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# OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

## *FY 2000 - 2005 Strategic Plan*

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**SEPTEMBER 29, 2000 (with February 25, 2002 interim adjustment)**

**INTERIM ADJUSTMENT TO THE FY 2000-2005 STRATEGIC PLAN  
FEBRUARY 25, 2002**

This Interim Adjustment was issued with the FY 2003 Performance Plan on February 25, 2002. It substitutes for the four Strategic Objectives on page 7 of the Strategic Plan.

STRATEGIC OBJECTIVES

OFHEO established three\* strategic objectives to support the achievement of the strategic goal and ultimately, the accomplishment of OFHEO's mission.

1. Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements.\*
2. Enhance public understanding of the nation's housing finance system.
3. Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.

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\* With this performance plan, OFHEO is making an interim adjustment to its Strategic Plan by forming one strategic objective out of what had been two. Combining these into one strategic objective better demonstrates the connectivity between capital adequacy and safety and soundness. An Enterprise's capital adequacy is one of the indicators of safety and soundness and depends on factors in addition to meeting the minimum and risk-based capital standards. The final two strategic objectives have been renumbered.

# OFHEO FY 2000 – 2005 STRATEGIC PLAN

## September 29, 2000

### *OFHEO MISSION*

***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.***

### **Introduction**

In 1992 Congress created the Office of Federal Housing Enterprise Oversight (OFHEO) to reduce the risk of failure of Fannie Mae and Freddie Mac so that they could continue to accomplish their important public missions. These government sponsored enterprises (GSEs) play a critical role in housing finance, keeping funds flowing to mortgage lenders, and in turn, to homeowners. Through effective regulation of the Enterprises, OFHEO contributes to a robust housing sector in the United States and the health of the nation's economy.

OFHEO was established as an independent entity within the Department of Housing and Urban Development (HUD) by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the Act) (Title XIII of P.L. 102-550). Its operations are funded through assessments on Fannie Mae and Freddie Mac and represent no direct cost to the taxpayer. To fulfill its mission, OFHEO has regulatory authority similar to other Federal financial regulators such as the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board. OFHEO's responsibilities include broad rulemaking authorities and specific authorities to conduct annual examinations, set capital standards, take enforcement actions and conduct research.

This is OFHEO's second strategic plan pursuant to the Government Performance and Results Act of 1993. It sets out the Office's mission, strategic goal and strategic objectives for the next five years (FY 2000-2005). To provide a context for what OFHEO does and the challenges it faces in achieving its mission, the next sections describe the Enterprises, the environments in which they operate and emerging trends.

### **The Enterprises and the Mortgage Markets**

Fannie Mae and Freddie Mac (also known as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, respectively) are publicly held companies chartered by Congress. They were established to create a secondary mortgage market to ensure a ready supply of mortgage funds for housing, including housing for low- and moderate-income families.

In performing their mission, they link capital market investors and primary lenders and have become two of the nation's largest financial institutions. The linkage helps provide continuous access to funds for mortgage lenders and lower interest rates for borrowers. In 1999, the two

Enterprises assisted in the funding of \$566 billion of mortgages, including 42 percent of the total volume of single-family loans originated that year. Since 1991, they have assisted in funding \$3.3 trillion of mortgages. Homeownership today is the highest in the nation's history at 67 percent.

To assist Fannie Mae and Freddie Mac in achieving their public mission, they receive numerous explicit benefits from the Federal government. These include an exemption from state and local income taxes, an exemption from the registration requirements of the Securities and Exchange Commission (SEC), and conditional credit lines available with the U.S. Treasury. However, the most important benefit is implicit. Because of investors' belief in an implied U.S. government guarantee on their securities, the Enterprises have been able to borrow money more cheaply and without the practical volume restrictions faced by other AAA-rated companies. This market perception also allows the Enterprises to operate with a higher degree of leverage than fully private firms.

The Enterprises have two principal lines of business. First, they guarantee securities backed by pools of mortgages. Their guarantee of the timely payment of principal and interest increases the attractiveness of the securities to capital market investors, but exposes the Enterprises to losses when borrowers default. In return, the Enterprises receive a share of the interest payments made by borrowers. Since 1991, the outstanding amount of mortgage-backed securities guaranteed by the Enterprises has more than doubled to \$1.8 trillion.

Second, the Enterprises invest in mortgage assets. These investments include a large portion of the mortgage-backed securities they have guaranteed, other mortgage-backed securities, and mortgages purchased directly from lenders. The Enterprises fund their mortgage investments primarily by issuing debt to capital market investors. Interest rates on the mortgage assets are generally higher than those on the debt, providing a stream of income to the Enterprises. These investments also expose the Enterprises to interest rate risk. Since 1991, mortgage investments at the Enterprises have grown by more than 475 percent to \$900 billion.

### ***The Enterprises and the Capital Markets***

In addition to their lead role in the secondary mortgage markets, the Enterprises are major players in the capital markets, particularly in the debt and derivatives markets. They enter the debt markets to fund the growth in their assets, and participate in the derivatives markets to hedge against the risks inherent in the assets that they hold.

In the debt markets, especially the long-term debt markets, the Enterprises are two of the largest private issuers in the world. At mid-year 2000, the Enterprises had over \$963 billion in debt outstanding. Because of their GSE status, the demand for Enterprise debt is strong. Bank and thrift investments in Enterprise debt are unrestricted, and many investors are buying Enterprise debt as substitutes for shrinking Treasury debt. Major investors in Enterprise debt include commercial banks, thrifts, pension funds, mutual funds, and foreign central banks. In addition to Enterprise debt, investors hold over \$1.2 trillion in Fannie Mae and Freddie Mac mortgage-backed securities. Enterprise debt and mortgage-backed securities account for about two-thirds of what is known in the financial markets as "agency debt".

The Enterprises are also two of the largest end-users of derivatives. Derivatives are financial instruments whose values explicitly depend on values of other instruments or market indexes. The Enterprises use derivative financial instruments as an integral part of their management of the risks in their portfolio as do other large firms. Their use has increased by nearly 400 percent in the last five years, at a rate just above the annualized rate of growth of the derivatives market as a whole. In 1999, the combined notional amount of derivatives contracts used by the Enterprises totaled nearly \$700 billion, just over one percent of the derivatives market. These contracts include interest rate swaps, interest rate caps and floors, foreign currency swaps, futures, options, and forward rate agreements. Continued stability and liquidity in these markets contribute significantly to the Enterprises' efficient funding of their asset growth and management of the associated market risks.

### **Emerging Market Trends**

Federal policies, new technologies, efforts by Fannie Mae and Freddie Mac to provide more funds to the secondary mortgage markets and increase their earnings, and economic and demographic trends transformed the U.S. housing finance system in the 1990s. In the next five years, those forces are likely to bring additional changes for mortgage borrowers, lenders, the Enterprises, and other firms in the industry.

The Enterprises' GSE status should continue to give them advantages over other firms in the housing finance market. Various regulatory changes, such as HUD's new affordable housing goals for Fannie Mae and Freddie Mac, the implementation of risk-based capital requirements for the Enterprises and the Federal Home Loan Banks, and the new mortgage purchase programs initiated by these banks in recent years, may affect each Enterprise's volume of business, financing strategies and risk.

Improvements in computer and telecommunications technologies will allow mortgage lenders to achieve increased scale economies in the servicing component of the lending process, which is likely to spur additional consolidation in the industry. Fannie Mae, Freddie Mac, and other firms will increasingly use e-commerce/new technology to conduct business, and a growing share of lenders will use web sites to originate loans. Using statistical techniques to evaluate, or score, the credit risk not only of specific borrowers, but also of loans, will continue to foster new loan products, greater outreach to new borrowers, more competitive markets for mortgage credit risk, and more active management of delinquent loans. The Enterprises are likely to continue to increase their purchases of loans to a broader range of borrowers, including those with varied credit histories, expand the services they provide to lenders, and improve risk management. The uses of technology will inevitably create opportunities and risks.

Fannie Mae and Freddie Mac have each established goals to increase the supply of mortgage funds to homeowners and to sustain double-digit growth in their earnings per share. Each Enterprise is likely to continue rapid growth of its retained mortgage portfolio, expand the range of loans it buys, provide new services to lenders, and take steps to lower the yields on its debt securities. Buying more types of loans and rapidly growing their portfolios will continue to require that Fannie Mae and Freddie Mac increase their use of credit enhancements and

derivatives. Those risk management techniques increase the focus of risk management on the financial strength of counterparties with whom the Enterprises have made these agreements and the adequacy of the collateral they post. In addition, the pace at which the Enterprises' debt is growing and their increasingly central role in financial markets is likely to continue to raise concerns about the risks they pose to the financial system. If current Federal budgetary policies are unchanged, Treasury debt held by the public will fall dramatically in the next decade, in which case debt issued by Fannie Mae and Freddie Mac could replace Treasury securities as a benchmark in financial markets.

The pace of the economy, the stock market, and housing market activity will continue to influence the health of the housing finance system. For example, if the economy were to fall into recession, housing and mortgage market activity would likely decline. A national economic downturn would be the first major test of the changes in credit risk management and new loan products introduced by Fannie Mae and Freddie Mac in the last decade. A recession accompanied by higher interest rates would test the Enterprises' abilities to manage the interest rate risk associated with their large retained mortgage portfolios. In addition, household growth fueled by immigration and changes in the age structure of the population, including the aging of the baby boom generation, will affect the volume and composition of housing activity and the composition of mortgage demand.

### **Components of the Strategic Plan**

There are four major components to OFHEO's Strategic Plan: (1) mission statement, (2) strategic goal, (3) strategic objectives, and (4) strategies to achieve the objectives.

OFHEO's **mission statement** reflects its congressional mandate to ensure the safety and soundness of Fannie Mae and Freddie Mac and emphasizes the need to foster the strength and vitality of the nation's housing finance system. It also recognizes that success in carrying out this mission promotes a robust housing sector and a strong economy.

To accomplish its mission, OFHEO will focus on one **strategic goal** and four **strategic objectives** that are necessary to accomplish the strategic goal. In the following sections of the Strategic Plan, OFHEO will describe how achieving the strategic goal is linked to accomplishing the mission and how the four strategic objectives are necessary to achieve the strategic goal.

The performance measures noted for each Strategic Objective are examples of the performance measures that OFHEO will use for its Annual Performance Goals in the Annual Performance Plans. OFHEO uses outcome measures where relevant and available, and uses output measures when they are the best indicators of achieving an objective. Outcomes are the results of what OFHEO does. Outputs are OFHEO's products. As for all regulators, the outcomes or results of OFHEO's work are achieved through the actions of others. The Office provides regulation, supervision, guidance, review and a variety of products that influence the Enterprises and the financial markets. In this strategic plan and the annual performance plans, OFHEO will describe its strategies—how the office will achieve its goals and objectives—and use the most meaningful ways of measuring their achievement. The plan also describes management strategies that are necessary to achieve these strategic objectives.

This FY 2000-2005 Strategic Plan updates the FY 1998-2003 Strategic Plan under which OFHEO has been operating for the last several years. As in prior years, OFHEO will use this Strategic Plan as a guide in developing its annual plans and will use both as a reference point to maintain priorities during the operating years.

### **Program Evaluations**

OFHEO regularly evaluates its activities, strategies and progress toward achieving its goals throughout the year. The Office uses regular management meetings, “all hands” meetings, and management reports to communicate and discuss organizational goals and objectives, and the status of activities, which further their achievement. OFHEO management also uses the budget formulation and execution processes as opportunities to determine resource needs, reallocating Office resources to meet its strategic goal and objectives. In its review, OFHEO uses cost-effectiveness as one of the primary criteria for determining the overall effectiveness in the achievement of the Office’s mission.

In 1995, the General Accounting Office (GAO) conducted an audit of OFHEO’s operations, as required by OFHEO’s enabling statute. In 1997, the GAO conducted a second study to assess OFHEO’s fulfillment of its safety and soundness mission, as required by a provision in the VA-HUD Appropriations Act of 1997 (P.L. 114-204). OFHEO described these reports in its last Strategic Plan and used them to complement internal evaluations, making appropriate changes in operations. There have been no additional GAO reports on OFHEO since then.

OFHEO’s enabling statute also prescribed another set of studies. For the initial risk-based capital standard (discussed in Strategic Objective 1), OFHEO may not incorporate Enterprise purchases of new mortgages into the stress test used to calculate the risk-based capital standard. The statute requires that once the initial risk-based capital regulation is final, the Congressional Budget Office (CBO) and the GAO study the advisability and appropriate form of any new business assumptions. OFHEO anticipates that these studies will take place by FY 2002, and will consider their results in future revisions of the risk-based capital standard.

### **Stakeholder Consultation and Development of the FY 2000-2005 Strategic Plan**

Since it began operating in 1993, OFHEO has maintained regular communications with Congress on its objectives and regulatory activities. OFHEO senior staff have met with Enterprise senior management and boards of directors in a variety of forums to enhance their understanding of OFHEO’s plans and operations and to receive feedback. In addition, OFHEO has also conveyed important information on its plans, products and operations to other members of the financial community. The Office has solicited input from these other stakeholders through participation in various mortgage and financial industry forums as well as through communications during the comment periods on its proposed rule for risk-based capital.

In developing this Strategic Plan, OFHEO sought input from stakeholders and the general public through an announcement in the *Federal Register* and through its web site, [www.ofheo.gov](http://www.ofheo.gov). Over the last several years, OFHEO has participated in several working groups and information

sessions on strategic planning and performance planning issues with other financial regulators and other Federal agencies. The primary goals of these working groups and consultations have been to work with the Office of Management and Budget (OMB) to develop shared expectations about the OFHEO plan; learn from the other executive branch agencies about their successes, pitfalls, and best practices; and discuss with other Federal financial regulatory agencies how they are addressing their goals, objectives and performance measures in order to identify useful similarities and differences for OFHEO.

In developing this plan, in addition to requesting stakeholder comments, OFHEO employees were invited to provide input on the trends in external factors that may affect the Office in the future and staff recommendations on the issues that OFHEO should address. OFHEO senior management reviewed this input, reassessed the Office's accomplishments, products and operations over the last several years in the context of its strategic plans and annual performance plans, and the gradual feedback that it received from stakeholders. OFHEO senior management revised the mission statement and developed a focused strategic goal and four strategic objectives, and then elicited staff feedback on a draft of the plan. OFHEO also posted this draft on its external web site for comments by stakeholders, briefed congressional staff and considered the comments received in completing the final Strategic Plan. OFHEO welcomes comments from all stakeholders in the development of future plans.



**OFHEO's Mission, Strategic Goal and Strategic Objectives**

**OFHEO MISSION**

**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 has developed a strategic goal and four strategic objectives to achieve its mission.

**STRATEGIC GOAL: TO ENSURE FANNIE MAE AND FREDDIE MAC REMAIN SAFE AND SOUND THROUGH EFFICIENT AND EFFECTIVE REGULATION AND BY FOSTERING A STRONG AND VITAL HOUSING FINANCE SYSTEM.**

OFHEO's strategic goal supports the clear and important mission of the Office. It recognizes the critical role that OFHEO plays in ensuring the safe and sound operations of the Enterprises. The goal also recognizes that OFHEO must foster the health of the nation's housing finance system in order to ensure the safety and soundness of the Enterprises. Without a strong housing finance system, the Enterprises could face limitations on their ability to buy and sell financial instruments, which could affect their safety and soundness.

**Strategic Objectives:**

OFHEO established four strategic objectives to support the achievement of the strategic goal and ultimately, the accomplishment of OFHEO's mission.

- 1. Ensure the Enterprises are adequately capitalized.**
- 2. Ensure the Enterprises comply with safety and soundness standards and other legal requirements.**
- 3. Enhance public understanding of the nation's housing finance system.**
- 4. Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.**

The following sections of the Strategic Plan describe each Strategic Objective, provide examples of how OFHEO will measure its achievement and detail OFHEO's strategies to achieve its objectives. These strategic objectives are inextricably linked and mutually reinforcing. Many of OFHEO's strategies lead to the attainment of more than one of these objectives. In a separate section, OFHEO has consolidated a number of management strategies that are necessary to achieve these strategic objectives, and, in turn, its strategic goal and mission.

***Strategic Objective 1: Ensure the Enterprises are adequately capitalized.***

Adequate capital protects an Enterprise from severe losses due to unexpected events. Generally, if a company has inadequate capital, difficult economic conditions or management deficiencies may cause the company to fail. Bad economic times are those in which the Enterprises would be needed most, and for which they must be sufficiently capitalized. Regulatory capital standards are designed to provide protection in circumstances more adverse than those against which an Enterprise may choose to hold capital, protecting the nation's housing markets during adverse conditions.

***Performance Measure: Each Enterprise's actual capital meets or exceeds applicable capital requirements on at least a quarterly basis.***

To ensure Fannie Mae and Freddie Mac are adequately capitalized, OFHEO has established a comprehensive program of capital regulation. This program sets a minimum capital requirement and a risk-based capital requirement for each Enterprise. Both requirements are calculated for a specific point in time. The minimum capital requirement uses a traditional ratio method, requiring that for broad business categories, such as total assets, a specific proportion is held as capital. The risk-based capital requirement is based directly on the risk inherent in the Enterprises' portfolios and other obligations, particularly the risk related to credit extended and to changes in interest rates. OFHEO uses a stress test—a test under stressful economic conditions—to determine each Enterprise's risk-based capital requirement. The stress test determines the amount of capital that each Enterprise would have to maintain in order to remain solvent during a 10-year period during which large, adverse movements in interest rates and high rates of mortgage default losses occurred. In order to be classified as adequately capitalized, the 1992 Act requires that an Enterprise's core capital meets or exceeds its minimum capital requirement and that its total capital meets or exceeds its risk-based capital requirement. Risk-focused continuous annual examinations, described in Strategic Objective 2, complement these point-in-time measures.

***Means and Strategies:*** OFHEO will make capital classification determinations on at least a quarterly basis to monitor and enforce the Enterprises' compliance with the Office's capital regulations. If capital standards are not met, OFHEO will work with the Enterprise to obtain acceptable capital plans to bring that Enterprise's capital to the required level.

The Office will submit its final risk-based capital rule to OMB for review by the end of this calendar year. OFHEO's risk-based capital standard will be published as a final rule in FY 2001. By law, it will be enforceable in FY 2002, a year after the rule is final. OFHEO's minimum capital and risk-based capital standards will be evaluated on an ongoing basis through research, analysis and modeling improvements and updated to ensure that the Enterprises' capital requirements are consistent with their risk profiles. This includes evaluating the risks associated with new programs and activities of the Enterprises and updating appropriately the risk-based capital standard.

Credit risk and interest rate risk are the two primary factors reflected in the risk-based capital standard and their treatment in the stress test is prescribed by law. The Office will enhance its modeling of Enterprise exposure to credit and interest rate risks by periodically re-estimating OFHEO's risk models with performance data as they become available and appropriately adjusting the models, when needed, to reflect changes in borrower and investor behaviors. The Office will continue to produce analytical tools such as OFHEO's quarterly House Price Index and models of mortgage performance that will be used in the stress test to assess credit risk. OFHEO will also analyze the performance of the Enterprises under alternative stressful economic scenarios to evaluate the continued appropriateness of statutorily defined credit and interest rate stresses.

New technologies and new lending practices in the mortgage industry are expanding homeownership opportunities and changing the ways in which mortgage loans are approved and rates are charged. As experience grows and data become available, OFHEO will refine and enhance its risk modeling to ensure that the appropriate risk is being reflected. One example is by investigating new ways to measure and evaluate mortgage credit risk through the inclusion of data describing mortgage performance of loans made to borrowers on the basis of their credit scores.

OFHEO's enabling statute recognizes that some risks are non-quantifiable. It requires that the risk-based capital standard include a 30 percent add-on to the capital calculated by the stress test as a proxy for management and operations risks. OFHEO will evaluate these and other non-quantifiable risks at the Enterprises to ensure that they hold sufficient capital to cover these risks.

OFHEO will ensure its continued ability to model and evaluate risk-taking at the Enterprises on a timely basis by maintaining and enhancing its technology and modeling capabilities. These capabilities are also necessary for analysis of future changes to the risk-based capital standard. OFHEO will increase its capacity to analyze and store data from the Enterprises as well as enhance the efficiency with which we receive, store and analyze data. The management strategies section of this plan describes OFHEO's data warehouse capabilities, which also support other strategic objectives.

***Strategic Objective 2: Ensure the Enterprises comply with safety and soundness standards and other legal requirements.***

OFHEO must maintain its ability and capacity to ensure that specific issues and emerging trends are identified early and that potential vulnerabilities are appropriately addressed. Critical to its mission is the knowledge, skills and expertise OFHEO acquires through its Examination Program. Maintaining a solid understanding of the Enterprises' exposures, risk management techniques, operating strategies, and financial condition is critical to OFHEO's responding rapidly and effectively.

OFHEO maintains a prospective focus to identify potential problems at the Enterprises or in the marketplace before they can cause significant harm. Also, OFHEO is committed to ensuring its supervisory practices are both up-to-date and adaptable to the rapid changes in the environment and the evolution of products and services provided by the Enterprises.

**Performance Measures: (a) *The Enterprises meet or exceed safety and soundness standards.***

***(b) The Enterprises comply with rules, regulations and directives based on the Federal Housing Enterprises Financial Safety and Soundness Act and their chartering statutes.***

- a) OFHEO has established and shared with the Enterprises safety and soundness standards that reflect various components of risk and risk management. For its annual risk-based examinations, OFHEO considers four major areas—credit risk, market risk, operations risk and corporate governance. These risk areas contain 10 program areas, such as interest rate risk, liquidity management, and information technology, for which numerous factors are assessed annually and updated quarterly to reflect changes. Each Enterprise's performance is assessed against these standards during each annual examination cycle. The results and conclusions of the examinations are reported in OFHEO's Annual Report to Congress.
- b) In the area of Enterprise compliance with the Act, Enterprise chartering acts and other applicable laws, OFHEO will continue providing standards against which Enterprise compliance may be measured. This performance measure is being refined through more specific regulations. OFHEO works to facilitate adherence to legal requirements through its regulatory programs and ongoing communications regarding business activities. While OFHEO cannot certify that the Enterprises comply with all laws, it can address activities that it considers under its regular and targeted reviews and will take appropriate action if an Enterprise is found to be in violation of any applicable legal requirement.

**Means and Strategies:**

One of the ways OFHEO maintains effective regulation is by conducting annual risk-based examinations of Fannie Mae and Freddie Mac, supported by complementary research and analysis. In risk-based examinations, resources are prioritized to cover the areas presenting the

most significant financial risk. The annual examination activities are customized for each Enterprise's risk profile and documented in an examination strategy.

The examination strategies are reconsidered quarterly in conjunction with an updated risk profile. OFHEO focuses resources on identifying potential vulnerabilities at the Enterprises and potential issues in the marketplace before they can result in a threat to their safety and soundness. This means that the examinations and research efforts concentrate on activities and issues that represent the greatest risks to the Enterprises' financial condition. The risk-focused approach used by OFHEO emphasizes planning, continuous information-gathering and knowledge building, ongoing communication, and follow-up. OFHEO maintains a continuous dialogue with relevant committees of each Enterprise's Board of Directors and the executive management teams through routinely scheduled meetings to discuss supervisory issues. In the event an Enterprise fails to achieve an acceptable assessment on one of these safety and soundness factors, OFHEO may require remedial actions to effect their compliance. OFHEO's Examination Handbook describes this in more detail and may be found at [www.ofheo.gov](http://www.ofheo.gov).

OFHEO remains committed to ensuring its examinations are relevant to the business of the Enterprises and the risks inherent in conducting their business. Periodically, OFHEO provides guidance to its examiners, the Enterprises, and other interested members of the public about the risks associated with the business activities of Fannie Mae and Freddie Mac. Among the intended purposes for this guidance is to clarify OFHEO's expectations for the Enterprises, to improve the quality of the examinations in these areas and also to lead toward enhanced business practices.

This approach emphasizes evaluating the integrity of the Enterprises' proprietary systems for managing risk continuously, complementing the point-in-time testing of the capital standards. Recognizing that capital requirements cannot substitute for effective risk management and internal controls at the Enterprises, OFHEO emphasizes prudential risk management and legal compliance in its regulatory programs. By conducting its risk-focused programs and applying its capital requirements in tandem, OFHEO provides effective regulation of Fannie Mae and Freddie Mac.

OFHEO is committed to an up-to-date, streamlined and clearly communicated supervisory system that enhances the Enterprises' ability to comply with safety and soundness standards and other legal requirements. A key OFHEO strategy is the effective public presentation of safety and soundness standards to permit both transparency of its regulations and a strong foundation for compliance by the Enterprises. OFHEO will continue to ensure that its safety and soundness standards are communicated in a timely fashion to the Enterprises and will strengthen and enhance its enforcement mechanisms available to remedy potential violations. The dynamics of the financial markets and the breadth and depth of the Enterprises' participation warrant an increased emphasis on these mechanisms. The Office will employ these tools as needed to ensure the effectiveness of its programs for safety and soundness.

***Strategic Objective 3: Enhance public understanding of the nation’s housing finance system.***

Enhancing the public’s understanding of the nation’s housing finance system, including the roles and activities of the Enterprises and OFHEO, contributes directly to the strength and vitality of that system. The public—borrowers, investors, market participants, policymakers and other stakeholders—will make better decisions about the allocation of their resources if they are well informed. OFHEO, with its expertise in housing finance, is uniquely positioned to provide the public with information and analysis, leading to more informed decision-making by the public.

***Performance Measure: Conduct a program of publications and outreach to the public.***

***Means and Strategies:*** OFHEO will work to enhance the public’s understanding of the housing finance system, particularly the role that Fannie Mae and Freddie Mac play in the provision of mortgage credit. OFHEO will use a variety of channels to achieve this objective.

The Office will work with Fannie Mae and Freddie Mac, as necessary, to improve and enhance the public disclosures of their activities, including measures of their risk exposure. OFHEO will work with each Enterprise to provide the public with an understanding of the meaning of its risk-based capital requirement and an accurate interpretation of the level of capital it maintains. OFHEO will also strive to maintain transparency in its regulatory oversight of the Enterprises. The results and conclusions of OFHEO’s examinations of the Enterprises will continue to be made public in OFHEO’s Annual Report to Congress. All of these efforts will balance the need for enhanced disclosure against the proprietary nature of certain information.

OFHEO must have a complete understanding of not just the Enterprises, but of the entire mortgage industry and the fast-paced changes underway. OFHEO will increase its research and analysis capabilities in order to better understand and prepare for these changes. The insights gained from this work will be used to continually improve our examination and capital regulation functions, as described in Strategic Objectives 1 and 2. OFHEO will also make its research and analysis available to the public to enhance the public understanding of the nation’s housing finance system. As described in the management strategies section, OFHEO is developing a repository of housing and mortgage data. As appropriate, OFHEO will make aggregated data available to the public.

OFHEO will periodically publish research papers and reports on various topics related to housing finance markets. Through speeches, testimony, and press releases, the Office will also inform the public of important developments in the market. OFHEO will also publish House Price Indexes, on a quarterly basis, to provide the public with information about activity in national, regional, and local housing markets. The OFHEO House Price Index, which is intrinsic to the risk-based capital calculation, is also useful to researchers, housing market analysts and the general public. It provides the only government source of house price changes based on repeat home sales. OFHEO will continue to make use of its web site, [www.ofheo.gov](http://www.ofheo.gov), to make information readily available to interested parties.

***Strategic Objective 4: Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.***

The secondary mortgage market and the capital markets have experienced dramatic growth and become increasingly complex. The Enterprises' role in several of these markets is a dominant one, and in others, their role has grown. To ensure that these dynamics are recognized, OFHEO must work with other Federal agencies to ensure a strong and vital housing finance system and efficient and effective capital markets. In addition, OFHEO will contribute to Federal efforts to promote homeownership and affordable housing as reflected in the Office's mission statement.

**Performance Measure:** *Conduct programs of interagency cooperation and stakeholder interaction.*

**Means and Strategies:** OFHEO will keep other Federal regulators of financial institutions (the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board, the National Credit Union Administration (NCUA), the Office of the Controller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Housing Finance Board (FHFB), the Farm Credit Administration (FCA) and the Office of Sallie Mae Oversight (OSMO)) informed about OFHEO's regulatory activities and solicit their views about issues related to Fannie Mae and Freddie Mac. OFHEO will evaluate this information and take it into account when making decisions consistent with its mission.

OFHEO will consult with the Federal Reserve Board, the Treasury Department, and other appropriate agencies on broad public policy issues affecting Fannie Mae and Freddie Mac and housing finance markets, and will contribute to Federal efforts to address these issues. Examples include the systemic risk posed to the financial markets by the Enterprises and the development of capital requirements for other Federally regulated financial institutions. In general, OFHEO will contribute its knowledge, expertise, and information about the Enterprises to any efforts to formulate or implement Federal policy that would affect the Enterprises. OFHEO will also work with the Congress to provide information on the effect of any proposed legislation affecting the Enterprises or the markets in which they operate.

OFHEO will inform the Secretary of HUD about the safety and soundness implications of any proposed changes to the Secretary's goals regarding Enterprise purchases of mortgages that finance affordable housing. The Office will also actively participate in policy discussions with HUD, other Federal agencies and stakeholders of the risks associated with mortgage lending, especially lending that finances affordable housing.

### Management Strategies to Achieve OFHEO's Strategic Objectives

OFHEO management recognizes that OFHEO's workforce and physical infrastructure are a critical foundation for attaining its strategic objectives. Underlying all four of the strategic objectives set forth in this plan is the need to have the best people and the best resources to oversee two of the most complex businesses in the world. OFHEO is committed to providing the needed resources to meet its legislated mandates.

Organization and Communication. OFHEO faces a competitive environment that demands organizational excellence. To accomplish OFHEO's mission effectively, OFHEO will continue to ensure its internal infrastructure is fully functional, retains flexibility and is tied to meeting its mission. A strong communication process is essential to ensure that every employee in OFHEO understands the mission and strategic goals and objectives, how their job is linked to the mission and that they have the opportunity to communicate to management about the mission and how to accomplish it.

Recruitment. OFHEO's productivity is tied directly to its workforce. A skilled, motivated and diverse workforce, with the unique talents and abilities required to oversee the government sponsored enterprises, is key to OFHEO's future. This same workforce continues to be in high demand nationwide. OFHEO's small size and its specialized information systems and financial analysis and economics requirements make recruitment and retention of these highly specialized staff a priority. OFHEO's experience with staff turnover and the associated erosion of depth in key mission-related areas makes it necessary to ensure that OFHEO's staff has sufficient breadth and depth to be thorough and minimize disruption during staff turnover.

OFHEO must attract information technology professionals who possess specific skills in software engineering, data analysis and data warehousing. OFHEO must also attract economists with unique skills related to financial markets and housing, and financial modeling specialists with financial instrument modeling expertise and a thorough understanding of the financial and housing markets. To acquire this expertise, OFHEO will conduct effective outreach through targeted recruitment efforts in order to recruit a diverse, high-quality workforce. Skilled support staff are critical as well to the smooth functioning of OFHEO's operations and to the effective productivity of its team of specialists. OFHEO must have available competitive salaries and benefits, including recruitment bonuses, and family-friendly programs such as flexible work hours and telecommuting.

Information Resource Requirements. Once part of the OFHEO workforce, staff must have the tools necessary to carry out their work in an efficient and effective manner. These tools include appropriate technology integrated for effective internal work teams and external communication. To assist in this effort, OFHEO will use a standards-based, open system environment with the flexibility to increase efficiency and compatibility among systems and to reduce the maintenance burden associated with extensive desktop applications. OFHEO will provide automated system and network management tools to enhance the integrity and reliability of its information technology infrastructure.



Information submitted by the Enterprises provides the basis for OFHEO's work in capital classification, risk-analysis for risk-based capital, Financial Simulation Model development, the examination process, and much of OFHEO research and analysis of the financial markets. As appropriate, OFHEO will also serve as a data clearinghouse, receiving information from other Federal entities on housing and mortgage activity, to provide a repository of aggregated data for research and analysis by OFHEO, other Federal agencies and the public. OFHEO will continue to strengthen the data warehouse and its surrounding processes that facilitates data sharing, data re-use, and interoperability across OFHEO's information systems.

OFHEO will continue to manage information technology projects as investments. Projects will focus on identifying and producing measurable process improvements and will apply risk management principles.

*Work Environment.* Employees should have a safe and efficient work environment that is conducive to productivity.

*Staff Retention.* OFHEO must not only recruit and support its vital human infrastructure, but must also retain these talented individuals. Due to the high demand for particular skills, OFHEO must focus on areas such as information technology. OFHEO will continue to make effective use of job advancement opportunities, retention bonuses, and recognition of excellence through our performance evaluation management system. Improving the quality of the work environment for employees enables them to balance the needs of work and family and is an important benefit to assist us in maintaining a quality workforce. OFHEO will strive to meet the needs, expectations and preferences of our employees by expanding our investment in family-friendly programs, including flexible work hours, leave sharing, casual dress, employee wellness programs, special award programs, and other benefits. OFHEO will continue to promote a healthy environment through its Transportation Incentive Program, which encourages employees to use public transportation.

*Performance Evaluation.* The performance evaluation management system permits OFHEO to measure results. Each employee will understand the relationship of his/her job to the strategic plan and the broader OFHEO organization. The success of this effort is tied to effective management practices, such as the use of strong two-way communication, and timely and consistent performance-related feedback. On-time training will be provided to staff members who need to learn new skills, brush up on old skills, or stay current in their field. Supervisory training skills will be made available to all supervisors. Pay increases will be merit-based and will reflect the level of performance exhibited by the employee.

*Management Activities.* In carrying forward its strategic objectives and focusing on OFHEO's workforce and technology needs, management must remain flexible and be willing to alter existing methods of operations to meet new challenges and review continuously OFHEO's needs in meeting its responsibilities. For example, management will focus on streamlining operations and regulation where possible.

Continuing integration of the financial market sectors, accompanied by technology innovations, new products and their means of execution and delivery have redefined the marketplace and the Enterprises' approaches to their business. Enterprise growth, complexity

and risk profile can pose a challenge to OFHEO's regulatory regime that must be addressed on an ongoing basis. In addition to remaining flexible, OFHEO management must have sufficient resources to maintain the Office's ability to adapt its approaches and standards to ensure the Enterprises are appropriately regulated while performing their congressionally mandated mission and changing to meet an evolving marketplace.

**Key External Factors that Could Prevent OFHEO from Achieving its Strategic Goal:**

OFHEO's plan, in all respects, assumes adequate budget resources throughout the period. A number of other factors could affect Enterprise performance and the housing finance system, and ultimately, the Office's ability to ensure the safety and soundness of the Enterprises' operations and condition. These include:

Lack of Financial Independence – Unlike all other Federal financial safety and soundness regulators, OFHEO's funding is dependent on annual Congressional Appropriations Acts. The uncertainty associated with this process hinders effective long-term planning and precludes flexibility in resource management. OFHEO operates as a lean and efficient agency and maintains the minimal staff necessary to achieve its mission. Should a situation arise, such as an economic crisis, where OFHEO quickly needed to hire additional examiners or other staff in response, it would be unable to do so. In addition, during periods when the government has operated under a continuing resolution, OFHEO has been forced to cut back on its activities.

Economic Performance – Significant increases in unemployment, significant decreases in house prices, or sharp, prolonged changes in interest rates could significantly affect the financial condition of the Enterprises. During exceptionally adverse economic periods, the Enterprises may be unable to meet regulatory standards. OFHEO would require strengthening of Enterprise financial practices or business operations to mitigate an identified weakness.

Enterprise Management – Failure of Enterprise management, such as fraud or negligence or incompetence in the conduct of business operations and risk management, could prevent OFHEO from meeting its goal. OFHEO can mitigate these events through the use of its broad range of enforcement authorities if necessary.

Legal Changes – Congress may choose to alter the existing regulatory regime for the Enterprises or their fundamental mission. Changes in the regulatory regime or the Enterprises' charters could affect OFHEO's ability to meet its strategic goal. Likewise, judicial decisions or actions of other regulators could also have a detrimental affect on OFHEO's ability to achieve its goal. OFHEO must be flexible and prepared to adapt to any statutory changes that might require alteration of regulatory programs.