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OFHEO Freddie Mac Report of Examination

Scott G. Calhoun

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REPORT OF EXAMINATION

2001 Examination Results and Conclusions

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

Open Date: January 2, 2001
Close Date: December 31, 2001

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2001 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 2001 annual risk based examination of Freddie Mac. I am pleased to share the conclusion from our 2001 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 and strategies. These judgments are also factored into OFHEO's process for determining Freddie Mac's capital adequacy.

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 2001 examination.** For more detail, Members of the Board may refer to the Summary Analysis portion of this report. Through the course of the 2001 examination process, OFHEO's examination staff and management had even more detailed communications with personnel across the company. The cooperation, professionalism, responsiveness 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 considered 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 risk and risk management. 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 2001 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 credit risk profile 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 and its credit risk models produce reliable results. Management prudently manages counterparty exposure. New products and initiatives are well-researched prior to implementation. The process for determining the reserve for credit losses, the credit risk sharing strategies, and the credit risk management tools are all 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 the strategy and the 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. Freddie Mac effectively analyzes and is well positioned to respond to trends and 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 and that the conduct of E-commerce is secure. 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 processes in place 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. The controls over end-user computing are effective and there are controls that secure networks and firewalls from inappropriate or unauthorized actions. Freddie Mac has processes in place to ensure data and information are processed accurately and in a timely manner.

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.

Business process controls exceed safety and soundness standards. Freddie Mac's corporate environment promotes and supports the introduction of new ideas and intellectual capital. The process and control environment used when considering or developing new or substantially revised business initiatives is effective. The criteria Freddie Mac uses to subject a business initiative to review as new or substantially revised are appropriate. The analysis and review of new

or substantially revised business initiatives are effective. Pilot programs are effectively used and the analysis and review conducted after the launch of a new or substantially revised business initiative is appropriate. The communications associated with new or substantially revised business initiatives are effective. Freddie Mac appropriately balances risk management, internal controls and the pressure to deliver new or substantially revised business initiatives.

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 Internal 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 has processes in place designed to hold 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.

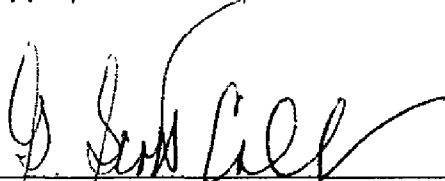
The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Management and the Board of Directors receive necessary reports on Freddie Mac's performance relative to established goals and objectives. Management reporting provides the levels of management 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. There are communications across the company and management communicates Enterprise strategy, roles and responsibility. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements.

Key management processes that influence corporate-wide behaviors exceed safety and soundness standards. The strategic planning process is

comprehensive and dynamic. Business unit goals are effective and implementation efforts reflect changing priorities. Management has the ability 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 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 2001 examination work did not identify any matters requiring the direct involvement of the Board of Directors. Operating management has been responsive and effective in addressing issues raised to their attention and action. 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 2002 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 2001 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

2001 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, Business Process 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. Policies and procedures, including underwriting and servicing guidelines, are thorough, comprehensive, well-documented, appropriately distributed and appropriately updated. In addition, as evidenced in the aftermath of September 11, management appropriately provides interpretations and advice on a case-by-case basis to ensure that Freddie Mac's standards and guidelines are consistently applied as intended. The comprehensive internal controls related to credit risk management are developed, applied and appropriately reviewed and revised by management. Management reporting for credit risk is comprehensive, timely, appropriately detailed, informative, and tracks variances between actual performance and business objectives.
- Freddie Mac has a comprehensive framework that ensures new products, programs and initiatives further the company's mission and objectives, and do not create unforeseen impacts on the company's credit risk profile. The

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 100 product and the various no appraisal products introduced in 2001 were all developed within Freddie Mac's established framework for new products. Both individually and as a whole, the new products introduced in 2001 are consistent with the company's credit risk profile.

- Freddie Mac's loan loss allowance determination process is effective and results in management's making well-informed decisions about the level of the loan loss reserve. The process for which individuals are appropriately held accountable results in a loan loss reserve that is appropriately based on economic estimates, movements in house prices, projected business volumes, the composition of the existing mortgage portfolio, historical performance, and identifiable credit performance trends. The conservative approach to the loan loss allowance process is well-documented and utilizes proven and reliable models.
- Freddie Mac has an extensive, quality methodology for identifying and quantifying its credit risk exposure. Freddie Mac uses a variety of reliable tools and effective processes that identify and quantify the company's credit exposure. Management thoroughly analyzes Freddie Mac's total mortgage portfolio using appropriate factors such as product type, borrower credit profile, loan-to-value (LTV), origination year, and geographic region. Technology tools and the company's substantial databases allow management to assess the performance, profitability and credit risk exposure of each segment of Freddie Mac's total mortgage portfolio.
- Freddie Mac's effective system of tracking and analyzing credit risk exposures provides appropriate credit-risk related information to different levels of management. The different levels of management receive appropriately detailed, periodic reports that facilitate the effective tracking and analysis of credit risk exposures. Both the regular reports that address portfolio performance, delinquency, foreclosures, credit losses, product composition, geographic and market concentrations, quality control findings, real estate owned (REO), loan repurchase trends, seller/servicer performance, loan loss forecasts and expected economic and market trends, as well as the ad hoc reporting capabilities allow management to conduct focused analyses of emerging credit risk issues. In addition, information about credit risk exposure is effectively communicated and followed up on in numerous regularly scheduled meetings, conference calls and forums.
- Freddie Mac routinely and consistently reconciles differences between actual and expected credit portfolio performance. Material variances between the actual and expected results are effectively and appropriately detailed in standard management reports. Deviations from expected performance are discussed and addressed during regular management meetings.

- Freddie Mac's management effectively follows up on credit related issues. The company's operating framework and reporting structure support management's ability to follow up on credit related issues in an effective manner. Regular meetings among individuals responsible for credit risk management and effective reporting allow management to track and address significant credit related issues in a timely fashion.

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.

- The products introduced in 2001 did not materially alter Freddie Mac's credit risk profile which remains at a safe and sound level.

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 management's prescribed limits and guidelines. The bulk of the mortgage portfolio consists of long-term fixed-rate loans that present a relatively low credit risk profile. The mortgage portfolio is appropriately diversified in terms of overall credit risk profile. 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 do not constitute excessive concentrations relative to the market area, and as a consequence, do not raise undue 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, processes, and tracking mechanisms to ensure that the company is compensated at or above a level commensurate with the actual credit risk to which it is exposed. In 2001 management continued to implement its enhanced version of the DEFCAP costing/pricing model which will allow management to more precisely price in relation to credit risk. Additional efforts are designed to further refine the pricing of subprime

mortgages. Freddie Mac's credit 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. Management appropriately assesses the credit models periodically and identifies those models that should be enhanced or replaced.

- Freddie Mac prudently manages its counterparty exposure with skilled managers and staff, extensive review and evaluation techniques, meaningful performance measures and effective tools. Freddie Mac appropriately commits substantial resources to identifying, measuring and monitoring its counterparty risk exposures to both seller/servicers and to mortgage insurance companies. The eligibility requirements and performance measures for counterparties are appropriate and are effectively monitored and reported.
- Freddie Mac's credit risk management tools are proven, reliable, and cover each key component of credit risk management. Management appropriately devotes attention and resources to enhancing tools to address emerging needs and to take advantage of advances in technology. Among the tools OFHEO evaluated in 2001 were the multifamily quality rating system, the REO manager, Early Resolution and Loan Prospector. In all cases the tools were found to be effective and the enhancements appropriate.
- Freddie Mac's risk sharing strategies effectively reduce the company's exposure to credit risk. Freddie Mac's primary forms of risk sharing continue to be mortgage insurance and structuring mechanisms (the subprime "T-deals" e.g.). Freddie Mac's monitoring of mortgage insurance companies' performance and condition, as well as the condition and performance of other risk sharing parties position Freddie Mac to anticipate, rather than merely react to, developments that could impair the effectiveness of risk sharing strategies.
- The technology and controls supporting Freddie Mac's credit risk management function are effective. Business unit personnel receive appropriate technology support, and technology tools are appropriately integrated 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. All departments 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 portfolio market value sensitivity (PMVS) and other risk measures are clearly communicated in policies and procedures as well as in senior management and Board reports. The control framework includes the appropriate separation of interest rate risk analysis functions from the transaction functions. Management reports provide clear, concise information on the market environment, its impact on Freddie Mac's interest rate risk profile and the company's earnings projections. Management reports include balance sheet and projected earnings in sufficient detail to identify sources of interest rate risk.
- Management effectively follows up on issues related to interest rate risk. Management effectively monitors its interest rate risk profile on a continuous basis, and throughout 2001 Freddie Mac's interest rate sensitivity remained below both operating- and Board-limits. Freddie Mac thoroughly analyzes and follows up on interest rate risk issues such as: risk/reward relationships, balance sheet sensitivity, potential changes in duration and convexity, and the effects of rebalancing transactions in appropriate daily, weekly and monthly settings.
- 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. For example, the remittance cycle redesign initiative was appropriately researched prior to implementation and received appropriate senior management approval and Board review.
- The appropriate separation of responsibilities exists between the strategy and analytics function and the execution function. Within the Funding and Investments Division, one unit is responsible for executing transactions for the retained portfolio while another unit is responsible for strategy and analysis. No personnel who execute trades are in the units responsible for developing and coding various interest rate risk models. The organizational structure and

assigned responsibilities of the Market Risk Oversight ("MRO") unit ensures its integrity as an independent risk management group. Although MRO provides opinions and guidance on market risk strategies, it does not execute transactions.

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.

- Freddie Mac appropriately responded to changing market conditions by making key rebalancing decisions and by employing new tools to support the achievement of key performance objectives.
- The Probabilistic VaR and Stress Test enhanced management's ability to monitor and manage aggregate interest rate risk exposure.

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 corporate risk management policies. Freddie Mac uses derivatives primarily for reducing interest rate risk, with the majority of the derivative contracts used as a substitute for non-callable debt. Interest rate futures are used to mitigate the risk of anticipated debt issuances. The swaptions portfolio is used as a substitute for callable debt, and the interest rate caps and floors are used to hedge the rollover of Discount Notes or floating rate debt. Basis swaps are used to convert the index of floating rate debt, and foreign currency swaps are used to hedge the foreign exchange risk associated with foreign denominated debt. Our examination found no 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 knowledgeable professionals. Systems for data capture, processing, settlement and management reporting are adequate and the daily VaR process has improved the consistency of derivative source data.

- Management governs the use of derivatives in accordance with the standards used by other large financial intermediaries. Freddie Mac sends derivative data to an outside vendor each day to obtain estimates of market value for each instrument. These values are then compared to market values obtained from a Wall Street pricing service. All derivatives are included in Freddie Mac's interest rate risk sensitivity analysis and cash management forecasts. Freddie Mac measures the credit risk and market risk of the derivatives portfolio independently of the portfolio management function. The counterparty risk is appropriately diversified and management places appropriate emphasis on the derivative counterparty's credit rating as well as its business experience and reputation.

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 PMVS 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 PMVS, 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 PMVS and to determine what actions are appropriate to keep the PMVS within the desired range. While Freddie Mac's PMVS is monitored and managed everyday based on parallel yield curve shifts, management performs other analyses that focus on more diverse rate scenarios. The Probabilistic VaR measures Market Risk Oversight developed in 2001 enhanced management's ability to measure and monitor its aggregate interest rate risk exposure.
- Technology and controls supporting the interest rate risk management function are effective. Freddie Mac supports the interest rate risk management function with qualified specialists who are experienced in the development, application and maintenance of complex interest rate risk management tools. Controls, including rigorous reconciliation processes, are in place to assure the integrity of data used in interest rate risk and portfolio management models.

- 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. Management appropriately continues to enhance its interest rate risk management tools and is in the process of integrating the prepayment calculator into NIMFEST for more efficient processing. The prepayment models are well documented, incorporate a wide range of appropriate factors that can affect prepayment speeds, and are specific to material asset categories. Interest rate generation models incorporate appropriate parameters and are rigorously tested and documented. The assumptions and parameters of models used to manage interest rate risk are continuously reviewed for reasonableness by both the developers and users of the models.

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 Funding and Investments Division's policies and procedures 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 models and stress tests.
- The planning process for liquidity management, including tactical, strategic and contingency planning is 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. The Funding and Investments Division plans and forecasts cash needs on a daily, weekly, monthly and quarterly basis. The capital allocation strategies which are set at the business unit level and reflect the Board's capital allocation decisions allow Freddie Mac to take advantage of opportunities to increase mortgage purchases. In keeping with its Voluntary Commitments, Freddie Mac maintains more than three months of liquidity, assuming no access to the public debt market, and maintains liquid non-mortgage investments of at least 5% of on balance sheet assets.

- Management is effective in following up on issues and initiatives that influence liquidity. The Treasurer's Office maintains continuous contact with groups whose activities impact forecasts. The forecasts capture all significant receipt and disbursement activity. Liquidity issues are covered by the audit functions and by the corporate self-assessment of risk process. Both processes have effective follow-up components.
- Technology and controls for liquidity management are effective. Freddie Mac has a sizeable, competent staff dedicated to: developing tools for liquidity management; maintaining a reliable hardware infrastructure; and enhancing and maintaining existing applications. Freddie Mac's systems provide prompt and accurate information on liquid investments, and Freddie Mac has the capability to receive real time direct feeds from several sources (ABSNET, Moody's, S&P) for monitoring changes in credit ratings on securities held by the company.
- The 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 effective tools to assess the impact of changing interest rates on its liquidity position and to assess both the capital adequacy and cost of funding in a variety of stressful credit and interest rate scenarios. 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. Freddie Mac has staff dedicated to the confirmation, compliance and settlement functions for non-mortgage investments, debt, and derivative transactions. They ensure that the transactions are appropriate, recorded accurately in corporate systems in a timely manner, and settle properly. Traders and portfolio analysts do not code software used for liquidity management.
- 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. Managers have ready access to spread information on all of Freddie Mac's debt products and continuously compare spreads on Enterprise debt to swaps to determine the most advantageous means of funding. Bid-ask spreads and historic spread volatility are regularly reviewed to assess the liquidity risk of investments to be purchased for the portfolio. Management also effectively monitors spreads to determine the most opportune time to purchase mortgages.
- Liquidity management is appropriately integrated into other management and financial performance issues. Freddie Mac's corporate plans and strategic initiatives fully account for the need to maintain adequate liquidity. Liquidity

risks are incorporated into corporate and business unit plans. Derivatives management includes appropriate consideration of liquidity, and Funding and Investments fully considers the ability to get out of positions quickly and cost effectively when contemplating derivative transactions. Liquidity management continues to be a key component of Freddie Mac's publicly reported "Voluntary Commitments".

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

Freddie Mac's actions in 2001 strengthened its liquidity position. The Enterprise's access to liquidity and reputation in the credit markets exceeds safety and soundness standards.

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 Enterprise Capacity and Performance function provides effective reports and analysis to support the technical departments' ability to make timely decisions, cost-effective deployment and beneficial usage of technical resources.
- There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. Physical security surrounding the Reston data center and the Beaumeade recovery site are adequate. Administrators appropriately update the McAfee anti-virus software, and users proactively report suspicious events to DIS. Remote authentication uses Secur-ID, and Freddie Mac's new telecommuting policy requires users to protect Freddie Mac information assets, including electronic information. When Checkpoint's VPN Software is fully implemented, computers dialing into the network will be checked for the most common anti-virus software.
- Freddie Mac has effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. There is a comprehensive, corporate-wide Business Continuity Plan, and a recovery site at Beaumeade that has sufficient equipment and space to accommodate critical staff during a contingency situation. Freddie Mac completed a full schedule of tests of its recovery abilities in 2001. After the tests, Freddie Mac generated action reports describing what went well, and what items could be enhanced. Business areas are involved in the recovery testing process and assess their recovery planning status through the quarterly MARC process.
- Freddie Mac has processes in place that ensure information technology plans effectively address business unit and corporate objectives. For 2001, Freddie Mac revised its corporate philosophy regarding IT strategic planning, changing it to a more top-down approach. IT, like the other divisions in Freddie Mac, crafted its division plan and budget only after senior management communicated the corporate strategies and priorities. All IT

functions are centralized under the ISS Division, thereby focusing IT resources and concentrating knowledge of corporate-wide IT strategies.

- Freddie Mac has effective processes in place to ensure appropriate controls are implemented and documentation for system development and maintenance is complete. The systems development methodology that incorporates and promotes best practices for web-based applications and integration was implemented in 2001. The Project Management Office provides assistance and support to the project managers. The Information Quality management program includes appropriate data integrity and quality control.
- Freddie Mac has implemented policies and procedures that ensure the conduct of E-commerce is secure. The policies and procedures support Freddie Mac's underlying corporate philosophy that functionality and security must operate jointly, and that security must be a focus in all efforts to leverage Internet and Intranet-based technologies.

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.

- Freddie Mac's full implementation of a systems development methodology that includes "best practices" for Web-based applications and integration enhances the company's ability to respond to and evaluate changes in Information Technology.
- The controls surrounding remote access, networks and firewalls position Freddie Mac to identify and remedy potential vulnerabilities.

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. The controls surrounding the Reference Bill Auction exemplify the nature and effectiveness of controls. Freddie Mac's change management and system development methodology specify 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 has controls that secure the networks and firewalls from inappropriate or unauthorized actions. Its Nokia appliances and software enable Freddie Mac to continuously analyze network logs to identify trends that might identify attempts to breach network security. TruSecure provides Freddie Mac with up-to-date security alerts and access to TruSecure's Risk Monitor website. In addition, Freddie Mac has a contract with TruSecure to provide ongoing vulnerability analysis.
- Management has implemented effective and efficient controls over end-user computing (EUC). Freddie Mac effectively uses the ReportWorks reporting tool to monitor and manage EUC applications. The EUC program office revised the EUC policy, enhanced training and improved the risk rating evaluation and justification.

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 exceed safety and soundness standards.

- Freddie Mac has accurate and reliable processes for identifying risks to business processes and implementing appropriate controls. The Management Assessment of Risk Controls (MARC) process is disciplined and provides a consistent framework for the company to discuss and monitor risks. The Business Risk Profile Exposure Report captures Freddie Mac's exposure to ten categories of risk across the company rather than by business unit or division, and includes assessments of the effectiveness of actions designed to control identified 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. The various management forums provide platforms for senior management to remain apprised of the status of resolution efforts. Internal Audit performs and reports on follow-up work within established timeframes to ensure that business units have initiated corrective actions for identified control issues, and that the actions are effectively addressing control weaknesses.
- 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 provide management with key information about the quality of controls and note identified deficiencies. The audit reports and summaries of the audit findings are appropriately distributed to management. 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 business units across the company have appropriate policies and procedures that specify authorization and approval limits. Management controls across the company are comprehensive and well-documented.

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

There were no adverse changes in 2001 influencing the effectiveness of internal controls.

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. 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.
- Freddie Mac's management enforces 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 prescribed 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 process and control structure Freddie Mac uses when developing new or substantially revised business initiatives is effective. The process is aligned with the appropriate planning and control functions.
- The communications associated with new or substantially revised business initiatives are effective. Freddie Mac's process for new or substantially revised business initiatives includes communication plans. The regular use of committees, teams and forums in connection with new or substantially revised business initiatives ensure that affected units throughout the company remain apprised of initiatives and progress. Routine reports to management and the Board of Directors are designed to capture and share information, and are effective and complete.
- The balance between risk management, internal controls and the pressure to develop new or substantially revised business initiatives is appropriate. The analysis and review that occur before, during and after a product's rollout is meticulous and deliberate. Although this can have the effect of slowing a product's introduction to the market place, this cautious approach provides management with the ability to evaluate the controls and manage the risks relative to the company's strategic goals.
- Freddie Mac effectively uses pilot programs. Pilots are evaluated, and necessary adjustments are made before the initiative is either expanded and/or brought into full production.
- The analyses Freddie Mac conducts to determine whether new initiatives are successful or warrant reconsideration/modification are effective. For example, at each step in the rollout of Project Enterprise, Freddie Mac evaluates and determines the success of that step toward meeting the ultimate goal of Project Enterprise. When steps have not met their intended purpose, the efforts are reevaluated and modified as necessary. The analysis and review that occurs after the rollout is meticulous and deliberate. 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 culture promotes and supports the introduction of new ideas. Freddie Mac encourages new ideas, and its corporate Needs Database is a storehouse for ideas identified by both internal and external sources.

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 criteria Freddie Mac uses for reviewing business are appropriate. The criteria employed are standardized and focused on risk.
- The analysis and review conducted are appropriate. The Product Development Process Manual is a comprehensive guide that ensures a rigorous review of business initiatives, and addresses the means by which strategic goals are to be achieved and risks managed. The reviews at the different stages of the development lifecycle are effective.

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. Audit reports and memos appropriately reflect the observations and control weaknesses made by the auditors and documented in their workpapers. The internal auditors conduct appropriate verification and testing, and on all full scope audits they assess the reliability of the business unit reports on the effectiveness of controls (MARC). The several instances of internal auditors' disagreeing with management's assessment of controls evidence the independence of the internal audit function. The internal and external auditors each meet in executive session with the Audit Committee.
- 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 Internal Audit staff are provided with appropriate training, certification and continuing education opportunities that further the professional qualifications of the staff. Internal Audit appropriately supplements its staff expertise by contracting with experts to assist on particular audit activities. The process Freddie Mac uses to select its external auditor 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 2001 Internal Audit plan was developed using a strong risk assessment process and robust audit frequency model. The 2000 Internal Audit plan appropriately reflected internal and external changes that impacted, or had the potential to impact risk profiles and assessments. Audit activities were appropriately expanded when significant issues and/or significant changes occurred in Freddie Mac's structure, activities, risk exposures and/or systems. There were appropriate audit activities related to the Voluntary Commitments and Project Enterprise. The expansive scope of audit work conducted on data security was appropriate given the complexity of the topic and the potential risks posed by identified weaknesses. Arthur Andersen's 2001 audit

plan reasonably reflected Freddie Mac's business strategies and risk management framework.

- The audit work performed at Freddie Mac is complete. The audit work conducted was consistent with audit plans, described the objectives of the audit work, listed procedures to be performed, summarized key internal controls, evaluated information received, followed-up on findings and effectively communicated results. The workpapers generated during Internal Audit's activities appropriately document the work performed and support the auditors' conclusions.
- Freddie Mac's Internal Audit Department is effectively managed. The quality of workpapers and reports demonstrate the effectiveness of Internal Audit management. Management provides the audit staff with effective and appropriate tools – including in 2001 an updated AIS Manual – and actively promotes and supports training opportunities for the audit staff. Internal Audit plans are met with 81% of scheduled audit activities completed in the first nine months of the 2001 audit year.
- 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 Internal Audit is comprehensive, re-evaluated annually and updated appropriately. The risk assessment process demonstrates an understanding of the significant business activities and their associated risks, including potential risks resulting from control deficiencies. The External Auditor's risk assessment process appropriately results in concentrating audit activities on activities and processes posing the highest risk to the company.
- Freddie Mac's Internal Audit Department is appropriately involved with 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 which results in new products and initiatives being subject to timely audits. In addition, the audit plan includes sufficient "uncommitted" time to permit work on unanticipated new products and initiatives. In 2001, Internal Audit conducted an appropriate amount of work related to Project Enterprise. Through a variety of effective formal and informal means, Internal Audit remains appropriately informed about new products and initiatives.

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 2001 there were no changes in the audit functions or roles that adversely impacted the work, timeliness or results of the audits.

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. Board packages are of the highest quality. The information contained in the Board packages is comprehensive, and in light of the meeting schedule and Board's expertise, not overwhelming. There are effective processes in place to ensure the integrity and accuracy of materials provided to the Board.
- 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. Changes made to the Board's Committee structure, designed in part to distribute responsibilities more evenly, should enhance the ability of each Committee to carry out its responsibilities.

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.*

Changes in the structure and composition of the Board of Directors enhanced Board oversight which already exceeded safety and soundness standards.

- In 2001, the Board's Committee structure was enhanced to reflect Freddie Mac's business operations and to more evenly distribute responsibilities across the Committees.
- Processes were in place that ensured shareholders were always represented by qualified individuals. When Mr. Palmer did not stand for re-election, Ms. Mater filled his place on the Board until Mr. O'Malley joined the Board.
- In May, President Bush appointed five qualified individuals – Mr. Cabrera, Ms. Engler, Mr. Gribbin, Mr. Powers and Ms. Stepp – to 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 remains appropriately engaged in charting the strategic direction for the Enterprise. The full Board and its Committees appropriately consider corporate strategy and strategy related issues on a regular basis. The new Board Committee structure includes an appropriate focus on strategic issues.
- 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 Board is appropriately informed through standard reports and presentations of performance as it relates to established standards and goals. The Board and Committees are provided with appropriate and sufficient information about both existing and potential new targets, goals and thresholds.
- Freddie Mac's Board of Directors has an effective process for hiring and maintaining a quality executive management team. The individuals in executive management are well qualified for the positions they hold. The Board appropriately reviewed and appropriately revised the compensation packages for the CEO and Vice Chairman to bring them in line with the market.
- Freddie Mac's Board of Directors holds the executive management team accountable for achieving the defined goals and objectives. The Board was provided with, and considered appropriate information when it established the 2001 compensation framework for Freddie Mac's senior executives. There are identified key competencies for each member of the executive management team, and the Board appropriately assesses the performance of its executive management team. Freddie Mac's performance and financial results are reflected in the executive management team's compensation.

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 multi-year Project Enterprise and the information systems related to Risk-Based Capital are examples of the connection between Freddie Mac's information systems and its strategic plans. Enhancements to HomeFront were completed pursuant to a comprehensive plan.
- The reports used by management for decision making are accurate. Reports used by management for decision making are generated from expected sources and roll up from business lines, through departments to Management Forum, executive management and the Board of Directors. Reports related to credit, market and operations risk and to corporate governance are generally accurate. The full implementation of the IQ Program and the Financial Reporting Controls Improvement Plan are expected to further enhance the reliability of management reports.
- Freddie Mac communicates Enterprise strategy, roles, and responsibilities. The IQ Rollout program effectively communicated roles and responsibilities. The redesigned HomeFront, the streamlined Performance Highlights and the 60 Minutes with David Glenn program are effective communication tools.
- Freddie Mac provides employees with effective means of providing feedback, reporting suspected improprieties, and suggesting enhancements. Comprehensive biennial surveys and targeted follow-up surveys provide employees with effective means to share their observations with management. The Q&A with David Glenn (on HomeFront) affords employees with meaningful opportunities to provide feedback and suggest enhancements to senior management. The Code of Conduct provides employees with effective mechanisms for reporting suspected improprieties.

- There are effective communications across Freddie Mac. Enhancements to HomeFront have improved the ability of users to obtain information from across the company in an easy manner. The decision to use a non-standard format for the IQ policy was appropriate given the complexity and importance of the subject matter. The Enterprise Team process supports informal but effective communications 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 the management information programs and processes that already exceed safety and soundness standards.

- The full implementation of Project Enterprise, the Information Quality Program and the Financial Reporting Controls Improvement Plan are expected to further enhance the reliability and consistency of management information.

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 and dynamic. Strategic planning cascades down from executive management to the divisions and business units. The corporate budget process supports and reinforces the strategic direction established by executive management in a clear and timely manner.
- Freddie Mac's key performance measures are appropriate, effective, and align with strategy. The metrics in the corporate scorecard are appropriate as are the metrics used for Project Enterprise and the measures for the IQ program. 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 Employee Performance Management System appropriately reflects whether strategic goals were accomplished. The Corporate Scorecard was appropriately expanded to include accountability for the corporate goal of retaining and developing key talent. The decision to elevate the financial bonus program to the corporate rather than divisional level furthers corporate goals and objectives. The enhanced communications about corporate goals in Performance Highlights supports the behavior programs designed to achieve corporate goals and objectives.
- Freddie Mac's management effectively conveys an appropriate message of integrity and ethical values. Freddie Mac's Codes of Conduct are *appropriately comprehensive and management dedicates sufficient resources to support the administration of the Codes.*
- Freddie Mac's organizational structure and the assignment of responsibilities provide for accountability and controls. Corporate wide control policies assign responsibilities and establish accountability. The policy on compliance with laws and regulations is being revised to clarify the respective roles of Internal Audit and Legal. The Market Risk Oversight unit performs an effective control function, as do the controllers assigned to each division. The roles and responsibilities for all aspects of Risk-Based Capital, for HomeFront content and format, and for IQ are clearly articulated and reasonable.

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.*

Changes further strengthen management processes that already exceed safety and soundness standards.

- The decision to no longer rank divisions for purposes of non-officer bonuses effectively reinforces the individual employee's role in achieving corporate strategic goals and objectives.

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 units have goals and implementing plans to achieve the corporate strategic plan. The ability to develop plans is evident throughout the company and the planning process is comprehensive with goals linking to both the strategic plan and corporate budget. Implementation efforts reflect changing priorities.
- Freddie Mac's management has the ability to monitor and manage change. Event management, such as managing the markets' actions and reactions to September 11th are effective. There are mechanisms in place, such as Management Forums and key management reports that position Freddie Mac to anticipate, identify and react to events or activities that affect the achievement of corporate and/or business unit objectives. Freddie Mac's strong control culture impacts its ability to manage change effectively.
- Freddie Mac has programs for career and management development. The orientation program is strong and effective. The training and development funds available for each employee and the comprehensive leadership development program demonstrate the corporate commitment to enhancing and supporting its work force. The target to have succession planning in place for all EVP and SVP positions was pushed back to 6/02. Freddie Mac appropriately decided to expand the scope of its succession planning to address its concerns that its current officer/director cadre may not have the depth to fully implement the corporate business strategy.

- Freddie Mac has an effective program for recruiting competent people. Freddie Mac expanded its recruitment beyond its traditional venues, accessed multiple new talent sources and filled positions in fewer days than were budgeted. The effectiveness of the recruiting programs is evident in the qualifications, experience and expertise of the staff working on and managing Risk Based Capital projects; the hiring of a new SVP for Human Resources and new Corporate Controller, and the simultaneous announcement of a new position for the former Chief Credit Officer and the naming of his successor.
- The results of operations, measures of credit performance and market risk indicators demonstrate the effectiveness of Freddie Mac's proprietary risk management programs and systems. The programs associated with the Voluntary Commitments and the associated disclosures are effective and include several best practices. The new HR system enhances Freddie Mac's ability to manage its human capital, and the IQ Program protects valuable corporate information assets. The enhanced HomeFront is an effective risk management system that provides crucial information across the company in a timely manner. The Board Questionnaire is an effective proprietary program that provides management with meaningful feedback and insight.
- The philosophy and operating style of Freddie Mac's management have a pervasive effect on the company. The Leadership Institute and Officer Selection Committee reinforce and support management's philosophy and operating style. The decision to no longer rank divisions for non-officer bonuses thereby focusing on corporate rather than divisional goals is an effective means to reinforce management's philosophy to staff. The myriad standard reports and measures used throughout Freddie Mac reinforce management's risk management philosophy effectively. In addition, the frequent interaction among levels of management across the company, and the 60 Minutes with David Glenn program reinforce the corporate philosophy and operating style.