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OFHEO Freddie Mac Report of Examination

Scott G. Calhoun

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800
Office of Examination and Oversight

February 24, 2000

Ms. Maud Mater
Corporate Secretary
Freddie Mac
8200 Jones Branch Avenue
McLean, VA 22102

Dear Ms. Mater:

Attached is the Annual Report of Examination for OFHEO's 1999 examination of Freddie Mac. The Report of Examination is written to inform the Board of Directors of the results and conclusions from our examination activities.

Our examination found Freddie Mac to be a well-managed company in a safe and sound financial condition.

We ask that the Board minutes reflect: 1) that the Board is in receipt of the Report of Examination; and 2) that the Overview of the 1999 Examination Results and Conclusions has been appropriately reviewed.

We would also like to take this opportunity to thank Freddie Mac's management and employees for their cooperation and professionalism demonstrated throughout the 1999 examination process. This cooperation has been beneficial in building the rapport that has allowed OFHEO to document both the quality of the tools used, and the decisions made by Freddie Mac's employees and management.

If you or any of the Board members have questions about the examination process or the Results and Conclusions in the Annual Report of Examination, please contact me at (202) 414-3858.

Very truly yours,

G. Scott Calhoun
Chief Examiner
Office of Examinations and Oversight

REPORT OF EXAMINATION

1999 Examination Results and Conclusions

**Prepared for
Freddie Mac's Board of Directors**

Open Date: January 4, 1999
Close Date: December 30, 1999

This Report of Examination is made available to Freddie Mac for its confidential use only, and remains the property of the Office of Federal Housing Enterprise Oversight (OFHEO). This Report of Examination and the information contained in it may be disclosed only with the prior written consent of OFHEO's Director. Unauthorized use or disclosure of this Report of Examination or its contents may result in the penalties provided in 18 U.S.C. 641.

1999 Examination Results and Conclusions

Table of Contents

Overview Prepared for Freddie Mac's Board of Directors	1
Analysis Supporting the Overview	6
Credit Risk Program	6
Interest Rate Risk Program	11
Liquidity Management Program	15
Information Technology Program	18
Internal Controls Program	22
Business Process Controls Program	25
Audit Program	28
Board Governance Program.	30
Management Information Program.	32
Management Processes Program.	35

1999 Examination Results and Conclusions Overview Prepared for Freddie Mac's Board of Directors

Members of the Board:

I am writing to share the results and conclusions of OFHEO's 1999 annual risk based examination of Freddie Mac. I am pleased to share the conclusion from our 1999 examination work that Freddie Mac is a well-run company in a financially safe and sound condition. Our judgments of Freddie Mac's condition, shared with you here, were formed during OFHEO's onsite examination and reflect OFHEO's assessment of Freddie Mac's current risk profile and risk management techniques. These judgments are also factored into OFHEO's process for determining Freddie Mac's capital assessment.

OFHEO's examination program is committed to providing customized communications to ensure that each audience is provided with an appropriate level of information and detail. **Accordingly, this Overview is intended to provide Freddie Mac's Board of Directors with the necessary information about the results and conclusions of OFHEO's 1999 examination.** For more detail, Members of the Board may refer to the Summary Analysis portion of this report. Through the course of the 1999 examination process, OFHEO's examination staff and management had even more detailed communications with personnel across the company. The cooperation, professionalism and courtesies Freddie Mac management and employees extended to OFHEO's examination staff are appreciated.

This Overview and the Analysis Supporting the Overview should be read and understood in the context of OFHEO's annual risk based examination program. The examination program is described in our *Examination Handbook* which has been provided to management. In brief, OFHEO's annual risk-based examination program encompasses the major areas of financial risk confronting Freddie Mac, and the quality of governance exercised in managing both those risks and Freddie Mac's business. Within OFHEO's examination program there are discrete program areas that evaluate a wide-ranging series of qualitative and quantitative features of those program areas. While conducting work in the discrete program areas, examiners focus on: the quality of Freddie Mac's policies and the adherence to these policies; the quality of the tools used to select and manage risks and portfolios of risk; the expertise of personnel and management; the effectiveness of business processes; the quality of management reporting; and the effectiveness of and adherence to Freddie Mac's control framework. In both this Overview and Analysis Supporting the Overview, we report results and conclusions for the examination program areas: Credit Risk, Interest Rate Risk,

Liquidity Management, Information Technology, Internal Controls, Business Process Controls, Audit, Board Governance, Management Information, and Management Processes.

In accordance with our examination program, the results and conclusions for each program area are reported in relation to safety and soundness standards – whether they meet, exceed, or fail to meet safety and soundness standards. The results of the 1999 examination show that in all of the program areas, Freddie Mac exceeds safety and soundness standards.

Freddie Mac's credit risk management and credit risk management framework exceed safety and soundness standards. The portfolio is diversified and the profile of credit risk is in compliance with the internally prescribed limits. Policies, procedures, internal controls and management reporting for the credit function are effective. Freddie Mac is adequately compensated for the credit risk it assumes. Management prudently manages counterparty exposure. New products and initiatives are well researched prior to implementation. The process for determining the reserve for credit losses, credit risk sharing strategies, and the credit risk management tools management uses are effective. Freddie Mac effectively identifies, quantifies and tracks its credit risk exposures. Management has an effective means for following up on credit related issues. The technology and controls supporting the credit risk management function are effective. Management effectively reconciles differences between actual and expected credit portfolio performance.

Freddie Mac's interest rate risk management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to interest rate risk are effective. Management has a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk. Freddie Mac's management effectively follows up on issues related to interest rate risk. Freddie Mac appropriately researches and controls the extent to which new products and initiatives may impact the interest rate risk profile. The technology and controls supporting the interest rate risk management function are effective. The tools used to model interest rate risk, and the strategies to alter the exposures to interest rates are effective. Management effectively incorporates tactical and strategic issues into the management of interest rate risk. The responsibilities for strategy and analytics functions are appropriately separated from those for the execution functions. Derivative instruments are used prudently and in accordance with the standards used by other large financial intermediaries.

Freddie Mac's liquidity management framework exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to liquidity management are effective. Management has an effective methodology for quantifying and monitoring liquidity, and management appropriately evaluates the impact of events and alternative environments when

developing contingency plans. The planning process for liquidity management is effective. Freddie Mac appropriately considers the impact new products and initiatives may have on liquidity. Management effectively follows up on issues and initiatives that influence liquidity. Technology and controls for liquidity management are effective. The quality of tools Freddie Mac uses to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are effective. An appropriate separation of duties exists between the strategy and analytics functions and the execution function. There are no adverse trends or anomalies in funding spreads. Liquidity management is appropriately integrated with other management and with financial performance issues.

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Operating processes are in place to ensure secure, effective and efficient data center processing and problem management. There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. There are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. Management has an adequate process to ensure information technology plans effectively address business unit and corporate objectives. Effective processes are in place to ensure appropriate controls are implemented. Documentation for system development and maintenance is complete. Freddie Mac has implemented effective processes to ensure data and information are processed accurately and in a timely manner. Freddie Mac's plan for identifying, renovating, testing and implementing solutions for Year 2000 issues was effective. Freddie Mac effectively coordinated its Year 2000 processing capabilities with customers, vendors and business partners.

The internal control framework and the management of that framework exceed safety and soundness standards. Management has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. Implemented controls properly address risks assessed by management. Management has a reliable process for ensuring the timely resolution of control related issues. Internal Audit appropriately identifies and communicates control deficiencies to management and the Board of Directors. There are established policies and procedures that delineate internal control process and standards for the control environment. Management effectively ensures compliance with established internal controls.

The audit functions exceed safety and soundness standards. The Internal and External Audit functions have the appropriate independence. Auditors performing the work possess appropriate professional proficiency. The scope of audit work performed is appropriate, and the audit work is complete. The management of the Internal Audit department is effective. Executive management and the Board of Directors are appropriately involved with and follow up on identified audit issues. The auditor's risk assessment process is

effective. Internal Audit is appropriately involved in new products and new initiatives.

The Board discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. We consider the Board to be appropriately engaged in the development of a strategic direction for the company. From our point of view, the Board ensures that management appropriately defines the operating parameters and risk tolerances of the Enterprise in a manner consistent with the strategic direction; legal standards; and ethical standards. Our examination activities find that the Board has an effective process for hiring and maintaining a quality executive management team, and that the Board effectively holds the executive management team accountable for achieving the defined goals and objectives. We consider the Board to be appropriately informed of the condition, activities and operations of the Enterprise. From our perspective, the Board has sufficient, well-organized time to carry out its responsibilities.

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Management and the Board of Directors receive necessary reports on Freddie Mac's performance relative to established goals and objectives. Management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively. Management reporting permits management to gauge the quality of their decisions. Information systems are linked to Freddie Mac's overall strategy, and are developed and refined pursuant to a strategic plan. The reports management uses for decision making are accurate. Enterprise strategy, roles and responsibility are effectively communicated. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements. Communications across the company are adequate.

Key management processes that influence company-wide talent and behaviors exceed safety and soundness standards. The strategic planning process is appropriately comprehensive. Business unit goals, implementation plans and programs designed to achieve the corporate plan are effective. Management is able to monitor and manage change. Key performance measures are appropriate, effective and align with strategy. The behavior management programs are effectively designed to achieve corporate goals and objectives. Freddie Mac has effective programs for career and management development, and for recruiting competent people. Freddie Mac's proprietary risk management programs and systems are effective. Management effectively conveys an appropriate message of integrity and ethical values. Management's philosophy and operating style have a pervasive effect on the company. The organizational structure and the assignment of responsibility provide for accountability and controls.

Our 1999 examination work did not identify any matters requiring the direct involvement of the Board of Directors. Had there been any issues meriting your direct involvement or immediate attention, I would have apprised you of that fact earlier. If anything arises during the 2000 examination that you should be aware of or involved with, consistent with our communication standards, I will share that information with you in a timely fashion. In addition, I will continue to provide periodic updates to ensure the Board and executive management are appropriately apprised of our examination judgments about the financial safety and soundness of Freddie Mac.

This Report of the 1999 Examination Results and Conclusions contains both examination-related information gained by OFHEO through its examination process and examiner judgments. We ask that you accord this document appropriate confidential treatment.

G. Scott Calhoun
Chief Examiner
Office of Examination and Oversight

1999 Examination Results and Conclusions Analysis Supporting the Overview Prepared for Freddie Mac's Board of Directors

This section of the Report provides summary analysis supporting results and conclusions for the Credit Risk, Interest Rate Risk, Liquidity Management, Information Technology, Internal Controls, Audit, Management Information, Management Processes and Board Governance examination program areas. The summary analysis describes our assessment of the examination objectives that are unique to each program area.¹ This section provides an assessment of, and support for, the examination objectives and rates each examination objective on a scale of "meets", "exceeds" or "fails to meet" safety and soundness standards.

CREDIT RISK PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the risk management framework surrounding credit risk.*

The risk management framework surrounding credit risk exceeds safety and soundness standards.

- The policies, procedures, internal controls and management reporting for credit risk management are effective. The policies and procedures cover appropriate areas of credit risk management and provide clear instruction to the intended audiences. Freddie Mac provides detailed underwriting standards and servicing guidelines to its seller/servicers in both written form and through electronic media. Throughout the year, Freddie Mac supplements these standards and guidelines with bulletins and case-by-case interpretations. Freddie Mac's user guide to Loan Prospector is comprehensive. Freddie Mac has comprehensive written policies that address quality control, loss mitigation and technology tools. Internal controls for credit risk management are comprehensive, and are developed and applied by management. The effectiveness of internal controls is formally evaluated quarterly. Management reporting within the credit risk management framework is comprehensive, timely, detailed, informative and tracks variances between actual performance and corporate objectives.

¹ The examination objectives common to all program areas are not included in this report. The common examination objectives which are set forth in the *Examination Handbook* do not reflect the financial safety and soundness of Freddie Mac, but instead relate to OFHEO's examination process.

- Freddie Mac has a comprehensive framework that ensures new products, programs and initiatives do not create unforeseen impacts on the company's credit risk profile. Management thoroughly evaluates new products through the use of pilots with selected lenders in selected markets. Product performance in pilots is analyzed as is the potential impact of the product on the overall credit quality.
- Freddie Mac effectively generates extensive and appropriate analyses that support the loan loss allowance determination. Freddie Mac's loss reserve determination process is administered by experienced management, provides reliable loss forecasts based on economic estimates, movements in house prices, projected business volumes, and the composition of the existing mortgage portfolio. The process takes historical performance and identifiable credit performance trends into account and enables management to make a well-informed determination about the amount of the reserve.
- Freddie Mac has an extensive, quality methodology for identifying and quantifying its credit risk exposure. Freddie Mac uses a variety of reliable, effective tools and processes to identify and quantify the company's credit exposure. Management thoroughly analyzes Freddie Mac's book of business, including factors such as product type, borrower credit profile, LTV, origination year, and geographic region. Technology tools and the substantial database allow management to accurately assess credit risk exposures in terms of performance and profitability of each segment of Freddie Mac's book of business. In addition, Freddie Mac performs monthly evaluations of credit risk exposure in relation to specified indicators of performance, and to assess activity in relation to established business objectives.
- Freddie Mac has an effective system of tracking credit risk exposures, and the system provides appropriate credit risk related information to the different levels of management. Management receives detailed, periodic reports that facilitate the tracking and analysis of credit risk exposures. The reports address portfolio performance, delinquency, foreclosures, credit losses, product composition, geographic and market concentrations, quality control findings, REO management, loan repurchase trends, seller/servicer performance, loan loss forecasts, and expected economic and market trends. In addition to the reports, management participates in committees and forums that evaluate performance trends, the status of pending initiatives, and corporate objectives.
- Freddie Mac routinely and consistently compares actual credit portfolio performance with expected performance, and identifies and addresses material variances between the two. Deviations from expected performance are explained and addressed during weekly and other periodic meetings, and through a variety of other effective communication channels. Evaluations of

actual versus expected credit portfolio performance are appropriately incorporated into Freddie Mac's management reports.

- Freddie Mac's management effectively follows up on credit related issues. The company's management framework and reporting structure ensure that Freddie Mac's management receives appropriate information to effectively follow up on credit related issues. Freddie Mac personnel responsible for credit risk management have frequent contact with each other and follow a regimented schedule of meetings that support the timely and effective follow up of credit related issues. The Credit Risk Oversight Committee addresses and follows up on credit related issues of significance to the company.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring in the level and quality of credit risk as well as the potential impact on the Enterprise.*

The level and quality of credit risk in the portfolio exceed safety and soundness standards.

- Freddie Mac has broadened the nature of its relationships with certain high volume seller/servicers through the use of strategic alliances. Freddie Mac already had commercial relationships with these counterparties. The alliances do not contemplate substantive changes in risk taking or credit risk management. The alliances have not had an adverse impact on Freddie Mac's credit risk profile.

EXAMINATION OBJECTIVE: *Assess the overall adequacy and effectiveness of credit risk management. Determine how well the Enterprise manages and/or hedges credit risk.*

Credit risk management at Freddie Mac exceeds safety and soundness standards.

- Freddie Mac's retained and guaranteed credit portfolios are appropriately diversified and are in compliance with established limits and guidelines. The total portfolio is geographically diversified and Freddie Mac is not unduly exposed to credit losses attributable to regional economic fluctuations. The concentrations of mortgages in highly-populated states and metropolitan areas are not excessive and do not raise safety and soundness concerns. The mortgage portfolio is appropriately diversified in terms of overall credit risk profile. The preponderance of the mortgage portfolio consists of long-term fixed-rate loans which present a relatively low credit risk profile. There is a concentration of loans that originated in 1998, however this concentration

reflects the market activity resulting from favorable long-term rates and the high level of refinancing that took place in 1998. Credit quality measures indicate that the 1998 book is high quality, and the concentration does not pose safety and soundness concerns.

- Freddie Mac is adequately compensated for the credit risk it assumes, and credit models produce reliable results. Freddie Mac uses a variety of effective analytical tools, decision processes and tracking mechanisms to ensure that the company is adequately compensated for the credit risk it assumes. For example, with DEFCAP management can forecast mortgage performance based on various economic and market scenarios, and given the specific profile of the products under consideration, establish appropriate prices. Freddie Mac's credit related models: provide reliable predictions of future mortgage performance; identify delinquent loans that are most likely to result in default and foreclosure; generate dependable quality ratings of seller/servicers; recommend methods of property valuation; evaluate repair/increased value scenarios for REO; and analyze mortgage pools to identify the highest grade pieces.
- Freddie Mac prudently manages counterparty exposure, and has an effective counterparty risk management framework that protects the company against the risk that borrowers, seller/servicers, and mortgage insurers fail to meet their obligations. Freddie Mac devotes considerable resources to monitoring each seller/servicer's financial, quality control, delinquency management and other critical performance measures. Freddie Mac has an extensive set of technology tools, performance measures and management reports that effectively analyze the company's seller/servicer counterparties. Freddie Mac also has an effective counterparty risk management framework for mortgage insurance companies. Freddie Mac has established financial strength and performance requirements for its mortgage insurance counterparties. In addition, Freddie Mac monitors mortgage insurance companies' claims payment performance and has concentration limits for individual mortgage insurance companies.
- Freddie Mac's credit risk management tools are proven, reliable, cover key components of credit risk management, and enable management to effectively access data and generate analyses. Freddie Mac's underwriting guidelines, bulletins, interpretations, Loan Prospector, tools that select the method of collateral valuation, tools that facilitate quality control reviews, and proprietary technology tools allow management to obtain detailed performance reports that facilitate well informed decision making across the credit risk management spectrum.
- Freddie Mac's risk sharing strategies effectively reduce the company's exposure to credit risk. The predominant form of risk sharing Freddie Mac uses is private mortgage insurance, and Freddie Mac requires mortgage

insurance companies to maintain the appropriate financial capacity. Ongoing monitoring of mortgage insurance companies performance and condition position Freddie Mac to anticipate rather than merely react to developments that could impair the effectiveness of risk sharing with mortgage insurance companies. Freddie Mac also monitors and evaluates the performance of other parties with which it has risk sharing arrangements, and is able to identify potential future problems and take appropriate action.

- The technology and controls supporting Freddie Mac's credit risk management function are effective. Freddie Mac practices ensure that business unit personnel receive direct support from the Business Applications Support group to integrate technology tools with business needs. There is a strong and effective control environment surrounding credit risk management functions across Freddie Mac.

INTEREST RATE RISK PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the risk management framework surrounding interest rate risk.*

The management framework surrounding interest rate risk exceeds safety and soundness standards.

- Policies, procedures, internal controls and management reporting relating to interest rate risk are effective. The Securities, Sales and Trading Group and all departments in Corporate Finance that manage interest rate risk have appropriately detailed and current policies and procedures. The personnel involved with interest rate risk know and comply with these policies and procedures. The risk limits and appetites for Value at Risk and other risk measures such as changes in volatility and LIBOR-discount note spread are clearly communicated. The control framework includes the appropriate separation of interest rate risk analysis functions from the transaction functions. Management reports for interest rate risk, including "the Green Package" present the balance sheet and projected earnings in sufficient detail to allow decision makers to effectively identify the sources of interest rate risk.
- Management is effective in following up on issues related to interest rate risk. Management continuously monitors its interest rate risk profile and takes prompt and appropriate action when risk limits are approached. Freddie Mac's Rebalancing Committee meets each week, and its Asset/Liability Committee meets each month to compare potential changes in duration and convexity to the gains or losses in income per share associated with rebalancing transactions. In addition, on a daily basis analysts in Mortgage Portfolio Management carefully weigh potential income from investments in mortgages and other securities against their potential interest rate risk.
- The impact of new products, programs and initiatives on the company's interest rate risk profile is well researched and receives appropriate senior management and Board review prior to implementation. Management has been closely involved in key business initiatives relating to interest rate risk. The Callable Reference Note program for example, received appropriate approvals by the Board and management before it was implemented. Management keeps the Board appropriately informed on the status of new products and initiatives, and their impact on the company's interest rate risk profile.
- The appropriate separation of responsibilities exists between the strategy and analytics function and the execution function. Personnel who craft strategy and analyze the balance sheet are appropriately separated from those

Freddie Mac personnel who execute transactions. Traders and portfolio analysts do not code software that is used for portfolio management. The Market Risk Oversight unit that keeps management apprised of market risks is independent of units that manage interest rate risk and units that execute trades.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring in the level and quality of interest rate risk as well as the potential impact on the Enterprise.*

Freddie Mac's management of changes in the level and quality of interest rate risk exceeds safety and soundness standards.

- In 1999, Freddie Mac improved the processes for estimating Value at Risk and now calculates the number daily.
- In 1999 a Market Risk Oversight Forum was established. That Forum assess risks and rewards of Freddie Mac's interest rate risk strategies.
- A significant initiative relating to interest rate risk management was the successful implementation of the ALADDIN trading system which automates many of the trade processes that had previously been done manually. ALADDIN also enables management to update asset/liability information each day to estimate Value at Risk.
- During 1999 Freddie Mac fully implemented the NIMFEST model that enhanced the company's capabilities for estimating the sensitivity of net interest income to changing interest rates.
- Management is effective in incorporating tactical and strategic issues into the management of interest rate risk. In 1999 Freddie Mac took advantage of robust earnings and made key asset/liability moves that dramatically reduced the company's interest rate sensitivity. By extending the company's successful Reference Note Program to include a program for issuing large callable debentures (Callable Reference Notes), management positioned the company to match the needs of investors with corporate objectives.
- In 1999 the Market Risk Oversight unit began completing Phase I reports in order to keep management apprised of market risks.
- The Credit Risk and Capital Management group within Corporate Finance is in the process of establishing collateral thresholds for even the highest rated counterparties, developing long term counterparty measures and reviewing risk limits and total exposure calculations. The group is also researching the feasibility of implementing collateral posting requirements based on potential

exposure measured by the liquidity of a counterparty's position under certain scenarios.

EXAMINATION OBJECTIVE: *Identify and evaluate the use of derivative instruments.*

Freddie Mac's framework for managing the use of derivative instruments exceeds safety and soundness standards

- Freddie Mac uses derivative instruments in a prudent manner. Derivatives are used in a manner that is consistent with the corporate risk management policies. Freddie Mac uses derivatives primarily for reducing interest rate risk, and our examination did not find a single instance of the company's using derivatives as a speculative vehicle. Derivatives are marked to market daily, and are included in interest rate risk sensitivity analyses and in cash management forecasts. The staffs that analyze and execute derivative transactions are experienced and well trained professionals. Systems for data capture, processing, settlement and management reporting are adequate and will be enhanced with the full implementation of the ALADDIN trading system. Management reports for derivatives are comprehensive and identify important attributes of the instruments.
- Management governs the use of derivatives in accordance with the standards used by other large financial intermediaries. Freddie Mac measures the credit risk and market risk of its derivatives portfolio independently of the portfolio management function. Freddie Mac has a sound method for determining mark to market exposure for collateral obligations. Counterparty risk is appropriately diversified, and the credit quality of counterparties is routinely monitored. The Credit Risk and Capital Management group within Corporate Finance regularly reviews risk limits and counterparty performance.

EXAMINATION OBJECTIVE: *Assess the overall adequacy and effectiveness of interest rate risk management. Determine how well the Enterprise manages and/or hedges interest rate risk.*

Freddie Mac's management of interest rate risk exceed safety and soundness standards.

- Management has established a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk. Freddie Mac uses a robust Value at Risk (VaR) measurement to gauge market value sensitivity. Freddie Mac sends detailed balance sheet data to BlackRock Financial which produces the "Green Package" that contains duration and convexity information on all of Freddie Mac's assets and liabilities. Every day, Freddie

Mac's management estimates the company's VaR, an estimate of how much market value Freddie Mac would lose if the yield curve moved parallel 50 basis points, up or down. Freddie Mac's Rebalancing Committee meets weekly to assess the VaR and to determine what actions are appropriate to keep the VaR within the desired range. While Freddie Mac's VaR is monitored and managed everyday based on parallel yield curve shifts, management performs other analyses including rate scenarios incorporated into stress test models.

- Throughout 1999, Freddie Mac's interest rate sensitivity was well below operating and Board limits.
- Technology and controls supporting the interest rate risk management function are effective. Freddie Mac has specialists who develop new tools, maintain a reliable hardware infrastructure and enhance and maintain existing applications for interest rate risk management. Controls are in place to ensure the integrity of data used in interest rate risk and portfolio management models. Technology and controls supporting business continuity plans for the continued monitoring of interest rate risks during emergency situations have been tested and found to be effective.
- The tools used to model interest rate risk and the strategies to alter the exposures to interest rates are effective. Freddie Mac has tools that evaluate the effect of changing interest rates on all areas of its balance sheet. Not only are new tools, such as NIMFEST introduced, but also the existing tools, such as the prepayment models for various types of models, are enhanced. The prepayment models developed by a unit of Asset Liability Management are well documented and incorporate a wide range of appropriate factors. The prepayment models are tailored to specific asset types including 30 year fixed, 15 year fixed and adjustable rate mortgages. Interest rate generation models incorporate appropriate parameters and are rigorously tested and documented. The assumptions and parameters are continuously reviewed for reasonableness by both the developers and users of the models. The Prepayment Steering Committee meets regularly to discuss prepayment forecasts and the accuracy of previous forecasts. The Market Risk Oversight unit reviews the assumptions used in models developed by Freddie Mac as well as those used in models Freddie Mac purchases from outside vendors.

LIQUIDITY MANAGEMENT PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the liquidity positions and surrounding management framework.*

Freddie Mac's management of its liquidity exceeds safety and soundness standards

- The policies, procedures, internal controls, and management reporting relating to liquidity management are effective. The Corporate Finance Division's policies and procedures precisely detail the nature of liquidity risk and how it is managed. Risk limits and lines of authority are clearly identified in policies and procedures. There are guidelines with respect to credit, maturity and issuer diversification, as well as for who may initiate transactions relating to non-mortgage investments, derivatives and debt issues. The types of investments in the Liquidity and Contingency Portfolios are consistent with Freddie Mac's goals and strategies. The internal controls for liquidity management are strong and operate as intended. Management reports are timely, accurate and provide meaningful information on liquidity. The various daily, weekly and monthly reports are appropriately distributed and support management's ability to make tactical and strategic decisions.
- Management has established an effective methodology for quantifying and monitoring liquidity. Management routinely evaluates the impact of events and alternative environments, and develops appropriate contingency plans. Management reviews short term cash requirements, purchase commitments and funding costs daily. Freddie Mac assesses the adequacy of its liquidity in simulated interest rate environments through various effective models and stress tests. The effectiveness of Freddie Mac's contingency planning for liquidity was evident in the Y2K process. Management took extraordinary, but appropriate steps including the purchase of options to secure term repo funding from the Federal Reserve Bank of New York to ensure that Freddie Mac would have ample liquidity during the year end date change.
- The planning process for liquidity management, including tactical, strategic and contingency planning are effective. Freddie Mac's planning takes short term cash needs, access to capital markets, cost of capital and the ability to liquidate market positions into consideration. Capital allocation strategies are set at the business unit level and reflect the Board's capital allocation decisions. When opportunities arise to increase mortgage purchases, capital can be reallocated from the Liquidity and Contingency Portfolio to the mortgage portfolio.

- Management is effective in following up on issues and initiatives that influence liquidity. Liquidity issues are effectively communicated across business units as was demonstrated by the coordination of Corporate Finance's efforts to ensure that all systems would be ready and functioning properly during the Y2K date change. Liquidity issues are covered by the audit functions and by the corporate self assessment of risk process.
- Technology and controls for liquidity management are effective. There are specialists who support the liquidity management functions by developing new tools, maintaining a reliable hardware infrastructure, and enhancing and maintaining existing applications. The information technology systems provide timely and accurate liquidity management information and reports. These systems will be enhanced in 2000 with the continuing implementation of the ALADDIN trading system. Technology and controls supporting business continuity plans for the continued monitoring of liquidity during emergency situations have been tested and found to be effective.
- The quality of tools used to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are effective. Freddie Mac uses a variety of tools to assess the effect of changing interest rates on its liquidity position. Management assesses the effect of liquid investments in its interest rate risk modeling.
- The duties of the strategy and analytics functions and the execution functions are appropriately separated. Operational Risk Management monitors the compliance with separation of duties policies. The traders and portfolio analysts do not code software used for liquidity management. Regular analysis of the underlying markets is performed independently from the traders.
- Freddie Mac effectively analyzes, and is well positioned to respond to, trends and anomalies in funding spreads. Management regularly reviews and assesses spreads for discount notes, medium term notes, Reference Notes, callable debt, interest rate swaps and mortgages and non-mortgage investments relative to funding benchmarks. Freddie Mac uses information about trends and anomalies in funding spreads to make appropriate choices regarding liquidity. For example, when spreads on long term pay fixed interest rate swaps were high, (relative to U.S. Treasuries) management chose to increase the issuance of bullet debentures rather than create synthetic long term debt by combining discount notes with swaps.
- Liquidity management is appropriately integrated into other management and financial performance issues. Liquidity risks are incorporated into corporate and business unit plans. Freddie Mac's corporate plans and strategic initiatives fully account for the need to maintain adequate liquidity. Liquidity risk is reflected in the management of derivatives. The Corporate Finance

Division fully considers the ability to get out of positions quickly and cost effectively when contemplating derivative transactions.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring in the quality of liquidity and the Enterprise's position in the credit markets.*

Freddie Mac managed changes in the quality of liquidity and the Enterprise's position in the credit markets in a manner that exceeds safety and soundness standards.

- The impact of new products, programs and initiatives on liquidity is adequately researched. Before Freddie Mac introduced callable debt in its Reference Note program, there was significant coordination with Wall Street dealers to assess the depth of the market for these notes. Management and the Board regularly assess the impact of the new products, programs and initiatives on the company's liquidity.
- Freddie Mac successfully introduced Reference Bills during 1999.

INFORMATION TECHNOLOGY PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the information technology infrastructure and the surrounding risk management framework.*

The Information Technology infrastructure and surrounding risk management framework exceed safety and soundness standards.

- Freddie Mac has processes in place to ensure secure, effective and efficient data center processing and problem management. The capacity planning function, including capacity analysis, system availability and compliance with Service Level Agreements, is effective and monitored appropriately. Reports are generated in an appropriately secure manner. The distribution of both hard copy and on-line reports is effectively controlled. Access to the data center operations is appropriately controlled and limited. Physical security controls are strong. Procedures for problem management and incident reporting are well documented and effective, and provide a consistent methodology for managing production system problems. Problem management appropriately includes: problem reporting, problem assignment and communication, managing open problems, critical problem management and the use of defined escalation procedures, and problem closure and follow-up.
- There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. Freddie Mac successfully implemented Axent Technologies Enterprise Security Manager, an effective tool for monitoring, reporting and managing security, across all Novell, WindowsNT, and UNIX platforms. Freddie Mac's connections to external networks and their related servers are well protected and present minimum access points from the Internet. Freddie Mac effectively controls firewalls and routers. Freddie Mac has an effective automated access request and validation process. Freddie Mac is working to more effectively monitor access permissions within its UNIX systems.
- Freddie Mac has effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. The corporate policy on business continuity planning sets appropriate guidelines for business process owners to follow when establishing and maintaining business continuity plans. The policy specifies that business areas are responsible for monitoring the assessments of recoverability, developing and maintaining BCP's in compliance with established standards, regularly exercising BCPs and developing BCPs for new or revised process or system

prior to their implementation. Freddie Mac's corporate wide contingency plan is a collection of effective business continuity plans developed by each business process owner.

- Freddie Mac has an adequate process to ensure information technology plans effectively address business unit and corporate objectives. The overall responsibility for the Information Technology function is appropriately allocated to a senior vice president. The senior vice president chairs the corporate Technology Forum which oversees critical enterprise-wide technology strategies, and issues relating to Y2K, technology infrastructure, data management, business systems/technology initiatives, and technology environment trends and benchmarks. Freddie Mac's budget and planning process includes a funding path for Business Technology Investments which includes an analysis of the impact of proposed business initiatives on existing information technology systems, information quality, web-technology and systems architecture.
- Freddie Mac has effective processes in place to ensure appropriate controls are implemented and documentation for system development and maintenance is complete. Freddie Mac's Application Development Reference Manual (ADRM) is an effective standard methodology that identifies the documentation and controls necessary to build and support applications. The ADRM includes appropriate task descriptions, generic work plans, deliverable templates, and required approval forms. Appropriate procedures are in place for change management processes, and include an effective release management program. Freddie Mac has several effective tools in place for change management, and the company is working to enhance its change management functions.

EXAMINATION OBJECTIVE: *Identify and evaluate changes that may influence the risks associated with information technology as well as the potential impact on the Enterprise.*

The manner in which the Enterprise responds to and evaluates changes in Information Technology that may influence the surrounding risk framework exceeds safety and soundness standards.

- By the end of 1999, Freddie Mac was implementing a product that enhanced the controls by providing real time alerts of access violations and suspicious network activity on routers.
- In 1999 the Corporate Controller assumed ownership of the End User Computing Systems, and the supporting policy and standards. The Controller

provides appropriate best practice guidance and tools to the business areas for use in controlling risks associated with their End User Computing Systems.

- The on-going implementation of the Information Quality Program will enhance the processes that ensure the accuracy of data and information.
- Freddie Mac effectively managed the effect of Year 2000 efforts on the company's strategic and operating plans. Freddie Mac designated the Year 2000 effort as the company's highest corporate priority for 1999. Freddie Mac developed several innovative and effective programs that ensured it had the critical skills and knowledge in place to achieve Year 2000 readiness and meet its top corporate goal. Among the programs Freddie Mac implemented which positioned the company to compete successfully in the marketplace were: retention and recruiting, reintegration (retraining and reassignment), reward, recognition, and lifestyle considerations.

EXAMINATION OBJECTIVE: *Assess the overall adequacy and effectiveness of risk management and controls for information technology.*

The adequacy and effectiveness of risk management and controls for Information Technology at Freddie Mac exceed safety and soundness standards.

- Freddie Mac has implemented effective processes for the processing of data and information to ensure accuracy and timeliness. Freddie Mac's system development methodology specifies the necessary controls for ensuring data integrity and processing accuracy. Business units, Information Systems & Services and Internal Audit all play effective and appropriate roles in ensuring controls are incorporated into the application development process.
- Freddie Mac's plan for identifying, renovating, testing and implementing solutions for the Year 2000 issue has been effective. The effectiveness of the plan has been demonstrated by the successful operation of the company after the date change. The plan includes appropriate actions throughout the first quarter 2000. The Year 2000 project was appropriately designated as the highest corporate priority for 1999, and responsibility and oversight has been appropriately assigned to centralized and decentralized units. The plan, based on a waterfall approach, ensured that information and deliverables flowed from one phase into the next. Key aspects of the plan were: the formal Y2K issue recognition and resolution process; the quality assurance program for Y2K readiness; the business continuity plans for eventualities

that may have occurred at the date rollover; the response integration process; and involvement of the internal audit department.

- Freddie Mac's Year 2000 processing capabilities have been effectively coordinated with customers, vendors and business partners. Freddie Mac appropriately and effectively analyzed the potential risks presented by third parties, and developed detailed risk mitigation plans, developed Y2K readiness assessment tools and procedures, validated external partner Y2K readiness, and implemented corrective actions and contingencies for external partners. Freddie Mac developed and implemented an effective communications strategy to assure lenders, borrowers, analysts, shareholders and other stakeholders that Freddie Mac was committed to aggressively preparing for the date change. Freddie Mac began testing with its business partners in 1998, and through 1999 it conducted testing with customers representing 96% of the company's portfolio. Freddie Mac appropriately participated in the MBA Industry Test, and performed extensive testing with the Federal Reserve Bank of New York and other critical financial market counterparties.

INTERNAL CONTROLS PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the framework for internal controls and the management of this framework.*

The internal control framework and the management of the framework substantially exceed safety and soundness standards.

- Freddie Mac has accurate and reliable processes for identifying risks to business processes and implementing appropriate controls. The MARC process is a disciplined process that provides a consistent framework for the company to discuss and monitor risks on a division and aggregate basis. The Corporate Controller's Office spot checks the integrity of a sample of MARC reports each quarter. The All Major Issues Report identifies control issues by business areas, and places each issue in one of ten identified categories of risk. The Enterprise Business Risk Profile Report capsulizes Freddie Mac's exposure to the ten categories of risk, and the information is appropriately communicated with senior management through the Risk Management Review Board and the Risk and Capital Forum. Freddie Mac assigns a controller to each division, and in a temporary but effective process, has identified "risk experts" for each of the ten corporate risks.
- Freddie Mac's management has reliable processes for ensuring the timely resolution of control-related issues. The Control Issues Resolution Report and its associated tracking reports, which include forecasts for resolution, provide management with an effective means of monitoring efforts to resolve control related issues. Senior management, through the Risk Management Review Board and the Risk and Capital Forum, are appropriately informed of control related issues and the status of efforts to resolve those issues. Internal Audit routinely performs follow-up work to ensure that business units have initiated corrective actions for identified control issues, and that the actions are effective in addressing the control weakness.
- Freddie Mac's Internal Audit unit appropriately identifies and communicates internal control deficiencies to management and the Board of Directors. The Internal Audit program appropriately focuses on the effectiveness of controls. All full scope audits include the verification of MARC reports -- Internal Audit tests business units' assertions about the effectiveness of their controls. The audit reports effectively provide management with key information about the quality of controls and clearly note identified deficiencies. The audit reports and summaries of the audit findings are appropriately distributed to management throughout the company. Through its Audit Committee, the

Board is appropriately apprised of Internal Audit activities, including findings about the effectiveness of controls.

- Freddie Mac has established policies and procedures that delineate internal control processes and standards for the control environment. Freddie Mac has an effective process for developing corporate wide internal control policies. The process emphasizes risk management and explicit accountability, and is based on the theory that coordinated action plans and empowered business unit managers can influence corporate behavior. Internal control policies clearly identify the roles and responsibilities of both policy owners and users, and provide an effective communications structure for reporting to management and the Board compliance issues. Business unit policies and procedures establish clear and appropriate controls and limits.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes that may influence the quality of internal controls and the potential impact on the Enterprise.*

Freddie Mac reacts to changes that affect internal controls in a manner that substantially exceeds safety and soundness standards.

- Freddie Mac is taking steps to enhance its control oversight process (the three dimensional risk framework and the control management model are still in formative stages), and is adopting a control management model which performed well in Y2K efforts.
- Freddie Mac is reviewing and revising its corporate wide control policies to ensure that the policies are effective risk management tools rather than just formalized pronouncements.

EXAMINATION OBJECTIVE: *Determine the adequacy and effectiveness of the Enterprise's system of internal controls.*

Freddie Mac's system of internal controls and its effectiveness exceed safety and soundness standards.

- The controls Freddie Mac has implemented properly address the risks assessed by management. The effectiveness of Freddie Mac's controls is demonstrated by among other things, measures of credit performance, liquidity, interest rate exposure, as well as by the results of audit activities. In 1999 Freddie Mac's top corporate priority was to effectively control the risks associated with Y2K. Results of industry tests and the continued uneventful

operations of the company through the date change demonstrate the effectiveness of Freddie Mac's controls.

- Freddie Mac's management ensures compliance with established internal controls. Management actively monitors compliance with internal controls and has effective processes in place to support the timely and effective resolution of deviations from established controls.

BUSINESS PROCESS CONTROLS PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the framework for building the control environment surrounding revisions to the business proposition or new initiatives.*

The framework for building the control environment surrounding revisions to the business proposition or new initiatives exceeds safety and soundness standards.

- The processes and control environment Freddie Mac uses when considering or developing new or substantially revised business initiatives is effective. Freddie Mac's Product Development Process manual provides a comprehensive road map for successful launch and introduction of new or substantially revised business initiatives. Freddie Mac's six-level development process lifecycle provides a standard and effective control environment for new or substantially revised business initiatives from concept through feasibility to rollout and post implementation assessment. Internal Audit's SDR, or Systems Development Review process which requires Internal Audit to sign off on the appropriateness and effectiveness of controls surrounding new applications contributes to Freddie Mac's strong control environment for new or substantially revised business initiatives.
- The communication flows associated with the new or substantially revised business initiatives are effective. Freddie Mac's processes for new or substantially revised business initiatives appropriately include communication plans. The regular use of committees, teams and forums in connection with new or substantially revised business initiatives ensure that affected business units throughout the company remain appropriately apprised of initiatives and progress. Routine reports to management and Board of Director are designed to capture and share information about new or substantially revised business initiatives.
- The balance between risk management, internal controls and the pressure to develop new or substantially revised business initiatives is appropriate. In keeping with its corporate culture, Freddie Mac may purposefully over-engineer new or substantially revised business initiatives. Freddie Mac completes meticulous and deliberate analyses and reviews which can slow the introduction of products to market, but permits management to thoroughly evaluate and refine its risk management approach for the new or substantially revised business initiative. In the case of Reduced MI and Custom MI, the products were deliberately placed on hold while management pursued other, higher priority strategies.

- Freddie Mac effectively uses pilot programs in connection with its new and substantially revised business initiatives.
- Freddie Mac's corporate culture and desired employee behaviors are appropriately considered when developing plans for managing and marketing new or substantially revised business initiatives.
- The analyses Freddie Mac conducts to determine whether launched new or substantially revised business initiatives are successful and/or have aspects that warrant reconsideration or modification, are effective. A post implementation evaluation of the new or substantially revised business initiative is built into the six level development process lifecycle. In addition, regular management reports and audit reports provide relevant information about the success of new or substantially revised business initiatives and their impact on the company's risk profile.
- Freddie Mac's corporate environment promotes and supports the introduction of new ideas and intellectual capital. Freddie Mac supports and encourages new ideas, and its corporate Needs Database is a storehouse for ideas identified by both internal and external sources. Ideas in the Needs Database are developed into initiatives when there is an identified market need that fits Freddie Mac's risk-management framework.

EXAMINATION OBJECTIVE: *Determine the adequacy and effectiveness of the due diligence process for new or revised business initiatives.*

The due diligence process for new or revised business initiatives exceeds safety and soundness standards.

- The analysis and review Freddie Mac conducts for new or substantially revised business initiatives are appropriate. The analysis and review conducted in connection with the Reduced MI and Custom MI products were rigorous, clearly documented and appropriate. The criteria Freddie Mac uses in its reviews of new or substantially revised business initiatives are appropriate. The criteria are standardized across the company, and are appropriately focused on risk.
- Freddie Mac's Board of Directors and executive management are appropriately informed about the adequacy of due diligence for new or substantially revised business initiatives. While initiatives are being developed, the teams, committees and forums responsible for the initiatives

keep management and the Board of Directors appropriately informed through regular and periodic status reports. In addition, management and the Board of Directors are informed about key aspects of initiatives through corporate MARC, Phase I and Enterprise Business Risk Profile reports.

AUDIT PROGRAM

EXAMINATION OBJECTIVE: *Assess the overall adequacy and effectiveness of both internal and external audit functions and the management of the audit program.*

The effectiveness of the internal and external audit functions and the management of the audit program exceed safety and soundness standards.

- Freddie Mac's audit functions have appropriate independence. The organizational structure and reporting lines effectively support and promote the independence of the audit functions. The budget process supports the independence of the Internal Audit Department. The process for selecting and engaging the company's external auditor supports the independence of the external audit function. The independence of the audit functions is evident in audit workpapers and reports.
- The auditors performing work at Freddie Mac possess appropriate professional proficiency. The Internal Audit staff have strong educational backgrounds, impressive professional certifications and significant work experience. The process Freddie Mac uses to select its external auditor appropriately includes an analysis of the auditors' experience and credentials. The work completed by both audit functions demonstrates the auditors' professional proficiency.
- The scope of the audit work performed at Freddie Mac is appropriate. The approved audit plan appropriately reflects the risks in Freddie Mac's operations and activities. The scope of the audit work is responsive to internal control needs, and the scope of the audit work expands appropriately when significant issues arise.
- The audit work performed at Freddie Mac is complete. Objectives for audit work are clearly identified and the procedures the auditors use are effectively designed to achieve audit objectives. The workpapers supporting Internal Audit's full scope audits, limited scope audits and system development reviews appropriately document the work performed and support the auditors' conclusions. Audit findings are effectively and appropriately communicated to their audiences.
- Freddie Mac's Internal Audit Department is effectively managed. Internal Audit's management uses tools effectively to manage and improve the efficiency and quality of the unit's work. Internal Audit's resources are

effectively managed and audit plans are met. The Internal Audit management has hired a quality staff, and expect and receive quality work.

- Freddie Mac's executive management and the Board of Directors are appropriately involved with, and follow up on, identified audit issues. There are effective processes in place to ensure that corporate management and the Board of Directors remain appropriately informed of audit issues, and the status of follow up activities.
- Freddie Mac's auditors have an effective risk assessment process. The risk assessment process used by the auditors is comprehensive, and is appropriately updated.
- Freddie Mac's Internal Audit Department is appropriately involved with new products and initiatives. Through a variety of effective formal and informal means, Internal Audit remains appropriately informed about new products and initiatives. The model used by Internal Audit to generate the audit schedule each year appropriately defaults to audit new products and processes. Freddie Mac requires that Internal Audit sign off on controls surrounding new applications through the Systems Development Review process.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring in internal and external audit functions or roles as well as the potential impact on the Enterprise.*

- In 1999 there were no significant changes in the audit functions or roles.

BOARD GOVERNANCE PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the framework for board governance and the management of this framework.*

The framework for board governance and the management of the framework exceed safety and soundness standards.

- Freddie Mac's Board of Directors remains appropriately informed of the condition, activities and operations of the Enterprise. The process management uses to prepare materials for the Board is comprehensive, and results in the Board's receiving appropriate and accurate information from a variety of sources.
- Freddie Mac's Board of Directors has sufficient well-organized time to carry out its responsibilities. The discipline of providing materials sufficiently in advance of meetings permits the Directors to maximize their time together. Summaries of standard Board and Committee reports are effective tools that facilitate discussions and understanding. Meeting agendas are designed to permit extended discussions if the Directors desire.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring in the structure and composition of the Board of Directors as well as the potential impact on the Enterprise.*

The results of changes in the structure of the Board of Directors and their potential impact on the Enterprise exceed safety and soundness standards. There were no changes in the composition of the Board of Directors in 1999.

- Changes to the Audit Committee's charter and the responsibilities of the Investment Committee enhance Board governance.
- The introduction of a Report Summary for standard reports to the Board of Directors and its committees enhanced already effective communications with the Board.

EXAMINATION OBJECTIVE: *Determine whether the Board effectively discharges its duties and responsibilities.*

The manner in which the Board of Directors discharges its duties and responsibilities exceeds safety and soundness standards.

- Freddie Mac's Board of Directors has been appropriately engaged in the development of a strategic direction for the Enterprise. The Board of Directors reviews and provides input to management during the strategic development process. The Board provided management with input regarding the company's future strategic direction throughout 1999, and agendas for the Board's meetings in 1999 demonstrate the scope of the Board's involvement with Freddie Mac's strategic direction. Board committees receive input on strategic direction from management Forum.
- Freddie Mac's Board of Directors ensures that executive management appropriately defines the operating parameters and risk tolerances of the Enterprise consistent with the strategic direction; legal standards; and ethical standards. The direct reporting link from management forum to either the full Board of Directors or one of its committees, as well as standard reports from management to the Board provide the Board with appropriate information about the parameters and tolerances within which management operates. The Board appropriately reviews levels of compliance with the ethical standards set forth in Freddie Mac's Code of Conduct, and receives information about compliance with legal standards.
- Freddie Mac's Board of Directors has an effective process for hiring and maintaining a quality executive management team. The Board of Directors has appropriate opportunities to assess the quality of its executive management team. The robust succession planning tool provides the Board with an effective tool to identify potential new members of its executive management team.
- Freddie Mac's Board of Directors holds the executive management team accountable for achieving the defined goals and objectives. The Board of Directors approves the compensation for the company's executive management team. Decisions about the different elements of executive management's total compensation appropriately reflect performance against defined short- and long-term goals and objectives.

MANAGEMENT INFORMATION PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the framework employed to produce reliable management information.*

The framework employed to produce reliable management information exceeds safety and soundness standards.

- Freddie Mac's information systems are linked to the company's overall strategy, and are developed and refined pursuant to a strategic plan. The responsibility for determining information needs and priorities rests with senior officials in the company who report through a management forum to a committee of the Board of Directors. The System Development Review process provides an effective control for Freddie Mac's information systems strategy.
- The systems and data used to generate reports are subject to effective controls.
- Freddie Mac effectively communicates Enterprise strategy, roles, and responsibilities. Freddie Mac uses performance management tools, other human resources tools, and management reports to set forth individual and division roles and responsibilities, and how those roles and responsibilities relate to each other and corporate objectives. Through the quarterly Performance Highlights, all employees are effectively informed about the Corporate Scorecard. Communications about Freddie Mac's strategy is tightly controlled, and information about the strategy is deliberately staged and layered.
- Freddie Mac provides employees with effective means of providing feedback, reporting suspected improprieties, and suggesting enhancements. The Hotline provides all employees with an effective means of reporting suspected violations of the Code of Conduct. The Corporate Communications Department conducts an annual e-mail survey of all employees to ascertain the success/usefulness of its programs and publications.
- Communications across Freddie Mac are effective. Corporate communications are precise and are subject to effective reviews and controls. In addition to formal written communications, the numerous committees and forum provide an effective means to share information and knowledge across the company.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring that may substantially alter the production of management information as well as the potential impact on the Enterprise.*

The changes that relate to the production of management information are designed to enhance management information programs and processes that already exceed safety and soundness standards.

- The Business Technology Initiatives track in the 2000 budget process is designed to ensure information systems expenditures are in line with Freddie Mac's strategy.
- Freddie Mac continued to make progress in 1999 in its long-term efforts to enhance information quality, the inputs that result in management reports.
- Freddie Mac is increasing its reliance on its Intranet site to share information across the company in a uniform and timely manner.
- In 1999, Freddie Mac conducted a comprehensive Organizational Environment Survey which followed up on issues identified in its 1996 survey, and which sought employee input on a wide variety of issues.

EXAMINATION OBJECTIVE: *Determine whether the Enterprise's management information produces timely, accurate and meaningful information and reports that are appropriately tailored for their audiences.*

Freddie Mac's management information exceeds safety and soundness standards, and produces timely, accurate and meaningful information and reports appropriately tailored for their audiences.

- Freddie Mac's executive management and Board of Directors receive necessary reports on the Enterprise's performance relative to established goals and objectives. Key regular management and Board reports clearly and consistently indicate whether progress toward meeting goals and objectives is "on", "above" or "below" plan.

- Freddie Mac's management reporting provides the levels of management with the information necessary to carry out their responsibilities efficiently and effectively, and to gauge the quality of their decision making. Management reports include the appropriate level of detail and provide the different levels of management with information needed to identify actions that need to be taken. Management reports include appropriate information about the impact decisions have on business unit and corporate risk profiles.

MANAGEMENT PROCESSES PROGRAM

EXAMINATION OBJECTIVE: *Evaluate the framework for management processes and the management of this framework.*

The framework for management processes and the management of this framework exceed safety and soundness standards.

- Freddie Mac's strategic planning process is *comprehensive*. The strategic planning process is iterative, rather than periodic. The multiyear planning process conducted in 1999 involved executive management, the Board of Directors and outside consultants. Strategic planning is reflected in operating plans, and in 1999 several projects that had the potential to adversely impact the company's ability to achieve its top corporate priority of Year 2000 compliance were reasonably deferred.
- Freddie Mac's key performance measures are appropriate, effective, and align with strategy. There are effective mechanisms in place to evaluate progress toward individual, divisional and corporate goals.
- Freddie Mac's behavior management programs are effectively designed to achieve corporate goals and objectives. The process for evaluating employee performance links directly with business unit goals and roll up to corporate goals. *Compensation is tied directly to both corporate and individual performance.*
- Freddie Mac's management effectively conveys an appropriate message of integrity and ethical values. Freddie Mac's Code of Conduct is appropriately comprehensive and management dedicates resources to support the administration of and compliance with the Code.
- Freddie Mac's organizational structure and the assignment of responsibilities effectively provide for accountability and controls. Each division has its own controller who brings a strong control focus to the business unit. The corporate wide control policies assign responsibilities and establish accountability.

EXAMINATION OBJECTIVE: *Identify and evaluate any changes occurring that may influence the quality of management processes, as well as the potential impact on the Enterprise.*

The changes that relate to management processes will further strengthen the management processes that already exceed safety and soundness standards.

- The new continuous budget process that is effective in 2000 supports the corporate strategic plan.
- In 2000, Freddie Mac will take actions to address the results of the People Management Study, the audit of employee performance management system and the Organizational Environment study. These actions are likely to impact behavior management programs.
- Efforts are planned for 2000 to rewrite job descriptions as a result of changes to Freddie Mac's grade structure. The revisions to job descriptions and grade changes may affect recruitment efforts in 2000 and beyond.

EXAMINATION OBJECTIVE: *Determine the adequacy and effectiveness of management processes to manage the Enterprise on a company-wide basis.*

The adequacy and effectiveness of management processes to manage Freddie Mac on a company-wide basis exceed safety and soundness standards.

- Freddie Mac's business unit goals, implementation plans and programs to achieve the corporate plan are effective. The business unit goals and objectives for 1999 aligned with strategic plans, long-term plans and budgets. The 1999 business unit goals and objectives were measurable, time bound and results oriented. In light of the tightly controlled and layered information about the current corporate strategy, business units will be challenged to achieve the same level of congruity with their unit goals and corporate goals.
- Freddie Mac's management is able to effectively monitor and manage change. Effective reporting keeps management apprised of actual and potential changes in Freddie Mac operations and the environment within which the company operates. The information contained in reports positions management to respond appropriately to change. In 1999 Freddie Mac repeatedly demonstrated its ability to effectively monitor and manage internal and external changes in connection with Year 2000.

- Freddie Mac has effective programs for career and management development. Freddie Mac strives to provide its employees with a continuous learning environment and emphasizes hands on training or key projects assignments in its training philosophy. Freddie Mac provides a variety of internal and external training opportunities and mentoring programs for its employees. Freddie Mac is shifting its focus from buying the talent it needs to building that talent. This shift heightens the importance of effective and appropriate training opportunities for Freddie Mac employees.
- Freddie Mac has an effective program for recruiting competent people. The company recognizes the importance of Human Capital and focuses on the fact that it must leverage each employee. Freddie Mac effectively uses internal and external postings to recruit competent people for open positions. Freddie Mac recognizes that by leveraging its business reputation and corporate mission it can enhance its recruitment efforts.
- Freddie Mac's proprietary risk management programs and systems are effective. Freddie Mac has effective processes for identifying, analyzing and prioritizing risks across the company. The results of operations, measures of credit performance and market risk indicators, as well as the successful transition into 2000 demonstrate the effectiveness of Freddie Mac's proprietary risk management programs and systems.
- The philosophy and operating style of Freddie Mac's management have a pervasive effect on the company. The standard reports and measures used throughout Freddie Mac effectively reinforce management's risk management philosophy. Formal internal communications are controlled to ensure that messages are consistent. In addition, the frequent interaction among levels of management across the company reinforce the corporate philosophy and operating style.