many changes in its practices since GAO last evaluated its mission activities. For example, OFHEO increased the depth and breadth of its staff and coverage of risk areas, dedicating significant resources in the accounting and compliance areas.

Operationally, OFHEO has conducted special examinations of both Enterprises and, through consent agreements with each, has directed improvements based on its findings. OFHEO's most recent improvements were described in the FY 2006 Performance and Accountability Report. During FY 2007, OFHEO is continuing to strengthen its supervisory infrastructure, as described in performance goal 1.4. OFHEO anticipates contracting for a program evaluation by an independent contractor in the future. The program evaluation, conducted by an independent contractor, will focus on assessing the effectiveness of OFHEO's supervision of Fannie Mae and Freddie Mac in ensuring that they are safe and sound and adequately capitalized.

Performance Assessment Rating Tool

OFHEO was reviewed by its management and OMB using the Performance Assessment Rating Tool in FY 2006. The results of this assessment, including OFHEO's rating, will be publicly released with the President's 2008 Budget in February 2007. In this performance budget, OFHEO is using all the performance measures described in the PART evaluation.

2005 - 2007 Resource Allocation Estimates*

2007 Dollars in Millions

	Strategic Goal 1		Strategic Goal 2		Strategic Goal 3		Total
Year	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars
2007	\$61.9	91.6	\$2.8	4.1	\$2.9	4.3	\$67.6

2007 FTE

	Strategic Goal 1		Strategic Goal 2		Strategic Goal 3		Total
Year	FTE	Percent	FTE	Percent	FTE**	Percent	FTE
2007	234	91.2	10	4.1	12	4.7	256

*FY 2007 is the first year that OFHEO is operating under its FY 2006-2011 Strategic Plan, which was issued September 29, 2006. With a new set of strategic goals, OFHEO's plan emphasizes strengthening its oversight over a multi-year period and the Office has adopted new measures and targets. OFHEO is also emphasizing working with other regulators to improve its oversight and to support national policy affecting the housing finance system. For FY 2005 and FY 2006, OFHEO operated under the Strategic Plan it adopted at the end of FY 2003.

2005-2006 Dollars in Millions

Year	Strategic Goal 1		Strategic Goal 2		Strategic Goal 3		Total
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars
2005	\$64.5	94.	\$3.6	5.7	\$0.2	0.3	\$64.3
2006	\$57.2	94.4	\$3.3	5.4	\$0.1	0.2	\$60.6

2005-2006 FTE

Year	Strategic Goal 1		Strategic Goal 2		Strategic Goal 3		Total
	FTE	Percent	FTE	Percent	FTE	Percent	FTE
2005	184	92.9	13	6.6	1	0.5	198
2006	211	93.9	13	5.9	<1	0.2	225

The FY 2007 Performance Plan was developed with an estimated resource level of \$67.6 million and 256 FTE. At the end of December 2006 the OFHEO budget level remains uncertain. If OFHEO were funded at \$60 million, as currently specified by the continuing resolution, it could result in delaying the achievement of quarterly milestones within Strategic Goals 1 and 3, and to the extent that staffing was delayed, it could affect the quality of OFHEO's oversight.

Performance Information					
	2003	2004	2005	2006	2007
Strategic Goal 1	Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized, and comply with other legal requirements.				
<i>Perf. Goal 1.1</i>	<i>The Enterprises comply with safety and soundness standards.</i>				
<i>Actual Performance</i>	Both Enterprises were financially sound, however, OFHEO identified unsafe and unsound practices at Freddie Mac and undertook remedial actions. OFHEO continues its review and remedial steps into the 2004 fiscal year.	Both Enterprises met safety and soundness standards, however, OFHEO continued to monitor required remedial actions based on unsafe and unsound practices identified by OFHEO at Freddie Mac in FY 2003. OFHEO identified safety and soundness concerns at Fannie Mae and took remedial action.	Both Enterprises met safety and soundness standards, however, OFHEO found inadequate controls and improper accounting at Fannie Mae and took remedial action. OFHEO continued to monitor both Enterprises' progress in completing remedial action to address special examination findings.	Both Enterprises continue to pose supervisory concern including internal controls and accounting problems. Both Enterprises have remedial plans in place to address special examination findings and OFHEO continues to identify other issues requiring attention. Although both Enterprises are responding to OFHEO's concerns they have considerable work to do to correct their accounting and internal controls problems.	

	2003	2004	2005	2006	2007
<i>Perf. Goal 1.2</i>	<i>The Enterprises are adequately capitalized.</i>				
<i>Actual Performance</i>	<p>Freddie Mac: classified as adequately capitalized each quarter.</p> <p>Fannie Mae: classified as significantly undercapitalized for the quarter ending December 31, 2002 and classified as adequately capitalized for the remaining quarters.</p> <p>Made technical amendments to the final rule and initiated projects to consider future changes.</p>	<p>Freddie Mac: classified as adequately capitalized each quarter.</p> <p>Fannie Mae: classified as adequately capitalized for the quarters ending March 31, 2004 and June 30, 2004; and classified as significantly undercapitalized for the quarters ending December 31, 2003 and September 30, 2004.</p>	<p>Freddie Mac: classified as adequately capitalized each quarter.</p> <p>Fannie Mae: classified as adequately capitalized for three quarters and classified as significantly undercapitalized for the quarter ending December 31, 2004.</p>	<p>Both Enterprises were classified as adequately capitalized each quarter, and were required to maintain a capital surplus 30% above the minimum capital requirement.</p>	
<i>Perf. Goal 1.3</i>	<i>The Enterprises comply with applicable laws, regulations and directives, including executive compensation, corporate responsibility and disclosure.</i>				
<i>Actual Performance</i>	<p>OFHEO identified instances of unsafe and unsound practices at Freddie Mac, undertook supervisory actions, and required remedial steps.</p>	<p>Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility and disclosure requirements. Each Enterprise responded appropriately to issues identified by OFHEO.</p>	<p>Issued corporate governance regulation and mortgage fraud regulation. Issued examination guidance and a Director's Advisory. Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility, executive compensation and disclosure requirements. Each Enterprise responded appropriately to issues identified by OFHEO.</p>	<p>Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility, executive compensation and disclosure requirements. Each Enterprise responded appropriately to issues identified by OFHEO.</p>	

	2003	2004	2005	2006	2007
<i>Perf. Goal 1.4</i>	<i>Strengthen regulatory infrastructure to enhance the supervision of the Enterprises.</i>				
<i>Actual Performance</i>	N/A	N/A	N/A	N/A	New Performance Goal
Strategic Goal 2	Provide support for statutory reforms to strengthen our regulatory powers.				
<i>Perf. Goal 2.1</i>	<i>Support efforts to strengthen OFHEO's authorities.</i>				
<i>Actual Performance</i>	N/A	N/A	N/A	N/A	New performance goal.
Strategic Goal 3	Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.				
<i>Perf. Goal 3.1</i>	<i>Promote an efficient secondary mortgage market by increasing the transparency of mortgage market developments, and Enterprise risks and activities.</i>				
<i>Actual Performance</i>	House Price Index (HPI) Report issued quarterly. Research and analysis of emerging issues have been ongoing. OFHEO made progress on its research agenda. Annual Report on OFHEO activities and examination results and conclusions sent to Congress June 4, 2003.	HPI Report issued quarterly. Research to meet the Director's priorities was completed. A report on the special examination of Freddie Mac and a report with findings to date on the Fannie Mae special examination were published. Other papers and reports on special topics were completed. Annual Report sent to Congress on June 15, 2004.	HPI Report issued quarterly. One research paper published as planned. Annual Report sent to Congress on June 15, 2005. Issued secondary mortgage market report for both 2003 and 2004.	HPI Report issued quarterly. Annual Report sent to Congress on June 15, 2005. Issued a research paper, a working paper and the Report of the Special Examination of Fannie Mae.	

	2003	2004	2005	2006	2007
<i>Perf. Goal 3.2</i>	<i>Communicate effectively with all stakeholders on Enterprise risks and activities, mortgage markets, the nation's housing finance system and regulatory issues.</i>				
<i>Actual Performance</i>	Responded to nearly all inquiries from Congress and the public within 7 days.	Responded to all inquiries from Congress within 14 days and responded to all public inquiries within 21 days.	Responded to all inquiries from Congress within 14 days and responded to all public inquiries within 21 days.	Responded to all inquiries from Congress within 14 days and all public inquiries within 21 days. Over 93% of respondents indicated they found OFHEO's web site a valuable resource.	
<i>Perf. Goal 3.3</i>	<i>Cooperate with other Federal financial agencies on mortgage markets and the nation's housing finance system and regulatory issues.</i>				
<i>Actual Performance</i>	Worked with other Federal financial agencies on regulatory issues.	Cooperated with other Federal financial agencies on regulatory issues.	Worked with other Federal agencies on various issues, participated in interagency task forces and responded to Federal agencies' requests for information within the timeframe.	Worked with other Federal agencies on various issues, participated in interagency task forces and responded to Federal agencies' requests for information within the timeframe.	
Resource Mgmt Strategy	<i>Manage effectively OFHEO's human capital and other resources to support our mission.</i>				
<i>Perf. Goal 4.1</i>	<i>Maintain a diverse workforce that is skilled, flexible, and performance-oriented to fulfill the goals of the agency.</i>				
<i>Actual Performance</i>	Completed annual revision of individual development plans for 95% of staff members. Training and development have been ongoing.	Completed annual revision of individual development plans for all staff members. Training and development ongoing.	Completed annual revision of individual development plans for all staff members. Training and development ongoing.	Completed annual revision of individual development plans for all staff members. Training and development ongoing.	

	2003	2004	2005	2006	2007
<i>Perf. Goal 4.2</i>	<i>Provide effective information resource management services to OFHEO managers and staff to support the goals of the agency.</i>				
<i>Actual Performance</i>	Implemented four projects from the fiscal year 2003 Component of 5-Year IT Strategic Plan, made substantial progress on two others, and suspended one project.	Implemented all three projects outlined in the FY 2004 Component of 5-Year IT Strategic Plan.	Implemented all three projects outlined in the FY 2005 Component of 5-Year IT Strategic Plan.	Successfully implemented four of six projects outlined in the FY 2006 component of the five-year IT Strategic Plan. Substantially completed the remaining two projects and expect to have them completed in the first and second quarter of 2007.	
<i>Perf. Goal 4.3</i>	<i>Maintain a strong internal control and risk management program.</i>				
<i>Actual Performance</i>	Received an unqualified audit opinion on financial statements, internal controls and compliance with laws and regulations from an independent, external auditor. No material weaknesses were reported during the independent review of OFHEO's information security program. The HUD IG issued a report with two findings: improve oversight of the travel program and implement a space utilization policy (which OFHEO satisfied by early fiscal year 2004).	Received an unqualified audit opinion on 2003 and 2004 financial statements, internal controls and compliance with laws and regulations from an independent, external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program. The HUD IG found OFHEO exceeded the requirements of the 2004 Appropriations Act to use no less than 60 percent of its 2004 funds for examination, supervision and capital oversight of the Enterprises.	Received an unqualified audit opinion on financial statements, internal controls and compliance with laws and regulations from an independent, external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program. The HUD IG found OFHEO's allocation of resources, staffing and compensation was comparable to other regulators.	Received an unqualified audit opinion on financial statements, internal controls and compliance with laws and regulations from an independent, external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program.	
<i>Perf. Goal 4.4</i>	<i>Ensure the continuity of OFHEO's business functions.</i>				
<i>Actual Performance</i>	N/A	N/A	N/A	N/A	New performance goal