



***FY 2003 - 2008  
STRATEGIC PLAN***

September 30, 2003

# OFHEO FY 2003 – 2008 STRATEGIC PLAN

## *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 or the Enterprises) 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 third strategic plan pursuant to the Government Performance and Results Act of 1993. It sets out the Office’s mission and strategic goals for the next five years (FY 2003-2008). 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 2002, the two Enterprises assisted in the funding of \$1.375 trillion of mortgages. In the last few years, falling

interest rates, coupled with rising house prices, provided incentives to households to refinance existing mortgages at lower rates and to take out new mortgages to purchase homes. A number of studies estimate that refinancings over the past 2 years comprise between 60 and 65% of the market. Since 1992, the Enterprises have assisted in funding \$5.6 trillion of mortgages. Homeownership today is the highest in the nation's history at 67.9 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),<sup>1</sup> 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.

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. At year-end 2002, the outstanding amount of mortgage-backed securities guaranteed by the Enterprises has increased to \$2.6 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 1992, mortgage investments at the Enterprises have grown by more than 620 percent to \$1.4 trillion.

### **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 year-end 2002, the Enterprises had \$1.5 trillion 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 Treasury debt. Major investors in Enterprise debt include commercial

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<sup>1</sup> In July 2002, Fannie Mae and Freddie Mac agreed to voluntarily register their common stock with the Securities and Exchange Commission (SEC). This voluntary agreement permanently requires the companies to file their periodic financial disclosures with the SEC under the Securities Exchange Act of 1934. This agreement does not subject the companies' securities to Securities Act registration requirements applicable to the public offering of new securities.

banks, thrifts, pension funds, mutual funds, and foreign central banks. In addition to Enterprise debt, investors hold over \$1.7 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 portfolios as do other large firms. At year-end 2002, the combined notional amount of derivatives contracts used by the Enterprises exceeded \$1.5 trillion. 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 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 last decade. 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.

In the last few years, issues of disclosure and corporate governance have become more significant for corporate America, leading to the passage of the Sarbanes-Oxley Act of 2002, a reform of corporate governance standards for publicly held corporations. Also, investors and market analysts have recently increased their focus on earnings management and accounting issues, particularly accounting for off-balance sheet activities due to changes in accounting standards. As a result of these general trends, as well as Freddie Mac’s restatement of earnings, management changes, and various investigations, the Enterprises will continue to face pressure to increase transparency in order to maintain access to funding in the capital markets.

The Enterprises’ GSE status continues to give them advantages over other firms in the housing finance market. 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. 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. Continued growth of the Enterprises requires increased attention to the associated systemic implications.

The pace of the economy, the stock market, and housing market activity will continue to influence the health of the housing finance system. While housing buoyed the economy through the recent recession, 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, growth in the number of households 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. The events of September 11, 2001, highlighted the need to ensure continued operation of all critical business operations.

The U.S. financial sector, including the Enterprises and their regulator, will continue to face these challenges. OFHEO has established three strategic goals to achieve its mission in this dynamic environment.

### **OFHEO's Mission and Strategic Goals**

#### **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'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.

#### **Strategic Goals:**

- 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.***

The following sections describe each strategic goal, provide examples of OFHEO's annual performance goals and detail OFHEO's strategies to achieve its goals. These strategic goals are inextricably linked and mutually reinforcing. Many of OFHEO's strategies lead to the attainment of more than one of these goals. In a separate section, OFHEO describes its management strategies to achieve these strategic goals and mission.

***Strategic Goal 1: Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements.***

OFHEO's primary duty as a regulator is to ensure that the Enterprises have the financial strength to fulfill their important role in the nation's housing finance system. Providing a comprehensive and effective oversight program requires attention to the Enterprises' operations, the risks inherent in their activities, their management, and the dynamic environment in which they operate. Maintaining risk-based standards and understanding the risk profiles of the Enterprises is essential to OFHEO's ability to ensure their continuity.

**Performance Goals:**

- 1. Ensure the Enterprises comply with safety and soundness standards.***
- 2. Ensure the Enterprises are adequately capitalized.***
- 3. Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure.***

OFHEO's oversight program includes conducting annual risk-based examinations, determining capital adequacy at least quarterly, and reviewing the Enterprises' compliance with legal requirements. These three interrelated elements, in conjunction with ongoing research and analysis, give a comprehensive picture of each Enterprise's safety and soundness. OFHEO uses continual and point-in-time measures, with both a qualitative and quantitative focus. OFHEO maintains a prospective focus to identify areas of potential problems at the Enterprises or in the marketplace before they can cause significant harm.

**Performance Goal 1: Ensure the Enterprises comply with safety and soundness standards.**

**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. 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 major risk areas such as credit risk, market risk, operational risk, corporate governance, model exposure risk, and accounting and financial reporting. These risk areas contain several program areas, such as mortgage credit risk, interest rate risk, liquidity management, and information technology, for which numerous factors are assessed annually and updated quarterly to reflect changes in risk management practices. Each Enterprise's performance is assessed against the standards during each annual examination cycle. The results and conclusions of the examinations are reported in OFHEO's Annual Report to Congress.

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 and resources are prioritized to cover the areas presenting the most

significant financial risk. 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 that OFHEO uses emphasizes planning, continuous information gathering and knowledge building, ongoing communication both internally and with Enterprise personnel, 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 will require remedial actions to address observed deficiencies. OFHEO's Examination Handbook describes the examination program in more detail and may be found at [www.ofheo.gov](http://www.ofheo.gov).

OFHEO remains committed to ensuring its examinations are appropriate to the business of the Enterprises and the risks inherent in conducting their business. Periodically, OFHEO provides guidance to its examiners and the Enterprises about the risks associated with the business activities of Fannie Mae and Freddie Mac. These are posted on OFHEO's web site and are available to interested members of the public. Among the intended purposes for such guidance are to clarify OFHEO's expectations for the Enterprises, to improve the quality of the examinations in these areas, and to lead toward enhanced business practices. In 2003, OFHEO took additional steps and created a unit that is focused on quality assurance and continuous improvement. This new unit is tasked with ensuring that OFHEO's examination practices and standards remain on the leading edge of professional standards. 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.

***Performance Goal 2: Ensure the Enterprises are adequately capitalized.***

***Means and Strategies:***

Determining capital adequacy is a key component of the oversight program. Adequate capital protects an Enterprise from severe losses due to unexpected events. Generally, 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.

OFHEO seeks to ensure the Enterprises remain adequately capitalized through a multi-faceted assessment. Capital compliance with the statutory prescriptions is achieved through quarterly measurements, routine updates about the Enterprises' financial condition and operating environment, the Office's examinations, scenario analyses, economic analysis, alternative modeling tools, additional capital measures and research. Collectively, these assessments position OFHEO to make informed decisions about the Enterprises' capital adequacy.

The two key quantitative assessments of capital are OFHEO's minimum and risk-based standards. The minimum capital standard, as with other financial regulators, is ratio-based and ensures that each Enterprise has a sufficient capital cushion relative to the size of the company.

The risk-based capital requirement is based directly on the risks inherent in the Enterprises' portfolios and other obligations, particularly the risks related to credit extended and to changes in interest rates. OFHEO uses a 10-year stress test to determine the amount of total capital that each Enterprise must hold to absorb projected losses from future adverse interest-rate and credit-risk conditions, plus an additional 30 percent to cover unspecified management and operations risk. Complete details on both the minimum and risk-based capital standards may be found at [www.ofheo.gov](http://www.ofheo.gov).

OFHEO will continue to make capital classification determinations at least quarterly to monitor and enforce the Enterprises' compliance with the Office's capital regulations. The minimum capital and risk-based capital standards are evaluated on an on-going basis through research, analysis, and modeling improvements. They are updated, as needed, to ensure that the Enterprises' capital requirements are consistent with their evolving risk profiles. OFHEO continually evaluates the risks associated with new programs and activities of the Enterprises, conducts additional analysis and tests to address risks that may not be reflected in the stress test, and applies capital measurement tools and techniques to capture alternative perspectives of risk. The Office will continue to research areas that have a direct impact on the effectiveness of the risk-based capital calculation and the other capital adequacy measures to ensure the risk-based capital stress test and its capital oversight processes remain dynamic. In addition, OFHEO will evaluate and, when appropriate, implement additional complementary capital standards, measures or requirements.

***Performance Goal 3: Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure.***

***Means and Strategies:***

OFHEO establishes standards against which Enterprise compliance with the 1992 Act, Enterprise chartering acts, and other applicable laws may be measured. OFHEO works to facilitate adherence to legal requirements through its regulatory programs and ongoing communications regarding business activities. 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. OFHEO employs specific regulatory tools as needed to ensure the effectiveness of its programs for safety and soundness.

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. OFHEO also monitors the early-alert triggers described in the Prompt Supervisory Response regulation so that any needed regulatory response would be timely. OFHEO will monitor Enterprise disclosure to ensure that the disclosure conforms to applicable laws and regulations and assists in their access to markets. OFHEO's regulations and guidance may be found on the web site at [www.ofheo.gov](http://www.ofheo.gov).



OFHEO's enabling statute requires the Director to prohibit the Enterprises from providing excessive compensation to any executive officer. Additionally, the Enterprises' chartering acts require the Enterprises to obtain the prior approval of OFHEO's Director before entering into or changing agreements to provide termination benefits to executive officers. OFHEO will review overall compensation and termination benefits to see that they meet statutory requirements for comparability with payments made by similar organizations.

Should a violation of law be determined by another regulator or by a judicial body under a statute not within OFHEO's direct enforcement authority, OFHEO may take such supervisory action as determined necessary within its authorities relating to safety and soundness and the chartering acts.

***Strategic Goal 2: 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 Goals:**

- 1. Enhance awareness and understanding of housing and mortgage market developments and Enterprise risks and activities.***
- 2. Undertake research and analysis of risks and emerging issues.***
- 3. Communicate effectively with all stakeholders on regulatory issues.***

**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 continue to work with Fannie Mae and Freddie Mac to improve and enhance the public disclosures of their activities, including measures of their risk exposure. OFHEO will work 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 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 continue to 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 adequacy functions, as described in Strategic Goal 1. OFHEO will also continue to make its research and analysis available to the public to enhance the public understanding of the nation's housing finance system.

Periodically, OFHEO will publish staff working papers and reports, and present research in conferences and journals, 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 host symposiums on key topics and emerging trends, featuring experts discussing a range of issues. OFHEO also will publish House Price Indexes quarterly to provide the public with information about activity in national, regional, and local housing markets. The OFHEO House Price Index, which is a key component of 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 Goal 3: Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.***

The secondary mortgage market and the diverse capital markets have experienced dramatic growth and have 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 Goals:**

- 1. Cooperate with other Federal financial agencies on regulatory issues.***
- 2. Ensure there is sufficient disclosure of information regarding Enterprise operations to allow market participants to trade their obligations efficiently and effectively in the financial markets.***

### **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, the Securities and Exchange Commission, 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 adequate financial disclosure, uniformity of supervisory standards, the development of capital requirements for other Federally regulated financial institutions, and the security and emergency preparedness of the nation's financial system. In general, OFHEO will contribute its knowledge and expertise about the Enterprises to 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 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 Goals**

OFHEO management recognizes that OFHEO's workforce and physical infrastructure are a critical foundation for attaining its strategic goals. Underlying all three of the strategic goals set forth in this plan is the need to have most highly skilled and knowledgeable employees 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, 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. Supervisors work with staff to communicate the connection between staff duties and the agency goals and mission. OFHEO will continue to implement staff suggestions to improve teamwork and communication in the organization.

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 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, financial analysis, economics and examining requirements make recruitment and retention of these highly specialized staff a challenging priority. OFHEO plans to expand its staff in its mission-related areas, particularly in examinations and accounting, to meet the challenges posed by regulating these two dynamic and fast-growing Enterprises. In some mission-related areas, OFHEO's experience with staff turnover and the associated erosion of depth in key specialties makes it difficult to ensure that OFHEO's staff has sufficient breadth and depth while maintaining a small staff size.

OFHEO must attract professionals for regulatory and oversight activities who possess specific skills in accounting, derivatives, securities disclosure, enforcement and litigation, operations, and model, market and credit risk. OFHEO must also attract examiners who specialize in risk management of large and complex financial institutions, economists with unique skills related to financial markets and housing, and financial analysts with risk management and modeling expertise. To acquire this talent, OFHEO continues to conduct effective outreach through targeted recruitment efforts in order to maintain a diverse, high-quality workforce. Skilled support staff are also critical to the smooth functioning of OFHEO's operations and to the productivity of its team of specialists. OFHEO must offer salaries and benefits that are comparable to compensation at other federal regulators, 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, Financial Simulation Model development, the examination process, and much of OFHEO research and analysis of the financial markets. OFHEO will also continue to build its data warehouse with information on housing and mortgage activity, to provide a repository of aggregated data for research and analysis by OFHEO. OFHEO will continue to strengthen the data warehouse and its surrounding processes that facilitate 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.

Continuity of Operations. OFHEO's emergency preparedness and its Continuity of Operations Plan protect our employees and facilities and help ensure that the agency continues to function in the event of an emergency.

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, accounting, financial modeling and risk management. OFHEO emphasizes training and continued professional development so that staff maintain their expertise in their dynamic fields.

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 its employees by maintaining its investment in family friendly programs and expanding 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 and development will be provided to all supervisors. Pay increases will continue to 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, the 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. At the same time, OFHEO will continue to ensure strong internal management controls are the cornerstone of OFHEO operations.

Continuing integration of the financial market sectors, accompanied by technology innovations, new products and their means of execution and delivery continually redefine the marketplace and the Enterprises' approaches to their business. Enterprise growth, complexity and evolving risk profiles 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 Goals:**

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. Having financial independence would enable OFHEO to minimize the possibility that the Enterprises would experience gross failures of management, such as fraud or negligence, or incompetence in the conduct of business operations and risk management. OFHEO continues to operate 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 or significant negative finding at an Enterprise, where OFHEO quickly needed to hire additional examiners, other staff, or purchase specialized services 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 Variables – 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.

### **OFHEO's FY 2003-2008 Strategic Plan and Annual Performance Plans**

OFHEO will use this strategic plan as a guide in developing its annual performance plans and will use both as a reference point to maintain priorities during the operating years.

In developing its annual performance plan, OFHEO sets annual performance goals to achieve each strategic goal. Examples of these annual performance goals show how OFHEO will target and measure its performance each year. Several of these have been used in annual performance plans in the last few years. OFHEO uses outcome measures where relevant and available, and uses output measures when they are the best indicators of achieving a goal. Outcomes are the results of what OFHEO does. Outputs are OFHEO's products. The Office provides regulation, supervision, guidance, review and a variety of products that influence the Enterprises and the financial markets. As for all regulators, the outcomes or results of OFHEO's work are achieved through the actions of others. Because of the nature of OFHEO's mission, several of OFHEO's annual performance goals target the steady state envisioned in OFHEO's strategic goals. The table below shows the relationship between OFHEO's strategic goals, annual performance goals, and performance measures.

OFHEO develops its Annual Performance Plans in tandem with its annual budget; the plan describes what OFHEO will accomplish with the resources proposed for the year. During the year, OFHEO monitors its performance against its goals. Senior management meets quarterly to discuss progress, and shares information with the staff. After the end of the year, OFHEO submits its annual performance report to Congress, describing its actual performance as compared to its plan.

### **Examples of Annual Performance Goals and Measures to Accomplish OFHEO's Strategic Goals**

<i>Strategic Goals</i>	<i>Annual Performance Goals (Examples)</i>	<i>Performance Measures (Examples)</i>
1. Ensure the Enterprises comply with safety and soundness standards, are adequately capitalized, and comply with other legal requirements.	Ensure the Enterprises comply with safety and soundness standards.	Each Enterprise responds appropriately to 100% of OFHEO's safety and soundness concerns.
	Ensure the Enterprises are adequately capitalized.	Each Enterprise meets the minimum capital standard at least quarterly.
		Each Enterprise meets the risk-based capital standard at least quarterly.
		Continually review the capital standards and risk-based capital model and change them as needed to reflect new risk measurement techniques and new Enterprise risks.
		Using the capital standards, a variety of analytics, environmental scans and early warning indicators, each Enterprise is determined by the OFHEO Director to be adequately capitalized on at least a quarterly basis.
Whenever an Enterprise does not comply with the OFHEO Director's determination of capital adequacy, OFHEO receives an acceptable capital plan.		
Ensure the Enterprises comply with applicable laws, regulations and directives, including corporate responsibility and disclosure.	Any identified instances of non-compliance with laws, regulations or directives are resolved to OFHEO's satisfaction.	
2. Enhance public understanding of the nation's housing finance system.	Enhance awareness and understanding of the housing and mortgage market developments and Enterprise risks and activities.	Analyze and report about house price trends quarterly through the House Price Index (HPI) report.
		Report on OFHEO activities, examination results and conclusions, and the secondary mortgage market in the OFHEO annual Report to Congress.
	Undertake research and analysis of risks and emerging issues.	Meet the Director's priorities for research as identified in the FY2005 research plan.
		Prepare special reports on topical issues.
Communicate effectively with all stakeholders on regulatory issues.	The majority of survey respondents attending OFHEO's symposium find it valuable.	
3. Contribute to Federal efforts to promote efficient and effective financial markets and homeownership.	Cooperate with other Federal Financial agencies on regulatory issues.	Participate in on-going task forces and forums with other regulatory agencies.
		Respond within 30 days to requests from other Federal agencies for information about housing finance markets and the Enterprises.
	Ensure there is sufficient disclosure of information regarding Enterprise operations to allow market participants to trade their obligations efficiently and effectively in the financial markets.	Any identified instances of non-compliance with laws, regulations or directives regarding disclosure are resolved to OFHEO's satisfaction.

## *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, management reports, and performance review meetings to communicate and discuss organizational goals and objectives, and the status of activities, which further the achievement of these goals. OFHEO management also uses the budget formulation and performance plan development process, to plan its goals and accompanying resource needs. During the operating year, the Office uses the performance review and budget execution processes as opportunities to reallocate Office resources to meet its strategic goals and objectives. OFHEO does not have a schedule of program evaluations.

OFHEO also relies on the General Accounting Office (GAO), the Congressional Budget Office (CBO), the HUD Inspector General (IG) and external auditors for reviews and audits. In 1995, the 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 used these reports to complement internal evaluations, making appropriate changes in operations.

In January 2001, GAO reported on a comparison of the enforcement authorities available to bank regulators, OFHEO and the Federal Housing Finance Board (FHFB). The report noted that OFHEO’s enforcement powers are based on broad safety and soundness authorities that are similar in scope and nature to the powers of federal bank regulators. GAO did not make recommendations but noted that several enhancements and clarifications could be made to OFHEO’s explicit enforcement authority to effect greater comparability. GAO also indicated that OFHEO has properly employed its current informal and formal authorities to address any ambiguities and uncertainties in the law. OFHEO continues to encourage passage of legislation to clarify and enhance its authority.

In July 2001, the GAO completed a study of the adequacy of the capital structure of the Federal Home Loan Bank System, as required by the Consolidated Appropriations Act of 2001. As part of this study, the GAO compared the risk-based capital standards for the Federal Home Loan Banks promulgated by the Federal Housing Finance Board and the risk-based capital standard completed by OFHEO for the Enterprises. The study noted differences in approaches, models and processes, and made no new recommendations.

OFHEO’s enabling statute also prescribed another set of studies. For the initial risk-based capital standard (discussed in Strategic Goal 1), OFHEO may not incorporate Enterprise purchases of new mortgages in 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 GAO and the Congressional Budget Office (CBO) study the advisability and appropriate form of any new business assumptions. The GAO issued its study in June 2002, recommending that incorporating new business assumptions into the risk-based capital stress test is not advisable. In January 2003, CBO issued a report that did not make recommendations, but offered observations on the



possible inclusion of new business activities in the stress period. OFHEO will consider their reports in considering future revisions of the risk-based capital standard.

At the request of the Senate VA-HUD Appropriations Subcommittee, in 2003, the Office of the Inspector General conducted an audit of OFHEO's travel program, space utilization and compensation comparability. The final report issued July 29, 2003, did not identify any significant control weaknesses. In July 2003, the OIG initiated an audit of OFHEO's examination activities and conclusions.

### **Stakeholder Consultation and Development of the FY 2003-2008 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 rules.

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; to learn from the other executive branch agencies about their successes, pitfalls, and best practices; and to 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 staff were invited to provide input on the trends in external factors that may affect the Office in the future, challenges that OFHEO faces, and issues that OFHEO should address. OFHEO senior management individually provided input, and as a group reviewed staff and management comments. They 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 maintained the focus of the prior strategic plan by retaining the mission statement and created OFHEO's three strategic goals from the prior plan's strategic objectives. A committee of senior staff developed the means and strategies to achieve the strategic goals and examples of the performance goals that OFHEO will use in its annual performance plan. After eliciting staff feedback on a draft of the strategic plan, OFHEO posted a revised draft plan on its external web site for comments by stakeholders, sought congressional feedback, and considered the comments received in completing the final Strategic Plan. OFHEO continues to welcome comments from all stakeholders in the development of future plans.