REPORT OF EXAMINATION

2002 Examination
Results and Conclusions

Prepared for
Freddie Mac's Board of Directors

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2002 Report of Examination

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2002 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 2002 annual risk based examination of Freddie Mac. I am pleased to share the conclusion that Freddie Mac is a well-run company and in 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 2002 examination. For more detail, Members of the Board may refer to the Appendix (Analysis Supporting the Overview). Through the course of the 2002 examination process, OFHEO's examination staff and management had 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 Appendix 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 the Appendix, we report results and conclusions for the
following 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 2002 examination show that in all of the program areas, Freddie Mac exceeds safety and soundness standards.

Also, during 2002, examiners remained apprised of the initiatives underway to strengthen the expertise and controls in the areas of financial accounting and operational control. In addition, examiners have been tracking the progress and issues that have arisen with the introduction of a new CPA firm as the external accounting firm. Examiners will continue into 2003 to evaluate the initiatives affecting financial accounting and the developments associated with the re-audit. We remain satisfied that the Board of Directors, its Audit Committee, and the executive management team are taking the appropriate actions and making responsible decisions. In the event the examiners alter their opinion or there are matters that require the Board’s attention, we will immediately contact the Board.

**Credit & Counterparty Risk**

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 credit risk sharing strategies and the credit risk management tools 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.

**Interest Rate Risk**

Freddie Mac’s interest rate risk management exceeds safety and soundness standards. During 2002, Freddie Mac’s hedging strategies and practices were effective in minimizing the financial impacts associated with a volatile rate environment that resulted in sharp increases in mortgage prepayment speeds. 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 and end-users.

Liquidity Management
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.

Information Technology
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 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.
Internal Controls
The internal control framework and the management of that framework exceed safety and soundness standards. Management has a reliable process for identifying risks to business processes and implementing appropriate controls. Implemented controls properly address risks that have been identified. Management has a formal process for the timely resolution of control related issues. Internal Audit 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
Business process controls exceed safety and soundness standards. 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 market pressure to deliver new or substantially revised initiatives to the marketplace.

Audit Activities
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.

Board Governance
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. During 2002, we noted several instances where the Board responded responsibly and decisively on matters that warranted their attention and were raised for their attention through routine channels.

Management Information
The framework used to produce timely, accurate and reliable reports for management and the Board exceeds safety and soundness standards. The framework has been temporarily impacted by the recent determinations reached by the new CPA firm about selected past accounting treatments. Upon the completion of the re-audit and once the resulting adjustments are made, the financial statement account balances will be certified by the new CPA firm. The existing framework allows management and the Board to receive 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 generally 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.

Management Processes
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 monitors and manages 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 personnel. 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.

Conclusion
Our 2002 examination work did not identify any supervisory or regulatory matters requiring the direct involvement of the Board of Directors. Operating
management has been responsive and effective in addressing issues raised to their attention. Had there been any supervisory or regulatory issues meriting your direct involvement or immediate attention, I would have apprised you of that fact earlier. If anything arises during the 2003 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 2002 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
Appendix

2002 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. 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, 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

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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.
not create unforeseen impacts on the company's credit risk profile. Both individually and as a whole, the new products introduced in 2002 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. During 2002, management and the Board in consultation with its new CPA firm, made an adjustment to the balance for the loan loss allowance. The process for determining the loan loss allowance results in a reserve that is 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 approach to the loan loss allowance process is well-documented.

- 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 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. Technological 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 2002 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 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. Management continues 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 will 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 seller/servicers, to mortgage insurance companies, and to derivative transaction counterparties. 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. For the tools OFHEO evaluated in 2002, 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 2002 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.

- 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. Hedging strategies were effective throughout 2002.

- The improvements to the suite of tools 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 and as an end-user. Derivatives are used in a manner that is consistent with corporate risk management policies. Derivatives are primarily used for reducing interest rate risk, with the majority of the derivative contracts used as a substitute for non-callable debt. Hedging strategies employing derivative instruments were effective and appropriate. Our examination found no instance where derivatives were used for speculative purposes. 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 and in accordance with internal policies. 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.
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- Management governs the use of derivatives in accordance with the standards used by other large financial intermediaries and in accordance with internal policies. 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 quality and the use of prudent collateral practices.

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 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.

- 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. 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.

- 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.
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 performance in 2002 enhanced its liquidity position. The Enterprise's access to liquidity and reputation in the credit markets exceeds safety and soundness standards.

(Subsequent Event: The January announcement of a delay in audited financial statements has not adversely impacted the company's access or cost of liquidity. Examiners will continue to monitor this situation.)
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 data center and the recovery site are adequate. Administrators appropriately update the McAfee anti-virus software, and users proactively report suspicious events to Desktop Integration Services (DIS). Remote authentication is used to protect Freddie Mac's data and network.

- 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 that has sufficient equipment and space to accommodate critical staff during a contingency situation. Freddie Mac conducts tests of its recovery capabilities and generates reports describing what went well, and what items could be enhanced. Business areas are involved in the recovery testing process.

- Freddie Mac has processes in place that ensure information technology plans effectively address business unit and corporate objectives and effectively incorporates strategic initiatives.

- Freddie Mac has effective processes in place to ensure appropriate controls are implemented and documentation for system development and maintenance is complete. 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. During 2002, we tested several areas for the controls surrounding the selected activities. We found the controls to be appropriate. The 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 vendor appliances and software enable Freddie Mac to continuously analyze network logs to identify trends
that might identify attempts to breach network security. Third-party vendors provide Freddie Mac with up-to-date security alerts and access their proprietary suite of tools. In addition, Freddie Mac has a contract with a third-party vendor to provide ongoing vulnerability analysis.

- Management has implemented effective and efficient controls over end-user computing (EUC). Freddie Mac effectively uses a reporting tool to monitor and manage EUC applications. The EUC program office revised the EUC policy, enhanced training and continues to improve its 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 current process is disciplined and provides a consistent framework for the company to discuss and monitor risks. Initiatives are being implemented to further strengthen the controls employed by the company.

- Freddie Mac’s management has reliable processes for ensuring the timely resolution of control-related issues. The tracking reports, which include forecasts for resolution, provide management with a 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 is responsible for identifying and communicating 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 key reports – Internal Audit tests business units’ assertions about the effectiveness of their controls. The audit reports are designed to provide management with key information about the quality of controls and to note identified deficiencies. The audit reports and summaries of the audit findings are distributed to management. Through its Audit Committee, the Board is appropriately apprised of Internal Audit activities, including findings and representations about the effectiveness of controls.

- Freddie Mac has established policies and procedures that delineate internal control processes and standards for its desired control environment. Freddie Mac has an effective process for developing corporate wide internal control policies. The business units across the company have policies and procedures that specify authorization and approval limits. Management controls across the company are comprehensive and require documentation.
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 to the control framework in 2002 that should influence the effectiveness of internal controls.

- Examiners performed sampling and verified the internal control practices in key business units during 2002 and found the appropriate separation of duties and responsibilities and the appropriate documentation. The areas sampled were in the areas of counterparty risk management, interest rate risk management, practices for derivative transactions, information technology security and liquidity management practices.

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 have properly protected the assets of the company.

- 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 control deviations that are identified.
BUSINESS PROCESS CONTROLS PROGRAM

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

The process employed for new or substantially revised business initiatives results in an appropriate level of control and exceeds safety and soundness standards.

- The control environment for new or substantially revised business initiatives is effective.

- 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 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.

- 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. When evaluating a new initiative if the intended purpose has not been achieved, the efforts are reevaluated and modified as necessary. The analysis and reviews performed after the rollout are detailed thoughtful. 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 and performance.

- Freddie Mac's corporate culture promotes and supports the introduction of new ideas.
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 use for reviewing business initiatives are appropriate with an appropriate focus on risk.

  - The analysis and review conducted are appropriate. The company uses a comprehensive guide to ensure a rigorous review of business initiatives, and addresses the means by which strategic goals are to be achieved and risks managed. The reviews performed 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 are appropriately independent and meet the AICPA, IIA, NYSE and emerging best practice standards for independence. The process for selecting the company's external auditor appropriately focused on auditor independence. Auditor independence is supported by the practice of the internal and external auditors meeting separately in executive sessions with the Audit Committee. 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, the Management Assessment of Risks and Controls (MARC) process. The several instances of internal auditors' disagreeing with management's MARC ratings evidence the independence of the internal audit function.

- The auditors performing work at Freddie Mac possess appropriate professional proficiency. The Internal Audit staff have strong educational backgrounds, recognized 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. The thorough process used to select an external auditor in 2002 included 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 2002 Internal Audit plan was developed using an thoughtful risk assessment process and audit frequency model. Audit activities were appropriately expanded when significant issues or changes were identified in Freddie Mac's structure, activities, risk exposures or systems. PriceWaterhouseCooper's (PWC) 2002 audit plan reasonably reflected Freddie Mac's business strategies and risk management framework and was designed to position PWC to opine for the first time on Freddie Mac's financial statements.
The audit work performed at Freddie Mac is comprehensive. 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 and actively promotes and supports training opportunities for the audit staff. Internal Audit management’s decisions to defer four of the planned 74 audits in the 2002 audit cycle were reasonable and appropriately justified.

Freddie Mac’s executive management is appropriately involved with, and follows up on, identified audit issues. The Board of Directors is also appropriately involved with, and follows up on identified audit issues. The Board’s Audit Committee required management to address its concerns related to follow up of identified audit issues. There are processes in place to ensure that corporate management and the Board of Directors remain 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.

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. 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 2002 changes in the audit functions or roles did not adversely impact the quality of the audits. The change of firms that conduct the external audit affected Freddie Mac's ability to provide audited financial statements for year-end 2002 within the usual timeframe.

- The most significant change in Freddie Mac's audit functions in 2002 was the change in the company's external auditor. The Board took appropriate and timely action in response to unrelated events surrounding the company's previous external auditor. In order to become appropriately familiar with Freddie Mac and its control environment, PriceWaterhouseCoopers (PWC) set a comprehensive scope for its audit activities. The Board's and management's decision to engage PWC to reaudit prior period statements related to accounting interpretations for certain types of hedge transactions and FAS 133 has delayed the issuance of the company's audited financials. We consider the actions being taken and the decisions being made by the Board and management to be responsible and prudent.
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, and the detailed briefings to the full Board and Committees on topics such as Callable Debt and Freddie Mac’s Management Framework provide the Board with the information needed to effectively oversee the operations of the company. Management provides the Board with requested materials and information in a timely manner. Board orientation provides new Board members with the tools they need to analyze and act on the information provided to them. 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. The practice of providing detailed briefings over the course of two Board or Committee meetings enhances efficiency. The Board meets deadlines, such as those related to the NYSE certifications and those required by OFHEO’s Corporate Governance Regulation. The Audit Committee’s decision to review and revise its standard agenda and schedule was appropriate, as is its practice of holding special meetings to review the company’s financial statements before they are published. Other Board Committees appropriately hold special meetings, or add time to their regularly scheduled meetings to ensure that required actions are taken in a timely manner.

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.

A change in the composition of the Board of Directors did not affect Board oversight which exceeds safety and soundness standards.

- Late in 2002, Mr. James Montgomery retired from the Board. Effective Board succession planning resulted in a qualified individual, Mr. Martin Leibowitz being named to fill the remainder of Mr. Montgomery’s term.
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. Board orientation materials and presentations specifically address Freddie Mac's strategic direction and provide Directors with useful tools to evaluate and oversee the company's strategic direction. The Board committee structure and roles provide appropriate and meaningful avenues for Directors to be engaged in the development and refinement of Freddie Mac's strategic direction. The Board has input into, and regularly reviews Freddie Mac's strategic direction, and has appropriate and timely opportunities to express its views and provide direction to management concerning the company's strategic direction.

- 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 changing standards, thresholds and targets, such as the revised PMVS limits and the revised loan loss reserve methodology.

- Freddie Mac's Board of Directors has effective processes for hiring and maintaining a quality executive management team. The individuals in executive management are well qualified for the positions they hold. The tenure of the executive management team demonstrates the Board's ability to maintain a quality team. Changes to certain aspects of the long-term incentives demonstrate the Board's active efforts to attract and maintain a quality senior management team. The Board formally assesses the performance of its executive management team. In 2002, the Board provided meaningful input into the revised corporate management succession planning process, and has enhanced its oversight of management succession planning.

- Freddie Mac's Board of Directors holds the executive management team accountable for achieving the defined goals and objectives. The Board sets the short- and long-term incentive targets for the CEO and President. For 2002, approximately 25% of senior management bonuses will be determined by the Audit Committee's assessment of the success of the Financial
Reporting Controls Implementation Plan, data quality, implementation of the data warehouse and the timely resolution of audit issues.
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 strategic plans. The multi-year Project Enterprise, efforts to improve the MARC process with Horizon, the Corporate Data Warehouse initiative and the securities transaction reporting on FreddieMac.com are examples of the strong connection between Freddie Mac's information systems and strategic plans.

- While the reports used by management for decision-making are generally accurate, Freddie Mac is actively working to enhance the accuracy of management reports by strengthening controls and upgrading resources devoted to management reporting. 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. It is expected that the Horizon process will result in more effective management reports about the quality of controls across the company. Implementation of the Financial Reporting Controls Improvement Plan and efforts such as the Financial Accountability Model are expected to further enhance the accuracy of financial reports. Efforts such as Project Enterprise, the Corporate Data Warehouse and the Information Quality initiatives will also enhance the accuracy of management reports by improving the reliability and quality of the inputs to those reports.

- Freddie Mac effectively communicates Enterprise strategy, roles, and responsibilities. The Corporate Scorecard is shared every quarter with all employees through Performance Highlights. HomeFront is an effective communications vehicle. The various Management Forum provide both formal and informal means of communicating roles and responsibilities.

- Freddie Mac provides employees with effective means of providing feedback, reporting suspected improprieties, and suggesting enhancements. Biennial surveys and targeted follow-up surveys provide employees with effective means to share their observations with management. Semiannual surveys of users on various aspects of HomeFront provide meaningful mechanisms for providing feedback and suggesting enhancements. 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 clearly communicates to employees the means by which they may report suspected improprieties.

- There are effective communications across Freddie Mac. In 2002 Freddie Mac continued its efforts to consolidate HomeFront and regroup information by function rather than by organizational unit of the owner. Enterprise Teams promote effective informal 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.

- There are a number of initiatives and efforts underway at Freddie Mac related to management information.

- The new Operating Risk Management framework should have a positive impact on the quality of management information across the company.

- The new Corporate Data Coalition charged with prioritizing and overseeing data quality initiatives should bolster and support efforts such as those proposed by the Information Quality Program Office.

- The multi-year Project Enterprise continues on plan and, to the extent that some modules have been implemented, has already enhanced management information. As the other aspects of Project Enterprise come on-line, Freddie Mac's management information should continue to improve.

- Various aspects of the Financial Reporting Controls Improvement Plan have been implemented and certain discrete issues have been successfully addressed. The Board and management recognize the importance of this area and as more aspects of the Plan are implemented, Freddie Mac's financial reporting should be further enhanced.

- The Horizon process is to be fully implemented by year-end 2003. Horizon should improve the quality of management information related to the effectiveness of controls (currently in MARC reports).
• Freddie Mac's voluntary registration will require the company to file certain reports with the SEC. While it has been Freddie Mac's practice to include all SEC required material in its public financial statements, upon registration the company will be required to produce the information in the exact format required by the SEC. We expect there will be additional work in 2003 to align Freddie Mac's management information processes to readily facilitate the production of high quality SEC filings.

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. In early June, management undertook a three-prong effort to establish corporate priorities for 2003, establish a framework for baseline resource allocation and simplify/strengthen the overall planning and budgeting process. Corporate goals are specific, measurable and time-bound.

- 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 for Project Enterprise. 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. Management bonuses and certain aspects of the long- and short-term incentives are tied directly to the Corporate Scorecard. Twenty-five percent of 2002 executive bonuses will be tied, in part, to the timely resolution of audit issues (as determined by the Audit Committee). The Employee Performance Management System ties directly to strategic goals.

- 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 decision to voluntarily report within two days on the company's web site all the securities transactions by senior officers and Board members demonstrates a commitment to integrity and high ethical standards, and evidences an appropriate "tone at the top".

- 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 new Operating Risk Oversight (ORO) Department is expected to enhance accountabilities and controls across the company. The ORO Department drafted its mission, vision and guiding principles in a timely fashion, and clearly set forth the respective roles and responsibilities for business units, ORO and Internal Audit. The new Regulatory and Risk Based Capital Infrastructure unit has enhanced accountability and controls.
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 creation and staffing of the ORO Department in 2002 has enhanced management processes especially those related to controls. The efforts of the unit in 2003 and the implementation of projects under its auspices should further enhance management processes, across the company.

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 and circumstances.

- Freddie Mac's management monitors and manages change. The decision to replace Arthur Andersen as the company's external auditor was made in a timely manner, well before many other companies reached the same decision, and evidences Freddie Mac's effective event management skills. Freddie Mac was among the first companies to provide information within two business days about Director and senior management securities transactions. There are mechanisms in place, such as Management Forums and key management reports that position Freddie Mac to anticipate, identify and respond to events or activities that affect the achievement of corporate and/or business unit objectives. Freddie Mac continues to recognize the challenges to its business units and financial reporting posed by changes in external business processes and volumes of new transactions.

- Freddie Mac has effective programs for career and management development. Freddie Mac enhanced its executive management succession planning processes and practices, and adapted those enhancements for use in the next tier of management succession planning. Development is a key component of all management succession planning. The on-line competency
evaluation system is designed to facilitate the creation of employee development plans based on individual needs and capabilities.

- Freddie Mac has programs for recruiting competent people. The effectiveness of the recruiting programs is evident, for example, in the qualifications, experience and expertise of the new SVP for the ORO Department. Freddie Mac continues to add additional responsibilities to key individuals, such as the VP for Shareholder Relations and Financial Planning who assumed Corporate Planning and Budget responsibilities. The SVP and General Manager of Community Lending assumed the added responsibility for the National Lending Division even though each unit operates under separate business models. In June the company announced a national search for a new position – Executive Vice President for Finance. As of year-end the position had not been filled. Freddie Mac's recruitment efforts place a premium on finding the "right" individual for this critical position rather than filling the position quickly.

- 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. Despite a challenging market and operating environment, Freddie Mac consistently remained within established tolerances for market and credit risk measures. Freddie Mac met the requirements of the enforceable Risk Based Capital rule with a healthy surplus. The new ORO framework is designed to be an effective risk management process. While the MARC process did not identify all the major control issues, Internal Audit's assessment of MARC findings serves as an effective backstop for the MARC process.

- 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. Standard reports and measures used throughout Freddie Mac effectively reinforce management's risk management philosophy. The creation and staffing of the ORO Department sends a clear message across the company about senior management's philosophy and commitment to managing risk. The frequent interaction among the various levels of management across the company, corporate-wide communications, and special events such as 60 Minutes with David Glenn program reinforce the corporate philosophy and operating style.