

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 fiscal year 2004 Budget Request proposes legislation that would provide direct funding to OFHEO. If enacted, this provision would put OFHEO on par with other safety and soundness regulators such as the Office of the 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 would provide the Office with the flexibility to manage 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. 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 2004 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. In so doing, OFHEO helps ensure the Enterprises are able to provide liquidity to the mortgage markets and promote homeownership.

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 2004 Budget seeks funding to enable the Office to perform essential oversight activities 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. At the center of OFHEO's regulatory program is the careful evaluation of these risks and their impact on the safety and soundness of the Enterprises.

The Enterprises engage in two principal lines of business: the buying and holding of mortgages, and the guaranteeing of securities backed by residential mortgages. The Enterprises' business decisions reflect their understanding, interpretation and management of risk. OFHEO must have the resources to understand and interpret the Enterprises' risk management strategies as well as how risks may evolve over time and what potential ramifications these risks may have within the United States' economy and housing sectors.

To put the explosive growth of the Enterprises into perspective, since the creation of OFHEO in 1993, the Enterprises have increased their overall mortgage business by more than 150 percent, partly by developing innovative mortgage, debt and derivatives products.

At the same time, the Enterprises have realigned their businesses 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 2002, they held 43 percent of their mortgages as assets. This realignment significantly alters the risk profile of the Enterprises, shifting risk management from credit guarantee to both credit risk and interest rate risk management. Thus, OFHEO has had to shift its oversight activities to focus more on interest rate risk management, even as credit exposures were growing rapidly.

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 standardized issuances. 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 \$1.3 trillion on September 30, 2002, representing a seventeen-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.

Another developing trend is the extent to which consumers are prepaying mortgage loans more rapidly than in the past. This development may represent a shift in the market risk of the Enterprises. As such, OFHEO must be positioned to evaluate this and other trends and understand any changes in an Enterprise's risk profile as it evolves.

OFHEO's small examination staff is challenged to keep up with the constantly evolving mortgage finance products and business strategies used by the Enterprises. With funding in fiscal years 2003 and 2004, OFHEO will be able to expand its examination staff and develop our Examiner Workstation, which will augment information available to examiners in the field.

OFHEO is realigning its resources away from the development of the Risk-Based Capital Rule toward utilizing the wealth of information provided by the stress test and the analytical models developed for the stress test. With resources received in fiscal year 2003 OFHEO will be expanding its capacity to use this information to analyze developing trends.

Three solid pillars support OFHEO's regulatory regime. These are examinations, capital standards, and research. The increase in staffing and resources requested for fiscal year 2004 represents a fully utilized, analytics-based regulatory organization that can provide value-added insights to changing housing finance markets, and ensure that safety and soundness factors are examined and evaluated.

BUDGET HIGHLIGHTS

The following table summarizes the funding and staffing levels in OFHEO's fiscal year 2002 and the proposed fiscal years 2003 and 2004 Budgets.

	ACTUAL 2002	ESTIMATE 2003	ESTIMATE 2004	INCREASE + DECREASE - 2004 vs 2003
				(Dollars in Thousands)
<u>From Appropriation:</u>				
Budget Authority (Assessed to GSE's)	\$27,000	\$30,000	\$32,415	+\$2,415
Interagency Agreements <u>a/</u>	122	75	...	-75
Prior Year Recovery <u>b/</u>	<u>216</u>	<u>70</u>	<u>...</u>	<u>-70</u>
Subtotal	27,338	30,145	32,415	+2,270
Total Obligations	27,336	30,145	32,415	+2,270
Unobligated Balance EOY
Outlays (net)	26,794	29,000	31,000	+2,000
Full-Time Equivalents	112	135	151	+16

- a/ The \$121,703 in 2002 represents the Economy Act Agreement between OFHEO and the Small Business Administration (SBA). OFHEO is assisting SBA in the development of an econometric equation-based computer model. The Office of Management and Budget (OMB) apportioned this amount to OFHEO for obligation during 2002. The \$75,000 in 2003 represents an extension of the 2002 Economy Act Agreement between OFHEO and the SBA.
- b/ OMB approved OFHEO's request to recover prior year obligations for re-obligation during fiscal year 2002. OMB reapportioned \$216,000 to OFHEO as an increase in budgetary resources available to OFHEO during fiscal year 2002. OFHEO has estimated that about \$70,000 in prior year obligations may be recovered during fiscal year 2003 and reapportioned by OMB to OFHEO for re-obligation in fiscal year 2003.

SUMMARY OF PROPOSED 2004 BUDGET

The proposed fiscal year 2004 Budget of \$32,415,000 represents an 8.1 percent increase from the fiscal year 2003 Budget Request of \$30,000,000. The proposed fiscal year 2004 Budget funds OFHEO's existing oversight activities and continues the initiative begun in 2003 to strengthen safety and soundness programs. The initiative will be accomplished by bolstering OFHEO's capacity to oversee Enterprise risk management activities.

Initiative: Strengthen Safety and Soundness Programs

OFHEO is requesting funding for eight new positions to strengthen its core safety and soundness programs. OFHEO is also seeking additional funding to procure contract services to complete development of the Examiner Workstation.

The eight new positions are to enhance the Examination and Oversight Program. This is the second phase of a plan proposed last year to expand OFHEO's examination staff. In 2003, OFHEO proposed a 3-year implementation plan to expand examination staff to 66. OFHEO currently expects to add examiners over 4 years to meet its goal. 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 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 activities and for key areas of specialization including accounting practices, risk measurement methods, operational risk, and Risk-Based Capital compliance. Finally, this increased capacity will bolster the program's infrastructure to incorporate regulatory and private sector "best practices" evaluating corporate governance and risk management strategies and techniques, and to ensure consistency and relevance of safety and soundness standards being employed.

In addition to the new examiners, OFHEO is requesting \$400,000 to complete development of a prototype of an automated examination tool that OFHEO calls the Examiner Workstation. The Examiner Workstation will allow examiners to electronically create, store and retrieve their examination work papers and risk assessments, and to have access to Enterprise data and risk measurement analytics and reports. The Examiner Workstation is similar in concept to initiatives being developed at the Federal Reserve and the Comptroller of the Currency.

The request also includes a Reception and Representation Fund of \$1,000. The fund would enable the Director to host meetings with industry and other external stakeholders to disseminate information and exchange ideas.

Funding

	ACTUAL	ESTIMATE	ESTIMATE	INCREASE + DECREASE -
	2002 a/	2003 b/	2004	2004 vs 2003
		(Dollars in Thousands)		
Personal Services	\$15,493	\$19,975	\$24,224	+\$4,249
Travel and Transportation Of Persons	95	300	332	+32
Transportation Of Things	6	10	11	+1
Rent, Communications, and Utilities	2,256	3,300	3,575	+275
Printing and Reproduction	57	150	60	-90
Other Services	1,441	4,920	2,707	-2,213
Supplies and Materials	128	180	278	+98
Furniture and Equipment	5,657	1,180	1,228	+48
Land & Structure	<u>2,203</u>	<u>130</u>	<u>...</u>	<u>-130</u>
Total Obligations	27,336	30,145	32,415	+2,270

b/ Fiscal year 2003 includes \$75,000 for an extension to the 2002 Interagency Agreement with SBA and an anticipated recovery of \$70,000.

OFHEO's fiscal year 2003 Budget Request is pending Congressional action. Based on Congressional action thus far, OFHEO anticipates an enacted level of \$30 million, which excludes funding for post-retirement costs. The fiscal year 2004 Budget Request carries forward the 3-year initiative to strengthen safety and soundness programs. OFHEO may also need to extend the phase-in period from 3 to 4 years depending on approved funding levels for 2004. For fiscal year 2004, OFHEO is seeking additional funding to add eight examination positions and to complete the development of the Examiner Workstation. The balance of the 2004 Budget Request continues existing programs and services.

ANALYSIS OF INCREASES AND DECREASES

EXPLANATION BY OBJECT CLASS

Personal Services.

In OFHEO's fiscal year 2003 Budget Request, it sought personal services funding of \$20.7 million for 142 FTE. The Budget Request assumed 145 positions including 24 new positions for fiscal year 2003. OFHEO's current estimate for fiscal year 2003 is 135 FTEs, a reduction of seven FTEs attributed to slower hiring due to uncertainty about OFHEO's fiscal year 2003 budget. The current revised personal services estimate is \$19.9 million.

The fiscal year 2004 Budget Request includes personal services funding of \$24.2 million for 151 FTE including eight new positions planned for 2004. The eight new positions are examination staff and will strengthen OFHEO's capability to evaluate risk management at the Enterprises.

In summary, the 12 percent increase in the personal services budget for 2004 reflects the cost of all planned 2003 positions, plus phased hiring during fiscal year 2004 for the 8 new positions. This represents the minimum staff required in fiscal year 2004 to ensure an adequate level to fulfill the 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. All of the new positions contribute directly to strengthening the oversight capacity of the Office.

Travel. OFHEO has lowered the funding requested for travel based on historical use of travel funds. During fiscal year 2002, OFHEO used only \$95,000 of travel funds. This reflects only the most essential travel because most staff were involved in the implementation of the Risk-Based Capital Rule. In fiscal year 2003, OFHEO requested \$417,000, and has now revised the 2003 estimate down to \$300,000 for 135 FTE. For fiscal year 2004, OFHEO is requesting, \$323,000, a 10 percent increase over the revised 2003 estimate. OFHEO's examiners must continue local travel to both Enterprises as well as temporary duty travel to Enterprise sites located outside the Washington, D.C. area. OFHEO will also continue outreach activities and participate in skill enhancement seminars and conferences. The increase reflects the estimated cost of travel for 151 FTEs for fiscal year 2004.

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

Rent, Communications and Utilities. The proposed fiscal year 2004 Budget reflects an increase of 8 percent. The increase represents base rent costs for existing space and new space procured at the end of fiscal year 2002 to accommodate new staff. It also includes estimated telecommunications costs for fiscal year 2004.

Printing and Reproduction. OFHEO is projecting that printing costs will decrease in fiscal year 2004. This is largely attributable to the completion of the regulatory infrastructure.

Other Services. The proposed fiscal year 2004 Budget reflects a decrease of 45 percent in other services. In fiscal year 2003, OFHEO requested \$1 million for the procurement of an integrated administrative and financial system, and \$500,000 for new analytical tools to enhance the understanding of the stress test and risk tied to capital. The fiscal year 2004 Budget does not request additional funding for these items. The Budget Request supports continued use of existing analytic and data services. OFHEO also requests \$400,000 to complete development of a prototype of the automated Examiner Workstation. The Examiner Workstation will dramatically increase the analytic capability and efficiency of examiners onsite at the Enterprises and in the OFHEO office. The Budget continues to fund training for OFHEO employees in support of performance goals.

Supplies and Materials. The increase in supplies and materials reflects the new staff added in 2003 and 2004, and inflationary increases for business-related subscriptions.

Furniture and Equipment. The small increase in the proposed fiscal year 2004 Budget primarily represents the phased replacement costs of obsolete personal computers and peripherals, and continues existing software licenses and maintenance agreements.

Land and Structure. OFHEO will have completed leasehold improvements in fiscal year 2003, and will not require funding in 2004 for existing space improvements.

PROGRAM DESCRIPTION

- 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 a 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. 2002 Accomplishments

Following are specific accomplishments during 2002:

EXAMINATION AND OVERSIGHT

- completed the CY 2001 and initiated the CY 2002 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 2001 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 with staff 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.

ANALYSIS AND RESEARCH

- continued quarterly classification of the capital adequacy of the Enterprises, applying minimum capital standards;
- calculated capital levels quarterly with the Risk-Based Capital stress test and analyzed the results to facilitate the Enterprises' transition to the Risk-Based Capital regulatory regime;
- 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, 2002;
- evaluated new programs proposed by either Enterprise to determine if they could risk significant deterioration of the financial condition of that Enterprise;
- developed and incorporated appropriate treatments for new Enterprise activities into the Financial Simulation Model that is used to run the risk-based capital stress test;
- improved the Financial Simulation Model based on OFHEO's research results and emerging developments affecting the Enterprises;

- continued 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;
- researched and analyzed new risk-measurement technologies for future incorporation in the stress test;
- continued research on systemic risk related to the Enterprises;
- published a review of mortgage markets and the Enterprises in 2001, including historical Enterprise data;
- continued research in the areas of mortgage, housing and securities markets to increase understanding of evolving and potential future changes in Enterprise risks; and
- conducted a study of the comparability of the executive compensation at the Enterprises with compensation at peer organizations and reviewed termination packages at the Enterprises.

RULEMAKING

- published final prompt corrective action and supervisory response regulation;
- published final corporate governance regulation;
- published two proposed amendments and one final amendment to the Risk-Based Capital regulation;
- published one technical clarifying amendment to the Risk-Based Capital regulation;
- published final flood insurance regulation;
- published guidance related to information systems and technology practices of the Enterprises;
- published proposed and final regulation supporting safety and soundness standards at the Enterprises;
- determined need to publish proposed financial disclosure regulations and commenced coordination with other agencies and preparation of regulatory documents; and
- determined possible need for corporate structure regulation or other guidance and commenced preparation of Advance Notice of Proposed Rulemaking.

OFHEO INFRASTRUCTURE

- purchased and installed a 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;
- purchased and installed a tape back-up solution to archive stress test runs involving large amount of data and calculations;
- continued 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;
- received an unqualified (clean) audit opinion on OFHEO's Year 2001 Financial Report;
- established a direct connection to the National Finance Center (NFC) to improve the efficiency of processing personnel actions;
- completed OFHEO's 5-year Information Technology Plan;

- completed an independent review of OFHEO's information security program, as mandated by the Government Information Security Reform Act, and implemented applicable recommendations from the prior year; and
- continued to improve the reliability and availability of the computer resources that support the regulatory infrastructure.

B. 2003 Plan

OFHEO has identified the following objectives for completion in 2003:

EXAMINATION AND OVERSIGHT

- 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 by management 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 calendar 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;
- restructure examination activities to better align examination resources to existing and emerging risks at the Enterprises;

- conduct a feasibility study 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.

ANALYSIS AND RESEARCH

- 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 as well;
- 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 in supporting 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, 2003;
- develop and incorporate into the Financial Simulation Model appropriate stress test treatments for new Enterprise activities;
- improve the Financial Simulation Model as necessary 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 tools to assess Enterprise risks that may not be captured in the stress test;
- publish a study of systemic risk related to the Enterprises;
- 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 improve understanding of evolving and potential future changes in Enterprise risks; and
- monitor changes to the comparability of executive compensation and review termination packages at the Enterprises.

RULEMAKING

- publish proposed and final amendments to minimum capital regulation to make supervisory monitoring of minimum capital more transparent, to accommodate changes in Generally Accepted Accounting Principles, and to clarify reporting requirements and procedures;
- Publish final amendment to Risk-Based Capital regulation to accommodate changes in Generally Accepted Accounting Principles and any other amendments necessary to reflect technical corrections and minor adjustments to the stress test.
- publish proposed and final regulations implementing the Rehabilitation Act;

- publish proposed and final regulation affecting financial disclosures and reporting requirements for Enterprises, if determined to be appropriate;
- publish proposed and final amendments to the Corporate Governance regulations;
- publish Advance Notice of Proposed Rulemaking regarding need for corporate structure regulation;
- 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, Risk-Based Capital report instructions, and supporting guidance, as needed, to incorporate new activities 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 making procurement decisions to migrate 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.

C. 2004 Goals

OFHEO has identified the following objectives for completion in 2004:

EXAMINATION AND OVERSIGHT

- complete the CY 2003 and initiate the CY 2004 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; reliable data are obtained, maintained and fairly disclosed in reports; and accounting policies and practices conform with GAAP prescriptions;
- 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 by management 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 calendar year 2003 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;
- restructure examination activities to better align examination resources to existing and emerging risks at the Enterprises;
- develop a prototype of the Examiner Workstation, a technology initiative to combine the risk assessment and risk analytics processes of the examination and oversight functions through the use of integrated software;
- maintain 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;
- host and participate in joint meetings with safety and soundness regulators of financial depository institutions, particularly with supervisors of large and complex financial intermediaries, to foster communications on examination policies, procedures, and practices; 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.

ANALYSIS AND RESEARCH

- continue quarterly classification of the capital adequacy of the Enterprises, applying both regulatory minimum capital standards and 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 2003;
- 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, 2004;
- develop and incorporate into the Financial Simulation Model appropriate stress test treatments for new Enterprise activities;
- continue to analyze the risks of the Enterprises using the Financial Simulation Model and other analytical tools for sensitivity and data analysis;
- publish a review of mortgage markets and the Enterprises in 2003, including historical Enterprise data;
- continue research in the areas of derivatives; mortgage products; and mortgage, housing and securities markets to better understand evolving and potential future changes in Enterprise risks;
- further analyze the characteristics and performance of sub-prime markets and incorporate this analysis into risk assessments and risk-based pricing;
- initiate development of new approaches to risk measurement, management and monitoring, focused on off-site monitoring of the financial condition of the Enterprises; and
- monitor changes to the comparability of executive compensation and review termination packages at the Enterprises.

RULEMAKING

- commence review of OFHEO regulations pursuant to OFHEO's published regulatory review policy;
- track issues related to the Risk-Based Capital regulation to assess the need for changes to the regulation;
- revise Risk-Based Capital regulation, Risk-Based Capital report instructions, and supporting guidance documents, as needed and within available resources, to incorporate new activities and improvements in risk measurement and any alterations of legal standards or regulations;
- track issues related to the minimum capital regulation to assess the need for changes to the regulation; and
- if determined necessary during fiscal year 2003, prepare and publish final corporate structure regulation.

OFHEO INFRASTRUCTURE

- continue to improve the quality assurance program for OFHEO's Risk-Based Capital related systems;
- 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;
- continue the implementation of new financial and human resources management systems 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
- continue to maintain and improve 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:

	ACTUAL <u>2002</u>	CURRENT ESTIMATE <u>2003</u>	ESTIMATE <u>2004</u>	INCREASE + DECREASE - <u>2004 vs. 2003</u>
Full-time Equivalent	112	135	151	16