Office of Examination

January 20, 2006

Richard F. Syron
Chairman and Chief Executive Officer
Freddie Mac
McLean, Virginia 22102

Eugene M. McQuade
President and Chief Operating Officer
Freddie Mac
McLean, Virginia 22102

Gentleman:

OFHEO believes the current approach to resolution of deficiencies must move from addressing individual problems to the identification and resolution of systemic issues associated with continued operational, control, capital and reporting matters. A comprehensive approach - identifying and correcting problems on a systemic basis, rather than ameliorating problems in isolation - must be implemented.

In furtherance of OFHEO's responsibilities to assure safe and sound operations at the Enterprise, including matters beyond routine capital supervision, the following summarizes our expectations going forward as Freddie Mac works to meet its commitments for problem remediation and to comply with its existing regulatory agreements, including the Consent Order dated December 9, 2003.

1. Operational Controls.

Freddie Mac should address the following operational control matters:

(a) Corporate Level Risk Management Function. Freddie Mac should establish an executive level risk management committee to address corporate-wide financial and non-financial related risks, including but not limited to credit, market, operational, accounting, liquidity, asset-liability management, modeling, technology, strategic, and reputation risks. The executive level risk management committee would be supported by and oversee business unit level risk committees and would be accountable to the Board.

Prior to its implementation, the establishment, maintenance, charter authorities and other operational features for this committee will be provided to OFHEO for review and comment. In particular, the committee should have reporting lines to the CEO and Board and the committee plan should include specific timelines for the committee to be fully operational. The committee
should be established as soon as possible and a copy of its charter should be provided to OFHEO.

The plan set forth by the Charter should address the following:

i. development and implementation of a comprehensive risk management framework that is linked to the strategic planning process;

ii. approval of appropriate governance policies, risk metrics, monitoring, and control mechanisms;

iii. periodic review of organizational structures to ensure appropriate segregation of duties, clarity of responsibilities, and sufficiency of staffing;

iv. effective coordination of risk management and oversight functions, including line of business risk activities, audit, and compliance;

v. development and implementation of a comprehensive and effective reporting process to ensure aggregate risks are captured, understood, and monitored, particularly in relation to capital requirements;

vi. development and implementation of acceptable corporate and line of business risk profiles; and,

vii. provision for the integrity and independence of risk governance process.

Freddie Mac should consider retaining a consultant to facilitate development of the committee and program implementation plan. OFHEO makes this suggestion based on our knowledge of the time demands already being made on employees of the Enterprise in connection with its restatement. The Enterprise’s addressing control problems is the highest priority of OFHEO’s regulatory agenda for Freddie Mac.

(b) End-to-End Analysis of Controls. Freddie Mac should provide a plan (including a summary of assumptions made to develop such plan) as soon as possible, but no later than March 31, 2006, to OFHEO for completion of an end-to-end analysis of key controls as soon as possible but no later than December 31, 2006. Freddie Mac must ensure internal controls are effectively designed to cover key financial statement assertions. Management should provide quarterly status reports to the Board and OFHEO on the progress of its end-to-end analysis. In addition, Freddie Mac should have its external auditor conduct a review of progress under the plan as of December 31, 2006 and issue a related report as soon thereafter as possible but in no case later than March 31, 2007.

In planning for review and remediation of control changes, the Enterprise should address, at a minimum,

i. key control identification;

ii. control design;

iii. risk assessments;

iv. prioritization of plans for remediation of systems (including the general ledger) and identified control weaknesses; and,

v. processes to insure a continuous internal control assessment program is in place.

(c) Reports Regarding Internal Controls. Freddie Mac should provide a plan to OFHEO as soon as possible, but no later than March 31, 2006 for conducting reviews and tests of remediation.
activities to confirm that internal control weaknesses and deficiencies have been remediated or reduced to an acceptable level. The plan should include a timetable for testing. Management should provide quarterly updates to the Board. Controls should be in place for management and regulatory reporting as well as public disclosure. Such controls should be in place by March 31, 2007, including controls relating to data integrity. The report prepared for the Board and OFHEO, at a minimum, should specifically address remediation of

i. the current financial close process that has been necessary due to limitations with core operational and financial systems;
ii. the significant back-end efforts and large number of simplifying assumptions required to comply with GAAP;
iii. the necessity to use a large number of compensating controls, and,
iv. over-reliance on EUC's.

(d) Accounting Policy Codification and Development. Freddie Mac should provide a plan to OFHEO as soon as possible but no later than March 31, 2006 describing the development and completion of their accounting policy manual. This report should address, but not be limited to:

i. codification of existing accounting policies;
ii. how these policies align with internal control documentation;
iii. how these policies are communicated to business users;
iv. the internal control process for assuring compliance with these policies;
v. the process to assure that the proper accounting policies are developed for new products; and,
vi. the process to assure that newly developed GAAP literature is incorporated into the process.

2. Quarterly Report to Board.

Management should provide a quarterly report to the appropriate Board committee regarding progress in implementing the provisions of this letter; a copy of such report should be provided to OFHEO at the same time the report is provided to the Board committee. The first such report should be provided to the Board committee and OFHEO by April 30, 2006 and quarterly thereafter. Submission of this report will satisfy the reporting requirements in paragraphs 26 and 27 of the December 9, 2003 Consent Order.


Freddie Mac should provide a plan to OFHEO by March 31, 2006 for beginning the registration process with Securities and Exchange Commission (SEC), and for complying, once Freddie Mac has completed the registration process and once Freddie Mac thereafter becomes an “accelerated filer,” with the related deadlines for filing quarterly and annual reports, as well as for including in its annual report management’s assessment of the Company’s internal control over financial reporting and an accompanying auditor’s report on management’s assessment.

The Board shall oversee management’s development of a capital planning process that seeks to maintain a level of capital tied not only to regulatory capital requirements but as well to an assessment of other relevant factors, including, but not limited to, needs of the company, the business environment and the level and management of risk.

(a) Capital Plan. Management shall develop, and the Board shall approve, an annual capital plan. This plan will be shared with OFHEO so that OFHEO may evaluate the Enterprise’s management of such plan. This plan should address, at a minimum,

i. goals and strategies that Freddie Mac will employ to manage capital to a safe and sound level;
ii. projections of capital and capital requirements based upon a forecast of changes in assets, liabilities, earnings, dividends, and off-balance sheet accounts. An analysis of the forecasts and assumptions should be included;
iii. a description of planned corporate actions, including stock repurchases, issuance of dividends, or other capital actions that impact the capital base. These planned events should be incorporated into the capital plan with accompanying analysis and financial projections;
iv. analysis of contingency sources of capital that could realistically be utilized should primary goals and strategies for maintaining capital prove insufficient; and,
v. the first annual plan shall be submitted within sixty days of the issuance of this letter and shall be updated quarterly or, as necessary, to assure that an annual plan is always in place.

(b) Capital Measurements & Reports. Management should assure that the information provided to OFHEO as formal submissions of data in connection with capital calculations is accurate and addresses the regulatory need for which it was requested and provides, at a minimum,

i. comprehensive set of ratios, benchmarks, and/or measurements that ensures capital is adequate and will remain adequate beyond mandatory statutory and regulatory measures;
ii. a means of updating, revising and ensuring measurements are current, accurate and meaningful;
iii. controls to ensure data integrity and data accuracy, including controls and documentation surrounding any models used in report generation and/or background analysis;
iv. analysis that reflects management’s consideration of risks and environmental factors that support a need for additional or reduced capital; and,
v. management shall report on a routine basis, as provided by OFHEO, on Freddie Mac’s capital policy, capital plan, capital management information systems, control environment and Board consideration and oversight of capital matters.
5. **Staffing and Training.**

Freddie Mac shall move expeditiously to address its staffing needs. By January 31, 2006, Freddie Mac should identify all open positions which are deemed by each business unit to be critical, including but not limited to, the Controller and General Counsel. By February 15, 2006, Freddie Mac should submit to the Examiner-in-Charge its plan for accelerating sourcing and recruitment for such critical vacancies, including projected milestones toward achieving this objective. Freddie Mac should use its best efforts to accelerate its hiring to fill such vacancies. Such plan should include descriptions of training programs to assist with staff education and retention.

6. **Annual Review of Legal and Regulatory Requirements.**

The Board of Directors and Senior Management should continue an annual review of applicable legal and regulatory requirements. Such review should be conducted with appropriate company personnel and outside legal assistance. Review materials should be provided to OFHEO’s Examiner-in-Charge.

7. **Cooperation with OFHEO.**

Freddie Mac will continue to cooperate with OFHEO in its administrative and litigation efforts related to matters that were subject to the Consent Order.

The above set forth OFHEO’s expectations for Freddie Mac as to areas needing remediation efforts. Should you have any question please contact me at (202) 414-3763.

Sincerely,

Jeffrey S. Spohn  
Examiner-in-Charge

cc: Stephen Blumenthal  
Alfred Pollard  
Wanda DeLeo  
Len Reid