

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Administrative Provision

In order to treat the Office of Federal Housing Enterprise Oversight (OFHEO) similarly to other financial regulators, the Budget proposes legislation that would provide direct funding to OFHEO. This provision puts OFHEO on par with other safety and soundness regulators such as the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Federal Housing Finance Board, the Federal Reserve Board and the National Credit Union Administration. This provision provides the Office with the flexibility to set resources in response to any rapid changes in the financial condition of Fannie Mae and Freddie Mac (the Enterprises) or in the markets in which they operate and serve. The provision is also consistent with the fact that OFHEO is not funded by taxpayer dollars. Rather, like other safety and soundness regulators, OFHEO is funded through annual assessments on the institutions that it regulates.

The following document summarizes OFHEO's budgetary requirements for fiscal year 2003 and details the workload goals the Office plans to achieve during this timeframe.

Salaries and Expenses

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

OFHEO's Mission Statement

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

OFHEO's proposed fiscal year 2003 Budget is essential for the Office to meet the congressionally mandated mission of ensuring the financial safety and soundness of Fannie Mae and Freddie Mac. The size, scope, and complexity of the Enterprises' activities continue to expand dramatically, as has the range of risks embedded in those activities. In addition, the Enterprises are utilizing technology as a strategic resource by developing and applying sophisticated risk management techniques, automated underwriting and cost control tools for seller/servicers, and communication and product delivery channels, with emphasis on the Internet. These business initiatives require a commensurate increase in staffing and in the application of technology by OFHEO to ensure effective and efficient supervision of the Enterprises.

Since the creation of OFHEO in 1993, the Enterprises have more than doubled in size and have fundamentally shifted their business mix from guarantors of mortgage-backed securities to asset managers, and have correspondingly developed innovative mortgage, debt, and derivative products.

As of year-end 1992, Fannie Mae and Freddie Mac held in portfolio or guaranteed \$1 trillion of mortgages representing 30 percent of the \$3.3 trillion in U.S. residential mortgage debt outstanding. In September 2001, the Enterprises had increased their

combined portfolio holdings and guarantees to \$2.6 trillion, representing 43 percent of the \$6.1 trillion in mortgage debt outstanding.

The Enterprises have also realigned their business to emphasize asset management rather than credit guarantee. At year-end 1992, Fannie Mae and Freddie Mac held 19 percent of their book of business in portfolio and guaranteed 81 percent in the form of mortgage-backed securities. By September 2001, the proportion of the book of business held in portfolio had increased to 44 percent, with a corresponding decline in the guarantee business to 56 percent of the total book of business. This realignment in business strategy significantly alters the risk profile of the Enterprises, shifting risk management from credit guarantee to both credit risk and interest rate risk management.

In response to more ambitious affordable housing goals and the shift in business strategy, the Enterprises have expanded business products, with increasing sophistication and complexity. Fannie Mae and Freddie Mac structured programs to purchase high loan-to-value mortgages to support the drive to higher rates of homeownership, promoted the expansion of reverse mortgages for elderly homeowners, and developed the means to reach less credit worthy borrowers. The Enterprises funded their expanded portfolios with innovative debt products, including instruments denominated in foreign currencies and a program of regular issuances that frequently serves as an alternative to U.S. Treasury securities. Furthermore, to manage these assets and liabilities, the Enterprises have increased their use of derivative instruments from a notional amount of \$72 billion at year-end 1993 to \$1.6 trillion on September 2001, representing a more than twenty-fold increase. Each of these initiatives represents a heightening of the sophistication and complexity embedded in the risk profiles of Fannie Mae and Freddie Mac.

Dramatic advances in technology represent the foundation for these business initiatives. The Enterprises employ cutting-edge risk management techniques, built on quantitative models, to manage the many alterations of their risk profiles. Automated underwriting and related technology innovations by Fannie Mae and Freddie Mac have revolutionized the mortgage finance process and have led to significant shifts in the structure of the mortgage finance industry. Communication technologies and E-Commerce represent further expansion opportunities for the Enterprises to streamline their businesses. These technologies carry with them operational challenges that not only permit Fannie Mae and Freddie Mac to leverage their resources but also heighten their operational risks.

These developments and trends have challenged the resources of OFHEO to keep pace with the Enterprises. An increase in staffing is imperative to ensure that OFHEO has the capability to assess the consequences of further growth and innovation by Fannie Mae and Freddie Mac. OFHEO also must share with the Enterprises a commitment to technology that will permit the Office to leverage the expertise and skills of its staff. These needs form the basis for OFHEO's fiscal year 2003 resource requirements.

BUDGET HIGHLIGHTS

The following table summarizes the funding and staffing levels in OFHEO's fiscal year 2001, fiscal year 2002 and the proposed fiscal year 2003 Budgets.

	<u>ACTUAL</u> 2001	<u>ENACTED</u> 2002	<u>ESTIMATE</u> 2003	INCREASE + DECREASE - <u>2003 vs 2002</u>
	(Dollars in Thousands)			
<u>From Appropriation:</u>				
Budget Authority (Assessed to				
GSE's)	\$22,000	\$27,000	\$30,843	+\$3,843
Prior Year Recovery	a/ \$605	\$100	...	-\$100
Subtotal	\$22,605	\$27,100	\$30,843	+\$3,743
Total Obligations	\$22,598	\$27,100	\$30,843	+\$3,743
Unobligated Balance EOY
Outlays (net)	\$23,267	\$26,000	\$29,843	+\$3,843
Full-Time Equivalents	105	118	142	+24

- a/ The Office of Management and Budget (OMB) approved OFHEO's request to recover prior year obligations for re-obligation during fiscal year 2001. OMB reapportioned \$605,000 to OFHEO as an increase in budgetary resources available to OFHEO during fiscal year 2001. OFHEO has estimated that about \$100,000 in prior year obligations will be recovered during fiscal year 2002 and reapportioned by OMB to OFHEO for re-obligation in fiscal year 2002.

SUMMARY OF PROPOSED 2003 BUDGET

The proposed fiscal year 2003 Budget of \$30,843,000 (includes \$843,000 for the Administration's proposal to fully fund retirement costs) represents a 14.2 percent increase from the fiscal year 2002 Budget Request of \$27,000,000. The proposed fiscal year 2003 Budget funds OFHEO's existing oversight activities and two initiatives. The first initiative is to strengthen OFHEO's safety and soundness programs. This will be done by bolstering OFHEO's capacity to oversee Enterprise risk management activities, by improving OFHEO's capacity to analyze stress test outputs, and by improving OFHEO's capacity to analyze developments in the mortgage and securities markets. In addition, OFHEO will expand its data warehouse and improve the efficiency of using this data to improve the productivity of regulatory staff.

The second initiative is to strengthen OFHEO's infrastructure. This will be done primarily by creating an integrated administrative and financial management system that is Joint Financial Management Improvement Program compliant and provides useful information for management decision-making.

Initiative One: Strengthen Safety and Soundness Programs

OFHEO is requesting 21 new positions and \$1.5 million to purchase data and computer software and hardware to strengthen its core safety and soundness programs.

A. Examination Program

OFHEO is seeking ten new examiners to enhance its Examination and Oversight Program. The ten new examiners would accomplish the first phase of a 3-year plan to expand OFHEO's examination staff to 66 examiners. OFHEO has determined that a larger examination staff is needed to fully cover the range of risk activities at both Enterprises. A larger examination staff would also be more consistent with the amount of resources Federal bank regulators devote to examining large money center banks, which are comparable in size and sophistication to the Enterprises.

The ten new examiners will be used to provide needed depth in the examination of the Enterprises' core credit, market, and interest rate risk areas to keep pace with continued rapid growth of the two companies. The new examiners will also provide capacity to expand the scope and depth of the program to include new and emerging risk areas including E-Commerce, communication networks, internal financial models, and risk-based capital compliance. Finally, this increased capacity will bolster the program's infrastructure to ensure that industry "best practices" are used as evaluation criteria for all risk areas. In addition, OFHEO will augment its expertise in evaluating accounting practices at the Enterprises.

In addition to the new examiners, OFHEO is requesting \$400,000 to conduct a requirements analysis and to build a prototype of an automated examination tool that OFHEO calls the Examiner Workstation. The Examiner Workstation will allow examiners to create, store and retrieve electronically their examination work papers and risk assessments, and to have access to Enterprise data and risk measurement analytics and reports. The Examiner Workstation will increase productivity by providing examiners with a comprehensive tool that will enable them to access information necessary to assess risk from a single software application on their computer, both onsite and off-site (at the Enterprises). The Examiner Workstation is similar in concept to initiatives being developed at the Federal Reserve and the Comptroller of the Currency.

B. Capital Adequacy

Three positions are requested to strengthen OFHEO's ability to assess the Enterprises' capital adequacy and continue to ensure that the risk-based capital stress test is effectively capturing risk. These positions will give OFHEO needed capacity to analyze and evaluate stress test outputs and conditions in order to inform the Director on the drivers of changes in risk-based capital requirements. In addition, OFHEO is requesting \$500,000 to purchase financial software to analyze Enterprise asset/liability positions and to value securities with option features. These tools will be used to strengthen OFHEO's analytic capacity by leveraging current staff resources to measure and analyze Enterprise risk. Also OFHEO is requesting \$165,000 to purchase historical sub-prime mortgage performance data from a private vendor. This data will be used to estimate the risk to the Enterprises and the associated required capital from purchasing higher risk sub-prime mortgages.

C. Market and Industry Analysis

Three positions are requested to strengthen OFHEO's capacity to stay current with and analyze the implications of the rapid changes occurring in the primary and secondary mortgage markets and securities markets. These positions will be used to analyze Enterprise disclosure issues, technological changes, house prices, and securities and derivatives used by the Enterprises.

D. Information Technology Supporting Safety and Soundness Programs

Five positions are requested to add required expertise to maintain and expand OFHEO's data warehouse and Surveillance and Monitoring System (SAMS). These positions would be used to integrate and maintain additional FHA and sub-prime mortgage performance data into OFHEO's existing data warehouse and to sort the data into data sets and reports that OFHEO examiners, researchers and modelers can productively use.

OFHEO is also requesting \$450,000 for a disk array that compliments the large-scale computer and tape back-up facility approved for fiscal year 2002. This disk array will allow large data sets to be processed more quickly, which will improve the productivity of OFHEO's researchers and modelers.

Initiative Two: Strengthening OFHEO's Infrastructure

OFHEO is also requesting funding for three new positions to strengthen administrative programs and overall program management. These positions would strengthen performance planning, reporting, and ongoing management to achieve OFHEO's performance goals, improve human resources support services, and support financial accounting to ensure smooth integration of administrative and financial systems.

In addition, OFHEO is requesting \$1.2 million to develop and implement an integrated administrative and financial system compliant with Joint Financial Management Improvement Program standards and create a management information system directly linked to the financial system. Currently OFHEO is supported by several other agencies and the disparate administrative systems are not integrated making tracking and control time-consuming and labor intensive. This configuration does not comply with new Federal standards and does not meet OFHEO's requirements for efficient operations and readily usable information to support program and management decisions. OFHEO would seek integrated financial and administrative services from a single federal provider or implement a system that has been tested and certified by Joint Financial Management Improvement Program meeting requirements to be placed on the Government Services Schedule for procurement by Federal agencies.

The request also includes a Reception and Representation Fund of \$500. The fund would enable the Director to host meetings with industry and other external stakeholders to disseminate information and exchange ideas.

Funding

The following table summarizes obligations for OFHEO by object class.

Office of Federal Housing Enterprise Oversight

	ACTUAL 2001 a/	ENACTED 2002 b/	ESTIMATE 2003	INCREASE + DECREASE - 2003 vs 2002
	(Dollars in Thousands)			
Personal Services	\$14,023	\$16,755	\$20,741	+\$3,986
Travel and Transportation Of Persons	\$117	\$302	\$417	+\$115
Transportation Of Things	\$6	\$10	\$10	...
Rent, Communications, and Utilities	\$2,780	\$2,537	\$3,100	+\$563
Printing and Reproduction	\$115	\$232	\$158	-\$74
Other Services	\$3,256	\$2,094	\$4,884	+\$2,790
Supplies and Materials	\$157	\$328	\$346	+\$18
Furniture and Equipment	\$1,064	\$4,392	\$1,187	-\$3,205
Land & Structure	<u>\$1,080</u>	<u>\$450</u>	<u>\$0</u>	<u>-\$450</u>
Total Obligations	\$22,598	\$27,100	\$30,843	+\$3,743

a/ Actual obligations include a recovery of \$605,000 of prior year obligations.

b/ Includes \$100,000 anticipated recovery of prior year obligations in fiscal year 2002.

1. CHANGES FROM ESTIMATES INCLUDED IN 2002 BUDGET

OFHEO received its full fiscal year 2002 budget request of \$27,000,000. The proposed fiscal year 2003 Budget seeks to strengthen safety and soundness activities through increased examination staffing, additional risk and market analysis staffing, additional information analysis staffing, and enhanced automated tools.

The Enacted Budget for fiscal year 2001 was \$3.8 million less than our request of \$25.8 million. OFHEO reallocated resources internally to address priorities and focus on the risk-based capital rule. This required delaying the development of a prototype of the proposed Examiner Workstation; decreasing the resources devoted to the Surveillance and Monitoring System (SAMS) development; and eliminating funding for the integrated administrative and financial system to bring OFHEO into compliance with the Federal Financial Management Improvement Act and Joint Financial Management Improvement Program standards. Each of the initiatives curtailed or eliminated are re-requested in the fiscal year 2003 Budget.

ANALYSIS OF INCREASES AND DECREASES

	CURRENT	
	ESTIMATE	ESTIMATE
	<u>2002</u>	<u>2003</u>
	(Dollars in thousands)	
Prior-year obligations.....	\$22,598	\$27,100
Estimates for personal services.....	+2,732	+3,986
Change to travel costs.....	+185	+115
Change to transportation of things.....	+4	+0
Change to rent, communications and utilities	-243	+563
Change to printing and reproduction.....	+117	-74
Change to other services.....	-1,162	+2,790
Change to supplies and materials.....	+171	+18
Change to furniture and equipment.....	+3,328	-3,205
Change to land and structure.....	<u>-630</u>	<u>-450</u>
Total Obligations.....	\$27,100	\$30,843

EXPLANATION BY OBJECT CLASS

Personal Services. OFHEO's fiscal year 2002 budget contains funding for 118 FTE, essentially flat with the positions on the fiscal year 2001 staffing plan. The fiscal year 2003 budget supports an increase in FTE of 24, bringing the total to 142. This is the bare minimum staff required in fiscal year 2003 to ensure that OFHEO has staffing at an adequate level to fulfill its safety and soundness mission in the oversight of Fannie Mae and Freddie Mac. The Enterprises continue to grow and to develop increasingly complex business practices, which OFHEO must be able to evaluate in order to fully assess their safety and soundness. The risk-based capital stress test is a sophisticated tool to measure specific risks mandated by Congress and OFHEO must ensure that the tool is kept up-to-date by effectively capturing changing risks, and compliment the results of that tool with qualitative analysis to make more complete safety and soundness determinations. Nearly 90 percent of the new positions contribute directly to strengthening the oversight capacity of the Office. The balance of the new positions would enhance existing performance planning and reporting, human resources and financial management activities. The fiscal year 2003 budget also includes full funding for retirement costs of \$843,000, compared to past years when these costs were reported in a government-wide centralized program and not reflected in individual programs.

Travel. OFHEO is requesting a 38 percent increase in travel to support the additional staff, provide sufficient resources for examiner related travel and outreach activities, and fund standard increases in travel costs.

Transportation of Things. OFHEO does not anticipate paying relocation expenses for new staff. This budget includes shipping costs for OFHEO's supplies and equipment.

Rent, Communications and Utilities. The proposed fiscal year 2003 budget reflects base rent increases for existing space.

Printing and Reproduction. OFHEO is projecting that printing costs will decrease in fiscal year 2003. This is largely attributable to the completion of the regulatory infrastructure and the risk-based capital regulation.

Other Services. The proposed fiscal year 2003 budget reflects an increase of \$2.8 million in other services. Of the \$2.8 million, \$1.2 million is requested for the procurement and implementation of an integrated administrative and financial system. This would include a requirements analysis, system procurement, data conversion and implementation as well as the creation of a management information system directly linked to the integrated system. OFHEO is also seeking \$500,000 to purchase software to analyze Enterprise asset/liability positions and value securities with option features. In addition, OFHEO is requesting \$165,000 to secure mortgage information from a commercial source to strengthen OFHEO's oversight program and policy analysis capability. OFHEO also needs \$400,000 to develop a prototype of an automated Examiner Workstation that will

dramatically increase the analytic capability and efficiency of examiners onsite at the Enterprises and in the OFHEO office. The budget continues to fund contract services for information systems and specialist support services and training for OFHEO employees.

Supplies and Materials. The small increase of 5 percent in supplies and materials represents increases to support new staff and professional publications to support policy analysis.

Furniture and Equipment. The 73 percent decrease in the proposed fiscal year 2003 Budget from the fiscal year 2002 Budget Request primarily represents the \$4 million capital acquisition of a large computer system planned for fiscal year 2002. The proposed fiscal year 2003 budget includes \$450,000 for the disk array, an incremental cost associated with the fiscal year 2002 capital acquisition. In addition, it supports replacement of broken and obsolete equipment, and continues existing software licenses and maintenance agreements.

Land and Structure. The \$1,080,000 in this category for fiscal year 2001 is primarily the phased replacement of outdated cabling with fiber optic cable. It also includes the construction of a new computer room to house OFHEO's computer infrastructure and the construction of office space into work areas for use by examination staff. In fiscal year 2002, OFHEO plans to make improvements to existing space to upgrade lighting and office fixtures to improve the work environment. OFHEO does not anticipate any additional land and structure expenses for fiscal year 2003.

PROGRAM DESCRIPTION

1. SCOPE OF ACTIVITY

OFHEO functions as an independent office within HUD, responsible for regulation of Fannie Mae and Freddie Mac in matters of capital adequacy and financial safety and soundness. The Office is headed by the Director who is appointed by the President for a 5-year term and is responsible for the overall operation of OFHEO.

The Act requires OFHEO to develop and maintain a stress test to determine risk-based capital requirements and to conduct other research and financial analysis necessary for effective regulatory oversight of the GSEs. OFHEO is also required by statute to conduct annual examinations of Fannie Mae and Freddie Mac to determine the condition of each Enterprise for the purpose of ensuring their financial safety and soundness. The examinations are designed to identify the overall risks in the business activities of the Enterprises, and to determine if those risks are being prudently managed, controlled, and monitored. Additional special examinations may be conducted as necessary, as determined by the Director.

2. WORKLOAD

A. **2001 Accomplishments**

Following are specific accomplishments during 2001:

RULEMAKING

- published final risk-based capital regulation;
- published proposed and final regulation on executive compensation;
- published proposed regulation clarifying minimum standards affecting corporate governance and internal controls of the Enterprises;
- published proposed regulation to implement the prompt corrective action provisions of the 1992 Act and to provide for early supervisory intervention;
- published proposed flood insurance regulations;

Office of Federal Housing Enterprise Oversight

- published proposed and final regulations to clarify policies and procedures for calculating and collecting annual assessment from Enterprises;
- published proposed and adopted amendments to Rules of Practice and Procedure regarding enforcement proceedings;
- published final regulation making inflation adjustment for civil money penalty provisions of Rules of Practice and Procedure regulation;
- published final regulation reorganizing and renumbering OFHEO regulations to accommodate anticipated expansions of regulatory infrastructure;
- drafted proposed regulations implementing the Rehabilitation Act and submitted to DOJ for review;
- adopted OFHEO policy statement on minimum safety and soundness standards for the Enterprises;
- adopted OFHEO policy statement on Non-Mortgage Liquidity Investments; and
- adopted OFHEO policy statement to provide for periodic review of regulations.

EXAMINATION AND OVERSIGHT

- completed the CY 2000 and initiated the CY 2001 annual continuous risk-based examinations of the Enterprises to ensure a comprehensive, ongoing assessment of safety and soundness;
- communicated the results and conclusions of the CY 2000 examinations to the Boards of Directors of the Enterprises and to the Congress;
- maintained the surveillance and monitoring programs to ensure a comprehensive and timely assessment of the safety and soundness of the Enterprises;
- hosted and participated in joint meetings of the GSE Examination Council to foster communications among federal agencies that supervise government sponsored enterprises; and
- participated in professional development and joint training projects with other federal financial regulatory agencies to maintain and enhance examiners' expertise and to stay abreast of best practices in examination.

RESEARCH AND POLICY ANALYSIS

- classified each of the Enterprises as "adequately capitalized" each quarter applying regulatory minimum capital standards;
- continued quarterly publication of OFHEO's House Price Index, documenting changes in home prices for the nation, each state, the nine census regions, and metropolitan areas;
- made a full and complete Report to Congress on OFHEO's activities and the condition of the Enterprises on June 15, 2001;
- completed independent validation and verification of aspects of the Financial Simulation Model;
- completed the RBC Report specifications for the Enterprises' data submission for the risk-based capital calculations;
- developed the RBC stress test model;
- provided the Enterprises and the public with the source code to run the stress test;
- began development of an analytical framework for analysis of Financial Simulation Model results to inform the Director of risks, trends and emerging issues related to the financial condition of the Enterprises;
- began research and analysis of evolving risk factors for eventual incorporation in the stress test, including credit scoring and subprime lending;
- solicited and received public comment on research questions for a study of systemic risks related to the Enterprises and conducted research for the study;
- published a study of mortgage markets and the Enterprises in 2000, including historical Enterprise data;
- conducted research in areas of house prices, housing finance, safety and soundness regulation, financial services industry consolidation, and

Enterprises financial performance. Published five papers in professional journals and books; and

- continued to monitor changes to the comparability of executive compensation and reviewed four termination packages at the Enterprises.

OFHEO INFRASTRUCTURE

- received an unqualified (clean) audit opinion on OFHEO's Year 2000 financial report;
- initiated independent review of OFHEO's information security program, as mandated by the Government Information Security Reform Act;
- completed draft of OFHEO's 5-year Information Technology Plan;
- installed hardware and software upgrades to the OFHEO information technology infrastructure to support migration to a high-speed network; and
- established facility for secure electronic transmission of GSE data.

B. 2002 Plan

OFHEO has identified the following objectives for completion in 2002:

EXAMINATION AND OVERSIGHT

- complete the CY 2001 and initiate the CY 2002 annual continuous risk-based examinations of the Enterprises to ensure a comprehensive, ongoing assessment of safety and soundness;
- communicate the results and conclusions of the CY 2001 examinations to the Boards of Directors of the Enterprises and to the Congress;
- maintain the surveillance and monitoring programs to ensure a comprehensive and timely assessment of the safety and soundness of the Enterprises;
- host and participate in joint meetings of the GSE Examination Council to foster communications among federal agencies that supervise government sponsored enterprises; and
- participate in professional development and joint training projects with other federal financial regulatory agencies to maintain and enhance examiners' expertise and to stay abreast of best practices in examination.

RESEARCH AND POLICY ANALYSIS

- continue quarterly classification of the capital adequacy of the Enterprises, applying minimum capital standards;
- calculate capital levels quarterly with the risk-based capital stress test and analyze the results to facilitate the Enterprises' transition to the risk-based capital regulatory regime;
- continue quarterly publication of OFHEO's House Price Index, documenting changes in home prices for the nation, each State, the nine census regions, and metropolitan areas;
- publish a median house price index for use by OFHEO and to support HUD and Treasury programs;
- make a full and complete Report to Congress on OFHEO's activities and the condition of the Enterprises by June 15, 2002;

- evaluate new programs proposed by either Enterprise to determine if they could risk significant deterioration of the financial condition of that Enterprise;
- develop and incorporate into the Financial Simulation Model appropriate stress test treatments for new Enterprise activities;
- improve the Financial Simulation Model based on OFHEO's research results and emerging developments affecting the Enterprises;
- continue development of an analytical framework for analysis of Financial Simulation Model results to inform the Director of risks, trends and emerging issues related to the financial condition of the Enterprises;
- research and analyze new risk-measurement technologies for future incorporation in the stress test;
- publish a study of systemic risk related to the Enterprises;
- publish a review of mortgage markets and the Enterprises in 2001, including historical Enterprise data;
- continue research in the areas of mortgage, housing and securities markets to better understand evolving and potential future changes in Enterprise risks; and
- conduct a study of the comparability of the executive compensation at the Enterprises with compensation at peer organizations and review termination packages at the Enterprises.

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RULEMAKING

- publish final prompt corrective action and supervisory response regulation;
- publish final corporate governance regulation;
- publish proposed and final amendments to the risk-based capital regulation;
- publish proposed and final amendments to minimum capital regulation to accommodate changes in Generally Accepted Accounting Principles and to clarify reporting requirements and procedures;
- publish proposed amendment to minimum capital regulation to make supervisory monitoring of minimum capital more transparent;
- publish final flood insurance regulation;
- publish proposed regulations related to information systems and technology practices of the Enterprises;
- publish proposed regulation codifying policies on minimum safety and soundness standards;
- publish proposed and final regulations implementing the Rehabilitation Act;
- ascertain need for financial disclosure regulations and publish advance notice of proposed rule making (ANPR) or proposed regulation if determined appropriate; and
- ascertain need for corporate structure regulation and publish ANPR or proposed regulation if determined appropriate.

OFHEO INFRASTRUCTURE

- purchase and install large-scale server to ensure that OFHEO can produce the quarterly risk-based capital calculations, quarterly House Price Index, and examination and research projects timely;
- purchase and install tape back-up solution to archive stress test runs involving large amount of data and calculations;
- continue to develop, implement and improve administrative and information systems and policies to support OFHEO's activities using the principles of the Government Performance and Results Act, the Government Management Reform Act, the Information Technology Management Reform Act and the Government Information Security Reform Act;
- continue to seek independent audit of OFHEO's financial statement and implement applicable audit recommendations from the prior year;
- establish a direct connection to the National Finance Center (NFC) to improve the efficiency of processing personnel actions;
- complete OFHEO's 5-year Information Technology Plan;
- continue to seek independent review of OFHEO's information security program, as mandated by the Government Information Security Reform Act, and implement applicable recommendations from the prior year; and
- continue to improve the reliability and availability of the computer resources that support the regulatory infrastructure.

B. 2003 Goals

OFHEO has identified the following objectives for completion in 2003:

EXAMINATION AND OVERSIGHT

- restructure the examination activities to better align examination resources to existing and emerging risks at the Enterprises;
- complete the CY 2002 and initiate the CY 2003 annual continuous risk-based examinations of the Enterprises to ensure a comprehensive, ongoing assessment of safety and soundness. For those examinations, review and evaluate each of the following program areas:
 - Credit Risk Program - assesses the risk that borrowers and counterparties will fail to meet their contractual or other obligations to the Enterprises;
 - Interest Risk Program - assesses the risk associated with movements in interest rates, including changes in: the level of interest rates; the shape of the yield curve; the level of volatility; and the relationships or spreads among various yield curves or indices;
 - Liquidity Management Program - assesses the Enterprises' ability to meet its obligations as they come due and to transact the next incremental dollar of business cost effectively;
 - Information Technology Program - assess the infrastructure, or the general controls, needed to safeguard data, protect computer application programs, prevent system software from unauthorized access, and ensure continued computer operations in case of unexpected interruptions;
 - Business Process Controls Program - assess the process employed to ensure business initiatives and endeavors are considered and evaluated within a complete business context with particular attention directed to risk assessment and risk management framework;
 - Internal Controls Program - Assess the plan of organization, methods and procedures adopted by management to ensure that: goals and objectives are met; resources use is consistent with laws, regulations and policies; resources are safeguarded against waste, loss and misuse; and reliable data are obtained, maintained and fairly disclosed in reports;
 - Board Governance Program - assess the manner in which the Boards discharge their duties and responsibilities in governing the Enterprises;
 - Management Process Program - assess the processes used to drive behaviors to support the Enterprises' defined corporate goals, standards and risk tolerances;
 - Audit Program - assess the appropriateness of the Enterprises' Board and management reliance on internal and external audits;
 - Management Information Program - assess the effectiveness, accuracy and completeness of information and reports; and
 - Model Exposure Program - evaluate the use and operation of internal models to determine that poor business decisions do not result from a model that is flawed in its logical operations, incorrectly operated or inappropriately applied.
- communicate the results and conclusions of the fiscal year 2002 examinations to the Boards of Directors of the Enterprises and to the Congress;

- enhance the examination program with additional depth in existing program areas, expanded coverage of emerging Enterprise business initiatives, and dedicated infrastructure positions to ensure the development and implementation of a "best practices" program;
- develop a prototype for an Examiner Workstation, a technology initiative to combine the risk assessment process of the examination and oversight functions through the use of integrated software;
- maintain the surveillance and monitoring programs to ensure a comprehensive and timely assessment of the safety and soundness of the Enterprises;
- host and participate in joint meetings of the GSE Examination Council to foster communications among federal agencies that supervise government sponsored enterprises; and
- participate in professional development and joint training projects with other federal financial regulatory agencies to maintain and enhance examiners' expertise and to stay abreast of best practices in examination.

RESEARCH AND POLICY ANALYSIS

- continue quarterly classification of the capital adequacy of the Enterprises, applying regulatory minimum capital standards;
- a year after the risk-based capital rule has been published in final, begin quarterly classification of capital adequacy using the risk-based capital standard;
- continue quarterly publication of OFHEO's House Price Index, documenting changes in home prices for the nation, each State, the nine census regions, and metropolitan areas;
- update the median house price index developed in fiscal year 2002;
- develop an additional house price index incorporating data on FHA-insured loans;
- make a full and complete Report to Congress on OFHEO's activities and the condition of the Enterprises by June 15, 2002;
- develop and incorporate into the Financial Simulation Model appropriate stress test treatments for new Enterprise activities;
- improve the Financial Simulation Model based on OFHEO's research results and emerging developments affecting the Enterprises;
- continue to analyze the risks of the Enterprises and improve analytic capacity using the Financial Simulation Model and other analytical tools;
- purchase and begin using new risk-measurement technologies to assess Enterprise risks that may not be captured in the stress test;
- publish a review of mortgage markets and the Enterprises in 2002, including historical Enterprise data;
- analyze the characteristics and performance of sub-prime markets;
- continue and expand research in the areas of mortgage, housing and securities markets to better understand evolving and potential future changes in Enterprise risks; and

- monitor changes to the comparability of the executive compensation and review termination packages at the Enterprises.

RULEMAKING

- publish final amendments to minimum capital regulation to make supervisory monitoring of minimum capital more transparent;
- publish final regulation affecting financial disclosures and reporting requirements for Enterprises, if determined to be appropriate;
- publish final regulation setting minimum standards for information systems and technology policies and practices of the Enterprises;
- publish proposed regulation to codify regulatory safety and soundness policy guidance affecting permissible activities and investments of Enterprises;
- track issues arising in the implementation of risk-based capital regulation to assess the need for changes to the regulation; and
- revise risk-based capital regulation, if needed, to incorporate new products and improvements in risk measurement and any alterations of legal standards or regulations.

OFHEO INFRASTRUCTURE

- purchase and install a disk array to accommodate the growth in on-line data that will be necessary to ensure that OFHEO can produce the quarterly risk-based capital calculations, quarterly House Price Index, and examination and research projects timely;
- continue to maintain and expand OFHEO's data warehouse to support OFHEO's risk assessment of the Enterprises. With this time series data, OFHEO's Surveillance and Monitoring program can provide a more robust analysis to update the risk profiles of the Enterprises;
- improve the quality and efficiency of OFHEO's current financial and human resources management systems by migrating these separate systems into an integrated system compliant with JFMIP standards, and link to an executive information system to support the effective management of OFHEO resources;
- continue to develop, implement and improve administrative and information systems and policies to support OFHEO's activities using the principles of the Government Performance and Results Act, the Government Management Reform Act, and the Information Technology Management Reform Act;
- continue to seek independent audit of OFHEO's financial statement and implement applicable audit recommendations from the prior year;
- continue to seek an independent review of OFHEO's information security program, evaluate the results and strengthen controls as necessary;
- continue to improve the reliability and availability of the computer resources that support the regulatory infrastructure; and
- develop internal procedures manual describing procedures for such matters as developing and processing regulations, holding a hearing, taking an enforcement action, and filing reports.

3. SUMMARY OF STAFFING REQUIREMENTS

All personnel in this office are assigned to Headquarters. OFHEO has no field offices. The FTE is as follows:

Office of Federal Housing Enterprise Oversight

	ACTUAL	ENACTED	ESTIMATE	INCREASE + DECREASE -
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2002 vs. 2003</u>
Full-time Equivalent	105	118	142	24