REPORT OF EXAMINATION

1999 Examination
Results and Conclusions

Prepared for
Fannie Mae's Board of Directors

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

1999 Examination Results and Conclusions

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1999 Examination Results and Conclusions Overview Prepared for Fannie Mae's Board of Directors

Members of the Board:

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

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

This Overview and the supporting Summary Analysis should be read and understood in the context of OFHEO's annual risk-based examination program. The examination program is described in our <u>*Examination Handbook*</u> which has been provided to management. In brief, OFHEO's annual risk based examination program encompasses the major areas of financial risk confronting Fannie Mae, and the quality of governance exercised in managing both those risks and Fannie Mae's business. Within OFHEO's examination program there are discrete program areas that evaluate a wide-ranging series of qualitative and quantitative features of those program areas. While conducting work in the discrete program areas, examiners focus on: the quality of Fannie Mae'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, Fannie Mae's control framework. In both this Overview and the Summary Analysis, 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 Process.

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. Throughout the annual examination cycle, OFHEO's examiners had ongoing dialogues with Fannie Mae's operating management about the company's operations and processes in the program areas covered by Credit Risk, Market Risk, Operational Risk and Corporate Governance. In these discussions, the examiners shared their views about discrete opportunities the company had to strengthen its operations and processes, including initiatives that if implemented, would enhance existing tools and processes and minimize the resulting exposure to financial risk. The goal of ensuring that Fannie Mae's operations meet or exceed financial safety and soundness standards at any given point in time is supported by this iterative process and netted results that find your organization to be well-managed and financially sound. At year-end 1999, Fannie Mae exceeds safety and soundness standards in all examination program areas.

Fannie Mae's credit risk management and credit risk management framework exceed safety and soundness standards. The portfolio is diversified and the profile of credit risk is in compliance with the internally prescribed limits. Policies, procedures, internal controls and management reporting for the credit function are effective. Fannie Mae is adequately compensated for the credit risk it assumes. Management prudently manages counterparty exposure. New products and initiatives are well researched prior to implementation. The process for determining the reserve for losses, credit risk sharing strategies, and the credit risk management tools management uses are effective. Fannie Mae 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.

Fannie Mae'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. Fannie Mae's management effectively follows up on issues related to interest rate risk. Fannie Mae appropriately researches and controls the extent to which new products and initiatives may impact the interest rate risk profile. The technology and controls supporting the interest rate risk management function are effective. The tools used to model interest rate risk, and the strategies to alter the exposures to interest rates are effective. Management effectively incorporates tactical and strategic issues into the management of interest rate risk. The responsibilities for strategy and analytics functions are appropriately separated from those for the execution functions.

Derivative instruments are used prudently and in accordance with the standards used by other large financial intermediaries.

Fannie Mae's liquidity management 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. Fannie Mae 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 Fannie Mae uses to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are effective. An appropriate separation of duties exists between the strategy and analytics functions and the execution function. There are no adverse trends or anomalies in funding spreads. Liquidity management is appropriately integrated with other management and with financial performance issues.

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

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

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

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

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Management and the Board of Directors receive necessary reports on Fannie Mae'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 Fannie Mae's overall strategy, and are developed and refined pursuant to a strategic plan. The reports management uses for decision making are accurate. Enterprise strategy, roles and responsibility are effectively communicated. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements. Communications across the company are adequate.

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

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

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

G. Scott Calhoun
Chief Examiner
Office of Examination and Oversight

1999 Examination Results and Conclusions
Summary Analysis Supporting the Overview Prepared for Fannie Mae'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, Board Governance, Management Information and Management Process examination program areas. The Summary Analysis is presented by 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.*

Fannie Mae's risk management framework surrounding credit risk exceeds safety and soundness standards.

- Fannie Mae has high quality policies, procedures, internal controls and management reporting for the credit risk management functions. Fannie Mae's credit related policies provide comprehensive guidance and instruction to targeted audiences. The policies define Fannie Mae's credit risk appetite, and establish management's expectations of the counterparties that service loans on behalf of Fannie Mae. Fannie Mae supplements these materials periodically with lender announcements and letters, as well as with case-by-case interpretations and advice. Management ensures that appropriate internal controls for credit risk management are established, observed and monitored. Fannie Mae's control oriented philosophy includes risk assessments, control designs, control implementation and results tracking. Reporting within the credit risk management framework is comprehensive, timely, appropriately detailed, and tracks variances between actual and forecasted performance. Fannie Mae routinely produces reports that cover the appropriate components of credit risk management.

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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 Fannie Mae, but instead relate to OFHEO's examination process.

- Fannie Mae has a comprehensive framework that ensures new products, programs and initiatives do not create unforeseen impacts on the company's credit risk profile. Management appropriately evaluates new products through the use of pilots with selected lenders in selected markets.

- Fannie Mae's reserve determination process is effective. The process follows a well-established and well-documented program; utilizes a proven and reliable financial simulation model; has access to extensive and detailed historical performance data and trend analyses; operates within an environment that promotes conservative loss forecasts and discourages surprises. Fannie Mae generates extensive analyses that provide reliable loss forecasts and are appropriately based on economic estimates, movements in house prices, projected business volumes, the composition of the current book of business, historical performance, and identifiable credit performance trends.

- Fannie Mae has an extensive, quality methodology for identifying and quantifying its credit risk exposure. Fannie Mae uses a variety of reliable, effective tools and processes to identify and quantify the company's credit exposure. Management thoroughly analyzes Fannie Mae's book of business, including factors such as product type, borrower credit profile, LTV, origination year, and geographic region. Technology tools and the substantial database allow management to accurately assess credit risk exposures in terms of performance and profitability of each segment of Fannie Mae's book of business. In addition, Fannie Mae performs monthly evaluations of credit risk exposure by analyzing the composition of the deliveries from each seller/servicer, using key risk assessment factors.

- Fannie Mae has an effective system of tracking credit risk exposures, and the system provides appropriate credit risk related information to the different levels of management. Management receives detailed, periodic reports that facilitate the tracking and analysis of credit risk exposures. The reports address portfolio performance, delinquency, foreclosures, credit losses, product composition, geographic and market concentrations, quality control findings, REO management, loan repurchase trends, seller/servicer performance, loan loss forecasts, and expected economic and market trends. In addition to the reports, management participates in regularly scheduled calls, meetings, and other forums to effectively track credit risk exposures.

- Fannie Mae routinely and consistently compares actual credit portfolio performance with expected performance, and identifies and addresses material variances between the two. Deviations from expected performance are explained and addressed during weekly and other periodic meetings, and through a variety of other effective communications channels. Evaluations of actual versus expected credit portfolio performance are appropriately incorporated into Fannie Mae's management reports.

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

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

The changes in the level and quality of credit risk result in a portfolio that exceeds safety and soundness standards.

- Fannie Mae's counterparty risk task force is implementing a series of initiatives that will augment existing tools and practices.

- Fannie Mae performed appropriate risk assessments before introducing the Construction to Permanent and the Timely Payment Rewards mortgage products, and established prudent safeguards to manage the additional risk associated with the Construction to Permanent mortgage product. The Timely Payment Rewards product does not introduce a new risk profile to Fannie Mae's book of business and existing controls are appropriate for this product.

- While Fannie Mae has formalized and broadened its relationships with certain high-volume seller/servicers, the changes do not have an adverse impact on the company's credit risk profile.

- Fannie Mae's initiatives to expand its purchase of "qualifying A" mortgages has not registered any meaningful change in the company's credit risk profile.

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

Credit risk management at Fannie Mae exceeds safety and soundness standards.

- Fannie Mae's retained and guaranteed credit portfolios are appropriately diversified and are in compliance with management's prescribed limits and guidelines. Fannie Mae's book of business is geographically diversified, and the company is not unduly exposed to credit losses attributable to regional economic fluctuations. While there are concentrations in highly populated states and in metropolitan areas, these concentrations are consistent with the market areas, and do not raise safety and soundness concerns. The preponderance of the mortgage portfolio consists of long-term, fixed-rate loans which present a relatively low credit risk profile. While there is a large percentage of loans originated in 1998, the concentration reflects the market activity in 1998 and the high level of refinancings that took place in that year. The credit risk profile of the portfolio is consistent with corporate objectives, and is in compliance with Fannie Mae's prescribed limits and guidelines.

- Fannie Mae is appropriately compensated for the credit risk it assumes, and Fannie Mae's credit models produce reliable results. Fannie Mae effectively uses a variety of analytical tools, decision processes, and tracking mechanisms to ensure that he company is adequately compensated for the credit risk it assumes. Fannie Mae has a variety of credit related models that provide reliable predictions of future mortgage performance; identify delinquent loans that are more likely to result in default and foreclosure; generate dependable quality ratings of seller/servicers; recommend methods of property valuation; evaluate repair/increased market value scenarios for REO; and analyze mortgage pools to identify the highest grade pieces. Management routinely reviews the performance of credit models and evaluates their performance against actual experience.

- Fannie Mae prudently manages counterparty exposure. Fannie Mae effectively measures, analyzes, tracks and modifies seller/servicer performance. Fannie Mae enforces its right to demand repurchase when appropriate, and the company effectively monitors sellers to identify things such as adverse trends in underwriting on a seller-by-seller basis. Fannie Mae has appropriate financial eligibility requirements for its selller/servicers. Fannie Mae effectively uses technology tools, information systems and performance measures to analyze its seller/servicer counterparties. Management pays particular attention to its largest seller/servicers, and the Credit Policy Committee conducts extensive annual reviews of the major seller/servicers. Fannie Mae's counterparty risk management framework appropriately encompasses mortgage insurance companies as well as seller/servicers. Fannie Mae requires mortgage insurance companies to meet and maintain appropriate financial strength and performance measures.

- Fannie Mae's credit risk tools are proven, reliable, cover key components of credit risk management and enable management to effectively access data and generate analyses. Fannie Mae's underwriting guidelines, instructional lender announcements and lenders, Desktop Underwriter, tools that select the method of collateral valuation, tools that facilitate quality control reviews, and proprietary technology tools allow management to obtain detailed performance reports that facilitate well informed decision making across the credit risk management spectrum.

- Fannie Mae's risk sharing strategies effectively reduce the company's exposure to credit risk. The predominant forms of risk sharing Fannie Mae uses are private mortgage insurance and the Delegated Underwriting & Servicing (DUS) program for multifamily loans. The defining feature of DUS is that the lender assumes the first loss position. Fannie Mae routinely analyzes DUS lender transactions and performance. Fannie Mae requires mortgage insurance companies to maintain appropriate financial capacity. Ongoing monitoring of mortgage insurance companies performance and condition position Fannie Mae to anticipate rather than merely react to developments that could impair the effectiveness of risk sharing with mortgage insurance companies. Fannie Mae also monitors and evaluates the performance of other parties with which it has risk sharing arrangements, and is able to identify potential future problems and take appropriate actions.

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

INTEREST RATE RISK PROGRAM

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

Fannie Mae's framework for managing interest rate risk exceeds safety and soundness standards.

- Fannie Mae's policies, procedures, internal controls and management reporting relating to interest rate risk are effective. Portfolio Management, Portfolio Strategy and the Treasurer's Office all have appropriate and current policies and procedures in place. The personnel involved with interest rate risk know and comply with these policies and procedures. The risk limits and appetites are clearly communicated through the monthly KPI reports and through the Office of the Chairman and the Portfolio and Investment Committee. The control framework includes the appropriate separation of interest rate risk analysis functions from the transaction functions. Management reports for interest rate risk, including the weekly package for the Portfolio Investment Committee present the balance sheet and projected earnings in sufficient detail to allow decision makers to effectively identify the sources of interest rate risk.

- Management is effective in following up on issues related to interest rate risk. Management continuously monitors its interest rate risk profile and takes prompt and appropriate action when risk limits are approached. Fannie Mae's senior management involved with managing interest rate risk meet formally every Thursday to discuss possible asset/liability strategies. Steps to implement the strategies are discussed the following morning by the Portfolio Investment Committee. In addition to these formal meetings, there is continuous and appropriate interaction and communication in the Market Room that keeps key personnel apprised of changing market conditions.

- The impact of new products, programs and initiatives on the company's interest rate risk profile is well researched and receives appropriate senior management and Board review prior to implementation. Management has been closely involved in key business initiatives relating to interest rate risk. The Callable Benchmark Note program for example, received appropriate approvals by the Board before it was implemented. Management keeps the Board appropriately informed on the status of new products and initiatives, and their impact on the company's interest rate risk profile.

- The appropriate separation of responsibilities exists between the strategy and analytics function and the execution function. Personnel who craft strategy and analyze the balance sheet are appropriately separated from personnel who execute transactions. Traders and portfolio analysts do not code software that is used for portfolio management.

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.*

- In 1999, Fannie Mae replaced ALMS with an object-oriented tool set linked through a system called Valuation Net. Objects in the tool set include interest rate generators and prepayment models that can be plugged into the Stochastic Income Model, the Portfolio Valuation Model, or the Securities Analyzer. The methodologies employed in this system are sound and provide management with an effective means to manage risk.

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

The framework for managing the use of derivative instruments at Fannie Mae exceeds safety and soundness standards.

- Fannie Mae uses derivative instruments in a prudent manner. Derivatives are used in a manner that is consistent with the corporate risk management policies. Fannie Mae uses derivatives primarily for reducing interest rate risk, and our examination did not find a single instance of the company's using derivatives as a speculative vehicle. Derivatives are marked to market daily using the DEBTS system, and the effect of derivative instruments are considered when Fannie Mae assesses the sensitivity of market values and earnings to changes in interest rates. Systems for data capture, processing, settlement and management reporting are effective and have been enhanced by the implementation of DEBTS. Management reports for derivatives are comprehensive and identify important attributes of the instruments.

- Management governs the use of derivatives in accordance with the standards used by other large financial intermediaries. Fannie Mae measures the credit risk and market risk of its derivatives portfolio independently of the portfolio management function. Fannie Mae has a sound method for determining mark to market exposure for collateral obligations. Counterparty risk is appropriately diversified, and the credit quality of counterparties is routinely monitored.

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.*

Fannie Mae's management of interest rate risk exceeded safety and soundness standards.

- Management has established a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk. Fannie Mae's primary measures of sensitivity to changing interest rates are Duration Gap and Duration Gap Sensitivity. While Fannie Mae's Duration Gap and Duration Gap Sensitivity measures are used as primary indicators, management performs other analyses, and uses stochastic tools that generate multiple interest rate paths, giving management probabilistic estimates of earnings sensitivity.

- Technology and controls supporting the interest rate risk management function are effective. Fannie Mae has specialists who develop new tools for managing interest rate risk. Fannie Mae also has functions that support hardware and networks for interest rate risk management. Controls are in place to ensure the integrity of data used in interest rate risk and portfolio management models. Technology and controls supporting business continuity plans for the continued monitoring of interest rate risks during emergency situations have been tested and found to be effective.

- The tools used to model interest rate risk and the strategies to alter the exposures to interest rates are effective. Fannie Mae has tools that evaluate the effect of changing interest rates on all areas of its balance sheet. The prepayment models are well documented and incorporate a wide range of appropriate factors. The prepayment models are tailored to specific asset types including 30 year fixed, 15 year fixed and adjustable rate mortgages. Interest rate generation models incorporate appropriate parameters and are rigorously tested and documented. The assumptions and parameters are continuously reviewed for reasonableness by both the developers and users of the models.

LIQUIDITY MANAGEMENT PROGRAM

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

Fannie Mae's management of its liquidity exceeds safety and soundness standards.

- Fannie Mae's policies, procedures, internal controls, and management reporting relating to liquidity management are effective. The Treasurer's Office policies and procedures precisely detail the nature of liquidity risk and how it is managed. Risk limits and lines of authority are clearly identified in policies and procedures. There are guidelines with respect to credit, maturity and issuer diversification. There are security specific guidelines, and maximum limits are in place. The types of investments in the Liquidity Investment Portfolio are consistent with Fannie Mae's goals and strategies. The internal controls for liquidity management are adequate 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. Fannie Mae assesses the adequacy of its liquidity in simulated interest rate environments through various effective models such as the Stochastic Income Model and the Portfolio Valuation Model. In addition, portfolio managers in the Treasurer's Office monitor the Liquid Investment Portfolio continuously to ensure the securities can be readily converted to cash is necessary.

- The planning process for liquidity management, including tactical, strategic and contingency planning are effective. Fannie Mae's planning takes short term cash needs, access to capital markets, cost of capital and the ability to liquidate market positions into consideration. Capital allocation strategies are set at the business unit level and reflect the Board's capital allocation decisions. When opportunities arise to increase mortgage purchases, capital can be reallocated from the Liquidity Investment Portfolio to the mortgage portfolio.

- Fannie Mae's management is effective in following up on issues and initiatives that influence liquidity. Liquidity issues are effectively communicated across business units as was demonstrated by the coordination of the Treasurer's Office efforts to ensure that all systems would be ready and functioning properly during the Y2K date change. Liquidity issues are covered by the audit functions and by the corporate self assessment of risk process.

- Technology and controls for Fannie Mae's liquidity management are effective. There are specialists who support the liquidity management functions by developing new tools, maintaining existing systems and ensuring the reliability of hardware and networks. The information technology systems provide timely and accurate liquidity management information and reports. Technology and controls supporting business continuity plans for the continued monitoring of liquidity during emergency situations have been tested and found to be effective.

- The quality of tools used to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are effective. Fannie Mae uses a variety of tools to assess the effect of changing interest rates on its liquidity position. Management assesses the effect of liquid investments in its interest rate risk modeling.

- The duties of the strategy and analytics functions and the execution functions at Fannie Mae are appropriately separated. The traders and portfolio analysts do not code software used for liquidity management. Regular analysis of the underlying markets is performed independently from the traders.

- Fannie Mae 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, Benchmark notes, callable debt, interest rate swaps and mortgages and non-mortgage investments relative to funding benchmarks. Fannie Mae uses information about trends and anomalies in funding spreads to make appropriate choices regarding liquidity.

- Liquidity management is appropriately integrated into other management and financial performance issues. Liquidity risks are incorporated into Fannie Mae's corporate and business unit plans. Fannie Mae's corporate plans and strategic initiatives fully account for the need to maintain adequate liquidity. Liquidity risk is reflected in the management of derivatives. The Treasurer's Office 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.***

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

- The Treasurer's Office conducted extensive research before extending the Benchmark Note program to include callable debt. There was significant coordination with Wall Street dealers to assess the depth of the markets for callable notes, and as the program was introduced, Fannie Mae provided information on its website. The callable notes provide Fannie Mae with optionality for its liability portfolio to offset the embedded options in the mortgage portfolio. The Benchmark Bonds and Benchmark Bills, also introduced in 1999 were issued only after extensive research was conducted.

- The two successful exchanges of debt completed in 1999 resulted in the redemption of more than $9 billion in medium-term notes, favorably impacting Fannie Mae's long-term funding costs.

- A primary focus of liquidity in 1999 was the year-end roll-over to ensure Fannie Mae had adequate liquidity to offset any potential Y2K related disruptions. The Treasurer's Office effectively coordinated its efforts with business units to ensure that all systems would function properly in the roll-over period.

INFORMATION TECHNOLOGY PROGRAM

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

Fannie Mae's information technology infrastructure and surrounding risk management framework exceed safety and soundness standards.

- Fannie Mae has operating processes are in place to ensure secure, effective and efficient data center processing and problem management. Procedures and controls for the management and security of the mainframe operating system and tape management are appropriate. System usage and other IT usage metrics are appropriately reported and monitored. System related problems are identified, tracked, resolved, and logged using an effective automated system.

- There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. Security administration is facilitated by an automated security request system, and user profiles are established based on business role and job assignment.

- Fannie Mae has effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. Fannie Mae conducted a comprehensive business impact analysis to prioritize the recovery of critical business processes. The analysis was then extended to non-mission critical business processes. Integrated business recovery tests are performed periodically.

- Fannie Mae has an adequate process to ensure information technology plans effectively address business unit and corporate objectives. Business units develop focused IT plans for their business processes. The Technology Committee provides oversight for strategic IT issues and is informed about CIS initiatives.

- Fannie Mae has effective processes in place to ensure appropriate controls are implemented and documentation for system development and maintenance is complete. The system development methodology is documented and provides guidance on key development tasks.

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 Fannie Mae responds to and evaluates changes in information technology that may influence the surrounding risk framework exceeds safety and soundness standards.

- In 1999 controls over software release management and user account administration were strengthened.
- Fannie Mae implemented a series of information security initiatives such as enhanced monitoring capabilities, improved virus detection, and strengthened application controls.
- Fannie Mae reorganized its information security function to enhance its effectiveness.

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 Fannie Mae exceeds safety and soundness standards.

- Fannie Mae has implemented effective processes for the processing of data and information to ensure accuracy and timeliness. The company's system development methodology provides guidance for controls to be implemented in software applications to ensure the integrity and accuracy of data processed by the applications. Internal Audit assesses new applications systems, data integrity controls in the applications, and processing controls.
- Fannie Mae's plan for identifying, renovating, testing and implementing solutions for Year 2000 issue has been effective and was appropriately incorporated into corporate strategic and operating plans. The effectiveness of the Year 2000 plan has been demonstrated by the successful operation of the company after the date change. The plan includes appropriate actions throughout the first quarter 2000. Fannie Mae established a separate Year 2000 testing environment that was successfully used to ensure the readiness of critical business operations through the date change. The plan included

comprehensive and effective contingency plans for critical business processes.

- Fannie Mae's Year 2000 processing capabilities have been effectively coordinated with customers, vendors and business partners. Fannie Mae effectively communicated its deadlines and requirements, and performed on-site compliance reviews of high-risk servicers and lenders. Fannie Mae appropriately participated in the MBA Industry Test and conducted tests with its business partners.

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.

- Fannie Mae has accurate and reliable processes for identifying risks to business processes and implementing appropriate controls. Business units annually assess their controls using a mechanism based on the COSO framework. The results of the business self assessments are verified by Internal Audit. Every month management measures and reports key indicators of risk.

- Fannie Mae's management has reliable processes for ensuring the timely resolution of control related issues. The design of the monthly Key Performance Indicator reports encourage management to take appropriate action before an item is in the "red" zone. The Audit Tracking List is shared with management and provides relevant information about the status of control issues identified by Internal Audit.

- Fannie Mae's Internal Audit unit appropriately identifies and communicates internal control deficiencies to management and the Board of Directors.

- In 1999 Internal Audit conducted more discrete audits than it did in 1998, and the reports from these discrete audit activities provided management with appropriate information about control deficiencies.

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

The Enterprise reacts to changes that affect internal controls in a manner that exceeds safety and soundness standards.

- In 1999, the Key Performance Indicator Reports and the Self Assessment Questionnaires were revised to enhance Fannie Mae's control framework.

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

Fannie Mae's system of internal controls and the effectiveness of that system exceeds safety and soundness standards.

- The controls Fannie Mae has implemented properly address the risks assessed by management. The effectiveness of Fannie Mae's controls is demonstrated by, among other things, measures of credit performance, liquidity, interest rate exposure, as well as by the results of audit activities. In 1999, a key risk for Fannie Mae related to the Year 2000. Results of industry tests and the continued uneventful operations of the company through the date change demonstrate the effectiveness of Fannie Mae's controls.

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

BUSINESS PROCESS CONTROLS PROGRAM

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

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

- The processes and control environment Fannie Mae uses when considering or developing new or substantially revised business initiatives is effective. The processes involve the effective identification of risks and the ability of controls to mitigate the identified risks.

- The communication flows associated with the new or substantially revised business initiatives are effective. The affected business and controls units are appropriately defined, and communications among the affected business and control units throughout the business initiative process are timely, appropriate and accurate.

- The balance between risk management, internal controls and the pressure to develop new or substantially revised business initiatives is appropriate. Management has appropriate and timely information about the effectiveness of risk management and internal controls surrounding business initiatives at critical decision points in the business initiative process. Management appropriately requires that adequate controls be in place before a business initiative is introduced.

- Fannie Mae effectively uses pilot programs in connection with its new and substantially revised business initiatives. Controls for pilots are well designed and provide clear guidance to both Fannie Mae employees and lenders involved in pilot programs.

- Fannie Mae's corporate culture and desired employee behaviors guide plans for managing and marketing new or substantially revised business initiatives. New and substantially revised business initiatives are designed to fit into Fannie Mae's established control and risk management framework.

- The analyses Fannie Mae conducts to determine whether launched new or substantially revised business initiatives are successful and/or have aspects that warrant reconsideration or modification, are effective. Fannie Mae effectively uses limited scope audits to assess the quality of controls surrounding new or substantially revised business initiatives.

* Fannie Mae's corporate environment promotes and supports the introduction of new ideas and intellectual capital. Fannie Mae supports and rewards ideas from sources across the company. The effective communication of corporate goals and strategy to all employees provide Fannie Mae with an informed and interested group who can and provide suggestions and 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 analysis and review Fannie Mae conducts for new or substantially revised business initiatives are appropriate. The analysis and review is structured, well documented and appropriately focused on risks and the effectiveness of risk mitigation efforts.

* Fannie Mae's Board of Directors and executive management are appropriately informed about the adequacy of due diligence for new or substantially revised business initiatives. Regular reports from management to the Board of Directors and its committees, and status reports on initiatives provide the Board and executive management with appropriate information about due diligence efforts and results. Reports appropriately highlight aspects of initiatives that merit additional attention or action.

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.

- The internal and external audit functions have appropriate independence to carry out their responsibilities. The independence of the audit functions is evident in audit workpapers that include testing and verification of business units. Issues identified by audit programs are communicated effectively to the Board through its Audit Committee. The Board's Audit Committee meets regularly in executive session with the SVP Audit and with representatives from the external auditors. In addition, the Chairman of the Board's Audit Committee is briefed by the internal auditors and the external auditors before Audit Committee meetings. The Board's process for hiring the company's external auditor supports an independent audit function.

- The auditors performing the audit work possess the appropriate professional proficiency. The auditors' proficiency is evident in the auditors' work. The Internal Audit department actively supports staff efforts to obtain additional certifications and training. The external auditors were selected in part because the company and individuals working on the engagement have appropriate professional expertise and background in both auditing and secondary mortgage market issues.

- The scope of the audit work is appropriate. Both internal and external audit have responsibility to ensure the entire scope of necessary audit work is completed. Internal Audit is also actively involved in corporate internal control matters beyond traditional audit activities. In 1999 Internal Audit spent considerable effort and resources in revising the corporate KPI and SAQ processes.

- The performance of the audit work has been complete. The management of the Internal Audit department effectively monitors the status of audit work and deliverables. Decisions made throughout the year to revise audit plans were sound and supported. Mechanisms are in place for management to follow up on issues identified by the audit programs.

- The management of the Internal Audit department is strong. Additions and changes in 1999 enhanced the Internal Audit management team. Accountability and responsibility are stronger as a result of changes implemented by the SVP Audit. The management style is appropriately pro-active and results in a corporate wide focus on key risks to the company.

- Executive management and the Board are appropriately involved with audit issues, and each group follows up on audit issues in an appropriate manner.

- The risk assessment process used by Internal Audit is strong. The Business Segment Risk approach adopted by Internal Audit, and approved by the Board's Audit Committee as the basis for the "priority-based risk management approach" to audit activities is comprehensive and well thought out. By clearly defining the seven Business Segment Risks (and subsidiary risks) and *applying them consistently across the company, the audit programs are* positioned to identify top corporate risks and prioritize audit work accordingly.

- Internal Audit is appropriately involved with new products and initiatives. Through both formal and informal means, Internal Audit remains informed on a timely basis about new products and initiatives. Internal Audit's risk assessment process appropriately includes: "major new initiatives," "new entrants" and "new products."

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.*

The changes implemented in internal audit in 1999 have enhanced the audit functions and Fannie Mae's risk management framework.

- In 1999 a Senior Vice President was named to head the Internal Audit unit. The decision to name a SVP to head up the audit function increased the stature and thus the independence of the internal audit department. The SVP brings an impressive background to the position and in his first year he implemented several significant changes to Internal Audit's processes and operations.

- The Audit Plan process in 1999 was significantly different from the process used in previous years and resulted in an enhanced audit plan. The drivers for the Audit Plan are the seven cross cutting Business Segment Risks which cover all areas of risk in Fannie Mae's operations. The discrete audit activities included in the Plan were prioritized by using another new tool, the Top Ten Corporate Risks. Unlike in previous years when the audit plan was reviewed two times over the course of the year, the Audit Plan is reviewed and revised every month. This iterative process is designed to allow the audit plan to be modified to reflect the environment Fannie Mae is operating in, to respond to issues, and to use resources effectively.

- The Gannt charts created monthly by Internal Audit's directors, are effective tools that provide key information about the status of audit activities and permit Internal Audit's management to make reasoned decisions about modifications to the Audit Plan.

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.

- Fannie Mae's Board of Directors remains appropriately informed of the condition, activities and operations of the Enterprise. The process management uses to identify materials that should be provided to the Board of Directors is comprehensive and is designed not to unnecessarily burden Board members. The committee structure and meeting frequency provide effective frameworks for an informed Board of Directors.

- Fannie Mae's Board of Directors has sufficient well organized time to carry out its responsibilities. Minutes reflect that the full Board and its committees appropriately prioritize issues, dedicating time to matters in direct relation to their significance to the company. The discipline of providing Board members with materials sufficiently in advance of meetings permits the members to maximize their time together. The practice of having certain topics covered at designated Board meetings permits members to prepare for and focus on discrete topics.

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 Board's composition further strengthen a Board that already exceeds safety and soundness standards.

- Mr. Garry Mauro was appointed to the Board by the President of the United States.

- Mr. James A. Johnson and Ms. Karen Hastie Williams will both step down from the Board of Directors at the first of the year. Fannie Mae has identified two qualified individuals who to fill those seats, Ms. Anne M. Mulcahy and Mr. Patrick Swygert.

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

The manner in which Fannie Mae's Board of Directors discharges its duties and responsibilities exceeds safety and soundness standards.

- Fannie Mae's Board of Directors is appropriately engaged in the development of a strategic direction for the company. Throughout the year, the Board is briefed by management and has appropriate opportunities to provide input into strategic planning. The two day Board meeting in July is focused on strategy and the Board is well positioned to have meaningful discussions about the corporate strategy and the means by which it will measure the success of the corporate strategic plan, business plans and corporate goals.

- Fannie Mae's Board of Directors ensures that executive management appropriately defines the operating parameters and risk tolerances of the company consistent with the strategic direction; legal standards; and ethical standards. The Board is regularly briefed by the Chair of the Business Conduct Committee about matters under that Committee's jurisdiction, including compliance with the Code of Business Conduct. The Board is appropriately apprised of progress toward meeting corporate objectives, including the status of operating parameters and risk tolerances. The KPI reports for the Board are effectively designed to alert the Board to trends and appropriately highlight indicators that are approaching or have breached tolerance levels.

- Fannie Mae's Board of Directors has an effective process for hiring and maintaining a quality executive management team. The success of Fannie Mae's operations in Mr. Raines' first year as CEO attest to the effectiveness of the Board's efforts to identify and hire a quality executive management team. In 1999 the Board also approved the hiring of a new General Counsel who brings strong credentials, appropriate skills and knowledge to the company. In the final quarter of 1999, the Board was appropriately engaged in the process to identify a qualified successor to President Small. The frequent and substantive interaction of the Board with its executive management team provides the Board with a sound basis for evaluating its team, and for identifying the qualities and competencies it wants when vacancies occur.

- Fannie Mae's Board of Directors holds the executive management team accountable for achieving the defined goals and objectives. The Board conducts a formal assessment of the CEO's performance against established and appropriate criteria. With the assistance of third party experts, and after assessing the status of and progress toward defined corporate short and long term goals and objectives, the Board determines the total compensation for its executive management team.

MANAGEMENT INFORMATION PROGRAM

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

Fannie Mae's framework for producing reliable management information exceeds safety and soundness standards.

- Information systems are linked to Fannie Mae's overall strategy, and information systems are developed and refined pursuant to a strategic plan for information systems. There is an effective overarching technology architecture for the company. Business units' IS strategies are designed to roll up into the global IS plan. The involvement of IS experts with business units results in effective integration of IS issues with business and corporate strategies.

- Information systems that capture and produce the data that generate reports are subject to effective and appropriate controls. The quality of data and reports are monitored on a regular and ongoing basis.

- Fannie Mae's strategy, roles and responsibility are effectively communicated. Employees at all levels across the company have clear understandings of Fannie Mae's role, and how their jobs support that role. In 1999 Fannie Mae enhanced its very strong and effective communications to employees by adding a "Mission Fact" section to its intranet site. Human Resource tools and processes, including the employee performance and compensation programs, effectively communicate and reinforce roles and responsibilities.

- Channels of communication available to Fannie Mae employees to provide feedback, report irregularities, and suggest enhancements are very effective. The biennial employee survey which was conducted in 1999 provides employees with an effective and meaningful channel of communication with senior management on a wide range of topics. Management reasonably decided to postpone the survey from 1998 in order that employees would have an opportunity to opine on the numerous changes implemented in 1998. Fannie Mae's executive management actively supported the survey and it is likely that the support accounts in part for the very strong response rate. Changes to Fannie Mae practices and processes demonstrate the willingness of management to listen to employee comments and concerns. There are clear and effective channels of communication for issues related to the Code of Business Conduct.

- Communications across Fannie Mae are effective. Effective internal and external communications are key corporate goals that Fannie Mae aggressively manages and achieves. Resources and tools are dedicated to ensuring effective communications. There are both formal and informal processes in place that support the effective and appropriate sharing of information 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 Key Performance Indicators process was revised and strengthened in 1999. Fewer and more relevant measures are now being tracked. The total number of critical indicators has been reduced to 39, a reasonable number of indicators for executive management to monitor. The new KPI format for the Board of Directors lists all 39 KPIs and provides a summary of the monthly trend of performance rather than providing details about the performance. The KPI process is designed to provide the Board with details whenever a KPI is in the "red" zone.

- Fannie Mae demonstrated the effectiveness of the integration of information systems with corporate strategic planning in the successful implementation of its revised and significantly enhanced intranet site.

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

Fannie Mae's management information exceeds safety and soundness standards and produces timely, accurate and meaningful information and reports that are appropriately tailored for their audiences.

- Fannie Mae's executive management and Board of Directors are appropriately and effectively informed of details relating to performance relative to established goals and objectives. The monthly Corporate Objectives Progress Report, and the semiannual summary prepared for the Board present the status of the metrics and milestones for achieving corporate objectives in easy to understand formats. The Key Performance Indicators Reports align with the Top Ten Corporate Risks and the Business Segment Risks.

- Management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively, and to gauge the quality of their decisions. Management reports are effective tools for identifying, monitoring and managing risks. Fannie Mae effectively uses tools to ensure decision makers have timely information about external events that have the potential to impact the company and its operations. Fannie Mae's Intranet is heavily used and provides relevant information on a real time basis across the company. The Intranet site Homesite is designed so information can be shared either on a limited basis or in summary documents with links to more detailed information.

- Reports used by Fannie Mae's management for decision making are accurate. Several Key Performance Indicators (KPIs) are designed to measure and monitor information accuracy and timeliness. New KPIs introduced in 1999 are designed to assess the quality and accuracy of financial reporting. Fannie Mae's external auditor has certified the accuracy of financial statements. The results of Internal Audit testing of KPIs and the Self Assessment Questionnaires demonstrate that these key management reports are accurate.

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.

- Fannie Mae's planning process is appropriately comprehensive. Fannie Mae has an effective framework that supports the strategic planning process. Fannie Mae has a strong, comprehensive, well thought out approach to strategic planning. The Corporate Development department effectively focuses on the future. Processes are in place so the Board will remain apprised of strategic issues throughout the year. The process for identifying metrics for the strategic goals is effective, and the monthly Corporate Objective Reports provide management with information about the status of efforts to achieve strategic goals.

- Fannie Mae's key performance measures are appropriate, effective and align with strategy.

- Fannie Mae's behavior management programs are designed to achieve corporate goals and objectives. The process for evaluating employee performance ties directly to business unit and corporate goals. The compensation program for all employees ties directly to long- and short-term business unit and corporate goals. Major elements of compensation for senior executive officers are tied to both annual and long term performance goals.

- Fannie Mae's management effectively conveys an appropriate message of integrity and ethical values. The Code of Business Conduct is easy to read and comprehensive, and applies to all employees, members of the Board and appropriately designated consultants. The organizational framework surrounding the Code of Business Conduct, including the Business Conduct Committee and Office of Corporate Justice and Employment Practices, is strong and effective.

- Decision making roles and the assignment of responsibilities effectively provide for accountability and controls. All Fannie Mae employees have ready access to clearly articulated statements of roles and responsibilities. The organizational structures within the company are appropriate and effective and support accountability and controls. Corporate wide risk management tools clearly identify expectations for business units.

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

- In 1999, the KPI process was changed resulting in fewer indicators being tracked overall, and tailored reports being generated for targeted audiences. The revised KPIs are appropriately consistent with the Strategic Business Risks and Top Ten Corporate Risks. The changes enhance management's ability to effectively monitor the most significant indicators.

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 Fannie Mae on a company-wide basis exceed safety and soundness standards.

- Fannie Mae's business unit goals, implementing plans and programs to achieve the strategic plan are effective. The company's strategic direction and goals are effectively communicated throughout Fannie Mae enabling the business units to define and refine their plans and programs to support corporate goals and objectives, and to meet identified metrics and milestones. Business unit plans are reinforced and effectively supported by the employee performance assessment process which ties individual employee performance to business unit and corporate goals. Business unit goals and plans to achieve the corporate strategic goals are effectively measured and monitored throughout the company.

- Fannie Mae is able to manage and monitor change effectively. Strong internal and external communications processes effectively support Fannie Mae's ability to monitor and manage change. The timely sharing of information across the company effectively positions the company to take advantage of changes and/or to respond to events. The identification, monitoring and consistent measurement of Business Segment Risks and the Top Ten Corporate Risks position Fannie Mae to react to changes that may have pervasive impacts on the company. The corporate culture of sharing knowledge and strategy enhance Fannie Mae's ability to manage change whether brought about by internal or external agents.

- The monthly measures of Fannie Mae's progress toward meeting strategic and business unit goals and objectives are relevant, meaningful and appropriate. The monthly Key Performance Indicators (KPI) Reports provide an effective means of measuring and monitoring strategic and business goals.

- Fannie Mae has an effective program for career and management development. The company's Job Family classification system supports employee career management. Fannie Mae has numerous effective programs designed to enhance employees' skills, knowledge and experience. The company's hiring process which generally includes posting internal positions internally and interviewing internal candidates who meet the minimum qualifications, support employee career management.

- Fannie Mae has effective programs for recruiting competent people. The qualifications and experience of individuals hired demonstrates that Fannie Mae effectively identifies the qualities it wants and needs. The processes supporting the recruitment efforts are strong and effective. Job descriptions are created in a collaborative effort between business unit managers and Human Resources. The efforts expended in the job description process contribute to the quality of the candidate pool from which selections are made. Fannie Mae effectively uses outside resources, technology and its own employees when recruiting, and incentive programs such as HERO contribute to the quality of the pool of candidates from which selections are made. Fannie Mae appropriately focuses on its diversity goals and objectives in its recruitment efforts.

- Fannie Mae's proprietary risk management systems and programs are effective. The results of operations, measures of credit performance and market risk indicators, as well as the successful transition into the Year 2000 demonstrate the effectiveness of Fannie Mae's proprietary risk management systems and programs.

- Management's philosophy and operating style have a pervasive effect throughout Fannie Mae. The employee performance process reinforces management's philosophy and operating style. Management's philosophy and operating style are supported by an effective Code of Business Conduct. Management effectively uses communication tools to share its philosophy and operating style with employees. Results demonstrate the pervasive effect of management's philosophy and operating style.