FEDERAL
HOUSING
FINANCE
AGENCY

2012
Performance and Accountability Report

BUILDING AN INFRASTRUCTURE FOR THE SECONDARY MORTGAGE MARKET

FEDERAL HOUSING FINANCE AGENCY

FHFA

2012 Performance and Accountability Report

MISSION

Provide effective supervision, regulation, and housing mission oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks to promote their safety and soundness, support housing finance and affordable housing, and support a stable and liquid mortgage market.

VISION

A reliable, stable, and liquid housing finance system.

FHFA VALUES

RESPECT

We strive to act with respect for each other, to promote diversity, to share information and resources, to work together in teams, and to collaborate to solve problems.

INTEGRITY

We seek to adhere to the highest ethical and professional standards and to inspire trust and confidence in our work.

EXCELLENCE

We aspire to excel in every aspect of our work and to seek better ways to accomplish our mission and goals.

DIVERSITY

We pursue the full inclusion of all segments of the U.S. population in our business endeavors and at the entities we regulate.

Table of Contents

Message from the Acting Director

I am pleased to present the Federal Housing Finance Agency's (FHFA's) *FY 2012 Performance and Accountability Report*. FHFA is an independent agency responsible for providing effective supervision, regulation, and housing mission oversight of Fannie Mae and Freddie Mac (the Enterprises), the Federal Home Loan Banks (FHLBanks) and the FHLBank's joint Office of Finance to promote their safety and soundness, support housing finance, affordable housing, and a stable and liquid mortgage market. Together, these 14 regulated entities are known as the housing government-sponsored enterprises, or housing GSEs.

This report describes FHFA's performance highlights, the challenges we face in supervising the regulated entities, the collective work among FHFA and the Enterprises to assist homeowners and support the housing market, and the ongoing initiatives by the agency to ensure FHFA meets the strategic goals that are set.

FHFA'S FY 2012 STRATEGIC GOALS AND RESOURCE MANAGEMENT STRATEGY	
1	The housing GSEs operate in a safe and sound manner and comply with legal requirements.
2	The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing.
3	FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.
4	FHFA has the personnel, resources, and infrastructure to manage effectively and efficiently to achieve its mission and goals.

Enterprises

The Enterprises have been in conservatorships since September 2008 and they have maintained a functioning conventional mortgage market throughout that period. Under FHFA direction, the Enterprises made significant progress remediating the problems that led to their being placed in conservatorships and refining programs designed to keep borrowers in their homes.

However, open-ended conservatorships cannot continue indefinitely. In February 2012, FHFA released *A Strategic Plan for Enterprise Conservatorships*. This plan identifies three strategic goals for the next phase of the conservatorships:

- **Build** a new infrastructure for the secondary mortgage market;
- **Contract** the Enterprises' dominant presence in the marketplace gradually while simplifying and shrinking their operations; and
- **Maintain** foreclosure prevention activities and credit availability for new and refinanced mortgages.

The plan is a roadmap for work FHFA and the Enterprises will undertake while the companies remain in conservatorship. FHFA created the Office of Strategic Initiatives to help the agency execute the activities associated with this plan.

Federal Home Loan Banks

The FHLBanks continued to improve their financial condition and performance during the fiscal year. Balances of private-label mortgage-backed securities (MBS) continued to decline and credit losses on these securities subsided, allowing the FHLBanks to generate positive net income and augment their retained earnings.

In April 2012, FHFA concluded that the FHLBank of Chicago had satisfied the requirements established by the cease and desist order that had been in place since October 2007 and removed that cease and desist order. In September 2012, FHFA determined that the FHLBank of Seattle was adequately capitalized under the risk-based capital framework, removing the discretionary undercapitalized designation that had been in place.

The FHLBanks' capital levels remained at or near historic highs during the fiscal year. Retained earnings have increased dramatically in the past five years and now top $9 billion. Retained earnings should continue to increase because of the capital plan provisions adopted last year to set aside 20 percent of income in restricted retained earnings.

New FHFA Strategic Plan

FHFA developed a new *Strategic Plan for FHFA for Fiscal Years 2013-2017* and released it in early October 2012. The plan sets four strategic goals:

FHFA'S FY 2013–2017 STRATEGIC GOALS	
1	Safe and sound housing GSEs.
2	Stability, liquidity, and access in housing finance.
3	Preserve and conserve Enterprise assets.
4	Prepare for the future of housing finance in the United States.

The new strategic plan builds on the agency's earlier document, *A Strategic Plan for Enterprise Conservatorships* and lays out a series of initiatives and strategies designed to improve current mortgage processes, inspire greater confidence among potential market participants and set the stage for an improved future system of housing finance.

In addition, the agency's FY 2013 Annual Performance Plan includes new performance measures for monitoring progress toward meeting the strategic and performance goals described in the *Strategic Plan for FHFA for Fiscal Years 2013-2017*.

Program Data and Financial Performance

For the fourth consecutive year, FHFA received an unqualified (clean) opinion on its financial statements from the U.S. Government Accountability Office (GAO). FHFA has no material internal control weaknesses, and our financial and performance data contained in this report are reliable and complete in accordance with Office of Management and Budget Circular A-123. FHFA met or exceeded 23 (92 percent) of its performance measures. The agency did not meet two (8 percent) of the measures (see the Performance Summary section on page 34).

Conclusion

The conservatorships of the Enterprises were never intended as a long-term solution but were meant primarily as a "time out." However, in the four years since FHFA established the conservatorships, we have made significant strides towards maintaining a functioning mortgage market. The cornerstone of *A Strategic Plan for Enterprise Conservatorships* is to build a new securitization platform that could serve both Fannie Mae and Freddie Mac while in conservatorship—and potentially serve the secondary mortgage market in a post-conservatorship world that has multiple issuers of mortgage-backed securities.

The FHLBanks have continued to play an important role in housing finance. There are many opportunities and challenges ahead, and the role of the FHLBanks in the country's housing finance system will be part of the policy discussion.

While the future structure of housing finance remains undetermined, the nation's confidence in the housing market seems to be returning. FHFA looks forward to working with the Administration, Congress, and market participants in continuing the work of rebuilding the country's housing finance system.

EDWARD J. DEMARCO
Acting Director
November 15, 2012

How the Report is Organized

This report highlights the agency's accomplishments in FY 2012 and our future challenges. This report has five sections, as follows:

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section is an overview of the entire *Performance and Accountability Report*. It briefly describes FHFA's mission and organization, performance highlights, management challenges, and key performance measures. It also gives a financial overview and management assurances of internal controls.

PERFORMANCE

This section identifies FHFA's strategic goals and describes the fiscal year performance relative to the goals and measures set forth in the agency's Annual Performance Plan.

FINANCIAL

This section includes a Message from the Chief Financial Officer, the independent auditor's report, Appendix I: Management's Report on Internal Control over Financial Reporting, Appendix II: FHFA Response to Auditor's Report, FHFA's Financial Statements, and Notes to the Financial Statements.

OTHER ACCOMPANYING INFORMATION

This section includes performance goals and measures no longer reported, the Inspector General's primary management and performance challenges and the Summary of Financial Statements Audit and Management Assurances.

APPENDIX

The appendix includes a glossary, a list of abbreviations and acronyms used in the report, acknowledgements, and an index of figures and features.

Management's Discussion and Analysis

Strategic Goals and Resource Management Strategy

STRATEGIC GOAL 1: SAFE AND SOUND HOUSING GSES	The housing government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Banks—operate in a safe and sound manner and comply with legal requirements.
STRATEGIC GOAL 2: HOUSING MISSION	The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing.
STRATEGIC GOAL 3: CONSERVATORSHIP	FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.
RESOURCE MANAGEMENT STRATEGY	FHFA has the personnel, resources, and infrastructure to manage effectively and efficiently to achieve its mission and goals.

Alignment of Resource Allocation with Strategic Goals

FHFA tracks resource allocations and program costs according to strategic goals. Figure 1 illustrates the costs that FHFA expended from FY 2010 to FY 2012 to accomplish its three strategic goals. Figure 2 shows the number of full-time equivalent employees working on each goal. Resources associated with the Resource Management Strategy were distributed proportionately to Strategic Goals 1 through 3 based on the percentage of direct costs of each strategic goal to the total direct costs for FHFA.

Figure 1: ACTUAL DOLLARS FY 2010–2012 (DOLLARS IN MILLIONS)

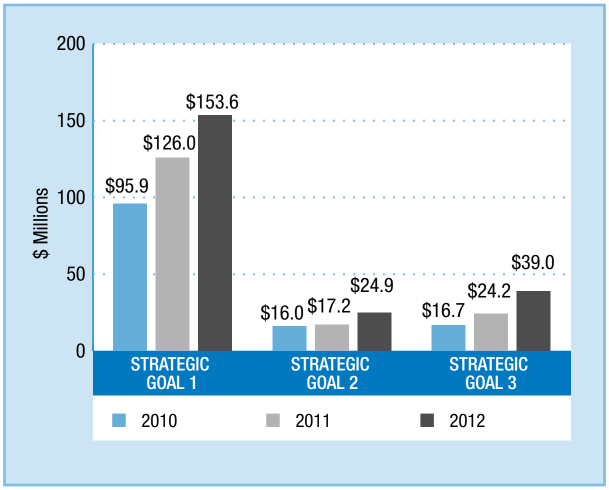
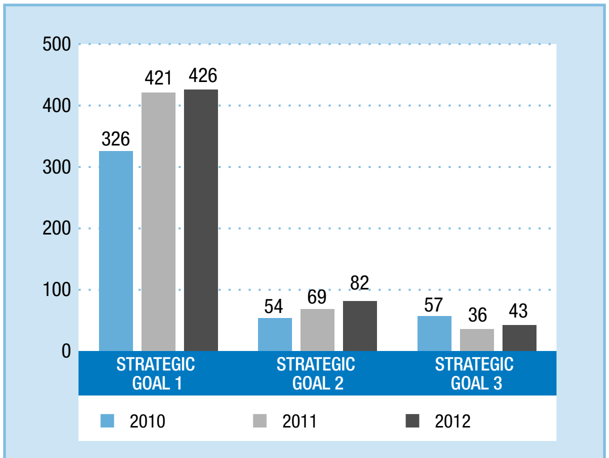


Figure 2: ACTUAL FULL-TIME EQUIVALENTS FY 2010–2012



Note: Full-time equivalent (FTE) is calculated as the total number of hours worked (or to be worked) divided by the number of compensable hours in each fiscal year.

FHFA at a Glance

OVERVIEW

The Federal Housing Finance Agency was created as an independent agency on July 30, 2008, when the President signed the *Housing and Economic Recovery Act of 2008* (HERA). This law merged the staffs at the Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board, and certain staff from the U.S. Department of Housing and Urban Development (HUD). FHFA is responsible for overseeing the financial safety and soundness and housing mission compliance of the housing GSEs.

REGULATOR OF THE ENTERPRISES AND THE FHLBANKS

As regulator, FHFA has a statutory responsibility to ensure that each regulated entity operates in a safe and sound manner and that the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets.

FHFA participates in a number of interagency initiatives to improve the effectiveness of its oversight, including the Financial Stability Oversight Council (FSOC), the Federal Housing Finance Oversight Board, and the Financial Stability Oversight Board (FINSOB). The FHFA Director is appointed by the President, subject to Senate approval. The Director represents the agency on FSOC and FinSOB, and chairs the Federal Housing Finance Oversight Board.

CONSERVATOR OF THE ENTERPRISES

In accordance with the *Federal Housing Enterprises Financial Safety and Soundness Act of 1992* as amended by HERA, FHFA was appointed conservator of Fannie Mae and Freddie Mac on September 6, 2008.

As conservator, FHFA is authorized to "take such action as may be:

(i) necessary to put the regulated entity in a sound and solvent condition; and

(ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."

In addition, FHFA holds authority over the management, boards, and shareholders of the Enterprises in conservatorship. However, the Enterprises continue to operate as business corporations. For example, they have chief executive officers and boards of directors, and must follow the laws and regulations governing financial disclosure, including requirements of the Securities Exchange Commission.

Like other corporate executives, the Enterprises' executive officers have legal responsibilities to use sound and prudent business judgment in their stewardship of the companies.

While FHFA has broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations. Instead, FHFA leadership reconstituted the Enterprises' boards of directors in 2008 and charged them with ensuring that normal corporate governance practices and procedures are in place. The boards are responsible for carrying out normal board functions, which are subject to FHFA review and approval on critical matters. This division of duties represents the most efficient structure for carrying out FHFA responsibilities as conservator.

FY 2012 Profile

- During each calendar year (CY), FHFA completes examinations for Fannie Mae, Freddie Mac, each of the 12 FHLBanks, and the Office of Finance. FHFA presents reports of examination to the respective boards of directors, though the scheduling of examination fieldwork and reviews of examination reports may vary from year to year. Results of the examinations are reported to Congress.
- FHFA consolidated its operations from three separate locations to a new headquarters at Constitution Center in Washington, D.C., in January 2012. This move allowed the headquarters staff to work in a single location, which facilitates coordination and communications across the agency's divisions and offices and contributes to more effective and efficient operations for the agency.
- FHFA developed two new strategic plans during FY 2012—*A Strategic Plan for Enterprise Conservatorships* that describes the initiatives that will be undertaken in the next phase of the conservatorships and the *Strategic Plan for FHFA for Fiscal Years 2013-2017*.
- FHFA created the Office of Strategic Initiatives to coordinate and oversee activities associated with *A Strategic Plan for Enterprise Conservatorships*.
- FHFA expanded its regulatory presence at the Enterprises by increasing the number of examiners permanently onsite at Fannie Mae and Freddie Mac.
- FHFA handled 246 congressional inquiries, 2,065 non-consumer general public inquiries, and 2,554 consumer inquiries in FY 2012.
- FHFA worked with the Enterprises to complete foreclosure prevention actions, which helped 522,575 homeowners avoid foreclosure from October 2011 to August 2012. These actions are intended to assist homeowners whose mortgages are in distress to maintain their homes. The Home Affordable Refinance Program (HARP) was established as a pre-distressed action to enable homeowners to refinance their mortgages and lower their monthly payments. From October 2011 to August 2012, 711,409 mortgages were refinanced through HARP.
- FHFA increased its staff by 64 employees in FY 2012, ending the year at 574 employees.
- FHFA's budget for FY 2012 was $185.8 million (excluding the Office of Inspector General); the agency's FY 2011 budget was $176.4 million.

Figure 3: FHFA'S WORKFORCE BY SPECIALIZED AREA

FHFA EMPLOYEES *(by specialized area)*		
	2012 Year End	2013 Budgeted
Examinations	242	272
Other Mission	139	134
Office of the Director	27	30
Legal	40	42
Information Technology	53	54
Infrastructure	73	78
TOTAL	574	610

Organization

FHFA is an independent government agency with a workforce that includes highly skilled examiners, economists, financial and policy analysts, attorneys, and subject matter experts in banking, technology, accounting, and legal matters. The Acting Director sets the direction for the agency to achieve its mission with core divisions and offices working together to ensure effective execution of the agency's mission (see Figure 4).

The Office of Inspector General (OIG) is responsible for conducting independent objective audits, evaluations, investigations, surveys, and risk assessments of FHFA's programs and operations. OIG informs the FHFA Director, Congress, and the public of any problems or deficiencies relating to programs and operations. OIG activities assist FHFA staff and program participants in ensuring the effectiveness, efficiency, and integrity of FHFA's programs and operations. The office was established by HERA in 2008 and commenced operation in October 2010.

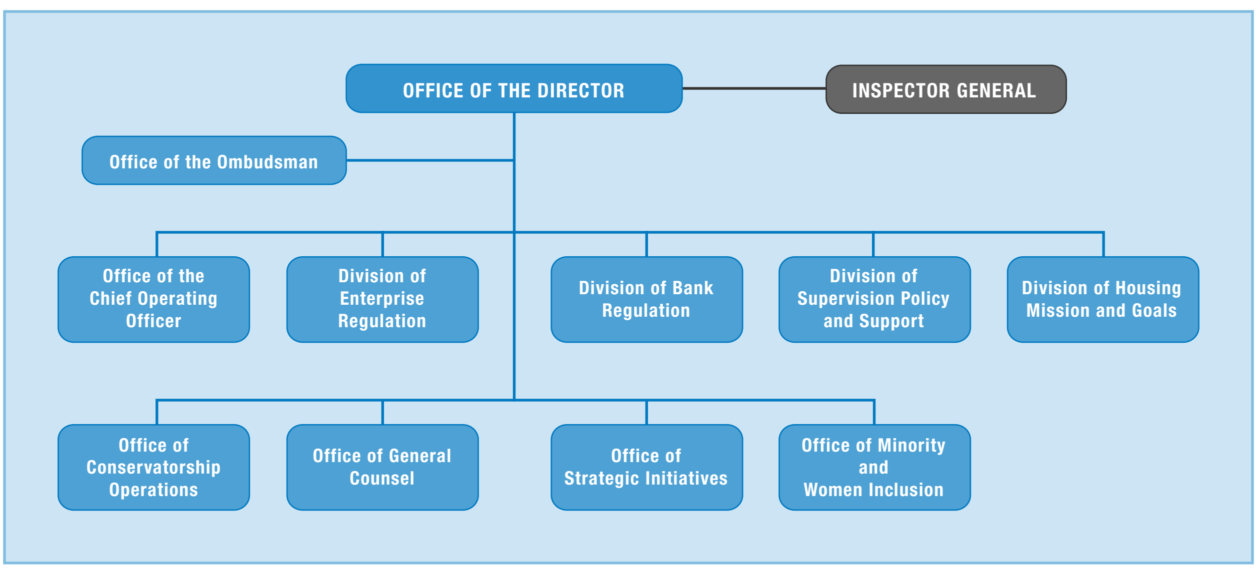
The Office of Ombudsman is responsible for considering complaints and appeals from any regulated entity, the Office of Finance, or any person who has a business relationship with a regulated entity or the Office of Finance concerning any matter relating to FHFA's regulation and supervision. Neither FHFA nor any of its employees may retaliate against a regulated entity, the Office of Finance,

FHFA staffers chat before the annual employee awards ceremony in June 2012.

or a person for submitting a complaint or appeal to the Ombudsman. The office was created by regulation under HERA and commenced operation in March 2011.

The Office of Chief Operating Officer oversees the agency's day-to-day operations, including facilities management, contingency planning, continuity of operations, financial and strategic planning and budgeting. The office also directs human resources management, information technology, quality assurance, internal and external communications, and coordination with the FHFA Office of Inspector General. The office leads

Figure 4: FHFA PRINCIPAL ORGANIZATION UNITS



reporting on strategic planning and accountability, and develops recommendations for long-term improvements in agency operations.

The Division of Enterprise Regulation (DER) is responsible for the supervision of the Enterprises to ensure their safe and sound operation. This office provides management oversight, direction, and support for all examination activity involving the Enterprises, the development of supervision findings, and preparation of the annual reports of examination. The division monitors and assesses the financial condition and performance of the Enterprises and their compliance with regulations through annual on-site examinations and periodic visitations. An examiner-in-charge leads examination activity at each Enterprise.

The Division of Federal Home Loan Bank Regulation (DBR) is responsible for supervising the FHLBanks and the Office of Finance to promote their safe and sound operation. The division oversees and directs all FHLBank examination activities, develops examination findings, and prepares annual examination reports. The division monitors and assesses the financial condition and performance of the FHLBanks and the Office of Finance and tests their compliance with laws and regulations through annual on-site examinations, periodic visits, and off-site monitoring and analysis. DBR also conducts Affordable Housing Program (AHP) on-site examinations and visits each FHLBank annually to ensure compliance with program regulations and to evaluate the effectiveness of each FHLBank's AHP program.

The Division of Supervision Policy and Support is responsible for monitoring the regulated entities for emerging risks in housing and financial markets and key counterparties. The division also is responsible for working with other federal financial regulators on identifying and assessing emerging risks and regulatory best practices as well as working with DER and DBR to incorporate this information into FHFA's supervisory program.

The Division of Housing Mission and Goals is responsible for FHFA policy development and analysis, oversight of housing and regulatory policy, and oversight of the mission and goals of the Enterprises, and the housing finance and community and economic development mission of the FHLBanks. In support of FHFA's mission and the Director's responsibilities as a member of the Federal Housing Finance Oversight Board, the Financial Stability Oversight Board, and the Financial Stability Oversight Council, the division also oversees and coordinates FHFA activities that involve data analysis, market surveillance, systemic risk monitoring, and analysis affecting housing finance and financial markets.

The Office of Conservatorship Operations assists the FHFA Director, as conservator, in preserving and conserving Fannie Mae's and Freddie Mac's assets and property. The office ensures that the Enterprises focus on their mission—providing stability, liquidity, and affordability to the housing market. The office interacts with the Enterprises and the conservator to help restore confidence in the Enterprises, enhance their ability to fulfill their mission, and mitigate issues of systemic risk leading to market instability. The office facilitates communications between the Enterprises and the conservator to ensure the prompt identification of emerging issues and their timely resolution. The office also works with the Enterprises' boards and senior management to establish priorities and milestones for accomplishing the goals of the conservatorship.

The Office of the General Counsel advises and supports the Director and FHFA staff on legal matters related to the functions, activities, and operations of FHFA and the regulated entities. It supports supervision functions, regulations writing, and enforcement actions. The office oversees the bringing or defense of litigation. The office also manages the *Freedom of Information Act* (FOIA) and Privacy Act programs. The ethics official advises, counsels, and trains FHFA employees on ethical standards and conflicts of interest, and manages the agency's financial disclosure program.

The Office of Strategic Initiatives leads, coordinates and clarifies agency and Enterprise activities related to FHFA's *A Strategic Plan for Enterprise Conservatorships* to achieve the objectives set forth therein. It oversees FHFA activities involving engagement with the Enterprises on specific projects associated with the strategic plan. The office promotes consistency between FHFA and the Enterprises with regard to priorities and timelines and ensures that projects achieve their objectives in a timely and efficient manner.

The Office of Minority and Women Inclusion (OMWI) is responsible for all matters of diversity in employment, management, and business activities at FHFA as well as programs to monitor minority and women inclusion at the regulated entities. OMWI ensures that FHFA is compliant with Equal Employment Opportunity laws and regulations, and protects staff against workplace discrimination. OMWI ensures that minorities, women, service-disabled veterans, and persons with disabilities are fully included in all job and business opportunities created as a part of the Federal Government's efforts to reform and strengthen the banking system and the financial services industry.

The Housing Government-Sponsored Enterprises

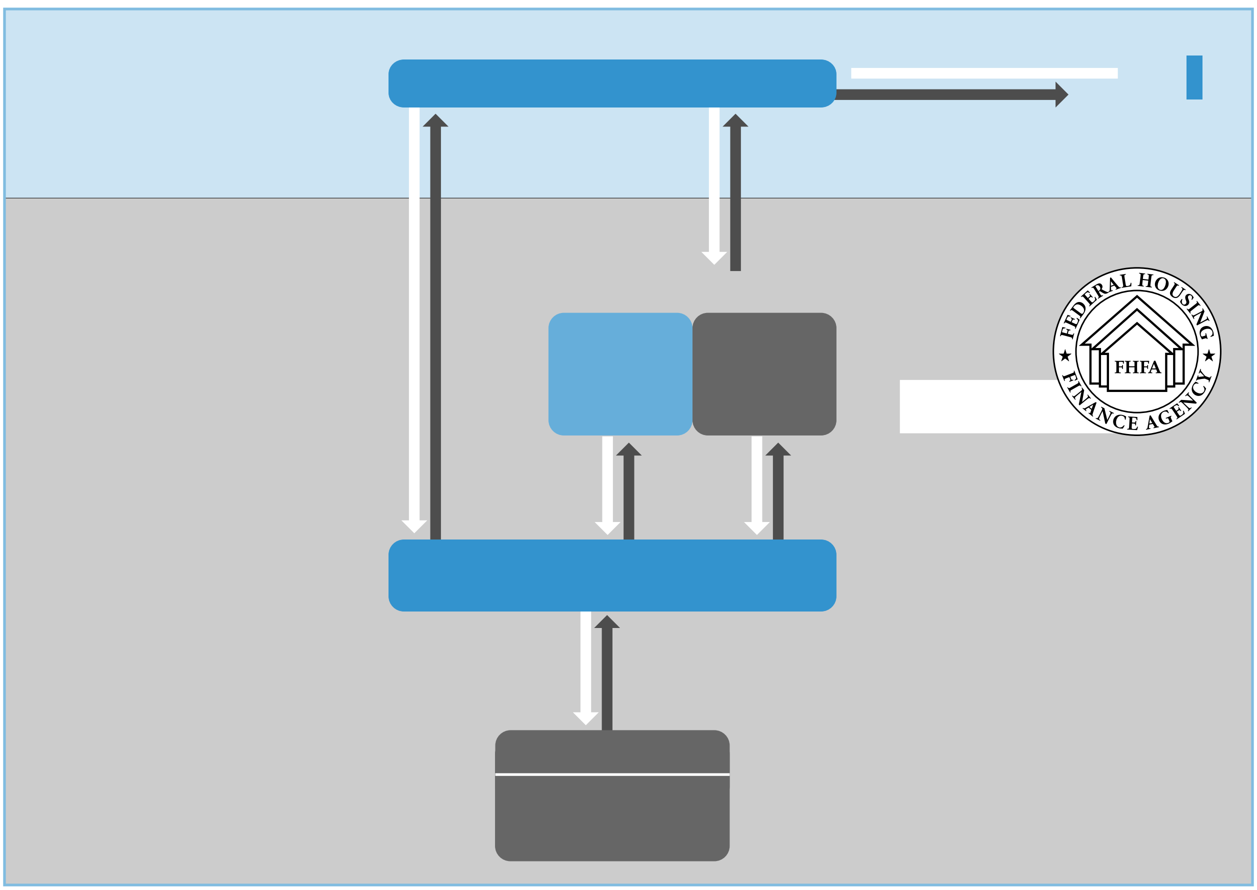
FANNIE MAE AND FREDDIE MAC (THE ENTERPRISES)

Fannie Mae and Freddie Mac were created by Congress to provide stability and liquidity in the secondary market for home mortgages. The Enterprises purchase mortgages that lenders have already made to homeowners. These mortgages are guaranteed by the Enterprise, pooled into mortgage-backed securities (MBS), and either sold to investors or kept by the Enterprise as an investment (see Figure 5).

The Enterprises have operated under conservatorship since 2008 with FHFA as the legal conservator. The U.S. Department of the Treasury supports the Enterprises through Preferred Stock Purchase Agreements, which ensure each Enterprise maintains a positive net worth.

The agreements require a 15 percent reduction in the Enterprises' retained portfolios each year. At the inception of the conservatorships, FHFA made clear that the Enterprises would continue to be responsible for normal business activities and day-to-day operations. FHFA exercises oversight as safety and soundness regulator while serving a more active role as conservator. To manage the work of overseeing the Enterprises' conservatorships and to assist the FHFA Director, FHFA created the Office of Conservatorship Operations in 2008. In February 2012, FHFA released *A Strategic Plan for Enterprise Conservatorships* that describes the next phase of the conservatorships. The Management Challenges and Performance Highlights sections of this report detail more about the strategic plan on pages 20–21 and 29.

Figure 5: FHFA OVERSIGHT AND CONSERVATORSHIP ROLES — FANNIE MAE AND FREDDIE MAC



Despite being in conservatorship, the Enterprises continue to play a dominant role in the secondary mortgage market. At the end of August 2012, the Enterprises owned or guaranteed nearly $5.2 trillion of mortgages consisting of approximately $1.2 trillion in mortgages and MBS held in the Enterprises' investment portfolios and nearly $4.0 trillion in MBS held by investors other than the Enterprises.

The Enterprises have been responsible for issuing the majority of all MBS to the market since 2008, when, as a result of the financial crisis, the private sector virtually withdrew from the market. As of August 2012, for example, the share of total MBS issued by the Enterprises stood at 78 percent. When combined with the 22 percent share for the Government National Mortgage Corporation (Ginnie Mae), the government sector accounted essentially for all issuances of MBS (see Figure 6).

The Enterprises have received substantial support from the Federal Government while in conservatorship. Through the purchase of Senior Preferred Stock, the Treasury Department has provided $187.5 billion to the Enterprises—$116.2 billion to Fannie Mae and $71.3 billion to Freddie Mac. In the most recent quarterly accounting period (second quarter 2012) and for the first time since 2008, neither Enterprise needed additional funding from the Treasury Department.

FEDERAL HOME LOAN BANKS

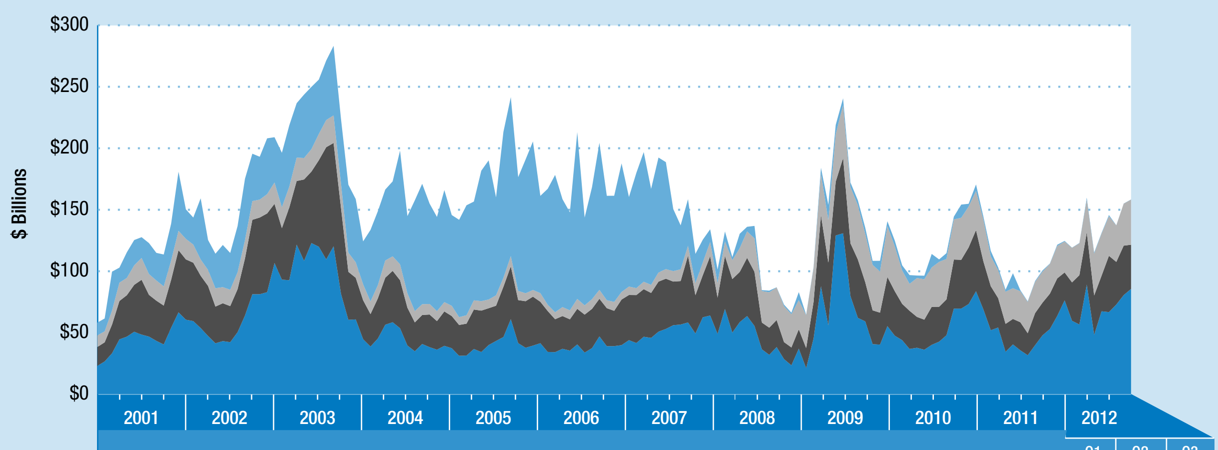
Congress passed the *Federal Home Loan Bank Act in 1932* to establish the Federal Home Loan Bank System and reinvigorate a housing market devastated by the Great Depression.

The System includes 12 district banks, each serving a designated geographic area of the United States, and the Office of Finance, which issues consolidated obligations to fund the banks.

The FHLBanks are member-owned cooperatives and provide a reliable source of liquidity to member financial institutions. At the end of fiscal year 2012, there were 7,699 FHLBank members, which included:

- 1,004 thrifts;
- 5,266 commercial banks;
- 1,158 credit unions; and
- 271 insurance companies

Figure 6: ENTERPRISES' MARKET SHARE—MBS ISSUANCE VOLUME



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 Q1	2012 Q2	2012 Q3
Enterprises	67%	68%	70%	47%	41%	40%	58%	73%	72%	70%	73%	79%	74%	78%
Ginnie Mae	13%	9%	8%	7%	4%	4%	5%	22%	25%	26%	25%	20%	26%	22%
Total Agency	80%	77%	78%	54%	45%	44%	63%	95%	97%	96%	98%	99%	100%	100%

■ Private-Label ■ Ginnie Mae ■ Freddie Mac ■ Fannie Mae

Sources: *Inside Mortgage Finance*, Enterprise Monthly Volume Summaries.
Issuance figures exclude MBS issued backed by assets previously held in the Enterprises' portfolios.

As of September 30, 2012, with total assets of $749 billion, the FHLBank system represents one of the largest banking structures in the country. Few bank holding companies—Citigroup, JP Morgan Chase, Bank of America, Wells Fargo, Goldman Sachs, and Met Life—are larger.

The FHLBank of Atlanta, with assets of $112.1 billion, is the largest FHLBank, and the FHLBank of New York, with assets of $107.1 billion, is the second largest. The FHLBank of Dallas is the smallest in the System at $35.2 billion in assets, followed by Topeka, at $35.4 billion in assets as of September 30, 2012 (see Figure 7).

FHLBanks make loans, known as advances, to member institutions and housing associates, such as state housing agencies. Those loans are underwritten based on the borrower's ability to repay and are collateralized by whole mortgage loans, securities, and other real estate related collateral (see Figure 8). Advances are the largest category of FHLBank assets and no FHLBank has ever incurred a credit loss on an advance. FHLBank advances and other credit-related products increase the availability of credit for residential mortgages.

As a condition of membership in an FHLBank or to obtain an advance, an institution purchases capital stock in that bank. Only member institutions can purchase the capital stock in an FHLBank and, with the exception of certain housing associates, only member institutions can borrow from an FHLBank.

Membership is limited to regulated depository institutions (banks, thrifts, and credit unions), insurance companies, and community development financial institutions engaged in residential housing finance. Approximately 58 percent of members are borrowers (see Figure 9). Each FHLBank district comprises whole contiguous states, including the District of Columbia and U.S. territories. The districts range in size from two to nine states (see Figure 10).

In addition to advances, the FHLBanks offer members letters of credit, correspondent banking (which includes security safekeeping, wire transfers, and settlements), cash management services, and derivative intermediation. Some FHLBanks have Acquired Member Assets (AMA) programs to purchase mortgages from their members. The volume of loan purchases is low relative to advances, and AMA balances have generally declined over the past five to seven years.

The FHLBanks also offer their members several housing and community investment programs, such as the Affordable Housing Program. Members receive a subsidy from an FHLBank used typically in conjunction with an affordable housing sponsor for the purchase, construction, or rehabilitation of housing for low- and moderate-income households. The Affordable Housing Program supports both multifamily rental properties and single-family home ownership projects. Each FHLBank must contribute the greater of 10 percent of its net income or an aggregate $100 million to fund the Affordable Housing Program. Since 1990, the FHLBanks have contributed $4.1 billion in subsidy to this program as of September 30, 2012.

Figure 7: TOTAL ASSETS OF THE FHLBANKS AT SEPTEMBER 30, 2012

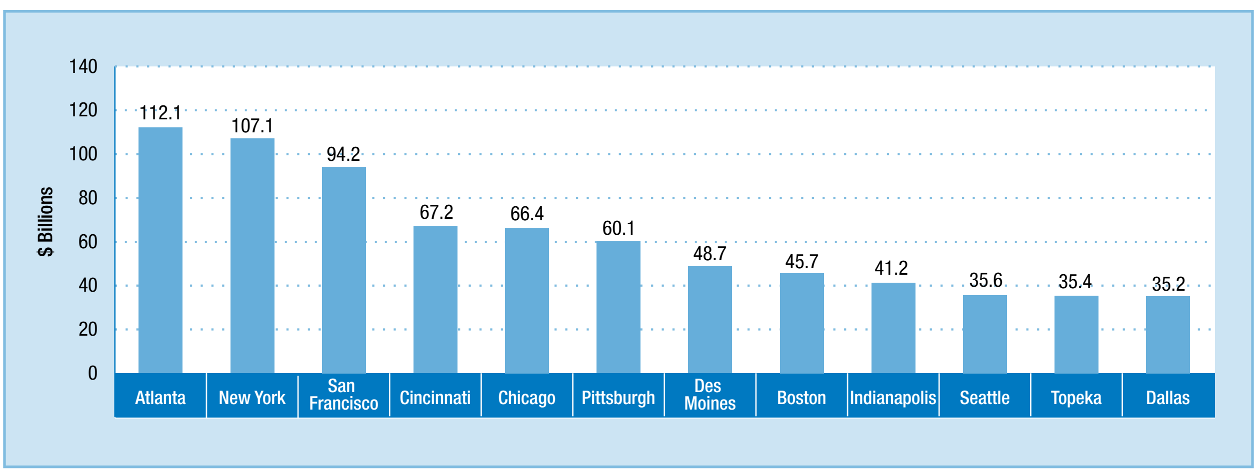


Figure 8: FHFA OVERSIGHT ROLE — FHLBANKS

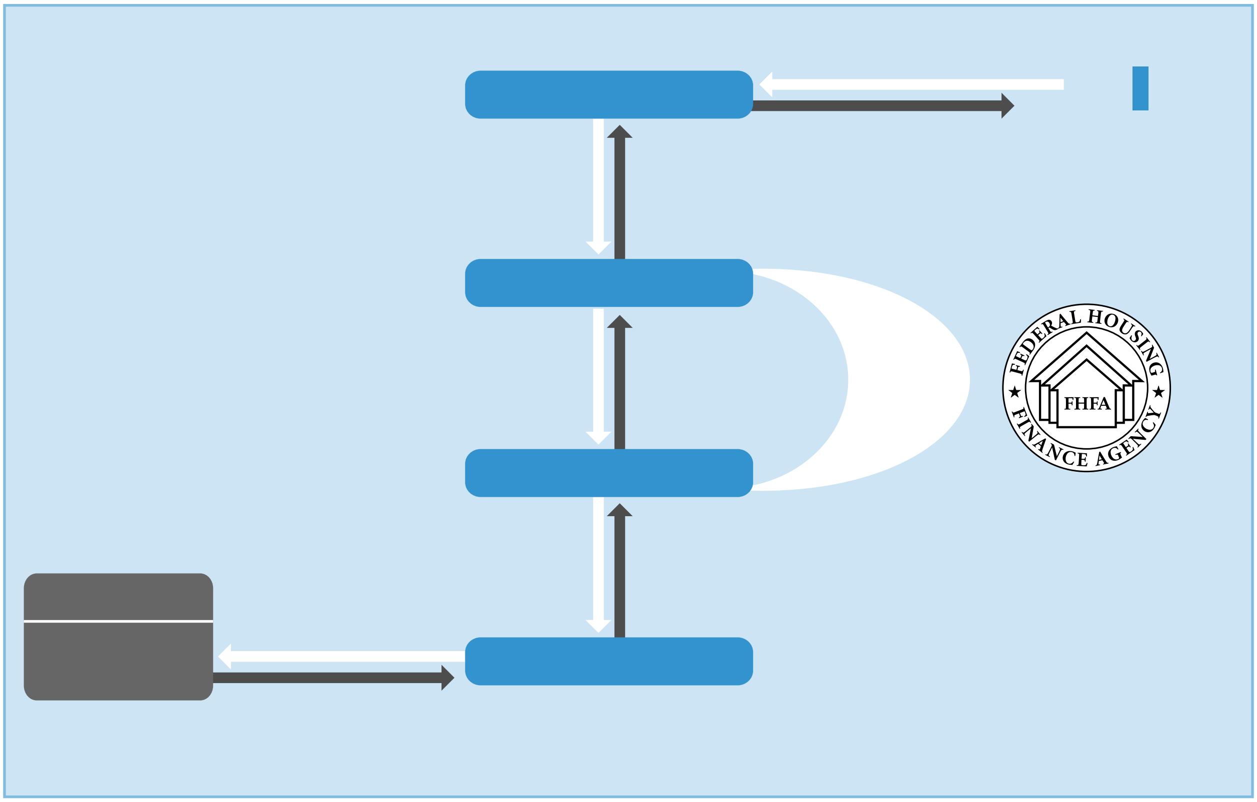


Figure 9: NUMBER OF FHLBANK MEMBERS AND PERCENT OF MEMBERS THAT BORROW

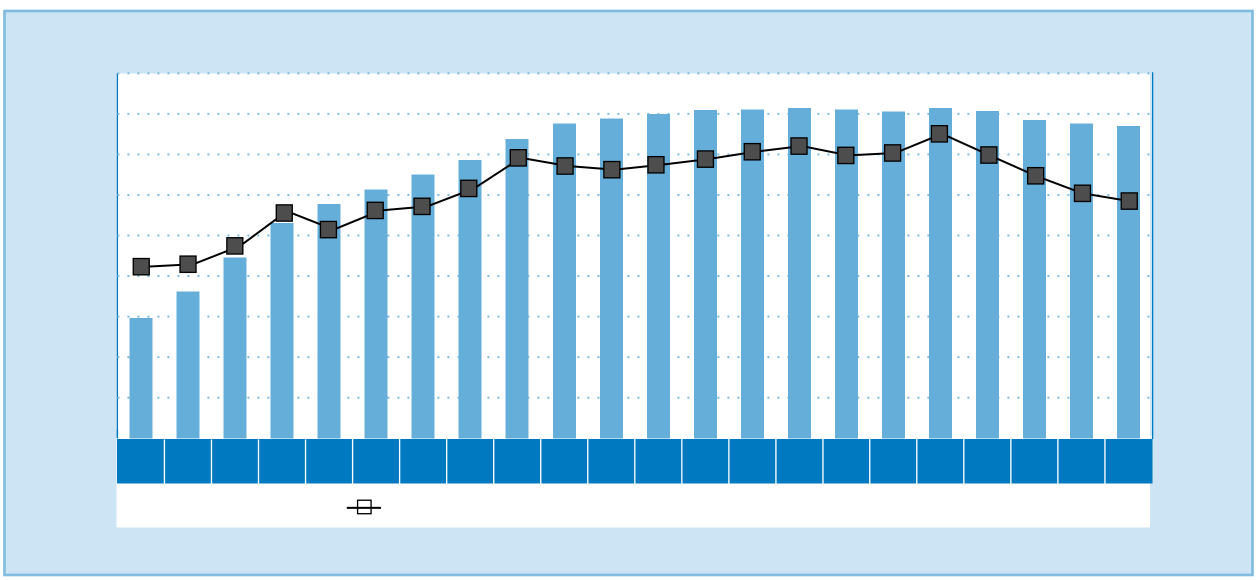
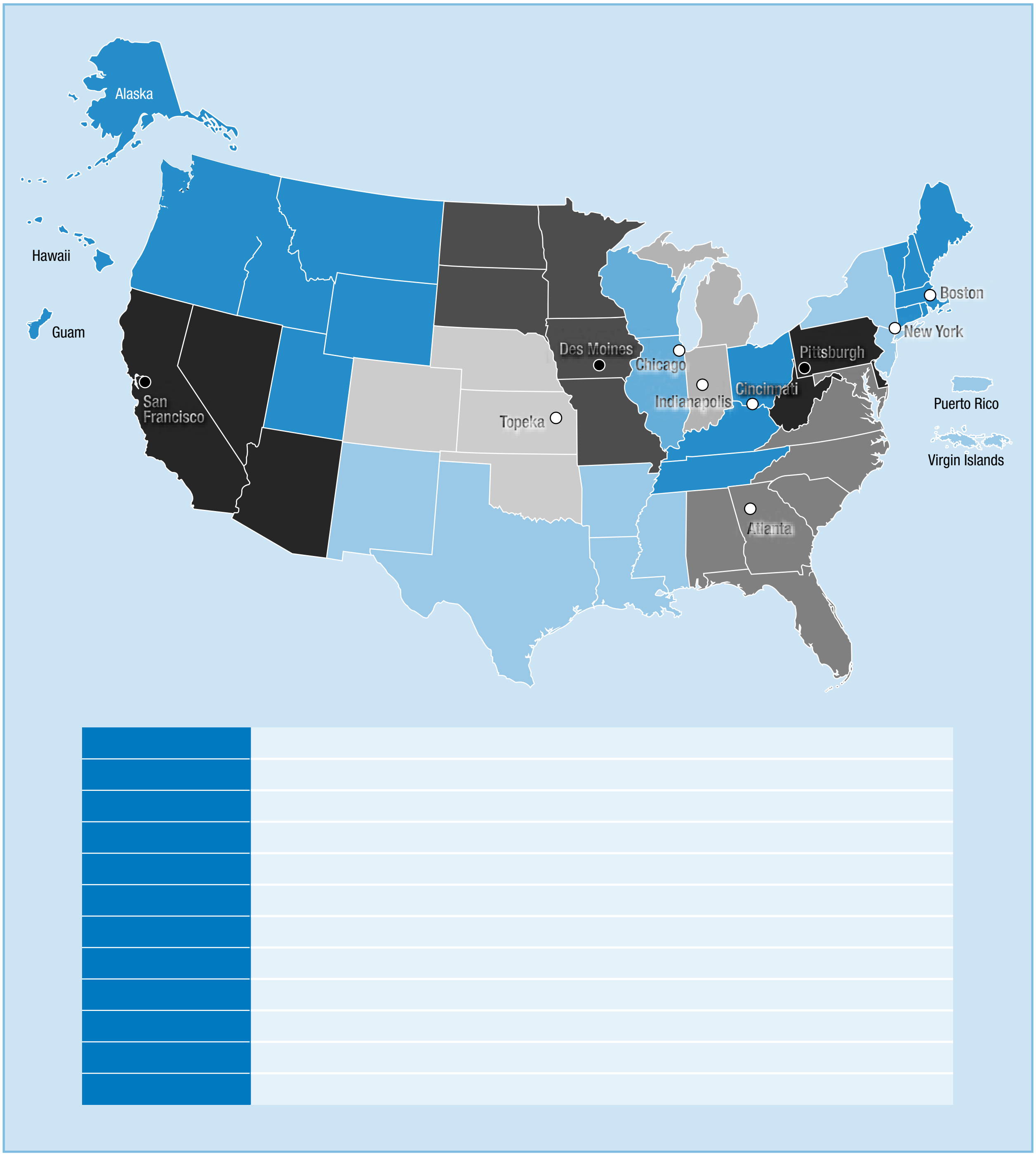


Figure 10: BANK LOCATIONS



Management Challenges and What Lies Ahead

Acting Director Edward J. Demarco addresses FHFA staff at a town hall meeting on the Conservatorship Strategic Plan in March 2012.

FHFA continues to face numerous challenges as regulator of the housing GSEs and conservator of the Enterprises.

MANAGING THE ENTERPRISES

In the four years since the establishment of the conservatorships of the Enterprises, FHFA has made significant progress in maintaining a functioning mortgage market; but there is still more to do. In February 2012, FHFA Acting Director Edward DeMarco formalized the agency's plans about long-term improvements to the housing finance system into *A Strategic Plan for Enterprise Conservatorships*. The plan details three strategic goals for the next phase of conservatorship and outlines an expansive and aggressive agenda of activities for FHFA, Fannie Mae, and Freddie Mac.

In conjunction with the strategic plan, FHFA developed a conservatorship scorecard for the Enterprises. This scorecard will hold management at the Enterprises accountable for meeting certain objectives. FHFA has also established the Office of Strategic Initiatives to coordinate and oversee the initiatives associated with the plan.

Several of the more challenging initiatives organized by goal, are described below.

Building a New Infrastructure for the Secondary Mortgage Market

Securitization Platform

FHFA and the Enterprises have begun work on a possible design for a common securitization platform to replace the Enterprises' current proprietary systems, which are aging, inflexible and in need of substantial improvement. This important infrastructure investment will provide a sound securitization platform designed to issue securities supported with or without a government guarantee.

FHFA issued a white paper entitled *Building a New Infrastructure for the Secondary Mortgage Market* on October 4, 2012. The white paper identifies the core components of mortgage securitization necessary in the housing finance system going forward, including two cornerstone operational features: 1) a securitization platform to process payments and perform other functions that could be used by multiple MBS issuers, and 2) a contractual framework supporting the new infrastructure. FHFA requested public input on the concepts outlined in the paper.

As the agency looks ahead to 2013, FHFA will continue to coordinate Enterprise efforts on new systems and a common platform while seeking input from industry stakeholders throughout this process. FHFA will remain mindful of policymakers' possible future determinations about the degree of government involvement and support in the nation's housing finance system.

Model Pooling and Servicing Agreements

Building for the future also requires developing and implementing standards for underwriting, disclosures, and servicing. Creating a robust and standardized pooling and servicing agreement is essential to improving the existing system. The white paper entitled *Building a New Infrastructure for the Secondary Mortgage Market,* published in October 2012 by the agency, also sought industry feedback on a potential contractual framework for standardized pooling and servicing agreements.

The conservatorship scorecard sets a goal for the Enterprises to propose a model pooling and servicing agreement framework, seek public feedback and produce final recommendations for standard Enterprise trust documentation by December 31, 2012. The longer-term goal is to develop pooling and servicing standards that not only create more efficiencies and best practices for the Enterprises, but also provide an option for other investors and participants to enter the secondary market by using a functional contractual framework that could address many of the shortcomings in today's private-label structures.

Contracting the Enterprises' Footprint in the Market

Raising Guarantee Fees

FHFA has been taking steps to improve the Enterprises' pricing of credit risk. In addition to strengthening market practices, these steps contribute to the strategic goal of gradually reducing the Enterprises' footprint in the mortgage market. Since being placed into conservatorship, the Enterprises have steadily raised guarantee fees, which should gradually reduce taxpayers' risk.

During fiscal year 2012, there were two guarantee fee increases. The first increase was an across-the-board 10-basis-point increase mandated by Congress and used to fund the temporary payroll tax cut. The second was designed to average 10 basis points, but the actual increase will vary depending on loan terms and other factors.

The agency plans to continually increase guarantee fees in anticipation of a future market where credit risk is borne principally or exclusively by private capital. These increases may also encourage private firms to increase their participation in the mortgage market.

FHFA will also consider guarantee fee pricing based on the costs of doing business in different parts of the country. FHFA sent a Notice to the Federal Register in September 2012, presenting an approach to adjust the guarantee fees that the Enterprises charge on single-family mortgages in states where costs related to foreclosure practices are statistically higher than the national average.

More Private Sector Risk Sharing

Shifting mortgage credit risk from the Enterprises to private investors is central to Goal 2—Contracting Enterprise Operations—outlined in *A Strategic Plan for Enterprise Conservatorships*. FHFA is considering a number of alternatives, including expanded use of mortgage insurance and security structures that allow for private sharing of risk.

Risk sharing is a complex, nuanced process that requires the evaluation of various avenues for investors to deploy private capital. In the private sector, the role of credit risk-taking through securitization can be divided into two categories: 1) operating companies such as the two GSEs and mortgage insurance companies that provide credit guarantee for a fee; and 2) investors in non-agency or private label securities (PLS).

A Strategic Plan for Enterprise Conservatorships focuses on creating a securitization framework of the future to facilitate mortgage funding. Among various alternatives for credit risk transfer, FHFA has considered expanded use of mortgage insurance and senior-subordinate securities structures that allow for private sharing of risk with the Enterprises. In addition to evaluating various mechanisms for risk transfer with regard to market opportunities, FHFA and the Enterprises also need to make operational changes and develop proper risk metrics and controls. FHFA and the Enterprises are working diligently and making progress on this and other complex risk-related issues.

Retained Portfolio Contraction

FHFA ensured that Fannie Mae and Freddie Mac contracted their respective retained portfolios consistent with the Senior Preferred Stock Purchase Agreements (SPSPA). FHFA is working with both GSEs to ensure that both remain in compliance with the revised SPSPA executed by the Treasury Department and FHFA as conservator in August 2012 (see sidebar regarding SPSPA on page 31).

Maintaining Foreclosure Prevention Efforts and Credit Availability

Improving Loss Mitigation Efforts

The third goal outlined in *A Strategic Plan for Enterprise Conservatorships*—maintaining foreclosure prevention activities and credit availability—continues to be central to the conservator's obligation to preserve and conserve the assets and property of the Enterprises. Foreclosure prevention efforts are designed to reduce credit losses, primarily on mortgages originated in the years before conservatorship.

Although loss mitigation efforts that focus on helping delinquent households as early as possible are in place, high levels of mortgage delinquencies continue. Since the conservatorships began, the Enterprises' foreclosure prevention activities, including loan modifications and short sales, have helped nearly 2.5 million borrowers avoid foreclosure as of August 2012. The Home Affordable Modification Plan (HAMP) and other modification programs have enabled the Enterprises to help more than one million families modify their loans since the start of the conservatorships. Both Enterprises have used HAMP as the first option for troubled borrowers.

In 2012, FHFA also announced steps to align and consolidate a number of previously existing short sales programs into one program. This streamlining will enable lenders and servicers to more quickly and easily qualify eligible borrowers for a short sale. FHFA also announced that the Enterprises would accelerate review and approvals of short sale transactions. FHFA will continue to find ways to help homeowners avoid foreclosure, reduce taxpayer losses, and help stabilize communities.

The Home Affordable Refinance Program (HARP) was modified in late 2011 to expand eligibility for participation. From January 2012 to August 2012, the new and streamlined HARP 2.0 has helped more than 618,217 borrowers refinance their loans. As FHFA continues to gain insight from the program, we will make adjustments as necessary to enhance access to HARP.

Although loss mitigation efforts have greatly improved, FHFA remains committed to enhancing these programs further. FHFA and the Enterprises will continue to improve existing programs for loan modifications, refinances, and other foreclosure avoidance tools.

In addition to the initiatives related to the strategic plan, the following initiatives support the goals of FHFA.

IMPROVING HOUSING GSEs SUPERVISION

Fully Implemented Realignment of Supervision Staff

In August 2012, Acting Director DeMarco announced organizational refinements that will place additional examiners on-site at each Enterprise. This move will consolidate core examination activities and provide in-depth technical support, advice, and analysis to enhance supervision under the examiners-in-charge at the Enterprises.

This supervision structure emphasizes:

- The authority and responsibility of the examiner-in-charge as the focal point for FHFA's supervision;
- Communication with the Enterprises; and
- FHFA's collaborative and coordinated approach to supervision.

Coordination and transition to new positions and offices have begun, but the agency is challenged to have the restructured division fully staffed and operating by the start of the 2013 exam cycle.

Implementing Examiner Development Program

In August 2012, FHFA Acting Director DeMarco emphasized at an all-hands meeting the agency's commitment to examiner development, including establishing an examiner-commissioning program and a "corporate university"-styled training program. FHFA has already made progress on developing an examiner-commissioning program, which it expects to introduce in FY 2013. The FHFA corporate university will focus on

Executives Steve Cross (left), Wanda DeLeo (center) and Jon Greenlee (right) spoke to FHFA staff at the annual supervision conference in December 2011.

continuous training for all employees, offering courses to improve skills and encourage professional development.

MONITORING THE FHLBANKS IN A CHANGING ENVIRONMENT

Aligning Operating Expenses to Assets

Despite the 12 FHLBanks' earnings improvements, the System still faces challenges. Advances and total assets of the System have contracted, but operating expenses have remained relatively steady.

The combination of lower interest income and level operating expenses means the FHLBanks spend a larger share of net interest income on operating costs. The ratio of operating expenses to net interest income was 21 percent in 2012, compared to the 2008 ratio of 14 percent.

To address this challenge, FHFA must ensure that the FHLBanks better align operating expenses with assets. However, FHFA also must ensure that the FHLBanks do not cut operating expenses imprudently, which may increase operational risks.

Expanding Core Business in a Weak Economy

Over the past year, FHLBank earnings have felt downward pressure because of the low interest-rate environment and a decline in demand for advances. The low interest-rate environment adversely affects the FHLBanks' net interest income by reducing return on invested capital, while fewer advances can lead to fewer return-generating assets.

FHFA's challenge is to make sure the FHLBanks stay focused on their core business—particularly advances to members—and promote competitive and balanced mortgage finance and servicing systems.

After increasing during the financial crisis to an historic high of more than $1 trillion in October 2008, advances fell to approximately $412 billion in September 2012. The decline was in part a reversal of the increase observed during the crisis. In addition, low loan generation and thriving deposits leave members with less need for the liquidity offered by FHLBank advances. FHLBanks price advances with relatively narrow spreads over funding costs to make them competitive to other sources of liquidity available to members, but advances have still dropped precipitously from their 2008 peaks.

The percentage of members with outstanding advances decreased to 58.4 percent as of June 30, 2012, compared with 60.3 percent on December 31, 2011. However, demand for advances has begun to show some signs of regional stabilization and some FHLBank members have increased their use of advances during the third quarter of 2012.

Performance Highlights by Strategic Goal

STRATEGIC GOAL 1	The housing government-sponsored enterprises operate in a safe and sound manner and comply with legal requirements

COMPLETED 2011 EXAMINATIONS OF THE ENTERPRISES AND FHLBANKS AND REPORTED SUMMARIES TO CONGRESS

FHFA released its 2011 annual *Report to Congress* in June 2012. The report contains the results and conclusions of the annual examinations of the Enterprises and the FHLBanks.

Report of Examinations of the Enterprises

The overall ratings for both Enterprises did not change from FY 2010 to FY 2011. However, Fannie Mae improved in three categories, including governance, which changed from significant concerns to limited concerns while both the market risk and operational risk management improved from critical concerns to significant concerns. The management and the boards at both Enterprises were responsive throughout 2011 to FHFA findings while continuing to take appropriate steps to resolve identified issues.

Report of Examinations of the FHLBanks

The FHLBanks showed some improvements in 2011. Overall, governance practices improved. The FHLBanks' financial condition and performance in terms of return on assets and return on equity remained fairly stable. All FHLBanks exceeded the minimum statutory capital requirement of 4 percent of total assets and their risk-based capital requirements at year end. Credit risk management was generally stable while mortgage assets continued to be the greatest source of market risk for the FHLBanks.

APPOINTMENT OF NEW CEOs FOR FANNIE MAE AND FREDDIE MAC

During FY 2012, FHFA as conservator for both Fannie Mae and Freddie Mac appointed new chief executive officers (CEOs) for their respective companies. Both CEOs possess a breadth of knowledge and experience in housing finance and financial services. They will also lead efforts in continuing to strengthen their companies while

A YEAR IN THE LIFE OF AN EXAMINER

FHFA's staff examiners collectively perform annual safety and soundness assessments of the 12 Federal Home Loan Banks, the Office of Finance, Freddie Mac and Fannie Mae. During these annual assessments, examiners perform a variety of tasks onsite at the subject institutions with the goal of identifying significant credit, market, and operational risks. Additionally, examiners evaluate effectiveness of board and senior management oversight during the onsite examination.

Key duties performed by an examiner before, during and after examinations include:

- Collaborates internally with FHFA staff to develop supervisory plans
- Identifies issues, trends and concerns on a broad range of business processes
- Plans, organizes and leads examinations
- Performs multiple complex tasks concurrently
- Directs, guides and consults with FHFA staff
- Observes FHLBank/Enterprise management meetings and conducts interviews with their staff
- Evaluates effectiveness of risk management practices
- Ensures pertinent regulations, policies and procedures are followed
- Communicates with FHLBank/Enterprise representatives in a tactful and effective manner
- Prepares report of examination, memoranda and other written communications
- Presents results to management and board of directors in a professional manner
- Documents support for findings, conclusions and annual assessments
- Exercises restraint and tact when approaching adversarial situations
- Provides performance input on examination team members
- Consults with examiners and senior agency officials on major oversight issues
- Reviews and edits examiners' work products internally

promoting foreclosure prevention activities and supporting *A Strategic Plan for Enterprise Conservatorships*.

IMPROVED FINANCIAL CONDITION OF THE ENTERPRISES REDUCING NEED FOR ADDITIONAL TREASURY SUPPORT

To date, the Enterprises drew $187.5 billion from Treasury to maintain positive net worth. FHFA's projections on the financial performance of the Enterprises (using data as of October 2012), including potential draws under the Senior Preferred Stock Purchase Agreements with the Treasury Department show cumulative Treasury draws are reduced and more stable compared to previous projections. The key drivers to these results include an overall reduction in actual and projected credit-related expenses and changes in the dividend structure contained in the Senior Preferred Stock Purchase Agreements, which eliminates the need to borrow from the Treasury Department to pay dividends.

Modeling results under three different Moody's house price paths, ranging from stronger near-term rebound, current baseline, and deeper second recession, reveal that Freddie Mac would not require additional Treasury draws after 2012 in any of the three scenarios while Fannie Mae would not require additional Treasury draws after 2012 in two of the three scenarios (only in the deeper second recession scenario).

FHFA TERMINATES FHLBANK OF CHICAGO CEASE AND DESIST ORDER

In October 2007, the FHLBank of Chicago entered into a consent cease and desist order with one of FHFA's predecessor agencies, the Federal Housing Finance Board. The cease and desist order limited the Bank's ability to redeem, repurchase, or pay dividends on its capital stock, and required the FHLBank to implement new management policies and practices acceptable to FHFA.

Following a period of improvement, in January 2012, the FHLBank of Chicago converted its capital structure to comply with statutory requirements enacted as part of the *Gramm-Leach-Bliley Act of 1999*, making the Chicago Bank the last FHLBank to make this conversion. In April 2012, FHFA terminated the cease and desist order on the FHLBank of Chicago because of improvements in its financial and capital positions, the resolution of risk management concerns, and consideration of specific commitments and assurances made by the FHLBank's board of directors to FHFA. This includes the limitation of dividends, maintenance of retained earnings, and the reduction of excess stock so long as certain financial thresholds are maintained.

FHLBANK OF SEATTLE ADEQUATELY CAPITALIZED

In 2010 as a result of deterioration in the value of its private-label MBS and other issues principally related to its capitalization, the FHLBank of Seattle entered into a consent order with FHFA. The consent order provided for a stabilization period for the FHLBank to meet financial thresholds related to retained earnings, securities impairments, and market value before the FHLBank Seattle could resume certain activities, including the paying of dividends and the repurchase or redemption of its capital stock.

In September of 2012, FHFA reclassified the FHLBank of Seattle as 'adequately capitalized'. This designation now permits the FHLBank of Seattle to repurchase excess capital stock, which is something it had been unable to do since December 2008. This reclassification is a significant milestone as the FHLBank of Seattle works its way back to autonomous activities.

STRATEGIC GOAL 2	The housing government-sponsored enterprises support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing

BORROWER ASSISTANCE ACTIVITIES

The Enterprises completed 389,741 home retention actions that allowed homeowners to save their homes from October 2011 to August 2012. Home retention actions include loan modifications, repayment plans, forbearance plans, and charge-offs-in-lieu. These actions are intended to assist homeowners whose mortgages are in distress with the goal of maintaining their homes. This number does not include HARP refinancing.

HARP Enhancements

HARP was established in 2009 to assist homeowners unable to refinance due to a decline in home values. The program was originally designed to provide these borrowers with an opportunity to refinance by permitting the transfer of existing mortgage insurance to their newly refinanced loan, or by allowing those without mortgage insurance on their previous loan to refinance without obtaining new coverage.

During FY 2012, FHFA worked collaboratively with the GSEs and other industry participants in an effort to increase access to the program for responsible borrowers. The result of these efforts was a series of enhancements to the program (HARP 2.0) which included:

- removing the 125 percent loan-to-value (LTV) ceiling for fixed-rate loans;
- waiving of certain lender representations and warranties;
- eliminating the need for an appraisal in many cases;
- eliminating certain risk-based fees for borrowers refinancing into a shorter term; and
- lowering fees for other borrowers, and extending the HARP end date to December 31, 2013.

Consequently, 711,409 refinances were completed through HARP from October 2011 to August 2012 compared with 448,746 refinances from October 2010 to September 2011. For the month of August 2012, 51 percent of refinances through HARP have been to underwater borrowers with a LTV ratio greater than 105 percent, a substantial improvement over the month of September 2011 when such borrowers accounted for just 17 percent of HARP refinances (see Figure 11). Since the program's inception in April 2009, the Enterprises have financed more than 1.6 million loans through HARP as of August 2012. HARP was established as a pre-distressed action to enable homeowners to refinance their mortgages and lower their monthly payments.

The continued high volume of HARP loans is attributed to record-low mortgage rates and program enhancements (see Figures 11a).

Figure 11: HARP REFINANCES

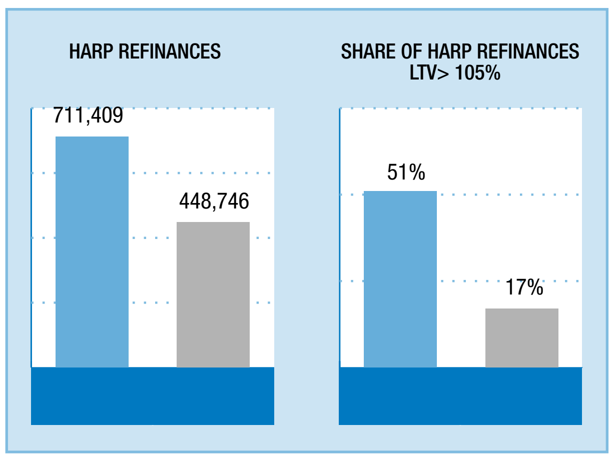
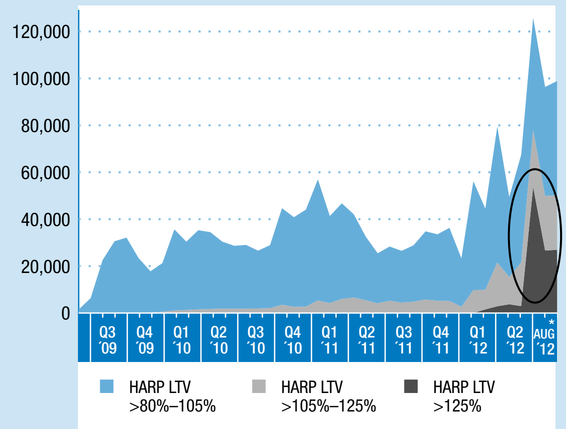


Figure 11a: MONTHLY HARP VOLUME BY LTV



* The number of completed HARP refinances reported for deeply underwater borrowers increased sharply in June 2012 as further enhancements to HARP went into effect. Starting June 1, 2012, lenders became able to deliver loans with loan-to-value ratios greater than 125 percent refinanced through HARP to the Enterprises to be securitized.

Streamlining Short Sales

In August 2012, Fannie Mae and Freddie Mac published aligned guidance that consolidates four existing short sale programs into one Standard Short Sale program. The newly enhanced and streamlined program rules will enable servicers to quickly and easily qualify eligible borrowers for a short sale.

The new guidelines went into effect on November 1, 2012, and permit borrowers with a Fannie Mae or Freddie Mac mortgage who have an eligible hardship to sell their home in a short sale, even if they are current on their mortgage. Servicers will not need Fannie Mae or Freddie Mac approval to expedite short sales that provide relief for borrowers with the following hardships: death of a borrower or co-borrower, divorce, disability, or employment relocation of more than 50 miles.

Military service members who relocate under Permanent Change of Station (PCS) orders will automatically be eligible for a short sale, even if they are current on their existing mortgage. Moreover, service members with PCS orders will not be obligated to contribute funds to cover the shortfall between the outstanding loan balance and the sales price for principal residences purchased on or before June 30, 2012.

As part of the approval process, servicers will evaluate borrowers for capacity to cover some or all of the shortfall between the outstanding loan balance and the property sales price. Fannie Mae and Freddie Mac will waive the right to pursue deficiency judgments for a financial contribution for all approved short sales. Borrowers who sell their home through a short sale will not be eligible for a new mortgage backed by Fannie Mae or Freddie Mac for at least two years after the short sale.

The new Standard Short Sale policies allow for a streamlined approach for borrowers who are seriously delinquent and who have low credit scores. In addition, Fannie Mae and Freddie Mac will offer up to $6,000 to second lien holders who expedite a short sale.

From October 2011 to August 2012, the Enterprises completed 132,834 short sales and deeds-in-lieu (nonforeclosure-home forfeiture actions) compared to 107,382 during the same period in 2011.

Improvements to Foreclosure Attorney Networks

In an effort to produce uniform foreclosure processing standards to assist servicers, homeowners, and lenders, FHFA directed the Enterprises to change the procedures for selecting foreclosure attorneys. FHFA instructed the Enterprises to transition away from current foreclosure attorney network programs and move to a system where mortgage servicers select qualified law firms that meet certain minimum, uniform criteria. These changes will support the consent orders entered into by financial regulators and servicers. FHFA is also working with other regulators and industry stakeholders to create uniform qualifications and oversight of foreclosure attorneys.

OVERSIGHT OF FEDERAL HOME LOAN BANKS' HOUSING AND COMMUNITY INVESTMENT PROGRAMS

FHFA has a responsibility to ensure that all FHLBanks comply with statutory and regulatory requirements. As required by law, the FHLBanks direct 10 percent of their previous year's annual earnings to the Affordable Housing Program (AHP). In both 2011 and 2012, the

FHLBanks fully funded their AHP programs consistent with their statutory mandate. In 2012, FHFA developed an examination module for the AHP and the Community Investment Program (CIP).This module is currently being pilot tested. AHP examiners conducted on-site examinations of all 12 FHLBanks and additional on-site visitations. During this reporting period, FHFA conducted on-site data integrity reviews of AHP and CIP data for five FHLBanks. All 12 FHLBanks complied with AHP and CIP data reporting requirements in a timely manner.

The Federal Home Loan Bank Act requires each FHLBank to appoint an advisory council made up of community representatives with experience in affordable housing. The law further requires that each council annually report to FHFA on the low-income housing activities of the FHLBanks. FHFA, in turn, analyzes the councils' reports and delivers a consolidated report to the councils on the low-income housing activities of all of the FHLBanks. The FHLBanks' advisory councils and FHFA fully complied with these requirements.

On November 10, 2011, FHFA issued proposed amendments to its community support regulation (12 CFR 1290). The proposed amendments, among other things, would require the FHLBanks to monitor and assess the eligibility of each member institution for long-term advances based on compliance with the regulation's Community Reinvestment Act of 1977 and first-time homebuyer standards.

STRATEGIC GOAL 3	FHFA preserves and conserves assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship

STRATEGIC PLAN FOR THE CONSERVATORSHIPS DEVELOPED

FHFA released *A Strategic Plan for Enterprise Conservatorships* that describes the next phase of conservatorship for the Enterprises in February 2012. The plan sets forth a series of initiatives and strategies to improve current mortgage processes, inspire greater confidence among prospective market participants, and set the stage for an improved future system of housing finance. The plan also sets forth objectives that are consistent with FHFA's legal mandate and the policy direction that emerged from the Administration and Congress. The three strategic goals identified for the next phase of the conservatorships are discussed in detail on pages 64–66.

Office of Strategic Initiatives

During FY 2012, FHFA appointed an executive to lead the newly established Office of Strategic Initiatives in coordinating and overseeing the activities associated with *A Strategic Plan for Enterprise Conservatorships*. This position reports directly to the Director and is responsible for identifying and organizing key stakeholders, work streams, and deliverables that flow from the plan.

Conservatorship Scorecards Developed for Enterprises to Achieve the Plan

A month after the release of A Strategic Plan for Enterprise Conservatorships, FHFA published a *Conservatorship Scorecard* to provide the implementation roadmap for the plan. The strategic plan is a multi-year endeavor; the scorecard sets forth performance goals under the plan for the current calendar year. FHFA, in concert with the Enterprises implemented the following initiatives:

Servicing Alignment Initiative

FHFA directed the Enterprises to develop the Servicing Alignment Initiative (SAI) to focus more aggressively on delivery of foreclosure prevention options. Through SAI, the Enterprises:

- Established new borrower communication requirements that ensure borrowers are contacted at the earliest stage of delinquency, when alternatives to foreclosure are most successful;
- Required that servicers simultaneously consider borrowers for the full range of loss mitigation options (as opposed to treating the consideration of each option as a separate process); and
- Required that servicers refer a loan to foreclosure only after an independent review of the case to ensure that the borrower was, in fact, considered for an alternative.

Under SAI, FHFA and the Enterprises have taken a highly targeted approach with the goal of refocusing the servicers' resources and attention on moving all borrowers into alternatives to foreclosure, quickly, efficiently, and aggressively. To accomplish this, the Enterprises aligned their requirements for servicing troubled loans and removed a significant barrier for homeowners seeking a loan modification—inconsistencies that caused servicers confusion and delay.

Uniform Mortgage Data Program

FHFA first announced the Uniform Mortgage Data Program in May of 2010, when Fannie Mae and Freddie Mac were directed to develop uniform standards for data reporting on mortgage loans and appraisals. This initiative is designed to improve the consistency, quality, and uniformity of data collected at the front-end of the mortgage process. By identifying potential defects as early in the origination and delivery process as possible, the Enterprises will improve the quality of mortgage purchases, which should reduce repurchase risk for originators.

In the last two years, substantial progress has been made. In March 2012, use of the Uniform Collateral Data Portal became mandatory, which ensures that all lenders are now submitting standard appraisal forms and appraisal data electronically. This allows the Enterprises to evaluate the information in a more seamless and efficient manner.

The Enterprises also developed the Uniform Loan Delivery Dataset standards that dictate the file format required at loan delivery for all mortgages delivered to the Enterprises on or after July 23, 2012, with applications dated on or after December 1, 2011. The Uniform Mortgage Data Program requires lenders to adopt this file format in an effort to further streamline and improve submissions of mortgage data. These efforts pave the way for future enhancements and offer an integrated and efficient way for mortgage investors to access basic loan-level information.

Enhanced Loan-Level MBS Disclosure Initiative

During FY 2012, Fannie Mae began making public disclosures of loan-level data about the mortgages backing newly issued single-class, single-family MBS, which are comparable to the MBS disclosures that Freddie Mac has been making to investors since 2005. Both Fannie Mae and Freddie Mac now disclose loan-level information when MBS are issued, and they will both issue monthly ongoing disclosures over the life of each security after Fannie Mae begins disclosures in the first quarter of FY 2013.

The Enterprises also jointly developed and submitted a template with a comprehensive list of loan-level disclosure data elements for their single-class, single-family fully guaranteed MBS. In FY 2012, the Enterprises also began working, at FHFA's direction, to develop plans to implement enhancements of their loan-level MBS disclosures consistent with the template. They are now working on a second version of the template that will encompass data elements needed to support nonguaranteed mortgage securities.

Changes In Enterprise Guarantee Fees

In December 2011, Congress directed FHFA in the *Temporary Payroll Tax Cut Continuation Act of 2011* to increase single-family guarantee fees by at least an average of 10 basis points. In fulfillment of that mandate, FHFA directed the Enterprises to raise guarantee fees by 10 basis points beginning in April 2012.

In August 2012, FHFA directed the Enterprises to make further changes to the single-family guarantee fees they charge lenders to be effective in December 2012. These changes will:

- Result in the Enterprises increasing guarantee fees on single-family mortgages by an additional 10 basis points on average;
- Make the guarantee fees the Enterprises charge lenders that deliver small and large volumes of loans more uniform; and
- Begin to address the cross-subsidization of pricing that exists whereby lower-risk loans currently subsidize the pricing of higher-risk loans.

In addition, FHFA announced in August 2012 that it was soliciting public comment on an approach to impose an up-front fee on newly acquired loans originated in specific states where the Enterprises are likely to incur default-related losses much higher than the national average because of the individual laws in these states.

Real Estate Owned Disposition Initiative

The Real Estate Owned (REO) Disposition Initiative is a joint initiative with the Treasury Department, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, the Federal Reserve System, and the Enterprises.

The REO Initiative is designed to reduce taxpayer losses, stabilize neighborhoods and home values, shift to more private management of properties, and reduce the supply of REO properties in the marketplace. This initiative holds promise for providing support to local neighborhoods that were especially hard hit by the housing crisis and will help meet the rising demand for rental housing in many communities.

FHFA began the initiative with a Request for Information aimed at garnering industry ideas on how to sell REO properties of Fannie Mae, Freddie Mac, and the Federal Housing Administration. After reviewing more than 4,000 responses, FHFA announced the first pilot transaction under the initiative in February 2012, targeting some of the metropolitan areas hardest hit by the housing market crisis—Atlanta, Chicago, Las Vegas, Los Angeles, Phoenix, and parts of Florida.

Investors were qualified to bid after a rigorous evaluation process. The process consisted of several factors, including financial strength, asset management experience, property management expertise and experience in the geographic area.

The winning bidders for the REO initiative were chosen to purchase approximately 1,772 single-family Fannie Mae foreclosed properties. Pacifica Companies, LLC has purchased 699 Fannie Mae properties in Florida, The Cogsville Group, LLC has purchased 94 properties in Chicago, and Colony Capital, LLC has purchased 970 properties in California, Arizona and Nevada. Although the Atlanta properties have not been awarded, they will be evaluated for future transactions.

This pilot is not intended to be a nationwide program. It is a targeted effort only in markets with a large number of foreclosed properties where local market conditions suggest a possible benefit from this approach.

MODIFICATIONS TO THE TREASURY SENIOR PREFERRED STOCK PURCHASE AGREEMENTS

In August 2012, FHFA and the Treasury Department modified the Senior Preferred Stock Purchase Agreements. Key components of the changes include:

- Accelerating reduction of the retained mortgage investment portfolios of the Enterprises from 10 percent per year to 15 percent per year. To begin with, the upaid principal balance (UPB) of Enterprise-related investments portfolio may not exceed $650 billion on December 31, 2012. Also, on December 31 of each year thereafter, each Enterprise's portfolio will not be allowed to exceed 85 percent of the aggregate amount of the preceding year's UPB until the portfolio reaches $250 billion.
- Requiring an annual risk management plan from the Enterprises while they are in conservatorship. Plans will detail actions each Enterprise will take to reduce both the financial and operational risk associated with each reportable business segment.
- Replacing the 10 percent fixed-dividend payment with a variable payment based on the Enterprise's net worth to ensure all earnings generated by the Enterprise benefit taxpayers and eliminate the need to borrow from the Treasury Department and pay back dividends.

SENIOR PREFERRED STOCK PURCHASE AGREEMENTS

The Enterprises continue to operate under conservatorship, as they have since 2008. The U.S. Department of the Treasury provides the Enterprises with financial support through the Senior Preferred Stock Purchase Agreements, established at the same time the Enterprises entered conservatorship. The Senior Preferred Stock Purchase Agreements were designed to ensure each Enterprise maintained positive net worth. If FHFA determines, on a quarterly basis, that an Enterprise's liabilities have exceeded its assets under generally accepted accounting principles, the Treasury Department will contribute cash capital to the Enterprise in an amount equal to the difference between liabilities and assets. An amount equal to such contribution will be added to the senior preferred stock of the Enterprise held by the Treasury Department. The terms of the agreements require a 15 percent reduction in the Enterprises' retained portfolios each year. The only material additions to these portfolios come from delinquent mortgages pulled out of Enterprise mortgage-backed securities after being four months delinquent. The Enterprises are required to pay the Treasury Department a variable payment based upon the Enterprise's net worth.

RESOURCE MANAGEMENT STRATEGY	FHFA has the personnel, resources and infrastructure to manage effectively and efficiently to achieve its mission and goals

CONSOLIDATING AGENCY RESOURCES TO IMPROVE COLLABORATION AND COMMUNICATION – CONSTITUTION CENTER

FHFA consolidated its operations from three separate locations into its new headquarters at Constitution Center in Washington, D.C., in January 2012. This move has improved collaboration and communications among the staff and program areas. It also allows for expansion in, and greater integration of, our examination and supervisory personnel and programs. The new headquarters is in the same building as the Office of the Comptroller of the Currency and located directly across the street from the Department of Housing and Urban Development.

Chief Operating Officer Rick Hornsby spoke to the agency's supervision divisions at the December 2011 annual FHFA supervision conference.

FHFA has won the CEAR award for four years.

FHFA SUPPORT FOR 40 EXTERNAL AUDITS, SURVEYS, AND EVALUATIONS

During FY 2012, FHFA staff and management effectively responded to 40 different external audits, evaluations, and surveys. As a result, significant amounts of resources were allocated into these efforts, especially in the mission areas. In order to more efficiently manage the volume of these outside reviews, FHFA expanded its capacity by assigning additional staff for audit follow-up and by developing an automated system to track audit recommendations and agency responses.

CERTIFICATE OF EXCELLENCE IN ACCOUNTABILITY REPORTING

FHFA has received the Certificate of Excellence in Accountability Reporting from the Association of Government Accountants each year since 2008, our first year as a new agency. This award demonstrates the agency's commitment to accountability and spotlights the high quality of our performance and financial information reporting.

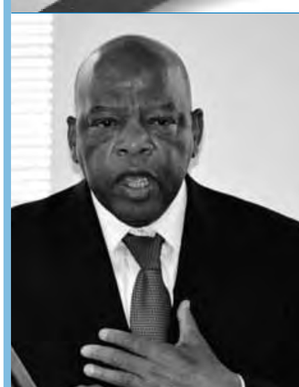
FREEDOM PROJECT

In FY 2010, FHFA began a special set of events called the Freedom Project to highlight and demonstrate how Americans of all races and backgrounds have contributed to the freedoms we enjoy in America. The Freedom Project brings agency employees together throughout the year to reflect on and celebrate the accomplishments of great men and women of our past and present. During FY 2012, the Freedom Project recognized and celebrated Veterans Day, Martin Luther King (MLK), Jr. Day, Washington's Birthday, Memorial Day, Independence Day, and Constitution Day.

FY 2012 FREEDOM PROJECT EVENTS

VETERANS DAY
FHFA held a special luncheon to honor all the employees who are military veterans. The veterans spoke about their time in the military, their service, and how long they served.

MLK & WASHINGTON'S BIRTHDAY
In February 2012, Dr. Daisy Nelson Century, a historical reenactor, portrayed Sojourner Truth in her later years remembering life from childhood through adulthood. She also recited Truth's most famously and oft-quoted speech, "Ain't I a Woman?"



FREEDOM LECTURE
U.S. Representative John Lewis is often called "one of the most courageous persons" the Civil Rights Movement ever produced. Representative Lewis shared with FHFA his contributions to the Civil Rights Movement and to building what he calls "The Beloved Community" in America.

MEMORIAL DAY
Thomas Sherlock, senior historian of Arlington National Cemetery, spoke to employees about the history of America's most famous burial ground to celebrate Memorial Day as part of the Freedom Project.

INDEPENDENCE DAY
Abigail Adams reminded FHFA of her famous plea to "Remember the Ladies" in the creation of the Constitution of the United States. Adams was the wife of President John Adams and mother of President John Quincy Adams. She was portrayed by actress and re-enactor Kim Hanley.

CONSTITUTION DAY
FHFA celebrated Constitution Day with copies of a "Pocket Constitution" that contains the Declaration of Independence, the Constitution of the United States, the Bill of Rights, Amendments XI-XXVII and Significant Dates for the staff.

FY 2012 Performance Summary

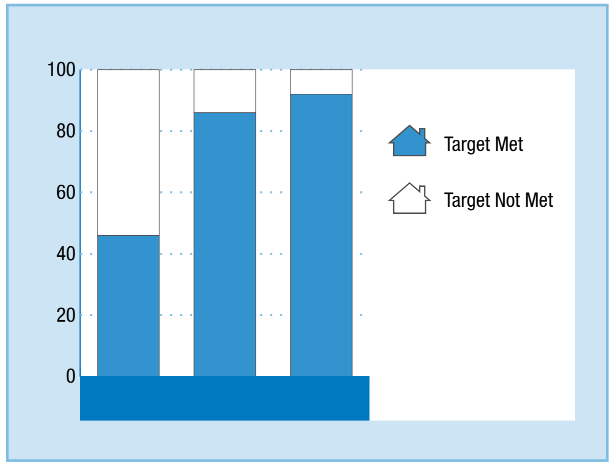
This section describes FHFA's strategic and performance-planning framework, performance measures not met, the reasons why, proposed improvements, and the seven key performance measures that most closely reflect the agency's achievements and desired outcomes. For a comprehensive list of performance measures, see pages 54–70. FHFA's performance measures are rated as:

Target Met; or

Target Not Met.

FHFA determines that performance goals are met if targets for all performance measures have been achieved. Goals are counted as not met if at least one target performance measure has not been achieved. In FY 2012, FHFA had 25 performance measures. The agency met or exceeded 23 of its measures and failed to meet two performance measures (see Figure 12).

Figure 12: FY 2012 PERFORMANCE RESULTS



FHFA met 92 percent and did not meet eight percent of its performance measures in FY 2012. For additional details on unmet measures see Figure 13.

Figure 13: STATUS OF PERFORMANCE MEASURES UNMET

UNMET MEASURES	REASON	STEPS REQUIRED TO MEET
Measure 1.1.1 **Improve component ratings at each Enterprise.**	Component ratings at the Enterprises remain unchanged given the absence of capital, the continuation of credit losses and subpar financial performance. Improvements in the ratings are also hampered by the ongoing challenges the Enterprises face in strengthening the operational risk environment and improving corporate governance.	FHFA will continue to conduct examinations and ongoing monitoring of the Enterprises and give feedback on remediation efforts.
Measure 4.3.2 **Ensure management completes corrective action on OIG findings within agreed timeframe**	One recommendation was originally closed by FHFA in the 4th quarter and then re-opened per agreement with the OIG.	FHFA and the OIG agreed to extend the timeline to close the recommendation to February 28, 2013, since the recommendations identified required work beyond FY 2012. This will enable the required final actions to be completed.

FHFA'S STRATEGIC PLANNING PROCESS

FHFA sets long-term and annual goals and monitors progress throughout the year. The agency assesses its record in meeting its performance measures through quarterly performance tracking meetings with the senior executive leadership team.

The FHFA Director chairs these quarterly meetings. FHFA staff prepare the performance reports and discusses the agency's record relative to its performance measures. The meetings highlight the agency's record-to-date and challenges for the future, with a focus on how to meet targets and ensure success in support of the agency mission.

During FY 2012, FHFA operated under its FY 2009-2014 strategic plan. FHFA began working on a new strategic plan after enactment of the Government Performance and Results Act Modernization Act of 2010. The agency published a new *Strategic Plan for FHFA for Fiscal Years 2013-2017* in October 2012. This plan details the outcomes the agency is seeking to achieve, the means and strategies that will be used to accomplish those outcomes, and the performance measures that will be used to gauge the agency's progress.

DATA COMPLETENESS AND RELIABILITY

This report contains complete and reliable performance and financial data for FHFA. Where appropriate, the report notes data limitations of specific performance goals. FHFA reviews, verifies and validates the accuracy of performance data reported on a quarterly basis.

Coordination with the applicable offices to validate performance measures is carried out with senior level executives. FHFA is also in the process of developing an automated performance measurement system that will be in place at the end of the first quarter of FY 2013.

Based on the agency's assessment of internal controls and compliance with Office of Management and Budget Circular A-123, the agency's risk management and internal control systems, taken as a whole, conform to the standards prescribed by the GAO and the Federal Manager's Financial Integrity Act.

FY 2012 ANNUAL PERFORMANCE PLAN

FHFA's *FY 2012 Annual Performance Plan* includes 25 performance measures (four that are new) and 14 performance goals to support our three strategic goals and one resource management strategy. The new measures represent ongoing activities related to the Office of Inspector General and FHFA's *A Strategic Plan for Enterprise Conservatorships*. The link to this plan is located at *http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf*.

This section also describes the agency's performance against its FY 2012 Annual Performance Plan, which outlined the means and strategies to achieve the annual performance goals and related measures for the past year. Eight measures were deleted from the FY 2012 plan: seven, which were process-oriented, and one that was met in FY 2011. (See page 105 for a list of the deleted measures in the Other Accompanying Information section.)

Overview of FHFA's Seven Key Performance Measures

FHFA identified seven of the 25 performance measures for FY 2012 as **key performance measures**. These measures are critical to achieving our strategic goals and objectives. The key performance measures address external and internal influences at the housing GSEs, loss mitigation efforts, and promptly responding to the Inspector General's recommendations. The seven key performance measures apply to all the agency's three strategic goals and the resource management strategy.

During FY 2012, FHFA met or exceeded all but two of the key performance measures.

STRATEGIC GOAL 1	The housing government-sponsored enterprises operate in a safe and sound manner and comply with legal requirements

The focus of Strategic Goal 1 is to promote the safety and soundness of the housing GSEs through prudential supervision and regulation (see pages 54–57 of the Performance Section for a list of all measures associated with this goal).

Table 1 summarizes the key performance measures for safety and soundness of the housing GSEs. During FY 2012, FHFA reassigned some examiners to the Enterprises to improve the efficiency and effectiveness of examinations and oversight functions. To consolidate core examination activities under the supervision of the examiner-in-charge at each of the regulated entities, FHFA also restructured the Division of Enterprise Regulation and the former Division of Examinations and Program Support (renamed the Division of Supervision Policy and Support). These changes will improve the oversight and risk focus of examinations and encourage more coordination and communication among the examination staff. Performance measure 1.1.1 requires an improvement in component ratings at each Enterprise. The measure was not met. As stated in Figure 13, improvements in the ratings are hampered by ongoing challenges the Enterprises face in strengthening the operational risk environment and improving corporate governance. FHFA will continue to conduct examinations and ongoing monitoring of the Enterprises and provide feedback on remediation efforts.

Table 1: KEY PERFORMANCE MEASURES FOR SAFETY AND SOUNDNESS OF THE HOUSING GSES

PERFORMANCE GOAL 1.1 Fannie Mae and Freddie Mac comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.			
PERFORMANCE MEASURE 1.1.1 **Improve component ratings at each Enterprise.**			
	FY 2010	FY 2011	FY 2012
Target	Improve in one or more by September 30, 2010	Improve in one or more by September 30, 2011	Improve in one or more by September 30, 2012
Performance Results Key: Goal Fulfillment	**Target Not Met**	**Target Not Met**	**Target Not Met**
PERFORMANCE GOAL 1.2 The FHLBanks and the Office of Finance comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.			
PERFORMANCE MEASURE 1.2.1 **Composite rating at each FHLBank.** *Note: If rating is less than "2", an acceptable performance improvement plan shall be included with the Bank's response to the Report of Examination.*			
	FY 2010	FY 2011	FY 2012
Target	"2" or better or, within 180 days of a rating downgrade to below "2", operating under an approved capital restoration plan	"2" or better or, within 180 days of a rating downgrade to below "2", operating under an approved capital restoration plan	"2" or better or, within 180 days of a rating downgrade to below "2", operating under an acceptable performance improvement plan: Quarterly
Performance Results Key: Goal Fulfillment	**Target Not Met**	**Target Met**	**Target Met**

STRATEGIC GOAL 2	The housing government-sponsored enterprises support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing

The focus of the second strategic goal is the housing mission of FHFA. As the supervisor for the housing GSEs, FHFA has a critical responsibility to foster a well-functioning, stable, and liquid housing finance system. Only through effective supervision can FHFA ensure that the entities serve as a source of liquidity to homeowner and rental housing markets at an efficient and reasonable price.

Table 2 summarizes the key performance measures for the housing mission. During FY 2012, the housing GSEs met or exceeded their required liquidity levels. A recent change to the Senior Preferred Stock Purchase Agreements with the Treasury Department will improve stability in the housing finance market and decrease the roles of the Enterprises in the market over the longer term. See the Performance Highlights section on page 31 for more about the amendment and pages 58–62 of the Performance Section for a list of all measures associated with this goal.

Table 2: KEY PERFORMANCE MEASURES FOR THE HOUSING MISSION

PERFORMANCE GOAL 2.1
FHFA ensures the housing GSEs support a stable, liquid and efficient mortgage market.

PERFORMANCE MEASURE 2.1.1
Ensure liquidity levels at Fannie Mae and Freddie Mac meet or exceed required levels or are brought into compliance within 5 business days.

	FY 2010	FY 2011	FY 2012
Target	Monthly	95 Percent	95 Percent Quarterly
Performance Results Key: Goal Fulfillment	Target Not Met	Target Met	Target Met

PERFORMANCE MEASURE 2.1.2
Ensure liquidity levels at the FHLBanks meet or exceed required levels or are brought into compliance within 5 business days.

	FY 2010	FY 2011	FY 2012
Target	Annually	95 Percent	95 Percent Quarterly
Performance Results Key: Goal Fulfillment	Target Met	Target Met	Target Met

STRATEGIC GOAL 3	FHFA preserves and conserves assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship

The focus of Strategic Goal 3 is on conservatorship of the Enterprises. As conservator, FHFA's role is to foster improvement in the Enterprises' financial condition, underwriting practices, and operational capacity so they can fulfill their role in the nation's housing finance system.

Table 3 summarizes the key performance measures that demonstrate FHFA's goal to preserve and conserve the Enterprise assets. During FY 2012, FHFA made significant progress improving loss mitigation strategies by streamlining the short sale process, and implementing HARP 2.0.

FHFA met or exceeded the key measures of performance goal 3 during FY 2012. Pages 63–66 of the Performance Section includes a list of all measures associated with this goal.

Table 3: KEY PERFORMANCE MEASURE DEMONSTRATING FHFA'S GOAL OF PRESERVING AND CONSERVING ENTERPRISE ASSETS

PERFORMANCE GOAL 3.3 Ensure the Enterprises have effective programs that respond to problems in mortgage markets by reducing preventable foreclosures.			
PERFORMANCE MEASURE 3.3.1 Prevent current loans from going delinquent by helping borrowers to refinance.			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	New Measure for 2012	Maintain the volume of HARP refinances as a percent of total refinances at 10 percent or higher
Performance Results Key: Goal Fulfillment			Target Met
PERFORMANCE MEASURE 3.3.2 Maintain the percentage of modified loans that are 60 plus days delinquent, nine months after modification, at or below 20 percent.			
	FY 2010	FY 2011	FY 2012
Target	35 Percent or less	35 Percent or less	Less than or equal to 20 percent
Performance Results Key: Goal Fulfillment	Target Met	Target Met	Target Met

RESOURCE MANAGEMENT STRATEGY

FHFA has the personnel, resources and infrastructure to manage effectively and efficiently to achieve its mission and goals

The focus of the resource management strategy is to create and sustain an infrastructure responsive to mission-critical program management. FHFA ensures effectiveness and efficiency in this area through the recruitment and retention of a diverse and highly skilled staff.

Table 4 summarizes the key performance measure that demonstrates FHFA's use of its resources. Pages 67–70 of the Performance Section includes a list of all measures associated with this goal. Performance measure 4.3.2 was not met. This measure requires management to complete corrective action on OIG findings within an agreed timeframe. One recommendation was originally closed by FHFA in the 4th quarter and later re-opened after a mutual agreement between FHFA and the OIG. The timeline was extended to close the recommendation by February 28, 2013.

Table 4: KEY PERFORMANCE MEASURE DEMONSTRATING FHFA'S USE OF RESOURCES

PERFORMANCE GOAL 4.3 FHFA has effective financial and risk management programs.			
PERFORMANCE MEASURE 4.3.2 Ensure management completes corrective action on OIG findings within agreed timeframe.			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	New Measure for 2012	No overdue corrective actions outstanding
Performance Results Key: Goal Fulfillment			Target Not Met

Program Evaluations

During fiscal year 2012, FHFA operated under its FY 2009-2014 strategic plan. In October 2012, the agency released a new *Strategic Plan for FHFA for Fiscal Years 2013-2017*. This plan sets out the agency's mission, vision, values, and strategic goals through FY 2017. Through quarterly performance tracking meetings with senior leadership, FHFA reviews its progress, and verifies and validates performance data to ensure reliability and accuracy. FHFA did not have an independent external evaluation conducted this fiscal year.

FHFA's Office of Inspector General began operations in October 2010. OIG assessed several of FHFA's most serious management issues during FY 2012. See pages 106–114 of the Other Accompanying Information section.

FHFA reviewed 10 audits, 7 evaluations, 2 evaluation surveys, and 3 white papers issued by the OIG in FY 2012. The OIG also issued 50 recommendations that were due in FY 2012. FHFA completed/closed 49 recommendations while one recommendation will remain open due to final actions that will extend beyond FY 2012—the new timeline was extended to February 28, 2013.

As of September 2012, OIG had completed the following evaluations of FHFA:

OIG PERFORMANCE EVALUATIONS		
Evaluation		
FHFA's Oversight of Troubled Federal Home Loan Banks – January 2012	Although FHFA has taken several important steps to monitor closely and control the four troubled FHLBanks, FHFA lacks a clear consistent and transparent written enforcement policy. The lack of a management reporting system as well as FHFA's practice of not consistently documenting troubled FHLBank interactions (i.e., recommending that FHLBank boards of directors remove certain senior officers), also impedes outside oversight of the agency.	FHFA disagrees with a number of statements, characterizations, or inferences in the report but generally agrees with the substance of the report's recommendations. FHFA will develop and implement a written enforcement policy; develop an automated information system for agency managers cataloguing examination findings, planned corrective actions, timeframes and status; and develop guidelines for documenting significant oral and written actions involving an FHLBank, including actions relating to the removal or replacement of senior officers.
Evaluation of FHFA's Management of Legal Fees for Indemnified Executives – February 2012	FHFA confronts a challenging balance of interests in avoiding potential losses by effectively defending ongoing lawsuits against the Enterprises while having an interest in controlling significant costs, particularly the tens of millions of dollars of payments made to attorneys and others involved in representing former senior executives. OIG recommends that FHFA work to limit legal expenses to the extent possible and reasonable and continue to control costs of legal expenses.	FHFA concurs with the recommendations and will undertake additional steps to address future indemnification agreements. FHFA will continue its efforts at cost control and work expeditiously to seek greater standardization in the administration of such legal costs by the Enterprises while increasing its scrutiny of legal costs. FHFA will also document oversight mechanisms and provide a summary report to OIG.
FHFA's Oversight of the Federal Home Loan Bank's Unsecured Credit Risk Management Practices – June 2012	As part of FHFA's ongoing horizontal review of unsecured credit practices at the FHLBanks, OIG recommends that FHFA follow up on any potential evidence of violations of the existing regulatory limits and take supervisory and enforcement actions as warranted, determine the extent to which inadequate systems and controls may compromise the FHLBanks' capacity to comply with regulatory limits, and take any supervisory actions necessary to correct such deficiencies, as warranted. To strengthen the regulatory framework around the extension of unsecured credit by the FHLBanks, OIG recommends, as a component of future rulemakings, that FHFA consider the utility of establishing maximum overall exposure limits; lowering the existing individual counterparty limits; and ensuring that the unsecured exposure limits are consistent with the FHLBank System's housing mission.	FHFA agrees with both recommendations. FHFA has alerted the FHLBanks of violations of existing regulatory limits identified by the OIG evaluation. Factors that led to those violations are being addressed. FHFA will follow-up on the adequacy of those efforts through its FHLBank examination program. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 require a review and modification of FHFA regulations that rely on such ratings. This effort is currently underway – FHFA will consider the factors recommended by OIG as part of its review and modification of the regulation governing unsecured credit at the FHLBanks. FHFA will complete its assessment and propose revisions to its rule governing unsecured credit at the FHLBanks by April 15, 2013.

continued on next page

OIG PERFORMANCE EVALUATIONS		
Evaluation	**Summary**	**Summary of FHFA s Response**
FHFA's Certifications for the Preferred Stock Purchase Agreements – August 2012	OIG recommended and FHFA agreed to: (1) adhere to the requirements to certify both that the Enterprises have complied with the preferred stock agreement covenants and that the Enterprises' financial statements and related documents are free of materially false or misleading representations; and (2) monitor the implementation of its oversight procedures to ensure that they are effective. These certifications enhance oversight of the preferred stock agreements and reduce the potential for errors and waste of taxpayer dollars.	FHFA took immediate action to strengthen oversight controls for the preferred stock agreements identified by OIG. FHFA established processes to enhance ongoing compliance with the agreements and has implemented additional procedures to oversee the certification processes including the engagement of the Enterprises' external auditors to independently test the covenant compliance. These actions will improve the oversight of the Preferred Stock Purchase Agreement process.
Follow-up on Freddie Mac's Loan Repurchase Process – September 2012	FHFA and Freddie Mac have acted on the concerns raised in OIG's report by adopting a more expansive loan review process. Specifically, Freddie Mac changed its policies to review for potential repurchase claims significantly larger numbers of loans that defaulted more than two years after origination. FHFA and Freddie Mac should continue to carry out the loan review and related reforms they have initiated since OIG's original report was issued.	FHFA agrees that reforms currently in place or underway will address the weaknesses identified by OIG and Freddie Mac Internal Audit. Additional steps are not planned at this time, but as noted in the follow-up report, three measures remain in progress for FHFA senior management: 1) ensure that Freddie Mac management resolves concerns associated with 'unsatisfactory' audit opinion; 2) initiate an independent assessment of Enterprise repurchase practices; and 3) evaluate whether the Enterprises should adopt consistent review practices for repurchase claims.
Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America (BOA) to High Touch Servicers – September 2012	Fannie Mae's purchase of mortgage servicing rights (MSR) was the most recent of several transactions executed as part of an ongoing initiative. BOA transaction was the largest of the transfers in the High Touch Servicing Program to date – however, the amount that Fannie Mae paid was consistent with the amount it had paid to other servicers from which it purchased MSR under the program. FHFA OIG found that Fannie Mae relied on a single consultant to price most of the MSR transactions under the program. OIG determined that FHFA can improve its oversight of Fannie Mae's program.	FHFA agrees with the following recommendations: 1) to consider revising FHFA's Delegation Authorities to require FHFA approval of unusual, high new initiatives; 2) ensure Fannie Mae does not have to pay a premium to transfer inadequately performing portfolios; 3) ensure Fannie Mae applies additional scrutiny and rigor to pricing significant MSR transactions and consider requiring Fannie Mae to assess the valuation methods of multiple MSR valuators in order to discern best practices; and 4) access the efficacy of the program and direct any necessary modifications.
FHFA's Oversight of Freddie Mac's Investment in Inverse Floaters – September 2012	OIG uncovered no evidence that FHFA or Freddie Mac obstructed homeowners' abilities to refinance their mortgages in an effort to influence the yields of the inverse floating-rate bonds that the Enterprise retained in its investment portfolio. Freddie Mac has an "information wall" policy to prevent its capital markets business from using non-public information to guide its investments. OIG found that FHFA's position on inverse floaters could have been communicated more clearly.	The following are FHFA's responses to the OIG recommendations: 1) FHFA will continue to follow Freddie Mac's portfolio and its hedging activities closely for many years (-this activity is part of our ongoing supervision program); 2) FHFA will incorporate reviews of Freddie Mac's information wall as part of its risk-based supervision of Freddie Mac's investment activities (-this activity is part of our ongoing supervision program); 3a) FHFA does not agree with the implication that there was confusion based on the timeline provided in our response, FHFA nevertheless agrees it is important to confirm supervisory views in writing and will continue to make this a critical part of our supervisory process; 3b) FHFA agrees that supervisory work and supervisory concerns should be based on the agency's work and analysis; and that the facts and high level timeline provided demonstrate that we base our supervisory work, discussions and findings on work that was well underway or completed prior to the reports, including the receipt of a confirming communication from Freddie Mac; 4) FHFA strongly believes that the public statement issued regarding inverse floaters accurately reflected all relevant facts and is supported by the timeline referenced in this memorandum and documentation provided to OIG.

Analysis of Financial Statements

Overview

FHFA prepares annual consolidated and combined financial statements for the agency and its Office of Inspector General in accordance with U.S. generally accepted accounting principles (GAAP) for Federal Government entities and subjects the statements to an independent audit to ensure their integrity and reliability in assessing performance.

FY 2012 Financial Statement Audit

FHFA achieved an unqualified opinion from the GAO on its annual financial statements. GAO noted no material weaknesses or significant deficiencies in FHFA's internal controls and cited no instances of noncompliance with laws and regulations.

Understanding the Financial Statements

The principal financial statements present FHFA's financial position, net cost of operations, changes in net position, and budgetary resources for fiscal years 2012 and 2011. Financial statements and notes for fiscal years 2012 and 2011 appear on pages 82–103. Highlights of the financial information presented in the principal financial statements are shown below.

Balance Sheet

The Balance Sheet presents, as of the end of the fiscal year, the recorded value of assets and liabilities retained or managed by FHFA. The difference between the assets and liabilities represents FHFA's net position. The Balance Sheet reflects total assets of $144.8 million, a 44 percent increase over FY 2011. The increase is primarily due to a $40.0 million increase in Property, Equipment, and Software due to leasehold improvements and furniture, fixtures and equipment purchases associated with FHFA's new location at Constitution Center. FHFA's total liabilities increased by $29.8 million, a 122 percent increase over FY 2011. The increase is primarily due to a tenant allowance provided to FHFA related to the new Constitution Center lease and an increase in deferred rent. As a result, FHFA's net position as of September 30, 2012 was $90.7 million, a $14.2 million increase over the $76.4 million net position as of September 30, 2011 see Figure 14).

Statement of Net Cost

The Statement of Net Cost presents the components of FHFA's net cost, which is the gross cost incurred less any revenues earned. FHFA's FY 2012 total program net (income)/costs, as reflected on the Statement of Net Cost, were -$8.4 million (or net revenue) as compared to the -$33.4 million in FY 2011. This change reflects the increase in gross costs and earned revenue needed to carry out its mission as reflected in its FY 2012 operating budget. The operating budget increase between fiscal years is the result of increased mission costs. However, during the course of the year, FHFA was unable to fully expend its FY 2012 earned revenue, thereby resulting in an excess of revenue over cost.

Consistent with the *Government Performance and Results Act of 1993*, the Statement of Net Cost is reported by FHFA's strategic goals. FHFA tracked resource allocations and program costs to the strategic goals (responsibility segments) developed for FHFA's strategic plan. Strategic Goals, 1–Safety and Soundness; 2–Affordable Housing (Housing Mission); and 3–Conservatorship, guide program offices to carry out FHFA's vision and mission. FHFA has a Resource Management Strategy, which is distributed proportionately to Strategic Goals 1-3 based

Figure 14: ASSETS AND LIABILITIES
(Dollars in Thousands)

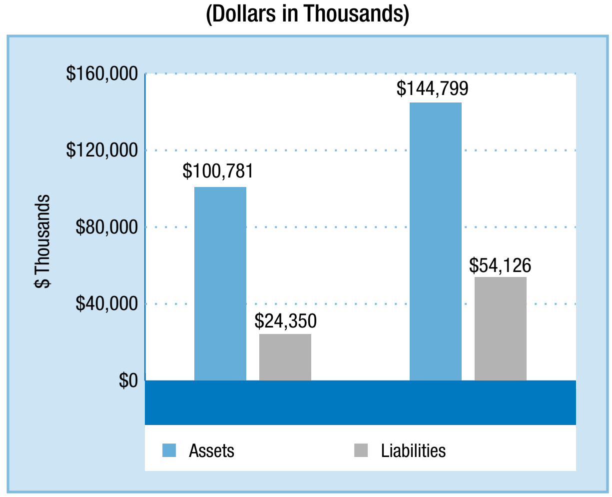


Figure 15: TOTAL NET (INCOME FROM)/COST OF OPERATIONS
(Dollars in Thousands)

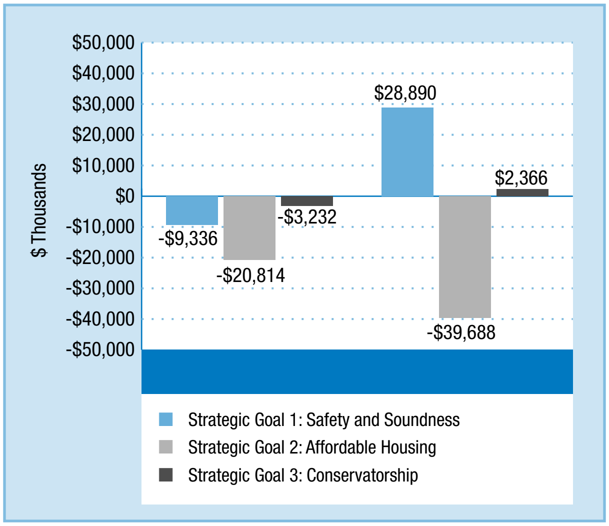
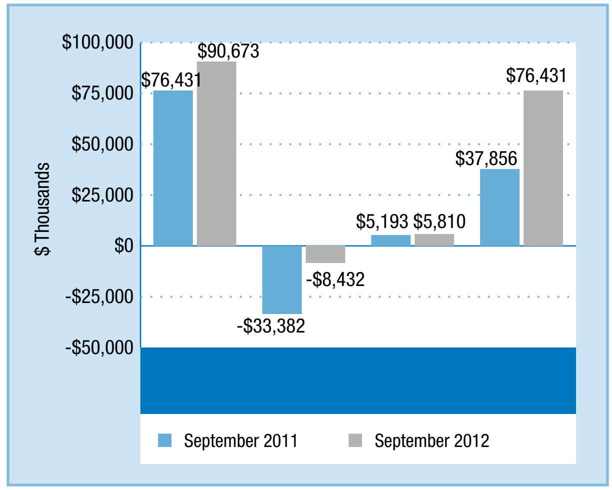


Figure 16: STATEMENT OF CHANGES IN NET POSITION
(Dollars in Thousands)



on the percentage of direct costs of each goal to the total direct costs for FHFA. FHFA places a significant emphasis on Strategic Goal 1, Safety and Soundness, which comprises a major portion of the total program costs. FHFA-OIG allocated their costs to FHFA's Resource Management Strategy, which is distributed proportionately to Strategic Goals 1-3 based on the percentage of direct costs of each goal to the total direct costs for FHFA (see Figure 15).

Statement of Changes in Net Position

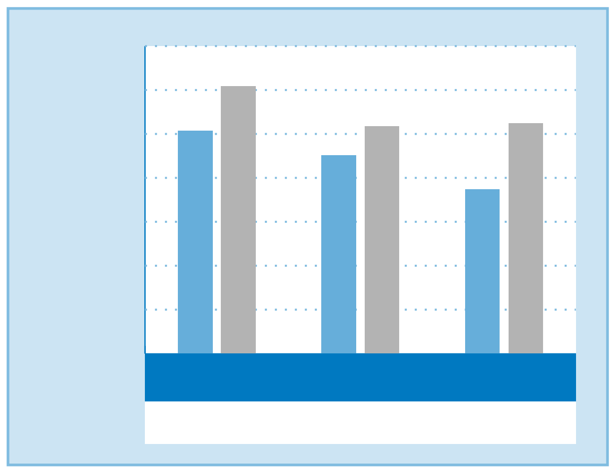
The Statement of Changes in Net Position presents those accounting items that caused the net position section of the Balance Sheet to change from the beginning to the end of the reporting period. Financing sources increase net position. FHFA's financing source is imputed financing from costs absorbed on FHFA's behalf by other Federal agencies. Net income from/cost of operations impacts net position.

FHFA's cumulative results of operations for the period ending September 30, 2012 increased $14.2 million (see Figure 16).

Statement of Budgetary Resources

This statement provides information about the budgetary resources available to FHFA and the status of these resources and the outlay of budgetary resources for the years ending September 30, 2012 and 2011. The

Figure 17: STATEMENT OF BUDGETARY RESOURCES COMPARISONS
(Dollars in Thousands)



statement shows that FHFA had $304.6 million in total budgetary resources for the 12 months ended September 30, 2012. The 20 percent increase in budgetary resources is the result of an increase in mission costs. Obligations incurred increased 15 percent to $259.1 million. Gross outlays increased 40 percent to $262.3 million (see Figure 17).

Source of Funds

HERA authorizes FHFA to collect annual assessments from its regulated entities to pay its costs and expenses and maintain a working capital fund. Under HERA, annual assessments are levied against the Enterprises and the FHLBanks to cover the cost and expenses of the agency's operations for supervision of the regulated entities.

FHFA calculates the assessments for each Enterprise by determining the proportion of each Enterprise's assets and off-balance sheet obligations to the total for both Enterprises and then applying each of the Enterprise's proportion (expressed as a percentage) to the total budgeted costs for regulating the Enterprises. FHFA calculates the assessments for each of the 12 FHLBanks by determining each FHLBank's share of minimum required regulatory capital as a percentage of the total minimum capital of all the FHLBanks and applying this percentage to the total budgeted costs for regulating the banks. Assessments are paid semiannually on October 1 and April 1. FHFA collected assessments of $224.4 million during FY 2012, which included a $5.4 million special assessment on the Enterprises related to conservatorship activities and a $38.8 million assessment for costs related to the operations of the Office of Inspector General.

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of FHFA, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of FHFA in accordance with GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Analysis of Systems, Controls and Legal Compliance

MANAGEMENT ASSURANCES

Federal Managers' Financial Integrity Act

During FY 2012, FHFA adhered to the internal control requirements of the Federal Managers' Financial Integrity Act (FMFIA) and the guidance provided by OMB Circular A-123. FHFA's Executive Committee on Internal Controls (ECIC) met quarterly to oversee internal controls and provide recommendations to the FHFA Acting Director on the effectiveness of FHFA's internal controls.

In 2012, the ECIC members were the Chief Operating Officer who served as the Chairman, the Chief Financial Officer who served as the Vice-Chairman, the Chief Information Officer, the Deputy Director for Enterprise Regulation, the Deputy Director for Bank Regulation, the Deputy Director for Examination Programs and Support, the Deputy Director for Housing Mission and Goals, the General Counsel, and the Associate Director Office of Quality Assurance. The Chairman and Vice Chairman of the ECIC invited other FHFA executives and managers when appropriate. The ECIC also established senior assessment teams to review specific areas when needed.

During FY 2012, pursuant to its obligations under OMB Circular A-123, FHFA monitored and assessed the following three areas:

Reliability over Financial Reporting

FHFA's Office of Budget and Financial Management assessed the agency's financial reporting controls according to the requirements outlined in OMB Circular A-123, Appendix A.

Compliance with Laws and Regulations

Assessment teams from FHFA divisions and offices identified the significant laws and regulations that relate to the operations for their respective offices. Assessment teams documented the actions that demonstrated compliance, and the agency's Office of General Counsel reviewed all submissions.

Effectiveness and Efficiency of Operations

Assessment teams from FHFA divisions and offices reviewed controls over operations using the criteria outlined in the GAO Internal Control Management and Evaluation Tool. Division and office managers and the

Office of Budget and Financial Management reviewed the reports of the assessment teams.

The ECIC reviewed documentation from all three areas. In compliance with the FMFIA requirements, the FHFA Acting Director, on the basis of a recommendation from the ECIC, provided reasonable assurance that internal controls over the effectiveness and efficiency of operations, compliance with applicable laws and regulations, and financial reporting as of September 30, 2012 were operating effectively and that no material weaknesses were found in the design or operation of the internal controls.

The FHFA-OIG began operation in mid-October 2010 and adhered to the internal control requirements of FMFIA and the guidance provided by OMB Circular A-123. In order to ensure compliance, the FHFA-OIG formed an ECIC and established a senior assessment team headed by the Chief of Staff to assess the internal controls of the OIG. The assessment team included participants from each office within the FHFA-OIG. Based on its review of the internal control assessments, the FHFA-OIG ECIC provided reasonable assurance that OIG offices have developed and maintained effective internal controls for FY 2012, and no significant deficiencies or material weaknesses have been identified.

The Office of Counsel (OC), under the Chief Counsel's direction, is FHFA-OIG's principal authority on legal matters pertaining to FHFA-OIG activities, duties, and authorities. The OC works to ensure that all FHFA-OIG activities are conducted in accordance with applicable legal requirements. Starting with the creation of FHFA-OIG in mid-October 2010, the OC has developed rules, policies, and procedures to ensure full FHFA-OIG compliance with such requirements. Although these efforts continue, no FHFA-OIG office identified substantive deviations from full compliance with those legal authorities to which it is subject. Based on these factors and the controls assessments performed at each OIG office, the FHFA-OIG ECIC members determined that the FHFA-OIG's A-123 efforts provide reasonable assurance that FHFA-OIG complies with laws and regulations applicable to FHFA generally, and to FHFA-OIG specifically. As such, the FHFA-OIG ECIC recommended the Inspector General sign an assurance statement to the FHFA Acting Director recommending an unqualified statement of assurance relative to the three areas assessed by the OIG; internal control over financial reporting, effectiveness and efficiency of operations, and compliance with laws and regulations.

Federal Management System and Strategy

Section 1106(g)(3) of HERA requires FHFA to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. FHFA, including FHFA-OIG, uses the Bureau of the Public Debt for its accounting services and that agency's financial management system (FMS) which includes (1) a core accounting system—Oracle Federal Financials; (2) three feeder systems—PRISM (procurement), GovTrip (travel), and Citidirect (charge card); (3) a reporting system—Discoverer; and (4) an inventory tracking system. FHFA is responsible for overseeing the Bureau of the Public Debt's performance of accounting services for the agency. A financial oversight document outlines the assignment of activities between FHFA and the Bureau of the Public Debt. FMS includes manual and automated procedures and processes from the point at which a transaction is initiated to issuance of financial reports. FMS meets the requirements of HERA Section 1106(g)(3). FHFA also uses the National Finance Center, a service provider within the Department of Agriculture, for its payroll and personnel processing. FHFA has streamlined accounting processes by electronically interfacing data from charge cards, investment activities, the GovTrip travel system, the PRISM procurement system, and the National Finance Center payroll system to FMS.

Federal Information Security Management Act

Title III of the Electronic Government Act of 2002, commonly referred to as the Federal Information Security Management Act (FISMA), requires all Federal agencies to develop and implement an agency-wide information security program. The program provides a framework to protect the agency's information, operations, and assets. During FY2011 and into FY2012, OMB issued guidance requiring federal agencies to continuously monitor the security posture of information systems to enable timely decision making regarding identified vulnerabilities and threats. In FY2012, OMB directed Federal Agencies to increase monitoring of security-related events and to acquire tools to automate security activities.

The FHFA-OIG is required to review the agency's information security program annually and report the results to OMB as required by FISMA. FHFA's information security program activities during FY2012 reflect efforts focused on enhancing the Agency's continuous monitoring program as well as increasing automation capabilities. The continuous monitoring program requires FHFA to proactively monitor the security posture of its information technology infrastructure through the implementation of operational, management, and technical controls, including automated security tools and supplemental resources for monitoring activities. The tools and activities include the FHFA Security Assessment and Authorization (SA&A) process for evaluating information systems before they become operational; reviewing system logs and configuration management activities; and conducting periodic vulnerability scans.

Other FY2012 information security program activities include implementing an enhanced vulnerability management capability, updating information security policy with corresponding procedures, and performing annual security control assessments of FHFA information systems, including the Agency's Financial Management System (FMS). FHFA maintained security authorization on 100 percent of all major systems in production which included a significant upgrade to the general support system as a result of the Agency's move to a new building. FHFA developed and distributed monthly, non-technical cyber security newsletters to all employees to enhance user awareness and successfully provided annual security training to all employees and contractors. FHFA also addressed security-related weaknesses for systems noted in the prior year FISMA review as well as mitigating vulnerabilities identified during other SA&A activities.

To support the annual FY2012 FISMA review, the OIG conducted several audits, including a network vulnerability assessment that resulted in a clean audit with no findings. The FY2012 FISMA audit report is in the final stages of OIG management review.

Management Report on Final Actions

As required under amended Section 5 of the Inspector General Act of 1978, the FHFA must report information on final action taken by management on certain audit reports. The tables that follow provide information on final action taken by management on audit reports for the Federal fiscal year period October 1, 2011, through September 30, 2012.

Table 5: MANAGEMENT REPORT ON FINAL ACTION ON AUDITS WITH DISALLOWED COSTS FOR FISCAL YEAR 2012

	AUDIT REPORTS	NUMBER OF REPORTS	DISALLOWED COSTS
	Dollars in Thousands		
A.	Management decisions – Final action not taken at beginning of period	0	$0
B.	Management decisions made during the period	0	$0
C.	Total reports pending Final action during the period (A and B)	0	$0
D.	Final action taken during the period:		
	1. Recoveries:		
	(a) Collections & offsets	0	$0
	(b) Other	0	$0
	2. Write-offs	0	$0
	3. Total of 1(a), 1(b), & 2	0	$0
E.	Audit reports needing final action at the end of the period	0	$0

Table 6: MANAGEMENT REPORT ON FINAL ACTION ON AUDITS WITH RECOMMENDATIONS TO PUT FUNDS TO BETTER USE FOR FISCAL YEAR 2012

	AUDIT REPORTS	NUMBER OF REPORTS	DISALLOWED COSTS
	Dollars in Thousands		
A.	Management decisions – Final action not taken at beginning of period	0	$0
B.	Management decisions made during the period	0	$0
C.	Total reports pending Final action during the period (A and B)	0	$0
D.	Final action taken during the period:		
	1. Value of recommendations implemented (completed)	0	$0
	2. Value of receommendations that management concluded should not or could not be implemented or completed	0	$0
	3. Total of 1(a), 1(b), & 2	0	$0
E.	Audit reports needing final action at the end of the period	0	$0

Table 7: AUDIT REPORTS WITHOUT FINAL ACTIONS BUT WITH MANAGEMENT DECISIONS OVER ONE YEAR OLD FOR FISCAL YEAR 2012

MANAGEMENT ACTION IN PROCESS		
Report No. and Issue Date	**Recommendation**	**Management Action**
EVL 2011-06, *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*, September 27, 2011	The OIG recommended that FHFA and its senior management must promptly act on the significant concerns raised about the loan review process. To ensure that Freddie Mac is maximizing its repurchase claim recoveries:	In 2012, FHFA has completed corrective actions to address the recommendations, including continuing to work with Freddie Mac on repurchase settlement processes and approvals. However, the actions to fully address the recommendations are still underway at the end of the fiscal year.
	▪ FHFA should continue to withhold approval of Freddie Mac repurchase settlements until such time as it is confident that the concerns about the Enterprise's loan review process have been resolved.	▪ Completed
	▪ FHFA senior management should ensure that Freddie Mac management resolves the concerns that prompted their internal auditors to issue an "Unsatisfactory" audit opinion.	▪ In-process, FHFA senior management has met regularly with Freddie Mac's Chief Enterprise Risk Office and its General Auditor and agree that progress has been made but work remains to be completed.
	▪ FHFA senior management should oversee Freddie Mac's "out-of-sample" loan testing and consider independently validating the testing.	▪ In-process, Freddie Mac continues to perform "out-of-sample" loan testing. FHFA is currently in the process of independently validating the conclusions. Freddie Mac's internal auditors also intend to validate the out-of-sample testing.
	▪ FHFA should evaluate whether Fannie Mae and Freddie Mac should adopt consistent review practices for repurchase claims	▪ In-process, FHFA issued a directive covering future repurchase claims by Fannie Mae and Freddie Mac. FHFA continues to assess the sampling strategies and implications for legacy repurchase claims.
	▪ FHFA senior management should initiate an independent assessment of Enterprise repurchase practices in order to ensure that they are maximizing their repurchase claim recoveries	▪ In-process, FHFA issued a directive covering future repurchase claims by Fannie Mae and Freddie Mac. FHFA continues to assess the sampling strategies and implications for legacy repurchase claims.
	▪ FHFA should issue internal guidance regarding its handling of future repurchase settlements, should they arise.	▪ Completed
		Expected Completion Date: FHFA will monitor the repurchase settlement process throughout fiscal year 2013.

FHFA's Statement of Assurance

FHFA Statement of Assurance

Federal Housing Finance Agency
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October 15, 2012

Federal Managers' Financial Integrity Act
Statement of Assurance
Fiscal Year 2012

The Federal Housing Finance Agency (FHFA) management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA).

FHFA conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, FHFA can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2012 was operating effectively and that no material weaknesses were found in the design or operation of the internal controls.

In addition, FHFA conducted its assessment of the effectiveness of internal controls over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, FHFA can provide reasonable assurance that its internal controls over financial reporting as of September 30, 2012 were operating effectively and no material weaknesses were found in the design and operation of the internal controls over financial reporting.

In accordance with the requirements of FMFIA, FHFA's financial management systems are substantially in compliance with the requirements for federal financial management systems as presented in A-127, Financial Management Systems as of September 30, 2012.

Edward J. DeMarco

Edward J. DeMarco
Acting Director

Performance Section

Managing and Measuring Performance

During FY 2012, FHFA retooled its performance measures to align with initiatives that are mission critical and reflective of how the housing market has evolved. The agency identified eight performance measures that will no longer be reported on externally. Although these performance measures will no longer be reported on externally, they remain important and will continue to be tracked and reviewed internally (see page 105 of the Other Accompanying Information for more information).

The Performance Section is organized by strategic goals to describe FHFA's efforts to meet the goals defined in the agency's FY 2009–2014 strategic plan. In October 2012, FHFA released a new *Strategic Plan for FHFA for Fiscal Years 2013-2017*. As a result of this plan and in concert with the initiatives associated with the new *A Strategic Plan for Enterprise Conservatorships*, four new performance measures will be added in FY 2013. The initiatives associated with the conservatorship strategic plan will be guided by our newly created Office of Strategic Initiatives.

The Performance Section also includes a discussion of each performance goal, the results of the performance measures for the current year as well as two prior fiscal years, the associated targets, how the agency verifies performance data, factors describing why performance measures were not met and our plans to improve our performance.

FHFA's annual performance plan establishes specific outcomes to accomplish the strategic goals. The annual plan also outlines performance measures used to track achievement of each goal while providing the means and strategies that will be utilized. Performance measures also highlight the achievement level towards the overarching performance goal. In FY 2012, there were 14 performance goals; 10 supported the agency's three strategic goals and 4 supported our resource management strategy.

Figure 18 shows the hierarchy of FHFA's performance goals and measures. It also depicts how FHFA intends to devote its resources to fulfill its mission in practical and measurable ways.

The annual performance budget describes how FHFA achieves its goals and the costs, systems, and initiatives associated with them. The agency accomplishes its mission primarily by:

- Examining the regulated entities;
- Monitoring their progress in completing their remediation plans;
- Assessing their capital adequacy;
- Preserving and conserving Enterprise assets;
- Setting and enforcing affordable housing goals;
- Monitoring credit and financial market conditions; and
- Researching and analyzing the regulated entities and the housing markets.

FHFA continued to employ a numbering system to link performance measures to strategic and performance goals. For each performance measure, the first digit represents the strategic goal it supports, the second digit is the number of the performance goal, and the third digit is the number of the performance measure related to that goal. For example, performance measure 1.1.1 supports strategic goal 1 and performance goal 1.1—it is the first performance measure under that goal.

Strategic and performance goals are developed during the planning process and approved by the Acting Director. Senior executive leaders develop performance

Figure 18: FHFA'S GOAL HIERARCHY

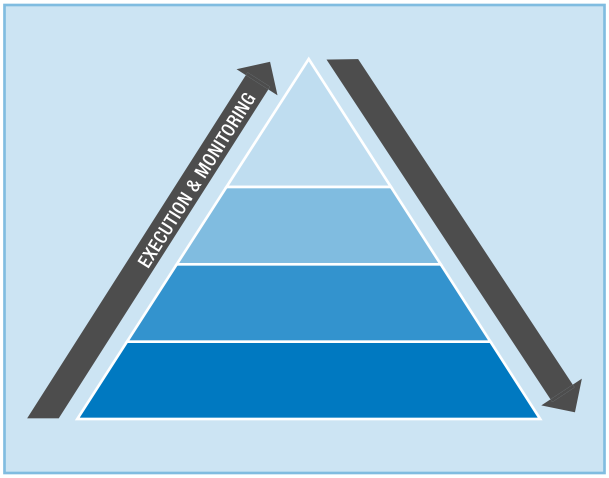
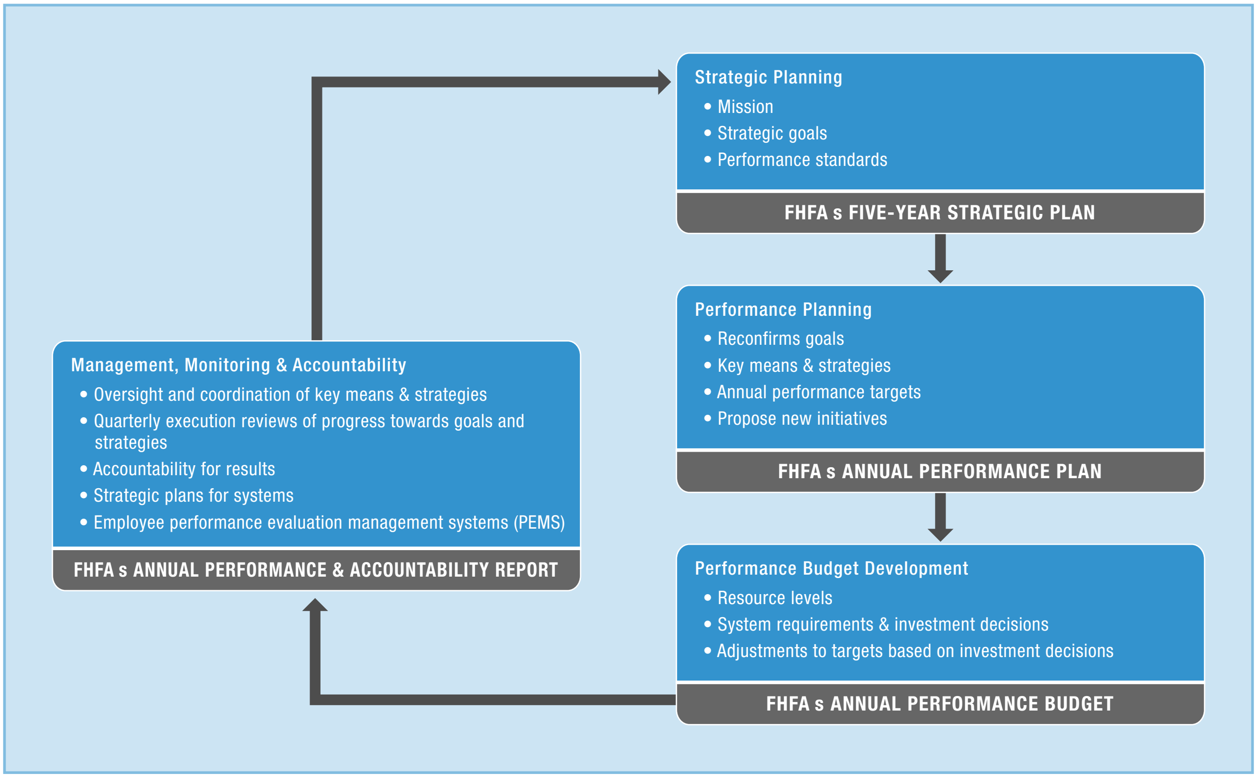


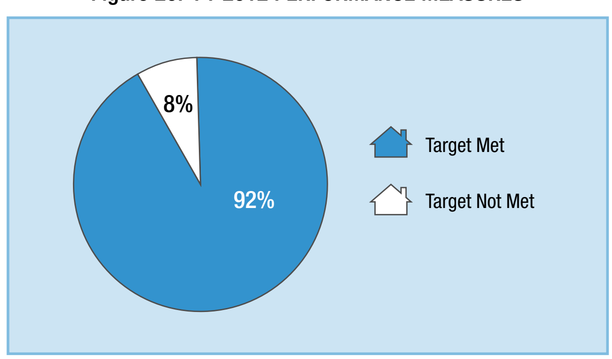
Figure 19: FHFA'S PERFORMANCE MANAGEMENT CYCLE



measures, as well as the means and strategies that describe how FHFA is going to measure performance. Performance results are monitored throughout the year to determine the success of program activities. During FY 2012, senior executives and supporting staff submitted quarterly reports on progress they made toward achieving performance measures for which they were accountable. These reports are reviewed and analyzed by the Performance Management and Strategic Planning staff to ensure accuracy, validity of information being reported, and progress toward achieving planned performance levels. The FHFA Acting Director then holds quarterly performance tracking meetings with senior executive leaders to review accomplishments and make required adjustments to programs. The agency uses the quarterly reports as the basis for developing the *Performance and Accountability Report*. See Figure 19 for an outline of FHFA's performance management cycle.

Most of FHFA's performance measures, with the exception of data used as input for capital calculations, reflect internal milestones. Some of the performance measures depend on the actions and results of the regulated entities. Figure 20 depicts FHFA's achievement of performance measures for FY 2012.

Figure 20: FY 2012 PERFORMANCE MEASURES



VERIFICATION AND VALIDATION OF PERFORMANCE DATA

Information reported in this Performance and Accountability Report is complete and reliable. The sources of data are identified and verified to ensure accuracy, reliability, and completeness. Individual offices maintain a checks and balances system that is reflective of their performance measures, e.g., measures that are more reflective to external influence versus internal influence. The data for all the performance goals are complete and reliable. The data are created internally, reported in the agency's performance tracking system, and reviewed each quarter by senior executive leadership. Additionally, FHFA's staff documents the procedures used to obtain and validate the data to ensure the accuracy and accountability of the information.

During the performance planning cycle, the following data are collected on each performance measure:

- Definition
- Data source
- Process for calculating or tabulating performance data
- Process for validation and verification
- Responsible manager
- Location of documentation

Data related to supervision activities are collected through FHFA's supervision process and reviewed by the quality assurance staff and FHFA management.

Strategic Human Capital Management

FHFA's Human Capital strategic plans, programs, and operations are aligned to fully support the agency's mission and performance goals. FHFA's workforce is its most valuable resource. Attracting, hiring, developing, rewarding, and retaining a diverse staff with cutting-edge professional skills that possess the breadth and depth of knowledge to support FHFA's mission and strategic performance goals is critical to the success of the agency. The FHFA Human Capital Management Balanced Scorecard highlights 18 key objectives that provide the structure and direction needed to achieve a high– performing workforce in support of FHFA's important mission and for furthering an agency culture that encourages collaboration, flexibility, and fairness to enable individuals to participate to their full potential.

Strategic Goal 1

STRATEGIC GOAL 1	The housing GSEs operate in a safe and sound manner and comply with legal requirements

FHFA's primary duty as regulator and conservator is to ensure that the housing GSEs have the financial strength, operational capacity, and risk management controls to fulfill their critical role in the nation's housing finance system. Providing a comprehensive and effective oversight program for the housing GSEs requires attention to all aspects of operations and management, the risks inherent in their activities, and the dynamic environment in which they operate.

During FY 2012, FHFA completed key organizational changes and established a new supervisory strategy to lead and coordinate the agency's activities highlighted in this strategic goal. Through its examination process, FHFA is improving the efficiency and effectiveness of examinations by integrating examination resources and standards. In addition, FHFA verifies that the GSEs are timely in managing required improvements, remedial actions, and litigation.

PERFORMANCE GOAL 1.1

Fannie Mae and Freddie Mac (the Enterprises) comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.

PERFORMANCE MEASURE 1.1.1

Improve component ratings at each Enterprise.

	FY 2010	FY 2011	FY 2012
Target	Improve in one or more by September 30, 2010	Improve in one or more by September 30, 2011	Improve in one or more by September 30, 2012
Performance	The market risk rating for Freddie Mac improved from critical to significant concerns for the quarter ending March 31, 2010, based on improvements in interest rate risk management. Component ratings did not improve at Fannie Mae during FY 2010. Several areas, improved, increasing the likelihood that some component ratings will improve during the next fiscal year.	The composite ratings for both Fannie Mae and Freddie Mac are critical concerns. Stress on the mortgage market and poor financial performance by the Enterprises continues. Target met for Fannie Mae though not for both Enterprises as Freddie Mac did not have component improvements	Examinations have been conducted through the course of 2012. Ratings will be assigned and included in the 2012 Reports of Examination for the Enterprises, which are scheduled to be prepared, finalized, and reported to the Enterprises in 2013. Target met for Fannie Mae though not for both Enterprises as Freddie Mac did not have component improvements.
Performance Results Key: Goal Fulfillment	Target Not Met	Target Not Met	Target Not Met

PERFORMANCE MEASURE 1.1.2

Matters Requiring Attention (MRAs) that are more than 120 days old are resolved or are being resolved in accordance with an acceptable remediation plan.

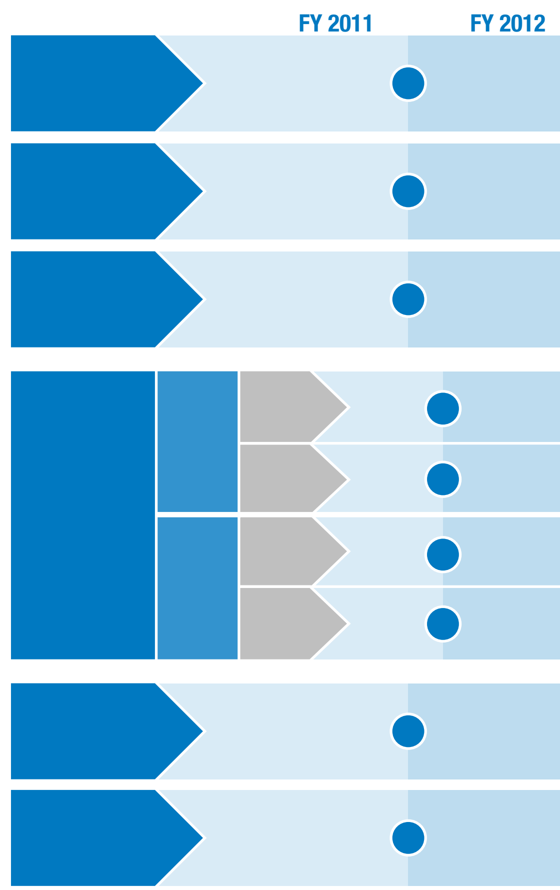
	FY 2010	FY 2011	FY 2012
Target	90 percent Quarterly	90 percent Quarterly	At least 90 percent each quarter
Performance	80 MRAs were cited. Of those, 61 (76 percent) were resolved or were in the process of being resolved in accordance with a remediation plan acceptable to FHFA within 90 calendar days of recognition. FHFA met this performance measure the last three quarters of the fiscal year, but the target was "not met" because of the failure to meet the target in the first quarter of FY 2010.	All MRAs were open fewer than 20 days. There were 27 total conclusion letters in FY 2011. All of them were resolved or were in the process of being resolved in accordance with a remediation plan acceptable to FHFA within 90 calendar days of recognition. FHFA met this target 100 percent each quarter of FY 2011.	All MRAs were resolved or were in the process of being resolved in accordance with a remediation plan acceptable to FHFA within 120 calendar days of recognition. FHFA met this target at least 99 percent each quarter of FY 2012.
Performance Results Key: Goal Fulfillment	Target Not Met	Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 1.1

FHFA conducts risk-based supervision and examinations at the Enterprises to ensure they operate in a safe and sound manner. Key areas of risk include: credit risk, market risk, operational risk, governance, solvency and earnings. While FHFA did not meet performance measure 1.1.1 in FY 2012, examinations were conducted and ratings will be assigned and included in the 2012 Reports of Examination (ROE). The absence of capital and the continuation of credit losses jeopardized improving the Enterprises' ability to make improvements in those areas. Human capital flight and the uncertainty of the conservatorship status jeopardized improvement in Governance, Market Risk, and Operational Risk. FHFA will continue to focus on the improvement of Enterprise operations. Key challenges to meeting this goal in the future will be the health of the U.S. economy, house prices, and human capital risk at the Enterprises. It should be noted that this performance measure has not been carried forward for the next fiscal year. FHFA will continue to conduct examinations and ongoing monitoring of the Enterprises, and ratings will be assigned in accordance with the revised FHFA ratings system.

For performance measure 1.1.2, FHFA met its quarterly target of 90 percent in FY 2012, requiring the submission, review and resolution of remediation plans within 120 days of issuance of an MRA. FHFA accomplished this goal by meeting with the Enterprises biweekly to track progress and reconcile to Enterprise remediation packages. The FHFA is in the process of developing an enhanced process for tracking MRA remediation due dates. FHFA continues to expend effort and resources to address high levels of nonperforming loans and evaluate the success of U.S. government programs, while maintaining a core risk-based supervision program. Throughout the supervision process, FHFA works with the Enterprises to ensure the MRAs have been resolved within 120 days of identifying an issue by requiring and monitoring corrective action plans. FHFA will continue to monitor the effectiveness of loss mitigation efforts to support the conservation of GSE assets.

DID YOU KNOW?



1 Data includes purchases of mortgages into portfolio and issuances of the MBS

2 FY 2012 total HARP refinancesis from Oct 2011–Aug 2012

PERFORMANCE GOAL 1.2 The FHLBanks and the Office of Finance comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.			
PERFORMANCE MEASURE 1.2.1 **Composite rating at each FHLBank.** *Note: If rating is less than "2", an acceptable performance improvement plan shall be included with the Bank's response to the Report of Examination.*			
	FY 2010	FY 2011	FY 2012
Target	"2" or better or, within 180 days of a rating downgrade to below 2, operating under an approved capital restoration plan	"2" or better or, within 180 days of a rating downgrade to below 2, operating under an approved capital restoration plan	"2" or better or, within 180 days of a rating downgrade to below 2, operating under an acceptable performance improvement plan
Performance	Seven institutions were rated below 2 in FY 2010. Four were operating under an acceptable performance improvement plan within 90 days of the downgrade, three were not.	One institution was downgraded below 2 during FY 2011 and developed a remediation plan within 180 days of the downgrade.	No FHLBanks were downgraded below 2 in FY 2012.
Performance Results Key: Goal Fulfillment	**Target Not Met**	**Target Met**	**Target Met**
PERFORMANCE MEASURE 1.2.2 **Classify capital rating at each FHLBank.**			
	FY 2010	FY 2011	FY 2012
Target	Quarterly	Classified as "adequately capitalized" or, within 180 days of a rating downgrade, operating under an approved capital restoration plan Quarterly	Classified as "adequately capitalized" or, within 180 days of a rating downgrade, operating under an approved capital restoration plan Quarterly
Performance	Eleven of the 12 FHLBanks were adequately capitalized throughout FY 2010. One Bank was classified as undercapitalized. That Bank subsequently stipulated to a consent order, which constituted its approved capital restoration plan.	Eleven of the 12 FHLBanks were adequately capitalized throughout FY 2011. FHFA has continued to classify one Bank as undercapitalized. The consent order and associated agreement constitute the FHLBank's capital restoration plan.	All of the 12 FHLBanks were adequately capitalized at the end of FY 2012. One FHLBank, previously classified as undercapitalized through a discretionary downgrade, was upgraded to adequately capitalized for the quarter ending June 30, 2012.
Performance Results Key: Goal Fulfillment	**Target Not Met**	**Target Met**	**Target Met**
PERFORMANCE MEASURE 1.2.3 **MRAs that are more than 90 days old are resolved or being resolved in accordance with an acceptable remediation plan.**			
	FY 2010	FY 2011	FY 2012
Target	90 percent Quarterly	90 percent Quarterly	At least 90 percent each Quarter
Performance	FHFA examiners identified MRAs at FHLBanks during FY 2010. All matters requiring attention were either successfully resolved or in the process of being resolved in accordance with an approved remediation plan within 90 calendar days.	FHFA examiners identified MRAs at FHLBanks during FY 2011. All MRAs more than 90 days old were either successfully resolved or being resolved with an acceptable remediation plan within 90 calendar days.	FHFA examiners identified MRAs at FHLBanks during FY 2012. All matters requiring attention were either successfully resolved or in the process of being resolved in accordance with an approved remediation plan within 90 calendar days.
Performance Results Key: Goal Fulfillment	**Target Met**	**Target Met**	**Target Met**

OVERVIEW OF PERFORMANCE GOAL 1.2

FHFA supervises each FHLBank to ensure it operates in a safe and sound manner. In FY 2012, FHFA conducted supervisory examinations primarily through on-site examinations and off-site monitoring and analysis.

During FY2012, composite ratings were assigned at each FHLBank. No FHLBanks were downgraded during FY 2012. All Reports of Examination regardless of a Bank's composite rating, contain a summary of examination issues identified and Matters Requiring Attention (MRA), which include follow-up dates by which the Bank is to resolve the identified issues.

In FY 2012, all of the FHLBanks were adequately capitalized per Prompt Corrective Action (PCA) rule thresholds. It should be noted that one FHLBank previously classified as *undercapitalized* through a discretionary downgrade, was upgraded to *adequately capitalized* for the quarter ending June 30, 2012. Although the PCA capital classification was upgraded to *adequately capitalized* and reflected on-going improvement in key risk metrics of the Bank, FHFA continues to monitor concerns with the level of retained earnings and the poor quality of the Bank's private label securities portfolio.

FHFA employs a risk-based examination program that focuses on five key areas: market risk, credit risk, operational risk, governance, and financial condition and performance. FHFA provides its ROE and related findings to FHLBank management and their boards of directors. FHFA also provides information on the condition of each FHLBank and the Office of Finance in its Annual Report to Congress.

In FY 2012, the FHLBanks successfully resolved or began resolving all MRAs with an acceptable remediation plan. All ROE contain a summary of examination issues identified and MRAs, which include follow-up dates by which the Bank is to resolve the identified issues. The resolution of some MRAs are long-term in nature (e.g., those that are information technology (IT)-related often do not lend themselves to short-term resolution).

Strategic Goal 2

STRATEGIC GOAL 2	The housing GSEs support a stable, liquid, and efficient mortgage market, including sustainable home ownership and affordable housing.

The housing GSEs contribute to the smooth operation of the markets by providing liquidity and stability and by meeting housing goals. Fostering a stable, liquid, and efficient secondary mortgage market promotes a steady stream of funds for sustainable homeownership and affordable housing. Since the housing GSEs comprise a large share of an increasingly dynamic and complex market, their role is critical in providing liquidity and stability and in addressing affordable housing needs.

During FY 2012, the housing GSEs have continued to have a central role in the mortgage market. FHFA's policy research and analysis helps inform stakeholders and contributes to effective supervision. FHFA's affordable housing goals are intended to influence the housing GSEs' actions. Further, they set a baseline for the housing finance system that includes community investment and affordable housing.

PERFORMANCE GOAL 2.1
FHFA ensures the housing GSEs support a stable, liquid and efficient mortgage market.

PERFORMANCE MEASURE 2.1.1
Ensure liquidity levels at Fannie Mae and Freddie Mac meet or exceed required levels or are brought into compliance within 5 business days.

	FY 2010	FY 2011	FY 2012
Target	Monthly	95 percent	95 percent Quarterly
Performance	Fannie Mae did not maintain liquidity levels consistent with FHFA requirements. All the other housing GSEs met the liquidity requirements.	Both Fannie Mae and Freddie Mac maintained liquidity levels consistent with FHFA requirements.	In FY 2012, both Fannie Mae and Freddie Mac maintained liquidity levels consistent with FHFA requirements.
Performance Results Key: Goal Fulfillment	Target Not Met	Target Met	Target Met

PERFORMANCE MEASURE 2.1.2
Ensure liquidity levels at the FHLBanks meet or exceed required levels or are brought into compliance within 5 business days.

	FY 2010	FY 2011	FY 2012
Target	Annually	95 percent	95 percent Quarterly
Performance	Liquidity levels at the FHLBanks met the required levels consistent with FHFA requirements.	All FHLBanks maintained liquidity levels consistent with FHFA requirements.	During FY 2012, liquidity levels at the FHLBanks met the required levels consistent with FHFA requirements.
Performance Results Key: Goal Fulfillment	Target Met	Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 2.1

Both Enterprises and FHLBanks support the health of the secondary mortgage market through their regular activities of guaranteeing, securitizing, and purchasing mortgage loans and securities. This support reduces the cost of mortgages to the public and promotes sustainable home ownership. The 95 percent target for each measure represents a very good level of compliance based on daily observations. Not falling within the liquidity limit would represent something that happens once every month at most.

The Enterprises must each meet certain liquidity criteria: maintain at least 30 calendar days of liquidity; hold at least 50 percent of their expected 30-day cash needs in Treasury and/or Federal deposits; and maintain at least 100 percent of their expected 365 day cash needs in cash and unencumbered assets. During FY 2012, liquidity levels were monitored daily at the Enterprises and as a result, the Enterprises exceeded required liquidity levels. Given ongoing problems in Europe and the U.S. debt ceiling debate, each Enterprise reduced or eliminated unsecured bank deposits and increased Treasury and/or Federal deposits to enhance liquidity.

FHFA also monitored each FHLBank's liquidity level to ensure their ongoing ability to respond to market demands. Specifically, FHFA requires each FHLBank to maintain positive cash balances for 15 days assuming no access to the capital markets while allowing maturing advances to roll off, and for 5 days assuming no maturing advances roll off. FHFA prepares a report each week to assess FHLBank compliance with these standards. Every FHLBank met the liquidity requirements for each week during FY 2012.

PERFORMANCE GOAL 2.2

FHFA ensures the housing GSEs provide leadership in housing finance and affordable housing by operating these programs in an effective and efficient manner, developing products, establishing partnerships, and financing homes for very low, low, and moderate income households.

PERFORMANCE MEASURE 2.2.1

Ensure all FHLBanks award affordable housing program (AHP) funds at least equal to statutory minimums.

	FY 2010	FY 2011	FY 2012
Target	September 30, 2011	100 percent	100 percent
Performance	FHFA completed AHP examinations at all 12 FHLBanks. FHFA identified one violation and recommended remediation.	FHFA completed AHP examinations at all 12 FHLBanks.	FHFA completed AHP examinations at all 12 FHLBanks. All FHLBanks awarded AHP funds at least equal to statutory minimums.
Performance Results Key: Goal Fulfillment	**Target Met**	**Target Met**	**Target Met**

PERFORMANCE MEASURE 2.2.2

Regulated entities will provide updated performance plans within 180 days in response to agency notification of potential performance shortfalls in meeting housing goals.

	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	100 percent	100 percent
Performance		FHFA required no updated performance plans during FY 2011 and met the target.	Each FHLBank provided updated performance plans during FY 2012.
Performance Results Key: Goal Fulfillment		**Target Met**	**Target Met**

OVERVIEW OF PERFORMANCE GOAL 2.2

The Bank Act requires each FHLBank to establish an affordable housing program (AHP) to enable members to provide long-term subsidized financing for very low-, low-, and moderate- income owner-occupied and affordable rental housing. These subsidies may be in the form of grants or subsidized interest rates on an advance to a member.

The Bank Act also requires each FHLBank to contribute at least 10 percent of its net earnings from the previous year to its AHP, subject to a minimum annual combined contribution by all 12 FHLBanks of $100 million. FHFA conducts on-site examinations and visitations of each FHLBank to ensure compliance with AHP regulations and to evaluate the effectiveness of the FHLBanks' programs. During FY 2012, FHFA did not identify nor were we advised of any violations of this statutory requirement, and met performance measure 2.2.1.

In response to agency notification of potential performance shortfalls in meeting housing goals, FHFA met its goal of requiring the Enterprises to provide updated performance plans in FY 2012. Each performance plan addresses unique benchmarks for the Enterprises. FHFA's approach while Fannie Mae and Freddie Mac are under conservatorship is to compare the Enterprises' affordable housing attainment to the overall volume of affordable housing produced in the primary market. With this fluctuating target, an indicative measure will not be set but the affordable housing objective remains an important component of the Enterprises' activities.

PERFORMANCE GOAL 2.3

FHFA supports an efficient secondary mortgage market through research that increases transparency of the housing GSEs' risks and activities and improves understanding of mortgage market developments.

PERFORMANCE MEASURE 2.3.1
Develop and publish house price indexes that omit or reduce the influence of distressed sales from the estimation sample for Metropolitan Statistical Areas (MSAs) or states.

	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	New Measure for 2012	By September 30, 2012
Performance			The updated Housing Price Index (HPI) published in July 2012 included new price indexes that omit or reduce the influence of distressed sales from the estimation sample for MSAs or states.
Performance Results Key: Goal Fulfillment			Target Met

PERFORMANCE MEASURE 2.3.2
Ensure working papers, mortgage market notes, or research papers are published.

	FY 2010	FY 2011	FY 2012
Target	Six by September 30, 2010	At least 6	At least 6
Performance	FHFA published two working papers, six research papers, and three mortgage market notes during FY 2010.	FHFA published two working papers, two mortgage market notes, one research paper, and one research report to Congress in FY 2011. These publications are posted on the agency's web site. This measure pertains to the number of such publications released in FY 2011.	FHFA published two working papers, two mortgage market notes, and two research papers during FY 2012. These publications are posted on the agency's web site. www.fhfa.gov/Default.aspx?Page=5
Performance Results Key: Goal Fulfillment	Target Met	Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 2.3

During FY 2012, FHFA continued 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 housing GSEs' risks and activities. FHFA publishes a variety of data and reports throughout the year to increase the transparency of mortgage market developments, as well as the housing GSEs' risks and activities.

FHFA conducted market research to assess likely distress-indicators that enabled the production of a distress-free Housing Price Index (HPI). The distress "discount" reflects a number of factors, including (frequently) deteriorated property condition. Many users of the HPI would prefer to remove the effects of those factors from FHFA's metrics. To satisfy that demand and to improve public understanding of housing market developments, FHFA met its goal of developing and publishing distress-free house price indexes that are available to the public *www.fhfa.gov/Default.aspx?Page=14*.

During FY 2012, FHFA also published several research papers, staff working papers, and mortgage market notes aimed at improving the public's understanding of mortgages, mortgage markets and the nation's housing financial system. These various publications cover topics related to the economic environment and complement FHFA's supervision of the housing GSEs. These publications include:

- *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2010 and 2011 http://www.fhfa.gov/webfiles/24558/rp_sf_guarantee_fees_2010_2011.pdf*;
- *FHFA Technical Analysis of Principal Forgiveness http://www.fhfa.gov/webfiles/24557/rp_technicalanalysisprincipalforgive.pdf*;

- *Countercyclical Capital Regime: A Proposed Design and Empirical Evaluation* http://www.fhfa.gov/webfiles/24538/countercyclicalcapitalregime122.pdf;
- *House Price Indexes for Homes in Different Price Tiers: Biases and Corrections* http://www.fhfa.gov/webfiles/24272/FHFA_Working_Paper_12-1.pdf;
- *20 Year vs. 30 Year Refinance Option* http://www.fhfa.gov/webfiles/24521/FHFA_Mortgage_Market_Note_12-2.pdf; and
- *A Primer on Price Discount of REO Properties* http://www.fhfa.gov/webfiles/24490/FHFA_Mortgage_Market_Note_12-1.pdf.

In June 2012, FHFA delivered its *2011 Annual Report to Congress* and published the report on its website (http://www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_14_508.pdf). The report includes the conclusions and findings of the agency's annual examination of the Enterprises and the FHLBanks.

In 2012, FHFA leaders testified at various congressional hearings, met and briefed Congress on current FHFA issues, provided technical assistance to members of Congress on proposed legislation, gave presentations at industry functions, and responded to inquiries from members of Congress on a variety of issues.

PERFORMANCE GOAL 2.4
FHFA collaborates with other federal agencies and stakeholders to share information concerning mortgage markets, the nation's housing finance system, and regulatory issues.

PERFORMANCE MEASURE 2.4.1 Respond to Ccongressional inquiries within 15 business days.			
	FY 2010	FY 2011	FY 2012
Target	90 percent	85 percent	85 percent
Performance	For FY 2010, FHFA responded to 253 formal congressional inquiries, and FHFA responded to 88 percent of those inquiries within 15 business days.	For FY 2011, 86 percent of the responses to congressional inquiries completed within 15 business days.	During FY 2012, FHFA responded to 246 formal congressional inquiries, and FHFA responded to 88 percent of those inquiries within 15 business days.
Performance Results Key: Goal Fulfillment	Target Not Met	Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 2.4

Communication with other federal agencies and stakeholders is key to FHFA's support of an efficient secondary mortgage market. FHFA provides information on the housing GSEs that includes the risks they face, the economic environment in which they operate, and policy issues facing the agency.

FHFA works with other federal agencies including the U.S. Department of Housing and Urban Development, the U.S. Department of the Treasury and the Federal Reserve System, and other stakeholders to share information and discuss issues of common interest to promote an efficient secondary mortgage market. FHFA promotes regular communication among financial regulators and works with the Financial Stability Oversight Council (FSOC) to develop regulatory standards that will improve safety and soundness, promote affordable housing, and ensure an efficient secondary mortgage market.

Congress is a key stakeholder. During FY 2012, FHFA met its goal of responding to congressional inquiries within 15 days. The inquiries tracked are formal inquiries regarding constituent or policy issues. Over the entire fiscal year, FHFA responded to a total of 246 congressional inquiries. Of the 246 inquiries, 216 received a response within 15 business days, which translates into 87.8 percent receiving a response within the target range of 15 business days. The annual average response time was 10 days. FHFA received congressional inquiries on a wide range of topics, including: Principal forgiveness, Home Affordable Refinance Program (HARP), Real Estate Owned (REO) bulk sales pilot, executive compensation at the Enterprises, constituent inquiries regarding their mortgages, Property Assessed Clean Energy (PACE) loans, Enterprise attorney networks, minority and women inclusion, Freddie Mac investments, and the proposed qualified residential mortgage regulation.

FHFA staff is also in continuous communication with relevant congressional staff on an informal basis. FHFA also provided outreach through meetings with industry stakeholders on mortgage market developments, policy positions, and activities of the agency that serve to develop an improved understanding of the financial condition of the housing GSEs. FHFA met with key organizations and associations in the housing industry regarding *A Strategic Plan for Enterprise Conservatorships*.

Strategic Goal 3

STRATEGIC GOAL 3	FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.

The conservatorships of Fannie Mae and Freddie Mac allow FHFA to preserve the assets of the Enterprises, ensure they focus on their housing mission and remediate operational and risk management shortcomings. As conservator, FHFA seeks to strengthen the Enterprises financial condition, minimize losses, and strive for operations, controls and risk management that meet or exceed industry standards. FHFA will continue to promulgate regulations mandated by HERA and to strengthen the Enterprises' safety and soundness.

FHFA has also directed Fannie Mae and Freddie Mac to pursue appropriate foreclosure mitigation activities, including loan modifications in a way intended to conserve the Enterprises' assets while providing foreclosure alternatives to eligible distressed borrowers. FHFA will continue to closely monitor market conditions, guide the Enterprises' activities and decisions, and work to improve their operations to ensure they are safe and sound and promote liquidity and stability in the housing market.

PERFORMANCE GOAL 3.1
Preserve and conserve each Enterprise's assets and property.

PERFORMANCE MEASURE 3.1.1
Each Enterprise submits an acceptable asset disposition plan for assets identified by FHFA.

	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	September 30, 2011	September 30, 2012
Performance		The plans the Enterprises submitted to FHFA in 2011 did not meet the requirements and were unacceptable.	Both of the Enterprises submitted acceptable asset disposition plans to FHFA during FY 2012.
Performance Results Key: Goal Fulfillment		Target Not Met	Target Met

PERFORMANCE MEASURE 3.1.2
Complete quarterly review of both Enterprises assets, partnerships, contracts and litigation activities.

	FY 2010	FY 2011	FY 2012
Target	Quarterly, beginning December 31, 2009	100% Quarterly	100% Quarterly
Performance	FHFA received Fannie Mae's inventory on July 13, 2010, and Freddie Mac's inventory on July 16, 2010.	Neither Enterprise submitted inventories on time.	Both Enterprises submitted all their quarterly inventories on time, allowing FHFA to conduct and complete its review of the Enterprises' submissions relative to assets, partnerships, contracts, and litigation activities.
Performance Results Key: Goal Fulfillment	Target Not Met	Target Not Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 3.1

FHFA placed both Fannie Mae and Freddie Mac in conservatorship in 2008 to preserve and conserve their assets and put both entities in a sound and solvent condition. During FY 2012, FHFA worked with the Enterprises to ensure they took important steps in asset disposition. The Senior Preferred Stock Purchase Agreement (SPSPA) required both Enterprises to reduce their retained mortgage portfolios by 10 percent from the previous year's maximum allowed portfolio level by December 31, 2011(see page 31 in the MD&A Section for SPSPA description). On December 31, 2011, both Enterprises were in compliance with this requirement. In addition, each quarter of the year, the Enterprises submitted quarterly asset inventories to FHFA. During the second quarter, Fannie Mae submitted an asset disposition plan through the Financial Activities Review (FAR) process. Furthermore, as part of FHFA's REO Initiative targeted to the hardest-hit metropolitan areas, which was announced in August of 2011, both Enterprises submitted acceptable plans to FHFA regarding REO disposition.

During FY 2012, FHFA reviewed non-core assets for feasibility of sale or liquidation, consistent with minimizing taxpayer's losses and the portfolio shrinkage required by the SPSPA with the U.S. Department of Treasury. FHFA reviewed the quarterly asset inventory submissions, the GSEs' non-mission activity reports, and the detail of specific accounts. We coordinated within FHFA to begin the process for automated submission of certain information from the asset inventory report. As part of the review, FHFA performed a comparison between quarters identifying any unusual activities and changes among accounts along with litigation trends (if any), new claims, dissolutions or new partnerships. The challenges faced include identifying assets and other items in the asset inventory submission in sufficient detail to make meaningful quarter to quarter comparisons. FHFA will continue to monitor developments in the markets and work to stabilize each Enterprise.

OVERVIEW OF PERFORMANCE GOAL 3.2

As conservator, FHFA has delegated operational and other duties to the Enterprises' directors and officers. FHFA manages all conservator requests received through the *FHFA Conservator Decision* email box, which are brought to the Conservator Governance Committee (CGC) and then assigned to a lead office for resolution within 15 calendar days of receipt of the request.

FHFA met this performance measure target for each quarter during FY 2012, assigning within 15 calendar days a lead office for resolution of all conservatorship requests. FHFA ensures the decision making process is timely and appropriately coordinated throughout the agency.

PERFORMANCE GOAL 3.3 Ensure the Enterprises have effective programs that respond to problems in mortgage markets by reducing preventable foreclosures.			
PERFORMANCE MEASURE 3.3.1 **Prevent current loans from going delinquent by helping borrowers to refinance.**			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	New Measure for 2012	Maintain the volume of HARP refinances as a percent of total refinances at 10% or higher
Performance			The Volume of HARP refinances as a percent of total refinances during FY 2012 (through August 31, the most recent data available) was approximately 18%.
Performance Results Key: Goal Fulfillment			Target Met

PERFORMANCE MEASURE 3.3.2 Maintain the percentage of modified loans that are 60- plus days delinquent, nine months after modification, at or below 20%.			
	FY 2010	FY 2011	FY 2012
Target	35 percent or less	35 percent or less	Less than or equal to 20 percent
Performance	Less than 35 percent of modified loans were 60-plus days delinquent after modification in three of the four quarters. During one quarter, the percentage of modified loans 60-plus days delinquent was 35 percent.	Approximately 16 percent of modified loans were 60-plus days delinquent six months after completion of a loan modification.	Approximately 13 percent of modified loans were 60-plus days delinquent nine months after modification in four out of the four quarters.
Performance Results Key: Goal Fulfillment	Target Met	Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 3.3

Performance measure 3.3.1 is an indicator of the ability of current borrowers with high loan-to-value loans to obtain refinances, which may prevent delinquency at a later date. During FY 2012, FHFA tracked the Enterprises' efforts to prevent avoidable foreclosures through a variety of mechanisms including loan modifications, refinances and short sales. This information was reported publicly in a monthly foreclosure prevention report. HARP, one of the refinance programs, accounted for 17.9 percent of total loan refinances between October 1, 2011 and August 31, 2012.

FHFA exceeded the annual target of having less than or equal to 20 percent of modified loans that are 60- plus days delinquent, nine months after modification. For loans modified between July 1, 2011 and September 30, 2011, 13 percent were 60-plus days delinquent nine months after completion of a loan modification. FHFA continues to work with the Enterprises and mortgage servicers to implement a Servicing Alignment Initiative to standardize their approaches to loss mitigation and foreclosure prevention. However, high levels of unemployment and underemployment and the decline of house prices continue to affect the ability and willingness of some borrowers to pay their mortgages.

PERFORMANCE GOAL 3.4

Work with the Administration and Congress to develop an effective structure for the Enterprises to emerge from conservatorship.

PERFORMANCE MEASURE 3.4.1
Provide technical assistance to Congress and the Administration on various future structures for the secondary mortgage market and for post-conservatorship outcomes for the Enterprises.

	FY 2010	FY 2011	FY 2012
Target	Ongoing	Participate in interagency meetings at least Quarterly	Develop and disseminate a strategic plan prescribing the next phase of the conservatorships for Fannie Mae and Freddie Mac.
Performance	FHFA provided technical assistance to the Administration and Congress regarding the secondary mortgage market and post conservatorship outcomes for the Enterprises through congressional testimony, full participation in the President's Working Group on Financial Markets, and meetings with key representative to explore topics related to overall housing policy.	FHFA provided technical assistance to the Administration and Congress through participation in meetings where options related to the future of the secondary mortgage market and post conservatorship outcomes for the Enterprises were discussed.	FHFA published a strategic plan for the Conservatorships on February 21, 2012 and provided technical assistance to the Administration and Congress through participation in meetings and speeches on the secondary mortgage market and post- conservatorship outcomes. In addition, FHFA participated in interagency meetings on Dodd-Frank, including risk retention, Strategically Important Financial Institutions (SIFI's), and Strategically Important Financial Market Utilities (SIFMU's).
Performance Results Key: Goal Fulfillment	Target Met	Target Met	Target Met

PERFORMANCE MEASURE 3.4.2
Discuss the progress regarding the objectives outlined in the Conservatorship Scorecard with each Enterprise.

	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	New Measure for 2012	Quarterly
Performance			During FY 2012, FHFA held meetings with Fannie Mae and Freddie Mac to review the progress made on the Conservatorship Scorecard goals. Assessments are reviewed quarterly. Each goal has an FHFA owner who provides input on their assessment of Fannie Mae's and Freddie Mac's achievements and obstacles.
Performance Results Key: Goal Fulfillment			Target Met

OVERVIEW OF PERFORMANCE GOAL 3.4

During FY 2012, FHFA provided technical assistance to Congress on a variety of legislative measures to address the future of secondary mortgage markets and mortgage securities markets. FHFA published *A Strategic Plan for Enterprise Conservatorships* detailing the agency's plans, and later published a Conservatorship Scorecard describing specific projects for the Enterprises to work on and accomplish in order for the Plan to be implemented.

Many of the items on the Scorecard require Freddie Mac and Fannie Mae to work together in order to achieve success. These projects focused on: (1) building a new infrastructure for the secondary mortgage market; (2) gradually contracting the Enterprises' dominant position in the marketplace while simplifying and shrinking their operations; and (3) maintaining foreclosure prevention activities and credit availability for new and refinanced mortgages.

Resource Management Strategy

RESOURCE MANAGEMENT STRATEGY	FHFA has the personnel, resources, and infrastructure to manage effectively and efficiently to achieve its mission and goals.

FHFA approaches the resources management strategy by ensuring that the agency is addressing its administrative and workforce needs including information technologies and systems, and financial and human resources programs and processes. FHFA management is successful with the integration of strategic planning efforts into everyday operations. Significant progress has been made with the implementation of new training programs for employees, upgrading information technology systems, updating infrastructure, and implementing a new strategic plan to provide a focus and direction for the next five years.

PERFORMANCE GOAL 4.1 FHFA has a diverse workforce that is highly skilled, highly motivated and results oriented.			
PERFORMANCE MEASURE 4.1.1 **Improve FHFA Employee Viewpoint Survey (EVS) results in the area of "Communication.**			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	Improvement over previous year's results	Improvement over previous year's results
Performance		FHFA increased scores in 6 of 10 questions in the area of communication.	FHFA increased scores in 6 of 10 questions in the area of communication.
Performance Results Key: Goal Fulfillment		Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 4.1

FHFA's workforce continues to be its most valuable resource. In accordance with Title 5, Code of Federal Regulations (CFR), part 250, federal agencies are required to annually survey employees. The Federal Employee Viewpoint Survey (FEVS) is administered each year by the Office of Personnel Management (OPM), and is a tool used to measure employees' feelings and perceptions in topic areas such as Talent, Leadership and Knowledge Management, Performance Culture, and Job Satisfaction. The ultimate goal of the survey is to provide agencies with information to build on identified strengths and focus on areas requiring additional attention, based on survey results. OPM is responsible for calculating and preparing survey result reports for each federal agency, based on the number of participating employees and the number of responses received. Agencies are responsible for analyzing and interpreting the results and using them to inform human capital management policies, programs, and initiatives.

The annual FEVS results in the area of communication indicates FHFA increased scores in six of the ten communication related questions. Based on the survey results and subsequent comparison, FHFA fully met the fiscal year 2012 measure to improve FHFA FEVS results in the area of "Communication" over fiscal year 2011 results.

PERFORMANCE GOAL 4.2 FHFA demonstrates a strong commitment to equal employment opportunity that supports diversity in employment, operations and the contracting of services.			
PERFORMANCE MEASURE 4.2.1 Number and variation of targeted outreach events designed to provide information and education to qualified candidates and facilitate increased employment applications and inquiries by women and minority candidates.			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	10 Annually	10 Annually
Performance		FHFA participated in 10 conference events and career fairs with minority and women groups during FY 2011.	FHFA participated in 17 conference events and career fairs with minority and women groups during FY 2012.
Performance Results Key: Goal Fulfillment		Target Met	Target Met
PERFORMANCE MEASURE 4.2.2 Percentage or number of contracts that are executed with minority-owned and women-owned businesses above 2011 levels.			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	Establish baseline and set a stretch goal	Increase from prior year as included in the *2011 Annual Report to Congress*
Performance		FHFA analyzed past and existing contracts to determine its spending on contracts with minority-owned, women-owned, and disabled- person–owned businesses. A baseline amount and goal were established.	FHFA increased the number of contracts executed by 122 percent from prior year results during FY 2012.
Performance Results Key: Goal Fulfillment		Target Met	Target Met

OVERVIEW OF PERFORMANCE GOAL 4.2

FHFA expanded its efforts to recruit qualified minority and women candidates by leveraging the Agency's resources with those of professional organizations that promote and advocate for minority and women financial services professionals. Measure 4.2.1 was designed to reflect the number of organizations the Agency has worked with as well as an estimate of the number of applications received as a result of these endeavors. FHFA's hiring practices follow merit system principles and OPM regulatory standards in addition to the hiring flexibilities provided to it by law.

During FY 2012, the agency participated in 17 events sponsored by different organizations to recruit qualified minority and women candidates for FHFA. FHFA also met with representatives of several organizations that promote workforce diversity in order to increase their awareness of FHFA and our job opportunities. FHFA also worked directly with the regulated entities during this period to follow up on the results of targeted events and outreach activities. FHFA also supports diversity in the contracting of services by encouraging the use of small business, veteran-owned small business, service-disabled veteran-owned small business, Historically Underutilized Business Zone (HUBZone) small business, small disadvantaged business, and women-owned small business concerns in its acquisition of goods and services, whether as contractors or subcontractors.

During FY 2012 FHFA sought partnerships, alliances, and agreements with organizations in order to enhance its ability to include and utilize minorities, women, disabled individuals and minority-owned, women-owned, and disabled-owned businesses when contracting for goods and services. FHFA has experienced a positive increase in contracting actions with minority- and women-owned businesses (MWOBs) in FY 2012. The number of transactions increased from 63 in FY 2011 to 140 in FY 2012. The 140 contracting actions represent $7.3 million dollars of business with minority- and women-owned firms and represent approximately 21 percent of the total dollars obligated during FY 2012.

PERFORMANCE GOAL 4.3 FHFA has effective financial and risk management programs.			
PERFORMANCE MEASURE 4.3.1 **Percentage of FHFA's external audits and reviews that receive unqualified opinions with no material weaknesses or unacceptable risks.**			
	FY 2010	FY 2011	FY 2012
Target	100 percent	100 percent	100 percent
Performance	In FY 2010, all external audits and reviews had unqualified opinions with no material weaknesses.	In FY 2011, all external audits and reviews had unqualified opinions with no material weaknesses or unacceptable risks.	In FY 2012, all external audits and reviews had unqualified opinions with no material weaknesses or unacceptable risks.
Performance Results Key: Goal Fulfillment	**Target Met**	**Target Met**	**Target Met**

PERFORMANCE MEASURE 4.3.2 **Ensure management completes corrective action on OIG findings within agreed timeframe.**			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	New Measure for 2012	No overdue corrective actions outstanding
Performance			In FY 2012, 49 of 50 corrective actions were completed and closed on time. One recommendation was originally closed by FHFA in the 4th quarter and then re-opened per agreement with the OIG.
Performance Results Key: Goal Fulfillment			**Target Not Met**

OVERVIEW OF PERFORMANCE GOAL 4.3

To ensure resources are managed effectively and efficiently, FHFA 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. FHFA must continue to maintain a strong internal control and risk management program. This includes financial management, information security and other management and operating processes.

During FY 2012, FHFA supported GAO's FY 2012 audit of FHFA's financial statements and revised agency policies and procedures, ensuring that resources were effectively and efficiently used to achieve agency strategic and performance goals. FHFA cooperated with the OIG, GAO and external auditors to conduct internal reviews of agency activities and respond to all audit findings and recommendations to improve agency operations.

FHFA did not meet Performance Goal 4.3.2 because one recommendation that was originally closed in the 4th quarter of fiscal year 2012 was re-opened per agreement with the OIG. FHFA completed 49 of 50 corrective actions on time during fiscal year 2012. The timeline for the one outstanding corrective action was extended to February 2013 since the recommendations that were identified would require actions beyond FY 2012.

PERFORMANCE GOAL 4.4 FHFA has the information technology and physical infrastructure needed to achieve its mission and goals.			
PERFORMANCE MEASURE 4.4.1 Percentage of incidents responded to by Help Desk personnel within 15 business minutes.			
	FY 2010	FY 2011	FY 2012
Target	New Measure for 2012	80 percent or more	80 percent or more Quarterly
Performance		Help Desk personnel responded to more than 80 percent of requests within 15 minutes each quarter of FY 2011.	Help Desk personnel responded to more than 93 percent of requests within 15 minutes each quarter of FY 2012.
Performance Results Key: Goal Fulfillment		**Target Met**	**Target Met**

OVERVIEW OF PERFORMANCE GOAL 4.4

FHFA's supervision of the housing GSEs is highly dependent upon the strategic use of technology. FHFA effectively uses IT to provide independent analysis of safety and soundness issues to accomplish FHFA's mission.

During FY 2012, 93 percent of Help Desk requests were responded to within 15 minutes. FHFA closely monitors Help Desk trouble tickets to ensure expectations are met for customers. The consolidation of users and Help Desk resources from three buildings into one facility helped with workload management and dispatching logistical support.

FHFA links IT initiatives to the annual performance budget which supports the agency in achieving its long term goals. FHFA will continue to ensure maximum availability of FHFA information resources, and continue to enhance the security, reliability and capacity of FHFA's IT infrastructure, consistent with the Federal Information Security Management Act, Federal Information Processing Standards, National Institute of Science and Technology special publications, and annual reviews and updates of common controls and continuous monitoring.

Financial Section

Message from the Chief Financial Officer

I am pleased to present the FY 2012 financial statements for the Federal Housing Finance Agency as an important component of the agency's 2012 Performance and Accountability Report (PAR). Once again, FHFA received an unqualified audit opinion on its financial statements from the Government Accountability Office (GAO). In its financial statements audit report, GAO concluded that 1) FHFA's FY 2012 financial statements are fairly presented in all material respects; 2) FHFA had effective internal control over financial reporting; and 3) there were no reportable instances of noncompliance with the laws and regulations it tested.

In addition to a clean audit opinion, FHFA received the Certificate for Excellence in Accountability Reporting (CEAR) award for its FY 2011 PAR from the Association of Government Accountants, the fourth straight year since its inception as a new agency that FHFA has received this prestigious award. The CEAR award is given to government agencies that received unqualified audit opinions on their financial statements and produced PARs that achieved the highest standards in communicating results and demonstrating accountability.

This year's PAR represents the last reporting year on FHFA's 2009-2014 Strategic Plan. FHFA developed a new Strategic Plan for the years 2013-2017 that will guide the agency's future activities and serve as the basis for performance reporting for next year's PAR. The new Strategic Plan continues to maintain the agency's focus on its core responsibilities for regulating the housing GSEs and managing the conservatorships of the Enterprises. In addition, the new plan incorporates all of the key elements contained in the Strategic Plan for Enterprise Conservatorships that was released by the agency to the public in February 2012.

Finally, the commitment of senior management and staff to maintain effective programs of internal control over agency activities and financial reporting provides the solid foundation necessary for managing and monitoring the effective and efficient use of FHFA resources.

Sincerely,

Mark Kinsey

MARK KINSEY
Chief Financial Officer
November 15, 2012

Independent Auditor's Report

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

Independent Auditor's Report

To the Acting Director of the Federal Housing Finance Agency

In accordance with the Housing and Economic Recovery Act of 2008 (HERA), we are responsible for conducting annual audits of the financial statements of the Federal Housing Finance Agency (FHFA). In our audits of FHFA's fiscal years 2012 and 2011 financial statements, we found

- the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- FHFA maintained, in all material respects, effective internal control over financial reporting as of September 30, 2012; and
- no reportable noncompliance in fiscal year 2012 with provisions of laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) required supplementary information and other information included with the financial statements; (3) our audit objectives, scope, and methodology; and (4) FHFA's comments on a draft of this report.

Opinion on Financial Statements

FHFA's financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, its assets, liabilities, and net position as of September 30, 2012 and 2011, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended.

As discussed in note 1A of the financial statements, FHFA's fiscal years 2012 and 2011 financial statements do not include the assets, liabilities, and activities associated with Fannie Mae and Freddie Mac. In early September 2008, less than 2 months after FHFA's establishment, the then-Director of FHFA placed Fannie Mae and Freddie Mac into conservatorship under the authority of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by HERA. FHFA's goal in placing the two entities into conservatorship was to stabilize them with the objective of maintaining normal business operations and restoring safety and soundness. From early September 2008 through September 30, 2012, about $188 billion in direct financial support from the Department of the Treasury (Treasury) has been provided to Fannie Mae and Freddie Mac. Shortly after Fannie Mae and Freddie Mac were placed in conservatorship, the Office of Management and Budget (OMB) and Treasury determined that the assets, liabilities, and activities of these entities would not be included in the consolidated financial statements of the federal government or those of Treasury, although Treasury records an asset for its investment in Fannie Mae and Freddie Mac and a liability for future payments to the two entities in its financial statements. In making this determination, OMB and Treasury concluded that because the entities were not listed in the "Federal Programs by Agency and Account" section of the federal government's budget and because the nature of the conservatorships and the federal government's ownership and control were considered to be temporary, the entities did not meet the conclusive or indicative criteria for inclusion in the consolidated federal government's or Treasury's financial statements.[1] OMB reaffirmed this conclusion with respect to fiscal years 2009 through 2012. FHFA management concurred with this conclusion. Consequently, FHFA did not include the assets, liabilities, and activities of Fannie Mae and Freddie Mac in its fiscal years 2012 and 2011 financial statements. Should circumstances change, such as the inclusion of Fannie Mae and Freddie Mac in the federal budget, this decision would need to be revisited.

Opinion on Internal Control

FHFA maintained, in all material respects, effective internal control over financial reporting as of September 30, 2012, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis. Our opinion on internal control is based on criteria established under 31 U.S.C. § 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

During fiscal year 2012, FHFA made progress but did not yet complete all actions necessary to fully resolve internal control deficiencies related to accounting and monitoring procedures, access controls, and information security management that we identified in our prior audits. During our fiscal year 2012 audit, we also identified additional deficiencies in accounting procedures and controls over FHFA's information security. We do not consider the remaining deficiencies from our fiscal years 2009, 2010, and 2011 financial audits, and those found during our fiscal year 2012 audit, individually or in the aggregate, to constitute material weaknesses or significant deficiencies.[2] We have communicated these matters to management and, where appropriate, will report on them separately.

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[1] The conclusive and indicative criteria used in deciding what to include as part of a financial reporting entity is included in the Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

[2] A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

Compliance with Laws and Regulations

Our tests of FHFA's compliance with selected provisions of laws and regulations for fiscal year 2012 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. The objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Required Supplementary Information

U.S. generally accepted accounting principles require that required supplementary information (RSI) be presented to supplement the financial statements.[3] This information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board (FASAB), who considers it to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

FHFA's other information[4] contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or required supplementary information. Our audit was conducted for the purpose of forming an opinion on FHFA's financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

Objectives, Scope, and Methodology

FHFA management is responsible for (1) preparing the financial statements in conformity with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with the prescribed guidelines in U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness; and (5) complying with applicable laws and regulations. FHFA management evaluated the effectiveness of FHFA's internal control over financial reporting as of September 30, 2012, based on the criteria established under FMFIA. FHFA management's assertion based on its evaluation is included in appendix I.

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[3]RSI comprises Management's Discussion and Analysis and the Statement of Budgetary Resources that is included with the financial statements.
[4]Other information comprises information included with the financial statements, other than RSI and the auditor's report.

We are responsible for planning and performing the audit to obtain reasonable assurance and provide our opinion about whether (1) FHFA's financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, and (2) FHFA management maintained, in all material respects, effective internal control over financial reporting as of September 30, 2012. We are also responsible for (1) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and (2) applying certain limited procedures to the RSI and other information included with the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in FHFA's financial statements;
- assessed the accounting principles used and significant estimates made by FHFA management;
- evaluated the overall presentation of FHFA's financial statements;
- obtained an understanding of FHFA and its operations, including its internal control over financial reporting;
- considered FHFA's process for evaluating and reporting on internal control over financial reporting that FHFA is required to perform by FMFIA;
- assessed the risk of (1) material misstatement in FHFA's financial statements and (2) material weakness in its internal control over financial reporting;
- evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;
- tested relevant internal control over FHFA's financial reporting;
- tested compliance with selected provisions of the following laws and their related regulations: 31 U.S.C. § 3902 (a), (b), (f) – Interest penalties under the Prompt Payment Act; 31 U.S.C. § 3904 – Limitations on Discount Payments Under the Prompt Payment Act; Presidential Memorandum on Freezing Federal Employee Pay Schedules and Rates That Are Set by Administrative Discretion, 75 Fed. Reg. 81829 (Dec. 29, 2010); Federal Employees' Retirement System Act of 1986, as amended; Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. No. 111-312, tit. VI, 124 Stat, 3296, 3309 (Dec. 17, 2010) (*reprinted in* 26 U.S.C. 1401 note); Temporary Payroll Tax Cut Continuation Act of 2011, Pub. L. No. 112-78, tit. I, 125 Stat. 1280, 1281-82 (Dec. 23, 2011) (*reprinted in* 26 U.S.C. 1401 note); Middle Class Tax Relief and Job Creation Act of 2012, Pub. L. No. 112-96, tit. I, 126 Stat. 156, 158-59 (Feb. 22, 2012) (*reprinted in* 26 U.S.C. 1401 note); Social Security Act of 1935, as amended; Federal Employees Health Benefits Act of 1959, as amended; 12 U.S.C. § 4515 – Personnel; Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Housing and Economic Recovery Act of 2008; 12 U.S.C. § 4517(h) – Appointment of accountants, economists, and examiners; and 12 C.F.R. Part 1206 – Assessments;
- conducted inquiries of management about the methods of preparing the RSI and compared this information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we

obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures;

- read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements; and
- performed such other procedures as we considered necessary in the circumstances.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal control relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting and may not be sufficient for other purposes. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness. Because of inherent limitations, internal control may not prevent or detect and correct misstatements due to error or fraud, losses, or noncompliance. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We did not test compliance with all laws and regulations applicable to FHFA. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements for fiscal year 2012. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe our audit provides a reasonable basis for our opinions and other conclusions.

Agency Comments

In commenting on a draft of this report, the acting Director of FHFA stated that he accepted the audit findings and commented that the agency would continue to work to enhance its internal controls and ensure the reliability of its financial reporting, its soundness of operations, and public confidence in its mission.

The complete text of FHFA's comments is reprinted in appendix II.

J. Lawrence Malenich
Director
Financial Management and Assurance

November 8, 2012

Appendix I:
Management's Report on Internal Control Over Financial Reporting

Federal Housing Finance Agency
Constitution Center
400 7th Street, S.W.
Washington, D.C. 20024
Telephone: (202) 649-3800
Facsimile: (202) 649-1071
www.fhfa.gov

Management's Report on Internal Control over Financial Reporting

The Federal Housing Finance Agency's (FHFA) internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

FHFA management is responsible for establishing and maintaining effective internal control over financial reporting. FHFA management evaluated the effectiveness of the agency's internal control over financial reporting as of September 30, 2012, based on the criteria established under 31 U.S.C. sec. 3512 (c), (d) (commonly known as the Federal Managers' Financial Integrity Act).

Based on that evaluation, we concluded that, as of September 30, 2012, FHFA's internal control over financial reporting was effective.

Federal Housing Finance Agency

Edward J. DeMarco
Acting Director

Mark A. Kinsey
Chief Financial Officer

November 8, 2012

Appendix II: FHFA's Response to Auditor's Report

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

November 8, 2012

Mr. J. Lawrence Malenich
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Malenich:

Thank you for the opportunity to respond to the Government Accountability Office's (GAO) draft audit report titled, Financial Audit: Federal Housing Finance Agency's Fiscal Years 2012 and 2011 Financial Statements (GAO-13-124R). This report presents GAO's opinion on the fiscal years 2012 and 2011 financial statements of the Federal Housing Finance Agency (FHFA). The report also presents GAO's opinion on the effectiveness of FHFA's internal controls as of September 30, 2012 and GAO's evaluation of FHFA's compliance with laws and regulations.

I am pleased to accept GAO's unqualified opinion on the FHFA financial statements and to note that there were no material weaknesses or significant deficiencies identified during the fiscal year 2012 audit. The GAO reported that: the statements and notes were presented fairly, in all material respects; FHFA had effective internal controls over financial reporting; and there were no reportable instances of noncompliance with laws and regulations tested by GAO.

FHFA will continue to work to enhance our internal controls and ensure the reliability of our financial reporting, soundness of operations, and public confidence in the agency's mission. We appreciate your support of these efforts. In addition, we would like to acknowledge the dedicated GAO staff that worked with FHFA to meet the reporting deadline for our audited financial statements and notes.

If you have any questions relating to our response, please contact Mark Kinsey, Chief Financial Officer, at (202) 649-3780.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
Acting, Director

400 7th Street, S.W., Washington, D.C. 20024 • 202-649-3801 • 202-649-1071 (fax)

FEDERAL HOUSING FINANCE AGENCY

CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 30, 2012 AND 2011

(In Thousands)

Assets:		
Intragovernmental		
Fund Balance With Treasury - Note 2		$ 16,445
Investments - Note 3		78,252
Accounts Receivable - Note 4		19
Total Intragovernmental		94,716
Accounts Receivable, Net - Note 4		5
Property, Equipment, and Software, Net - Note 5		5,569
Prepaid Expenses		491
Liabilities:		
Intragovernmental		
Accounts Payable		$ 1,221
Other Intragovernmental Liabilities - Note 7		1,219
Total Intragovernmental		2,440
Accounts Payable		6,601
Other Liabilities - Note 7		15,309
Total Liabilities		24,350
Net Position:		
Cumulative Results of Operations		76,431
Total Net Position		$ 76,431

The accompanying notes are an integral part of these financial statements.

FEDERAL HOUSING FINANCE AGENCY

CONSOLIDATED STATEMENTS OF NET COST

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

(In Thousands)

	2012	2011
Program Costs by Strategic Goal:		
Safety and Soundness:		
Gross Costs	$ 153,621	$ 125,961
Less: Earned Revenue	(124,731)	(135,297)
Net Safety and Soundness (Income from)/Cost of Operations	**$ 28,890**	**$ (9,336)**
Affordable Housing:		
Gross Costs	$ 24,919	$ 17,240
Less: Earned Revenue	(64,607)	(38,054)
Net Affordable Housing (Income from)/Cost of Operations	**$ (39,688)**	**$ (20,814)**
Conservatorship:		
Gross Costs	$ 38,961	$ 24,200
Less: Earned Revenue	(36,595)	(27,432)
Net Conservatorship (Income from)/Cost of Operations	**$ 2,366**	**$ (3,232)**
Total Gross Program Costs	$ 217,501	$ 167,401
Less:Total Earned Revenue	(225,933)	(200,783)
Net (Income from)/Cost of Operations	**$ (8,432)**	**$ (33,382)**

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

(In Thousands)

Cumulative Results of Operations:		
Beginning Balance	$ 76,431	$ 37,856
Budgetary Financing Sources:		
Imputed Financing Sources	5,810	5,193
Total Financing Sources	5,810	5,193
Net Income From Operations	8,432	33,382
Net Change	14,242	38,575
Cumulative Results of Operations	$ 90,673	$ 76,431

The accompanying notes are an integral part of these financial statements.

COMBINED STATEMENTS OF BUDGETARY RESOURCES

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

(In Thousands)

Budgetary Resources:		
Unobligated Balance Brought Forward, October 1		$ 22,743
Recoveries of Prior Year Unpaid Obligations		1,033
Unobligated Balance From Prior Year Budget Authority, Net		23,776
Appropriations		200,689
Spending Authority From Offsetting Collections		29,103
Status of Budgetary Resources:		
Obligations Incurred - Note 11		$ 225,896
Unobligated Balance, End of Year:		
Exempt from Apportionment		27,672
Total Unobligated Balance, End of Year		27,672
Change in Obligated Balance:		
Unpaid Obligations, Brought Forward, October 1		$ 29,135
Uncollected Customer Payments From Federal Sources, Brought Forward, October 1		–
Obligated Balance, Start of Year		29,135
Obligations Incurred		225,896
Outlays (Gross)		(186,945)
Change in Uncollected Customer Payments From Federal Sources		(28)
Recoveries of Prior Year Unpaid Obligations		(1,033)
Obligated Balance, End of Year		
Unpaid Obligations, End of Year (Gross)		67,053
Uncollected Customer Payments From Federal Sources, End of Year		(28)
Budget Authority and Outlays, Net:		
Budget Authority (Gross)		$ 229,792
Actual Offsetting Collections		(29,075)
Change in Uncollected Customer Payments From Federal Sources		(28)
Outlays (Gross)		$ 186,945
Actual Offsetting Collections		(29,075)
Outlays, Net		157,870
Distributed Offsetting Receipts		(200,689)

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Federal Housing Finance Agency (FHFA) was established on July 30, 2008, when the President signed into law the *Housing and Economic Recovery Act of 2008* (HERA). FHFA is an independent agency in the Executive branch empowered with supervisory and regulatory oversight of the twelve Federal Home Loan Banks (FHLBanks), Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), and the Office of Finance, all of which are referred to as Regulated Entities. FHFA is responsible for ensuring that each Regulated Entity operates in a safe and sound manner, including maintenance of adequate capital and internal control, and carries out their housing and community development finance missions.

HERA provided for a FHFA Office of the Inspector General (FHFA-OIG), which has maintained its own Agency Location Code and set of books since April, 2011. The Inspector General Act of 1978, as amended, sets forth the functions and authorities of the FHFA-OIG. The reporting entity for purposes of financial statements includes FHFA and FHFA-OIG.

Under the authority of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by HERA, FHFA placed Fannie Mae and Freddie Mac under conservatorship on September 6, 2008, to stabilize the two entities with the objective of maintaining normal business operations and restoring safety and soundness. FHFA, as Conservator, assumed the power of stockholders, boards, and management. FHFA delegated to Fannie Mae and Freddie Mac certain business and operational authority. FHFA personnel monitor the operations of the enterprises.

In September 2008, after Fannie Mae and Freddie Mac were placed in conservatorship under the FHFA, the Office of Management and Budget (OMB) determined that the assets, liabilities and activities of the companies would not be included in the financial statements of the federal government. For fiscal year 2008, OMB and the Department of the Treasury (Treasury) concluded that Fannie Mae and Freddie Mac did not meet the conclusive or indicative criteria for a federal entity contained in OMB Circular A-136, *Financial Reporting Requirements*, and Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, because they are not listed in the section of the federal government's budget entitled "Federal Programs by Agency and Account," and because the nature of FHFA's conservatorships over Fannie Mae and Freddie Mac and the federal government's ownership and control of the entities is considered to be temporary. Treasury reaffirmed this position for fiscal year 2009, with which FHFA concurs. OMB continued to hold this view in the President's fiscal year 2010, 2011, 2012 and 2013 budget submissions to Congress. Consequently, the assets, liabilities, and activities of Fannie Mae and Freddie Mac have not been consolidated into FHFA's financial statements. However, Treasury records the value of the federal government's investments in Fannie Mae and Freddie Mac in its financial statements as a General Fund asset.

Both Fannie Mae and Freddie Mac, as represented by FHFA as their Conservator, entered into separate agreements with Treasury known as the Senior Preferred Stock Purchase Agreements (Agreements) on September 7, 2008. These two Agreements are identical and have since been amended on September 26, 2008, May 6, 2009, December 24, 2009, and August 17, 2012. The Agreements commit Treasury to provide funding for each Enterprise up to the greater of: (1) $200 billion; or (2) $200 billion plus the cumulative total of draws for each calendar quarter in 2010, 2011 and 2012 minus any amount by which the assets of the Enterprise exceed its liabilities on December 31, 2012. This funding is to ensure that each Enterprise maintains a non-negative Net Worth, thereby avoiding a statutory requirement that an Enterprise be put in receivership following an extended period of negative Net Worth. Under the Agreements, each Enterprise submits a request for any needed draw amount once their financials (to be published in their 10-K or 10-Q) are finalized. The Enterprise also submits a statement certifying compliance with Agreement covenants, which include limits on portfolio size and indebtedness. FHFA, in its role as Conservator, reviews any request for a draw and certifies that the request is available for funding under the Agreement. FHFA then sends a letter to Treasury requesting the draw amount prior to the end of the current quarter.

The August 17, 2012 amendment eliminates the circularity of Treasury funding dividends paid to Treasury. Beginning on January 1, 2013, all future net income/profits above an established threshold will be distributed to Treasury as dividends. The Agreements require each Enterprise to obtain Treasury approval for the disposition of assets, except under certain circumstances. FHFA as Conservator reviews these requests. Draws by Fannie Mae and Freddie Mac on their Agreements with Treasury are summarized below (dollars in billions). These draws are reported in Treasury's financial statements.

ENTERPRISE DRAWS ON TREASURY AGREEMENTS

Quarter	Fannie Mae	Freddie Mac
September 30, 2008	$ –	$ 13.8
December 31, 2008	15.2	30.8
March 31, 2009	19.0	6.1
June 30, 2009	10.7	–
September 30, 2009	15.0	–
December 31, 2009	15.3	–
March 31, 2010	8.4	10.6
June 30, 2010	1.5	1.8
September 30, 2010	2.5	0.1
December 31, 2010	2.6	0.5
March 31, 2011	8.5	–
June 30, 2011	5.1	1.5
September 30, 2011	7.8	6.0
December 31, 2011	4.6	0.1
March 31, 2012	–	–
June 30, 2012	–	–
Cumulative Draws	$ 116.2	$ 71.3

B. Basis of Presentation

FHFA's principal statements were prepared from its official financial records and general ledger in conformity with accounting principles generally accepted in the United States and follow the presentation guidance established by OMB Circular No. 136 "Financial Reporting Requirements," as amended. The statements are a requirement of the Government Management Reform Act of 1994, the Accountability of Tax Dollars Act of 2002, and HERA. These financial statements are in addition to the financial reports prepared by FHFA, pursuant to OMB directives, which are used to monitor and control budgetary resources. As required by HERA, the financial statements of FHFA are audited by the U.S. Government Accountability Office (GAO). The financial statements include the activities and transactions of the FHFA-OIG. The amounts reported in the financial statements are consolidated totals net of intra-entity transactions, except for the Statement of Budgetary Resources (SBR), which is presented on a combined basis. The financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and the status and availability of budgetary resources of FHFA. Unless specified otherwise, all amounts are presented in thousands.

C. Basis of Accounting

Transactions are recorded on both an accrual accounting basis and a budgetary basis. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements and controls over the use of funds. FHFA's financial statements conform to accounting principles generally accepted in the United States for federal entities as prescribed by the standards set forth by the Federal Accounting Standards Advisory Board (FASAB). FASAB is recognized by the American Institute of Certified Public Accountants as the body designated to establish generally accepted accounting principles for federal entities. Certain assets, liabilities, earned revenues, and costs have been classified as intragovernmental throughout the financial statements and notes. Intragovernmental is defined as transactions made between two reporting entities within the federal government.

D. Revenues, Imputed & Other Financing Sources

Operating revenues of FHFA are obtained through assessments of the Regulated Entities. The agency's acting Director approved the annual budget in August 2012 and 2011. By law, FHFA is required to charge semi-annual assessments to the entities. Assessments collected shall not exceed the amount sufficient to provide for the reasonable costs associated with overseeing the entities, plus amounts determined by the acting Director to be necessary for maintaining a working capital fund.

FHFA develops its annual budget using a 'bottom up' approach. Each office within the agency is asked to bifurcate their budget request between the amount of resources needed for the regulation of Fannie Mae and Freddie Mac and the resources needed for the regulation of the twelve FHLBanks. The office requests are then aggregated (with overhead costs distributed proportionately) to determine the total expected costs associated with regulating Fannie Mae and Freddie Mac and the total expected costs associated with regulating the FHLBanks. These two totals, along with any expected collection for the working capital fund, comprise the fiscal year budget for the agency. Additionally, FHFA levied a special assessment for conservatorship activities on Fannie Mae and Freddie Mac during fiscal years 2012 and 2011.

Fannie Mae and Freddie Mac pay a pro rata share of their portion of the total assessment based on the combined assets and off-balance sheet obligations of each enterprise. Each FHLBank's share of their portion of the total assessment is based on the dollar value of its capital stock relative to the combined dollar value of all FHLBanks' capital stock. Assessment letters are sent to the entities 30 days prior to the assessment due dates of October 1st and April 1st. Assessments received prior to due dates are available for investment but are unavailable for obligation. These assessments are recorded as deferred revenue.

Federal government entities often receive goods and services from other federal government entities without reimbursing the providing entity for all the related costs. In addition, federal government entities also incur costs that are paid in total or in part by other entities. An imputed financing source is recognized by the receiving entity for costs that are paid by other entities. FHFA recognized imputed costs and financing sources in fiscal years 2012 and 2011 as prescribed by accounting standards. FHFA recognizes as an imputed financing source the amount of pension and post-retirement benefit expenses for current employees accrued on FHFA's behalf by the Office of Personnel Management (OPM).

E. Use of Estimates

The preparation of the accompanying financial statements in accordance with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Actual results could differ from those estimates.

F. Earmarked Funds

FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 27 "Identifying and Reporting Funds from Dedicated Collections" established certain disclosure requirements for funds defined as "funds from dedicated collections." SFFAS No. 27 states that "funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the Government's general revenues." The standard also presents three required criteria for a fund from dedicated collections. Based on the standard's criteria, FHFA determined that it has no funds from dedicated collections.

G. Fund Balance with Treasury

The U.S. Treasury (Treasury) processes cash receipts and disbursements on FHFA's behalf. Funds held at the Treasury are available to pay agency liabilities and finance authorized purchase obligations. FHFA does not maintain cash in commercial bank accounts or foreign currency balances.

During the year, increases to FHFA's Fund Balance with Treasury are comprised of semi-annual assessments, investment interest, collections on reimbursable agreements, civil penalty monies, and Freedom of Information Act (FOIA) request fees. FHFA is not authorized to retain civil penalty monies or FOIA fees, and as such, records these as custodial liabilities (See Note 15. Incidental Custodial Collections) until transferred to the Treasury General Fund.

HERA provides authority for FHFA to maintain a working capital fund. The working capital fund is defined in FHFA's Assessment Regulation as an account for amounts collected from the Regulated Entities to establish an operating reserve that is intended to provide for the payment of large or multiyear capital and operating expenditures, as well as unanticipated expenses. The balance in the working capital fund is evaluated annually.

H. Investments

FHFA has the authority to invest in U.S. Treasury securities with maturities suitable to FHFA's needs. FHFA invests solely in U.S. Treasury securities, which are normally held to maturity and carried at amortized cost. Investments are adjusted for unamortized premiums or discounts. Premiums and discounts are amortized and interest is accrued using the level-yield, scientific method of effective interest amortization over the term of the respective issues.

I. Accounts Receivable

Accounts receivable consists of amounts owed to FHFA by other federal agencies and the public. Amounts due from federal agencies are considered fully collectible and consist of interagency agreements. Accounts receivable from the public include reimbursements from employees, civil penalty assessments, and FOIA request fees. An allowance for uncollectible accounts receivable from the public is established when either (1) management determines that collection is unlikely to occur after a review of outstanding accounts and the failure of all collection efforts, or (2) an account for which no allowance has been established is submitted to the Department of the Treasury for collection, which takes place when it becomes 180 days delinquent. Based on historical experience, all receivables are collectible and no allowance is provided.

J. Property, Equipment, and Software, Net

Property, Equipment and Software is recorded at historical cost. It consists of tangible assets and software. Based on a review of capitalization policy thresholds of 22 other agencies, FHFA implemented new capitalization thresholds beginning in June 2011. The new capitalization thresholds are being applied prospectively.

Under FHFA's Oversight Procedures for the Identification of Capitalized Assets, revised June 2011, the following are the capitalization thresholds:

Description	Threshold	
Furniture and Equipment	$	50,000
Leasehold Improvements	$	250,000
Software: Internally Developed	$	500,000
Software: Off-the-Shelf	$	200,000
Capitalized Leases	$	250,000
Bulk Purchases	$	250,000

Prior to the revision in June 2011, the capitalization thresholds were as follows:

Description	Threshold	
Furniture and Equipment	$	25,000
Leasehold Improvements	$	25,000
Internal Use Software	$	25,000
Capitalized Leases	$	25,000
Bulk Purchases	$	250,000

Depreciation is calculated using the straight-line method over the estimated useful life of the asset. Applicable standard governmental guidelines regulate the disposal and convertibility of agency property and equipment. The useful life classifications for capitalized assets are as follows:

Description	Useful Life (Years)
Furniture, Fixtures, and Equipment	3
Internal Use Software	3

A leasehold improvement's useful life is equal to the remaining lease term or the estimated useful life of the improvement, whichever is shorter. FHFA has no real property holdings or stewardship or heritage assets. Other property items and normal repairs and maintenance are charged to expense as incurred.

K. Advances and Prepaid Charges

Advance payments are generally prohibited by law. There are some exceptions, such as reimbursable agreements, subscriptions, and payments to contractors and employees. Payments made in advance of the receipt of goods and services are recorded as advances or prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received.

L. Liabilities

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

FHFA reports its liabilities under two categories, Intragovernmental and With the Public. Intragovernmental liabilities represent funds owed to another government agency. Liabilities With the Public represent funds owed to any entity or person that is not a federal agency, including private sector firms and federal employees. Each of these categories may include liabilities that are covered by budgetary resources and liabilities not covered by budgetary resources.

Liabilities covered by budgetary resources are liabilities funded by a current appropriation or other funding source. These consist of accounts payable and accrued payroll and benefits. Accounts payable represent amounts owed to another entity for goods ordered and received and for services rendered except for employees. Accrued payroll and benefits represent payroll costs earned by employees during the fiscal year which are not paid until the next fiscal year. The Department of Labor (DOL) is the central paying agent for all workman compensation claims filed under the Federal Employees Compensation Act (FECA). Accrued FECA represents the amount FHFA is to reimburse DOL for claims paid to FHFA employees.

Liabilities not covered by budgetary resources are liabilities that are not funded by any current appropriation or other funding source. These liabilities consist of accrued annual leave, deferred rent, deferred liability and the amounts due to Treasury for collection and accounts receivable of civil penalties and FOIA request fees. Annual leave is earned throughout the fiscal year and is paid when leave is taken by the employee; the accrued liability for annual leave represents the balance earned but not yet taken. Deferred rent is the difference at year-end between the sum of monthly cash disbursements paid to-date for rent and the sum of the average monthly rent calculated based on the term of the lease. This determination and recording of deferred rent is applicable to the lease agreements on the properties at 400 7th Street Constitution Center and 5080 Spectrum Drive (See Note 8. Leases).

M. Employee Leave and Benefits

All full-time FHFA employees are entitled to accrue sick leave at a rate of four hours per pay period. Annual leave is accrued based on years of creditable federal service and military service, with the following exceptions: Former Office of Federal Housing Enterprise Oversight (OFHEO) employees hired between April 25, 2005 and July 30, 2008 accrue annual leave based on years of creditable federal and military service as well as years of relevant private sector experience (HERA abolished OFHEO when FHFA was established in July 2008). Additionally, FHFA employees hired into mission critical positions, EL-13 and above, after May 2011 accrue annual leave under this same formula. For most employees, annual leave may be accrued up to 240 hours each year. The FHFA executive employees equivalent to the Senior Executive Service (SES) employees may accrue annual leave consistent with the rules for SES level employees. Accrued annual leave is treated as an unfunded expense with an offsetting liability when earned. The accrued liability is reduced when the annual leave is taken. Any unused annual leave balance is paid to the employee upon leaving federal service, based on the employee's earnings per hour. There is no maximum limit on the amount of sick leave that may be accrued. Upon separation, any unused sick leave of Civil Service Retirement System (CSRS) plan employees is creditable as additional time in service for the purpose of calculating an employee's retirement annuity. Credit is given for sick leave balances in the computation of annuities upon the retirement of Federal Employees Retirement System (FERS)-covered employees effective at 50% beginning in fiscal year 2010 and 100% beginning in fiscal year 2014.

Health Benefits and Life Insurance: FHFA, through programs established for all agencies by the federal government, offers its employees health and life insurance coverage through the Federal Employees Health Benefits Program and Federal Employees Group Life Insurance Program. The cost of each is shared by FHFA and its employees. In addition, all employees have 1.45% of gross earnings withheld to pay for future Medicare coverage.

N. Retirement Plans

FHFA employees participate in the retirement plans offered by OPM, which consist of CSRS, CSRS – Offset, or FERS (FERS is provided under calculations for both regular employees as well as law enforcement employees in the Office of the Inspector General). The employees who participate in CSRS are beneficiaries of FHFA's contribution, equal to 7% of pay, distributed to the employee's annuity account in the Civil Service Retirement and Disability Fund. Prior to December 31, 1983, all employees were covered under the CSRS program. From January 1, 1984 through December 31, 1986, employees had the option of remaining under CSRS or joining FERS. As of January 1, 1987, hires to FHFA without previous Federal service are automatically covered under FERS. Both CSRS and FERS employees may participate in the federal Thrift Savings Plan (TSP). FERS employees receive an automatic Agency contribution equal to 1% of pay. Effective July 31, 2010, FERS employees are automatically enrolled in TSP equal to 3% of pay unless they make an election to stop or change the contribution. FHFA matches any FERS employee contribution up to an additional 4% of pay. For FERS participants, FHFA also contributes the employer's matching share of Social Security.

FERS employees and CSRS – Offset employees are eligible to participate in the Social Security program after retirement. In these instances, FHFA remits the employer's share of the required contribution, which is 11.9% for FERS and 7% for CSRS.

FHFA expenses its contributions to the retirement plans of covered employees as the expenses are incurred. FHFA reports imputed (unfunded) costs with respect to retirement plans, health benefits and life insurance pursuant to guidance received from OPM. These costs are paid by OPM and not by FHFA. Disclosure is intended to provide information regarding the full cost of FHFA's program in conformity with generally accepted accounting principles.

FHFA does not report on its financial statements information pertaining to the retirement plans covering its employees. Reporting amounts such as plan assets, accumulated plan benefits, and related unfunded liabilities, if any, is the responsibility of OPM as the administrator.

In addition to the TSP, FHFA offers a supplemental 401(K) plan that is administered by T. Rowe Price. All CSRS employees are eligible to contribute to the 401(K). Only FERS employees contributing at least 3% to the TSP are eligible to participate in the 401(K). All eligible employees that participate may contribute up to 10% of their bi-weekly salary on a pre-tax basis while FHFA will match contributions up to 3% of the employee's salary. Qualified employees may participate in the TSP and/or FHFA's 401(K) Savings Plan, up to the Internal Revenue Code limitations established for salary deferral and annual additions.

O. Contingencies

FHFA recognizes contingent liabilities, in the accompanying balance sheet and statement of net cost, when they are both probable and can be reasonably estimated. FHFA discloses contingent liabilities in the notes to the financial statements when a loss from the outcome of future events is more than remote but less than probable or when the liability is probable but cannot be reasonably estimated.

NOTE 2. FUND BALANCE WITH TREASURY

Fund Balance with Treasury consists of an Operating Fund and a Working Capital Fund. The funds in the Working Capital Fund were fully invested during fiscal years 2012 and 2011. Fund Balance with Treasury (FBWT) account balances as of September 30, 2012 and 2011, were as follows (dollars in thousands):

	2012	2011
Fund Balances:		
Operating Fund	$ (20,998)	$ (16,445)
Total	**$ (20,998)**	**$ (16,445)**
Status of Fund Balance with Treasury:		
Unobligated Balance		
Available	$ 45,535	$ 27,672
Obligated Balance Not Yet Disbursed	52,883	67,025
Investments	(77,420)	(78,252)
Total	**$ 20,998**	**$ 16,445**

(See Note 12. Legal Arrangements Affecting Use of Unobligated Balances)

NOTE 3. INVESTMENTS

Investments as of September 30, 2012 consist of the following (dollars in thousands):

	Cost	Amortized (Premium) Discount	Interest Receivable	Investments Net	Market Value Disclosure
Intragovernmental Securities:					
Non-Marketable					
Market-Based	$ 77,420	$ –	$ –	$ 77,420	$ 77,420

Investments as of September 30, 2011 consist of the following (dollars in thousands):

	Cost	Amortized (Premium) Discount	Interest Receivable	Investments Net	Market Value Disclosure
Intragovernmental Securities:					
Non-Marketable					
Market-Based	$ 78,252	$ –	$ –	$ 78,252	$ 78,252

Non-marketable, market-based securities are Treasury notes and bills issued to governmental accounts that are not traded on any securities exchange, but mirror the prices of marketable securities with similar terms. FHFA is currently investing in one-day certificates issued by the U.S. Treasury. There were no amortized premiums/discounts or interest receivable on investments as of September 30, 2012 or 2011. Interest earned on investments was $57,000 and $66,000 for fiscal years 2012 and 2011, respectively.

NOTE 4. ACCOUNTS RECEIVABLE

Accounts Receivable balances as of September 30, 2012 and 2011, were as follows (dollars in thousands):

	2012	2011
Intragovernmental		
Accounts Receivable	$ –	$ 19
With the Public		
Accounts Receivable	13	5
Total Accounts Receivable	**$ 13**	**$ 24**

There are no amounts that are deemed uncollectible as of September 30, 2012 and 2011.

NOTE 5. PROPERTY, EQUIPMENT, AND SOFTWARE, NET

Schedule of Property, Equipment, and Software as of September 30, 2012 (dollars in thousands):

Major Class	Acquisition Cost	Accumulated Amortization/ Depreciation	Net Book Value
Equipment	24,630	10,980	$ 13,650
Leasehold Improvements	31,708	1,515	30,193
Capital Lease	–	–	–
Internal-Use Software	4,160	3,542	618
Construction-in-Progress	1,067	–	1,067
Total	**$ 61,565**	**$ 16,037**	**$ 45,528**

Schedule of Property, Equipment, and Software as of September 30, 2011 (dollars in thousands):

Major Class	Acquisition Cost	Accumulated Amortization/ Depreciation	Net Book Value
Equipment	13,958	10,874	$ 3,084
Leasehold Improvements	6,974	6,902	72
Capital Lease	22	22	–
Internal-Use Software	30,316	29,286	1,030
Construction-in-Progress	1,383	–	1,383
Total	**$ 52,653**	**$ 47,084**	**$ 5,569**

The leasehold improvement acquisition cost for September 30, 2012 includes a Constitution Center tenant allowance in the amount of $21 million.

NOTE 6. LIABILITIES COVERED AND NOT COVERED BY BUDGETARY RESOURCES

Liabilities Covered and Not Covered By Budgetary Resources as of September 30, 2012 consist of the following (dollars in thousands):

	Covered	Not-Covered	Total
Intragovernmental Liabilities			
Accounts Payable	$ 766	$ –	$ 766
Other Intragovernmental Liabilities	2,727	–	2,727
Total Intragovernmental Liabilities	**$ 3,493**	**$ –**	**$ 3,493**
Accounts Payable	$ 9,728	$ –	$ 9,728
Other Liabilities	6,503	34,402	40,905
Total Public Liabilities	**$ 16,231**	**$ 34,402**	**$ 50,633**
Total Liabilities	**$ 19,724**	**$ 34,402**	**$ 54,126**

Liabilities Covered and Not Covered By Budgetary Resources as of September 30, 2011 consist of the following (dollars in thousands):

	Covered	Not-Covered	Total
Intragovernmental Liabilities			
Accounts Payable	$ 1,221	$ –	$ 1,221
Other Intragovernmental Liabilities	1,216	3	1,219
Total Intragovernmental Liabilities	**$ 2,437**	**$ 3**	**$ 2,440**
Accounts Payable	$ 6,601	$ –	$ 6,601
Other Liabilities	5,809	9,500	15,309
Total Public Liabilities	**$ 12,410**	**$ 9,500**	**$ 21,910**
Total Liabilities	**$ 14,847**	**$ 9,503**	**$ 24,350**

NOTE 7. OTHER LIABILITIES

Current liabilities are amounts owed by a federal entity for which the financial statements are prepared, and which need to be paid within the fiscal year following the reporting date. The other liabilities for FHFA are comprised of FECA liability, unemployment insurance liability, payroll accruals, payroll taxes payable, deferred liabilities and unfunded leave. Payroll accruals represent payroll expenses that were incurred prior to year-end but were not paid. Deferred liabilities represent recording of the deferred rent that is associated with the leased premises at 400 7th Street SW – Constitution Center and at the leased premises at 5080 Spectrum Drive. The deferred liabilities also include the Constitution Center tenant allowance.

Other Liabilities as of September 30, 2012 consist of the following (dollars in thousands):

	Non Current	Current	Total
Intragovernmental Liabilities			
Funded FECA Liability	$ –	$ 11	$ 11
Accrued Funded Payroll	–	36	36
Payroll Taxes Payable	–	1,500	1,500
Advances and Prepayments	–	1,180	1,180
Total Intragovernmental Other Liabilities	**$ –**	**$ 2,727**	**$ 2,727**
With the Public			
Payroll Taxes Payable	$ –	$ 713	$ 713
Accrued Funded Payroll	–	5,790	5,790
Unfunded Leave	10,485	–	10,485
Deferred Lease Liabilities	22,352	1,565	23,917
Total Public Liabilities	**$ 32,837**	**$ 8,068**	**$ 40,905**

Other Liabilities as of September 30, 2011 consist of the following (dollars in thousands):

	Non Current	Current	Total
Intragovernmental Liabilities			
Funded and Unfunded FECA Liability	$ –	$ 3	$ 3
Unemployment Insurance Liability	–	1	1
Payroll Taxes Payable	–	1,215	1,215
Total Intragovernmental Other Liabilities	**$ –**	**$ 1,219**	**$ 1,219**
With the Public			
Payroll Taxes Payable	$ –	$ 624	$ 624
Accrued Funded Payroll	–	5,185	5,185
Unfunded Leave	–	9,500	9,500
Total Public Liabilities	**$ –**	**$ 15,309**	**$ 15,309**

NOTE 8. LEASES

Operating Leases Terminated During Fiscal Year 2012

1700 G Street NW

FHFA had an occupancy lease with the Office of the Comptroller of the Currency (OCC) at 1700 G Street NW, Washington, DC that covered office space and building services, including utilities, security guards, janitorial services, mail delivery, use of the loading dock, garage parking and building operation and maintenance. The initial term of the lease was for five years beginning in 1993, with the option to renew for three 5-year terms with OFHEO. This lease was transferred to FHFA with its creation. FHFA exercised the third of the three option terms. FHFA terminated the lease effective January 31, 2012.

1750 Pennsylvania Avenue NW

FHFA leased office space in Washington, DC at 1750 Pennsylvania Avenue NW. The lease term expired on January 31, 2012.

1625 Eye Street NW – FHFA-OIG Space

FHFA-OIG leased office space at 1625 Eye Street NW. The FHFA-OIG lease terms at 1625 Eye Street NW expired one year after the occupation date, January 24, 2011, with optional renewal periods for up to two years. FHFA-OIG terminated the lease on January 24, 2012.

Current Operating Leases

1625 Eye Street NW – FHFA Space

FHFA leases office space in Washington, DC at 1625 Eye Street NW. The lease terms of 1625 Eye Street expire on June 30, 2015. The lease is non-cancellable. FHFA entered into an Interagency Agreement (IAA) with the Consumer Financial Protection Bureau (CFPB) on March 29, 2012 for the use of certain already-acquired but unused services, supplies and space available on a short-term basis. The IAA includes, but is not limited to, furniture, equipment, IT network infrastructure, and space at 1625 Eye Street, NW. The CFPB took occupancy on April 1, 2012. The IAA expires on June 30, 2015 in conjunction with FHFA's lease expiration. The receipts from CFPB are less than the lease expenditures, thus requiring FHFA to record a loss. Therefore, the loss recognized as of September 30, 2012 is $679 thousand. FHFA will not recognize a loss contingency for the remaining life of the IAA since the agreement is with a federal agency and is deemed collectable.

400 7th Street SW – Constitution Center

FHFA entered into a lease for office space at 400 7th Street SW, Constitution Center, on January 31, 2011. FHFA took occupancy in January 2012. FHFA does not have the right to terminate the lease for the convenience of the government. FHFA may only exercise a one-time early termination at the end of the 10th year, contingent upon FHFA having less than 400 employees in the Washington DC area as of the date that is 20 months prior to the early termination date and representing that it reasonably believes it will have less than 400 employees in the DC area as of the termination date. The lease terms of 400 7th Street SW expire on January 31, 2027.

5080 Spectrum Drive

FHFA entered into a lease for office space at 5080 Spectrum Drive in Addison, Texas on April 23, 2012. FHFA took occupancy on August 16, 2012. FHFA does not have the right to terminate the lease for the convenience of the government. FHFA may only exercise a one-time early termination at the end of the 39th month following the commencement date of the lease. The written termination notice must be provided to the landlord nine months prior to the termination date. The lease terms of 5080 Spectrum Drive expire on July 31, 2017.

The minimum future payments for the 400 7th Street SW, 1625 Eye Street NW, and 5080 Spectrum Drive operating leases are as follows (dollars in thousands):

Fiscal Year	Amount
2013	$ 19,544
2014	19,951
2015	19,362
2016	16,703
2017	16,982
Thereafter	77,557
Total Future Payments	**$ 170,099**

The minimum future receipts for the IAA with CFPB for the 1625 Eye Street NW space are as follows (dollars in thousands):

Fiscal Year	Amount
2013	$ 2,877
2014	2,992
2015	2,319
2016	–
2017	–
Thereafter	–
Total Future Operating Lease Receivables	**$ 8,188**

Additionally, FHFA leases contingency space at an undisclosed location. The lease expires on March 31, 2013.

Total rental payments for the fiscal years ended September 30, 2012 and 2011 were $15.6 million and $6.1 million, respectively.

NOTE 9. COMMITMENTS AND CONTINGENCIES

FHFA did not have any material commitments or contingencies that met disclosure requirements as of September 30, 2012 and 2011.

NOTE 10. PROGRAM COSTS

Pursuant to HERA, FHFA was established to supervise and regulate the fourteen Regulated Entities. The Regulated Entities include Freddie Mac, Fannie Mae and the twelve FHLBanks. FHFA tracks resource allocations and program costs to the strategic goals (responsibility segments) developed for FHFA's strategic plan. Strategic Goals, 1–Safety and Soundness; 2–Affordable Housing; and 3–Conservatorship, guide program offices to carry out FHFA's vision and mission. FHFA has a Resource Management Strategy, which is distributed proportionately to Strategic Goals 1–3 based on the percentage of direct costs of each goal to the total direct costs for FHFA. FHFA-OIG allocated their costs to FHFA's Resource Management Strategy. FHFA's revenue was provided by the Regulated Entities through assessments. FHFA-OIG received their funding through a $38.8 million transfer from FHFA in fiscal year 2012 and a $29 million transfer in fiscal year 2011. FHFA-OIG's total expenses for fiscal years 2012 and 2011 were $36.2 million and $17.3 million, respectively.

Program costs are broken out into two categories—"Intragovernmental" and "With the Public". Intragovernmental costs are costs FHFA incurs through contracting with other federal agencies for goods and/or services, such as rent paid to OCC, payroll processing services received from the Department of Agriculture and imputed financing costs for post-retirement benefits with OPM. With the Public costs are costs FHFA incurs through contracting with the private sector for goods or services, payments for employee salaries, depreciation, annual leave and deferred rent expenses. Revenue is comprised of assessments, investment interest, and miscellaneous revenue. Intragovernmental expenses relate to the source of goods and services purchased by the agency and not to the classification of related revenue. Such costs and revenue are summarized as follows (dollars in thousands):

	2012	2011
Safety and Soundness		
Intragovernmental Costs	$ 31,042	$ 27,364
Public Costs	122,579	98,597
Total Program Costs	153,621	125,961
Less: Intragovernmental Earned Revenue	904	108
Less: Public Earned Revenue	123,827	135,189
Net Safety and Soundness Program (Income)/Costs	**28,890**	**(9,336)**
Affordable Housing		
Intragovernmental Costs	6,059	4,216
Public Costs	18,860	13,024
Total Program Costs	24,919	17,240
Less: Intragovernmental Earned Revenue	468	30
Less: Public Earned Revenue	64,139	38,024
Net Affordable Housing Program (Income)/Costs	**(39,688)**	**(20,814)**
Conservatorship		
Intragovernmental Costs	267	2,683
Public Costs	38,694	21,517
Total Program Costs	38,961	24,200
Less: Intragovernmental Earned Revenue	265	22
Less: Public Earned Revenue	36,330	27,410
Net Conservatorship Program (Income)/Costs	**2,366**	**(3,232)**
Total Intragovernmental costs	37,368	34,263
Total Public costs	180,133	133,138
Total Costs	217,501	167,401
Less: Total Intragovernmental Earned Revenue	1,637	160
Less: Total Public Earned Revenue	224,296	200,623
Total Net (Income)/Cost	**$ (8,432)**	**$ (33,382)**

NOTE 11. APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

All obligations incurred are characterized as Category C, Exempt from apportionment (i.e. not apportioned), on the Statement of Budgetary Resources. Obligations incurred and reported in the Statement of Budgetary Resources in fiscal years 2012 and 2011 consisted of the following (dollars in thousands):

	2012	2011
Direct Obligations, Category C	$ 256,340	$ 225,802
Reimbursable Obligations, Category C	2,760	94
Total Obligations Incurred	**$ 259,100**	**$ 225,896**

NOTE 12. LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

HERA requires that any balance that remains unobligated at the end of the fiscal year, except for amounts assessed for contribution to FHFA's working capital fund, must be credited against the next year's assessment to the Regulated Entities. As of September 30, 2012 and 2011, the unobligated balance was $45.5 million and $27.7 million. The portion of the fiscal year 2012 unobligated available balance that will be credited against the Regulated Entities' April 2013 assessments is $19.9 million with the remaining $10 million retained in the working capital fund and $15.6 million retained for conservatorship activities. The portion of the fiscal year 2011 unobligated balance that was credited against the Regulated Entities' April 2012 assessment was $9.5 million with the remaining $9 million retained in the working capital fund and $9.2 million retained for conservatorship related activities. (See Note 2. Fund Balance With Treasury)

NOTE 13. BUDGETARY RESOURCE COMPARISONS TO THE BUDGET OF THE UNITED STATES GOVERNMENT

Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting", calls for explanations of material differences between amounts reported in the Statement of Budgetary Resources and the actual balances published in the Budget of the United States Government (President's Budget). The President's Budget that will include fiscal year 2012 actual budgetary execution information has not yet been published. The President's Budget is scheduled for publication in February 2014 and can be found at the OMB Web site: *http://www.whitehouse.gov/omb/*. The 2013 Budget of the United States Government, with the "Actual" column completed for 2011, has been reconciled to the Statement of Budgetary Resources and there were no material differences.

NOTE 14. UNDELIVERED ORDERS AT THE END OF THE PERIOD

For the fiscal years ended September 30, 2012 and 2011, budgetary resources obligated for undelivered orders amounted to $35.2 million and $52.7 million, respectively.

NOTE 15. INCIDENTAL CUSTODIAL COLLECTIONS

FHFA's custodial collections primarily consist of Freedom of Information Act requests and civil penalties assessed. Custodial collections are reflected in Fund Balance with Treasury during the year. While these collections are considered custodial, they are neither primary to the mission of the agency nor material to the overall financial statements. FHFA also collects civil penalties assessed against the Regulated Entities. FHFA's custodial collections are $6.7 thousand for the year ended September 30, 2012. Custodial collections totaled $3.4 thousand for the year ended September 30, 2011. There were no civil penalties assessed or collected in fiscal year 2011 or 2012. Custodial collections are transferred to the Treasury General Fund on September 30 and are not reflected in the financial statements of the Agency.

NOTE 16. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

FHFA has reconciled its budgetary obligations and non-budgetary resources available to its net cost of operations (dollars in thousands).

	2012	2011
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 259,100	$ 225,896
Spending Authority from Offsetting Collections and Recoveries	(52,611)	(30,136)
Obligations Net of Offsetting Collections and Recoveries	206,489	195,760
Offsetting Receipts	(224,353)	(200,689)
Net Obligations	(17,863)	(4,929)
Other Resources		
Imputed Financing from Costs Absorbed by Others	5,810	5,193
Net Other Resources Used to Finance Activities	5,810	5,193
Total Resources Used to Finance Activities	**(12,053)**	**264**
Resources Used to Finance Items Not Part of the of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	18,689	(32,083)
Resources That Fund Expenses Recognized in Prior Periods	(10)	(55)
Resources That Finance the Acquisition of Assets	(47,679)	(5,226)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(29,000)	(37,364)
Total Resources Used to Finance the Net Cost of Operations	**(41,053)**	**(37,100)**
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	986	1,662
Other	23,917	2
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	24,903	1,664
Components Not Requiring or Generating Resources		
Depreciation and Amortization	6,907	2,164
Revaluation of Assets or Liabilities	963	–
Other	(152)	(110)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	7,718	2,054
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	32,621	3,718
Net (Income from)/Cost of Operations	**$ (8,432)**	**$ (33,382)**

Other Accompanying Information

- Performance Goals and Measures No Longer Reported
- Inspector General's FY 2013 Management and Performance Challenges
- Summary of Financial Statement Audit and Management Assurances

FHFA FY 2011 Performance Goals and Measures No Longer Reported

PERFORMANCE MEASURES

STRATEGIC GOAL 2: The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing.	
MEASURE 2.2.3: Finalize the duty to serve regulation.	
Why Discontinued:	Although the final rule continues to be under consideration, FHFA is reassessing the duty to serve requirements in light of changing economic conditions, and the financial condition of the Enterprises to determine the best manner in which to proceed.

STRATEGIC GOAL 3: FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.	
MEASURE 3.3.1: Number of loan modifications and foreclosure alternatives completed by the Enterprises.	
Why Discontinued:	This measure was not discontinued but refined; the measure now reads "Prevent current loans from going delinquent by helping borrowers to refinance."
MEASURE 3.3.2: Percentage of modified loans that are 60-plus days delinquent.	
Why Discontinued:	This measure was not discontinued but refined; the measure now reads "Maintain the percentage of modified loans that are 60 plus days delinquent, nine months after modification, at or below 20 percent."

RESOURCE MANAGEMENT STRATEGY: FHFA has the personnel, resources, and infrastructure to manage effectively and efficiently to achieve its mission and goals.	
MEASURE 4.1.2: Percentage of FHFA supervisors who receive supervisory, management, or leadership training in compliance with 5 CFR, part 412, which requires agencies to train new supervisors within one year of appointment and retrain every three years.	
Why Discontinued:	Progress in supervisory training as gauged by this measure did not offer fair illustration of the wide-ranging trainings FHFA managers are exposed to.
MEASURE 4.2.1: Number of partnerships, alliances, and agreements FHFA established to increase diversity in its workforce.	
Why Discontinued:	FHFA currently has two measures which successfully reflect the outlook in this discontinued indicator (The activities within 4.2.1 and 4.2.3 are represented in the two measures that were kept that speak to (i) outreach events and (ii) number of contracts awarded).
MEASURE 4.2.3: Number and variation of targeted outreach events designed to provide information, education and capacity building assistance to potential minority and women owned businesses to increase procurement contracts awarded for goods, services, and technical assistance provided to FHFA.	
Why Discontinued:	FHFA currently has two measures which successfully reflect the outlook in this discontinued indicator (The activities within 4.2.1 and 4.2.3 are represented in the two measures that were kept that speak to (i) outreach events and (ii) number of contracts awarded).
MEASURE 4.3.2: Percentage of FHFA resources allocated directly to supervision of the housing GSEs – Strategic Goals 1 and 2.	
Why Discontinued:	This indicator is not illustrative of current agency resource apportionments which now include management of the two conservatorships.
MEASURE 4.4.1: Ensure FHFA s infrastructure systems are continuously available for use by FHFA staff.	
Why Discontinued:	While systems availability is a priority for the agency and continues to be monitored internally, FHFA regards this measure as more of a process indicator that does not warrant external reporting.

Inspector General's FY 2013 Management and Performance Challenges

OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

October 16, 2012

TO: Edward J. DeMarco, Director (Acting)

FROM: Steve A. Linick, Inspector General

SUBJECT: FY 2013 Management and Performance Challenges

Since beginning operations in October 2010, the Federal Housing Finance Agency (FHFA or Agency) Office of Inspector General (FHFA-OIG) has initiated audits and evaluations of FHFA's programs and operations. A significant area of focus has been on the risks in key FHFA mission areas, such as regulating and supervising the government-sponsored enterprises (GSEs) – Fannie Mae, Freddie Mac, and the Federal Home Loan Banks – and operating the Fannie Mae and Freddie Mac (Enterprise) conservatorships. FHFA-OIG has also participated in investigations involving the GSEs.

FHFA-OIG's work has identified three serious management and performance challenges facing the Agency in FY 2013. FHFA is challenged to: (1) manage in an uncertain environment; (2) improve its management of the Fannie Mae and Freddie Mac conservatorships; and (3) adequately supervise and regulate the GSEs. As required by the Reports Consolidation Act of 2000, FHFA-OIG has attached its summary of these challenges and an assessment of FHFA's progress in meeting them.

In general, the Agency can make meaningful headway on these challenges by independently testing and validating the Enterprises' determinations rather than deferring to their decision-making and by being more proactive in its risk management and oversight of the GSEs.

If you or your staff has any questions, please contact Russell Rau, Deputy Inspector General for Audits, at (202) 730-0390, or Laura Benton, Audit Director, at (202) 730-0443.

cc: Richard Hornsby, Chief Operating Officer
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The Federal Housing Finance Agency Office of Inspector General's FY 2013 Management and Performance Challenges

In FY 2012, FHFA-OIG summarized three management and performance challenges facing FHFA: (1) leading and directing the GSEs; (2) improving its management of the Fannie Mae and Freddie Mac conservatorships; and (3) adequately supervising and regulating the GSEs. With FHFA's recently released strategic plan for 2013-2017, increased supervisory staffing, reorganization to facilitate GSE oversight, and a more focused approach to fulfilling its responsibilities, the Agency has made significant progress in addressing the first challenge. However, the Agency's ability to provide leadership and direction may pose a challenge in the future given that FHFA still does not have a permanent director and Congress may enact changes affecting the Enterprises.

Because the Enterprises' ultimate fate and the broader structure of the secondary housing finance market remain undetermined, FHFA-OIG recognizes that FHFA faces challenges managing in an uncertain environment. The Agency must simultaneously fulfill its current responsibilities while remaining open to potential legislative reform ranging from eliminating the GSEs to making them permanent parts of the government. Below, FHFA-OIG outlines the nature of this challenge for FY 2013 and describes the Agency's progress on the two challenges that remain from last year.

1. FHFA is Challenged to Manage in an Uncertain Environment

In February 2012, FHFA's Acting Director described the difficulty of fulfilling the Agency's oversight responsibilities in the midst of uncertainty about the Enterprises' future:

> At FHFA we are faced with a fundamental task of directing the operations of two companies that account for roughly three-quarters of current mortgage originations and have approximately $5 trillion in outstanding obligations and credit guarantees. FHFA's task is complicated by the uncertain future of the Enterprises and increasing dissatisfaction with various aspects of their business operations.[1]

In other words, FHFA must effectively direct the Enterprises' operations while fundamental questions about its role and theirs remain unanswered. For example, in September 2008, when Fannie Mae and Freddie Mac entered into conservatorships overseen by FHFA, it was generally assumed that FHFA's role as conservator would be temporary and short-lived. Yet, four years later, Fannie Mae and Freddie Mac are still in conservatorships. The current $187.5 billion in assistance received by the Enterprises is so large that, "the companies cannot repay the taxpayers

[1] *Statement of Edward J. DeMarco, Acting Director, Federal Housing Finance Agency, Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs On the State of the U.S. Housing Market: Removing Barriers to Economic Recovery*, pg. 6 (February 28, 2012). Accessed October 16, 2012, at http://www.fhfa.gov/webfiles/23408/02-28-12%20FINAL%20DeMarco%20Testimony%20SBC.pdf.

OTHER ACCOMPANYING INFORMATION

in any foreseeable scenario."[2] Indeed, no one is sure how long the Enterprises will exist in their current form and, consequently, their future role in the housing finance market. FHFA's strategic plan sets a goal of preparing for the future of housing finance in the United States, which will continue to be a challenge for the foreseeable future.

Related to this, human resource issues will remain a challenge for FHFA and the Enterprises. Not only does the uncertain future present a challenge in recruiting and retaining employees, the Agency is hampered in making longer-term staffing allocations because it does not know what its future role, and thus the associated staffing needs, will be. For example, the Enterprises have experienced turnover in key management positions and face significant challenges in recruiting and retaining experienced personnel. As noted by the Acting Director, "[A]chieving the goals of conservatorship depended on retaining capable and knowledgeable staff….it was and remains imperative that the Enterprises attract and retain the particular specialized skills needed."[3]

2. FHFA is Challenged to Improve Its Oversight of the Fannie Mae and Freddie Mac Conservatorships

In FY 2012, FHFA-OIG identified FHFA's conservatorship operations as a management challenge. In general, FHFA was challenged to engage more fully with its role as conservator of Fannie Mae and Freddie Mac by, for example, proactively overseeing significant Enterprise business activities and decisions and guiding their housing finance policy. FHFA-OIG determined that the Agency needed a longer-term management approach since there was (and still is) no end in sight for the conservatorships. FHFA has made strides toward improving its conservatorship oversight, in part by developing a strategic plan for the Enterprises and establishing an organizational structure to effect the plan. However, FHFA-OIG's work has shown that the Agency can further strengthen its oversight by independently testing and validating the Enterprises' determinations and decision-making because some matters are sufficiently important to warrant greater involvement and scrutiny by FHFA, especially because it is unclear that the interests of the Agency and the Enterprises always align.

In a number of recently issued reports FHFA-OIG found that FHFA continues to give undue deference to Enterprise determinations. For example:

- In a March 22, 2012, report, FHFA-OIG found that: (1) the Agency's oversight of underwriting, along with the accompanying variances that effectively further loosen underwriting standards, is limited; (2) FHFA relies on the Enterprises to oversee and

[2] *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending*, page 9 (February 21, 2012). Accessed October 16, 2012, at http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf.

[3] *Statement of Edward J. DeMarco, Acting Director, Federal Housing Finance Agency, Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on Oversight of the Federal Housing Finance Agency*, page 12 (November 15, 2011). Accessed October 16, 2012, at http://www.fhfa.gov/webfiles/22754/SBCTestimony111511.pdf.

establish underwriting standards and to grant variances; and (3) it currently does not have a formal process to review the Enterprises' underwriting standards and variances from them.[4]

- In a September 18, 2012, report, FHFA-OIG found that FHFA had inconsistent involvement in an initiative involving multiple transfers of mortgage servicing rights for over 700,000 loans with an unpaid principal balance in excess of $130 billion. As part of the High Touch Servicing Program, an initiative that utilizes specialty services to work with higher risk borrowers to reduce the number of defaults in mortgages owned or guaranteed by Fannie Mae, the Enterprise paid Bank of America a $421 million fee to transfer mortgage servicing rights for approximately 384,000 mortgage loans to high touch mortgage servicers. Although FHFA reviewed the Bank of America transaction and allowed it to proceed, it did not conduct similar reviews of other transactions in the High Touch Servicing Program, nor did it analyze the program as a whole.[5]

- In a September 27, 2012, report, FHFA-OIG found that FHFA unduly relied on information provided by Fannie Mae when it issued a "no objection" response to Fannie Mae's request to make an investment of between $55 million and $70 million in order to protect an existing $40 million investment. Fannie Mae requested the Agency's approval as conservator to buy a loan made to a business by another lender in order to protect its existing loan to the same business. On the same day as the request, FHFA stated that given the complex nature of the transaction and the short timeframe for its decision, the Agency could not assess the reasonableness of the proposal but still it gave "no objection" to the transaction.[6]

- In the same report, FHFA-OIG also found that over a three-year period Fannie Mae took over 4,500 actions to increase the Enterprise's counterparty risk limits without first obtaining conservator approval, despite the fact that risk limit increases are a matter for which the Enterprise does not have delegated authority. Although Freddie Mac had submitted counterparty risk limit increases for conservator approval, Fannie Mae's lapse was not identified by the conservatorship.[7]

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[4] *FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards* (AUD-2012-003, March 22, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD-2012-003_0.pdf.

[5] *Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers* (EVL-2012-008, September 18, 2012); available at http://www.fhfaoig.gov/Content/Files/EVL-2012-008.pdf.

[6] *FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions* (AUD-2012-008, September 27, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD-2012-008.pdf.

[7] *Id.*

On the other hand, FHFA has taken steps towards improving oversight of the conservatorships. FHFA's recent strategic plan for the Enterprises demonstrates the Agency's longer-term commitment to its role as their conservator. In February 2012, FHFA's conservatorship plan listed three broad goals outlining how the Agency intends to guide the Enterprises through 2017. The first goal is to build a new infrastructure for the secondary mortgage market, such as a securitization platform. The second goal is to contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations. The third goal is to keep the Enterprises focused on preventing foreclosures and providing mortgage credit.

FHFA has also taken organizational steps to ensure that the plan comes to fruition. In March 2012, FHFA released a conservatorship scorecard that outlines a roadmap for implementing the plan. Then, in June 2012, FHFA established the Office of Strategic Initiatives to oversee all FHFA activities involving Enterprise conservatorship projects and initiatives associated with the strategic plan. Further, FHFA is contracting for project management expertise to strengthen its oversight of conservatorship activities.

Additionally, FHFA-OIG reports have shown that the Agency has made progress towards employing additional testing and validation in its role as conservator. For example:

- In an August 23, 2012, report, FHFA-OIG found that FHFA began providing Treasury with all three certifications required under the Senior Preferred Stock Purchase Agreements governing Treasury's investments in the Enterprises. Previously, the Agency was making only one of the three required certifications and for the other two, was relying on work and certifications of the Enterprises.[8]

- In a September 13, 2012, follow up report, FHFA-OIG found that FHFA acted on concerns regarding Freddie Mac's process to review non-performing mortgage loans for potential repurchase claims, and the Enterprise is now reviewing a significantly larger number of loans defaulting more than two years after origination. It is estimated that the expanded loan review process will generate additional recoveries ranging from $0.8 billion to $1.2 billion for loans selected for review in 2012 and $2.2 billion to $3.4 billion overall.[9]

3. FHFA is Challenged to Ensure Adequate Supervision and Regulation of the GSEs

In FY 2012, FHFA-OIG described FHFA's ability to fully staff and train its examination team as its most significant challenge. In general, FHFA-OIG found that FHFA had difficulties identifying new and emerging risks potentially impacting the GSEs, issuing guidance and regulations governing risk management at the GSEs, and providing strong and consistent

[8] *FHFA's Certifications for the Preferred Stock Purchase Agreements* (EVL-2012-006, August 23, 2012); available at http://www.fhfaoig.gov/Content/Files/EVL-2012-006_3.pdf.

[9] *Follow-up on Freddie Mac's Loan Repurchase Process* (EVL-2012-007, September 13, 2012); available at http://www.fhfaoig.gov/Content/Files/EVL-2012-007.pdf.

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enforcement for violations of policy. FHFA has taken positive steps to meet this challenge, including adding staff and developing consistent examination guidance in some areas, but the Agency still needs more proactive oversight to identify and mitigate risks and enforce for violations of its policies.

The limitations on FHFA's ability to detect and address possible problem areas through its regulatory functions become especially important in the context of FHFA's challenges in its role as conservator. The largely hands-off approach to the conservatorships exacerbates FHFA's challenges in anticipating problems in its supervisory capacity.

Several examples demonstrate that within its regulatory functions, the Agency needs to better identify new and emerging risks potentially impacting the GSEs; establish guidelines and policies governing Enterprise oversight; and provide strong, consistent enforcement for violations of policy.

Identification of Risks

- In a March 7, 2012, report, FHFA-OIG found that as early as 2008, FHFA had information indicating that mortgage servicing represented a heightened risk to the Enterprises. In early 2009, FHFA became aware of servicers' poor performance and of weaknesses in Freddie Mac's oversight of its servicers. Yet, FHFA did not take timely or appropriate action to address these indicators. Even now, FHFA has not clearly defined its role in relation to servicers or sufficiently coordinated with federal banking regulators about risks and supervisory concerns with individual servicers.[10]

- In a July 19, 2012, report, FHFA-OIG found that since 2008, FHFA has consistently listed the Enterprises' large inventories of real-estate owned as contributing to "critical concern" ratings in their quarterly risk assessments. FHFA, though, did not conduct targeted examinations or focused reviews of real-estate owned until 2011. FHFA's eventual targeted examinations in 2012 were positive supervisory steps, but expanding the scope of the assessments to evaluate more risks can help the Agency better design its supervision of real-estate owned.[11]

- In another July 19, 2012, report, FHFA-OIG found that FHFA was not fully using its call report system, which gathers GSE data and is useful as a supervisory tool to measure risk, analyze finances, and examine GSE performance. For example,

[10] *FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors* (AUD-2012-001, March 7, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD%202012-001_0.pdf.

[11] *FHFA's Supervisory Risk Assessment for Single-Family Real Estate Owned* (AUD-2012-005, July 19, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD-2012-005_2.pdf.

two FHFA supervisory divisions rarely use the call report system in their analysis and oversight of the Enterprises even though the system contains data on the Enterprises' total net assets.[12]

Management of Risks

The Agency has not always managed identified risks by establishing sufficient regulations or guidance. For example:

- In a March 22, 2012, report, FHFA-OIG found that FHFA would have greater assurance of the effectiveness and consistency of its supervision through additional guidance on examination of underwriting and specific procedures for oversight of compliance with the complex, voluminous, and interrelated factors involved in the Enterprises' underwriting standards and the variances from them. In 2011, FHFA began targeted examinations that included Fannie Mae's quality control of compliance with underwriting standards. This was a positive step, but additional guidance is needed to ensure the success of underwriting examinations going forward. Such guidelines should include criteria for independent testing of quality control, at a minimum. Additionally, guidance on examination planning would benefit from addressing comprehensive supervisory plans to lead examinations of underwriting, and providing more detailed information on underwriting variances approved by Fannie Mae, the lenders authorized to use them, and their effective time periods.[13]

- In a June 1, 2012, report, FHFA-OIG found that FHFA can improve its framework for supervising advances and collateral risk management practices for institutions presenting heightened supervisory concerns. Although FHFA conducted a system-wide horizontal review of secured credit among the Federal Home Loan Banks (FHLBanks) and an internal study identified numerous significant risks, the Agency did not take sufficient steps to ensure that FHLBanks effectively managed risks posed by member banks that represented heightened supervisory concerns. Of the seven recommendations from its horizontal review, FHFA had not implemented six, including updating the Agency's examination guidance for collateral reviews, providing guidance to the FHLBanks about effective collateral risk management, and offering relevant training to FHFA examiners.[14]

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[12] *FHFA's Call Report System* (AUD-2012-006, July 19, 2012); available at http://www.fhfaoig.gov/Content/Files/EVL-2012-006_3.pdf.

[13] *FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards* (AUD-2012-003, March 22, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD-2012-003_0.pdf.

[14] *FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management* (AUD-2012-004, June 1, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf.

- In a September 18, 2012, report, FHFA-OIG found that FHFA has not timely addressed known risks presented by mortgage seller/servicers by developing sufficient regulations or guidance governing the Enterprises' oversight and risk management of such counterparties. The Enterprises work with numerous seller/servicers for post-origination mortgage work, such as collecting mortgage payments, and these seller/servicers represent an important risk to the Enterprises. Specifically, FHFA has not published standards for the development of contingency plans related to failing or failed high-risk counterparties. Contingency plans help to manage such risks because they identify actions to pursue when a counterparty's changing financial or other circumstances pose a financial threat to an Enterprise. Counterparty contingency plans will not eliminate losses, but they can serve as a road map to help reduce the Enterprises' risk exposure. Contingency plans can also prepare the Enterprises for unexpected collapses of counterparties that handle a concentrated, high-volume of their business. Managing such seller/servicer risk is important, as the Enterprises have incurred losses of $6.1 billion from failures at just four of their counterparties since 2008.[15]

Enforcement of Directives

The Agency has not consistently enforced its directives to ensure that identified risks are, in fact, adequately addressed. As conservator and regulator, FHFA's authority over the Enterprises is broad and includes the ability to discipline or remove Enterprise personnel in order to ensure compliance with Agency mandates. FHFA-OIG has reported that FHFA's supervision and regulation of the GSEs is strengthened by exercising this authority when warranted.

- For instance, FHFA has not compelled Fannie Mae's compliance with the requirement to have an effective operational risk management program. Fannie Mae's lack of an acceptable and effective risk program may have resulted in missed opportunities to strengthen oversight of law firms with which it contracts to process foreclosures.[16]

The benefit of stronger FHFA enforcement also extends to FHLBanks. For example, since 2008 at least four FHLBanks have faced significant financial and operational difficulties, primarily due to their investments in high-risk mortgage securities. The

[15] *FHFA's Oversight of the Enterprises' Management of High-Risk Seller/Servicers* (AUD-2012-007, September 18, 2012); available at http://www.fhfaoig.gov/Content/Files/AUD-2012-007.pdf.

[16] *Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk* (EVL-2011-004, September 23, 2012); available at http://www.fhfaoig.gov/Content/Files/EVL-2011-004.pdf.

Agency has oversight responsibility for FHLBanks and recognizes the need to ensure that they do not abuse their GSE status and engage in imprudent activities.

- However, an FHFA-OIG report revealed that FHFA has not established a consistent and transparent written enforcement policy for troubled FHLBanks classified as having "supervisory concerns." This has contributed to instances in which FHFA may not have held these banks and their officers sufficiently accountable for engaging in questionable risk taking.[17]

- Another FHFA-OIG report identified FHFA's current regulation governing unsecured lending by the FHLBanks as possibly outdated and overly permissive, as well as identifying non-compliance with the Agency's existing regulation.[18]

FHFA has improved its ability to supervise and regulate the GSEs by augmenting and aligning its organization to meet that challenge and by developing a common examination approach. For example, FHFA has improved its examination staffing by adding 24 employees in the supervision area and is implementing a program to certify its examiners. The Agency has also committed to recruit new examination and oversight staff until it can provide adequate supervisory coverage. In addition, FHFA has consolidated its operations; instead of having examination staff divided between three locations, they now work together in one, which facilitates communication and collaboration. FHFA also established a framework for written examination findings that applies to all the GSEs and is field-testing a common examination manual.

Further, in August 2012, FHFA's Acting Director announced that he would continue to refine the Agency's organization so that it could better examine and oversee the GSEs. FHFA plans to place at least 25 examiners onsite at each Enterprise. Additionally, Examiners-in-Charge of each regulated entity will supervise core examination activities, which will improve risk focus.

In sum, FHFA made significant strides to address FY 2012 management challenges, such as developing conservatorship and strategic plans, increasing oversight staff, and reorganizing to facilitate supervision. For FY 2013, FHFA-OIG challenges the Agency to show continuing progress by: (1) managing in an uncertain environment; (2) improving its management of the Fannie Mae and Freddie Mac conservatorships; and (3) ensuring adequate supervision and regulation of the GSEs. FHFA-OIG's work highlights FHFA's opportunities to meet these challenges by routinely testing and validating the Enterprises' decision-making and by proactively overseeing the GSEs and enforcing Agency policy.

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[17] *FHFA's Oversight of Troubled Federal Home Loan Banks* (EVL-2012-001, January 11, 2012); available at http://www.fhfaoig.gov/Content/Files/Troubled%20Banks%20EVL-2012-001.pdf.

[18] *FHFA's Oversight of the Federal Home Loan Banks' Unsecured Credit Risk Management Practices* (EVL-2012-005, June 28, 2012); available at http://www.fhfaoig.gov/Content/Files/EVL-2012-005_1_0.pdf.

Summary of Financial Statements Audit and Management Assurances

Table 1: SUMMARY OF FINANCIAL STATEMENTS AUDIT

AUDIT OPINION	UNQUALIFIED				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weaknesses	0	0	0	0	0

Table 2: SUMMARY OF MANAGEMENT ASSURANCES

EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING (Federal Management Financial Integrity Act Paragraph 2)						
Statement of Assurance	Unqualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	0	0	0	0	0	0
EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (Federal Management Financial Integrity Act Paragraph 2)						
Statement of Assurance	Unqualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	0	0	0	0	0	0
CONFORMANCE WITH FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS (Federal Management Financial Integrity Act Paragraph 4)						
Statement of Assurance	Systems conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Non-Conformances	0	0	0	0	0	0

Erroneous Payments

The Improper Payments Elimination and Recovery Act requires that agencies (1) review activities susceptible to significant erroneous payments; (2) estimate the amount of annual erroneous payments; (3) implement a plan to reduce erroneous payments; and (4) report the estimated amount of erroneous payments and the progress to reduce them. The Act defines significant erroneous payments as the greater of 2.5 percent of program activities or $10 million.

FHFA, in the spirit of compliance and as part of a sound internal control structure, has established controls to detect and prevent improper vendor payments. FHFA has identified no activities susceptible to significant erroneous payments that meet the Act's thresholds.

Prompt Pay

The Prompt Payment Act requires federal agencies to make timely payments to vendors and improve the cash management practices of the government by encouraging the use of discounts when they are justified. This also means that FHFA must pay its bills within a narrow window of time. In FY 2012, the dollar amount subject to prompt payment was $71.9 million. The amount of interest penalty paid in FY 2012 was $372 or 0.00052 percent of the total dollars disbursed.

Appendix

Glossary

Advances – Core mission assets in the form of loans to member institutions.

Basis Points – Unit of measure used in finance to denote a change in value. Basis points are commonly used to express a change of less than one percent. For example, 50 basis points denote a 0.5 percent shift.

Capitalization – The sum of a firm's or individual's long-term debt, stock and retained earnings.

Cease and Desist Order – A directive halting certain financial activities and requiring improvements to risk management policies and practices. Orders may be terminated following improvements in and entity's financial condition, capital position, and resolution of risk management concerns.

Collateralize – To secure a financial instrument, such as a loan, with an asset, such as a security or property.

Conservatorship – Statutory process designed to stabilize a troubled institution with the objective of maintaining normal business operation and restoring safety and soundness.

Consolidated Obligations – A term for the joint obligations of the 12 FHLBanks. Consolidated obligations are debt instruments that are sold to the public through the Office of Finance but are not guaranteed by the U.S. government.

Earnings – Includes adequacy of earnings to build and maintain capital and provide acceptable returns to shareholders, the quality of earnings, earnings projections, the integrity of management information systems, and the soundness of the business model.

Enterprise(s) – Represent Fannie Mae and Freddie Mac.

Enterprise Risk – Includes enterprise credit risk, market risk, and operational risk.

Forbearance Plans – An agreement between the servicer and the borrower (or estate) to reduce or suspend monthly payments for a defined period, after which the borrower resumes regular monthly payments and pays additional money toward the delinquency to bring the account current or works with the servicer to identify a permanent solution, such as a loan modification or a short sale, to address the delinquency.

Foreclosure – A legal process dictated by state law in which the mortgaged property is sold to pay off the mortgage of the defaulting borrower.

Governance – Includes policies and controls related to financial and regulatory reporting, leadership effectiveness of the board of directors and enterprise management, compliance, overall risk management, strategy, internal audit, and reputational risk.

Government Sponsored Enterprises (GSE) – Fannie Mae, Freddie Mac and the twelve Federal Home Loan Banks.

Home Affordable Modification Program (HAMP) – A program designed to help homeowners avoid foreclosure by modifying loans to a level that is affordable for borrowers and sustainable over the long term.

Home Affordable Refinance Program (HARP) – A home retention program that focuses on mortgages Fannie Mae and Freddie Mac already hold in their portfolios or guarantee through their mortgage-backed securities. It provides unique flexibilities on the level of credit enhancement required on loans with loan-to-values greater than 80 percent. Borrowers who are current on their mortgages can refinance into a lower mortgage payment or more sustainable mortgage without requiring additional credit enhancements—generally private mortgage insurance.

Loan Modification – A change or changes to the original mortgage terms, such as a change to the product (adjustable-rate or fixed-rate), interest rate, term and maturity date, amortization term, or amortized balance.

Matter Requiring Attention (MRA) – A specific written recommendation made to Enterprise management that requires attention and correction, but does not include consent order items. Each MRA requires a due date for correction.

Operating Risk – The risk of possible losses resulting from inadequate or failed internal processes, people, and systems or from external events.

Permanent Capital – The sum of common stock, preferred stock, and retained earnings.

Permanent Change of Station (PCS) – The official relocation of an active duty military service member or a civilian employee along with any family members living with him or her to a different duty location such as a military base – the permanent move may be within or outside the continental United States. A permanent change of station applies until muted by another PCS order, completion of active duty service, or some other preemptive event.

Portfolio – A collection of investments, either diverse or similar in nature, held by an institution or individual.

Preferred Stock Purchase Agreement (PSPA) – PSPAs ensure that the Enterprises maintain a positive net worth so they can continue to be active suppliers of housing finance. The agreements are ongoing, explicit, and irreversible contractual commitments of the federal government ensuring that Fannie Mae and Freddie Mac can meet their obligations and maintain a positive net worth.

Private-label Mortgage-backed Securities (PLMBS) – A residential mortgage-backed security where the underlying loans are not guaranteed by the U.S. government or a government-sponsored agency. The collateral is often referred to as “nonconforming loans” because the loans usually do not meet all the strict requirements for a government or government agency guarantee.

Repayment Plans – An agreement between the servicer and a borrower that gives the borrower a defined period to reinstate the mortgage by paying normal regular payments plus an additional agreed upon amount in repayment of the delinquency.

Reports of Examination (ROEs) – During each calendar year, FHFA complete ROEs for each of the 12 FHLBanks and the Office of Finance (OF) and presents them to their respective boards of directors. The scheduling of examination fieldwork and the review of ROEs may vary from one year to the next.

Secondary Mortgage Market – A market in which mortgages or mortgage-backed securities are acquired by the Enterprises and traded.

Senior Preferred Stock – Capital stock owned by the Treasury Department, which pays specific dividends before preferred stock or common stock dividends. In the event of a liquidation, senior preferred stock takes precedence over preferred and common stock.

Short Sale – A sale of real estate in which the proceeds do not satisfy the full balance owed on the property’s loan.

Supervisory Rating – FHFA has established four rating levels for supervisory concerns: (1) no or minimal concerns; (2) limited concerns; (3) significant concerns; and (4) critical concerns. These ratings describe how well risks are identified, measured, monitored, controlled, and managed. No or minimal concerns have very minor weaknesses or criticisms that affect the Enterprise’s safety and soundness, while critical concerns involve a consent order or formal agreement between FHFA and the Enterprise to ensure that appropriate corrective action is taken.

Total Capital – The sum of permanent capital, the par value of Class A stock outstanding, a general allowance for losses, and the amount of any other instruments identified in an FHLBank’s capital plan that FHFA has determined to be available to absorb losses.

Undercapitalized – A state of hindered operation for an FHLBank resulting from limited amounts of capital.

Underwriting Standards – The process a lender uses to determine whether the risk of lending to a particular borrower under certain parameters is acceptable. Most of the risks and terms underwriters consider fall under the three C’s of underwriting: credit, capacity, and collateral.

Acronyms

AGA	Association of Government Accountants
AHP	Affordable Housing Program
BOA	Bank of America
C&D	Cease and Desist
CEO	Chief Executive Officer
CFR	Code of Federal Regulations
CGC	Conservatorship Governance Committee
CY	Calendar Year
DBR	Division of FHLBank Regulation
DER	Division of Enterprise Regulation
DOL	U. S. Department of Labor
DSPS	Division of Supervision Policy and Support
ECIC	Executive Committee on Internal Controls
EESA	Emergency Economic Stabilization Act of 2008
EIC	Examiner in Charge
EVS	Employee Viewpoint Survey
Fannie Mae	Federal National Mortgage Association
FASAB	Federal Accounting Standards Advisory board
FBWT	Fund Balance with Treasury
FECA	Federal Employees Compensation Act
FEVS	Federal Employee Viewpoint Survey
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
FHFB	Federal Housing Finance Board
FHLBank	Federal Home Loan Bank
FICO	Fair Isaac Corporation
FinSOB	Financial Stability Oversight Board
FISMA	Financial Information Security Management Act
FMFIA	Federal Managers Financial Integrity Act of 1982
FMS	Federal Management System
FOIA	Freedom of Information Act
Freddie Mac	Federal Home Loan Mortgage Corporation
FSOC	Financial Stability Oversight Council
FTE	Full-Time Equivalent
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	U.S. Government Accountability Office
Ginnie Mae	Government National Mortgage Association
GSE	Government-Sponsored Enterprise
HAMP	Home Affordable Modification Program

APPENDIX

Index of Figures and Features

FIGURES

PHOTO CREDITS

Photos appearing in the text were taken in-house.

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