

**REDACTED**

Federal Housing Finance Agency  
Office of Inspector General



**After Four and a Half Years, DER  
Still Fails to Ensure that Enterprise  
Boards are Notified of Serious  
Deficiencies in a Timely Manner**

This report contains redactions of information that is privileged or confidential.

Compliance Review • COM-2021-002 • January 21, 2021



COM-2021-002

January 21,  
2021

## Executive Summary

As the federal regulator of Fannie Mae and Freddie Mac (collectively, the Enterprises), the Federal Housing Finance Agency (FHFA or Agency) is tasked by statute with ensuring that they operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Critical to FHFA's supervision of the Enterprises are on-site examinations, including ongoing monitoring and targeted examinations into strategically selected areas of high importance. FHFA's Division of Enterprise Regulation (DER) conducts safety and soundness examinations of the Enterprises, reports on examination findings, and, when necessary, issues findings identifying deficiencies. Matters Requiring Attention (MRA) are issued for serious supervisory concerns or deficiencies that require prompt correction.

After FHFA placed the Enterprises into conservatorships in September 2008, it delegated to each of their boards of directors (Board) the responsibility for overseeing general corporate matters. FHFA's corporate governance regulation makes each Board responsible for having policies in place to assure oversight of the Enterprise's risk management program and of "[t]he responsiveness of executive officers ... addressing all supervisory concerns of FHFA in a timely and appropriate manner."

Our March 2016 evaluation on the Agency's standards for communicating serious deficiencies to each Board found that DER sent MRAs to Enterprise management, rather than directly to the Board. This forced the Board to rely upon the very management team responsible for the MRA, creating "a significant risk that management will put its own spin on the deficiencies giving rise to the MRA or will filter the information it provides to the Board[.]" and framing the Board's view of MRAs through management's lens. We recommended that FHFA "[r]evise its supervision guidance to require DER to provide the Chair of the Audit Committee of an Enterprise Board with each conclusion letter setting forth an MRA[.]"

FHFA agreed with our recommendation, issuing and subsequently revising a new Operating Procedures Bulletin (OPB), DER-OPB-03.1, *Examination Documentation and Report of Examination Guidance*, requiring its Examiners-in-Charge to "address all supervisory correspondence" – including but not limited to such correspondence containing MRAs – "to responsible Enterprise management official(s), with copies to the chief audit executive, the head of compliance, the head of enterprise risk management, and the chair of the [B]oard audit committee[.]" After review of this OPB, we closed our recommendation in November 2016.



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In our 2018 compliance review, we tested DER's implementation of this OPB. We found that DER had ignored the requirements. It sent supervisory correspondence with MRAs to Enterprise management and expected management to transmit that correspondence to the Board's audit committee chair. We determined that DER lacked any internal control to verify whether Enterprise management had transmitted such correspondence to the audit committee chair. We re-opened the March 2016 recommendation and stated that FHFA should "direct DER either to amend its guidance to implement the recommendation, or require that DER put into place an internal control to ensure that it receives contemporaneous, written certification from Enterprise management that each supervisory correspondence containing MRAs has been timely provided to the Audit Committee Chair of the affected Enterprise." Because FHFA had previously agreed to this recommendation, re-opening it put FHFA on notice that we did not consider its implementation of corrective actions to be satisfactory.

In December 2018, DER advised us that it would require Enterprise management to contemporaneously notify the audit committee chairs of all MRAs. It subsequently provided emails to management of each Enterprise dated January 10, 2019, directing them to provide DER with documentation that each audit committee chair received "contemporaneous, written notification" of MRAs.

In this second compliance review, we assessed whether DER kept its commitment to ensure that Enterprise management contemporaneously notified each audit committee chair, in writing, of MRAs contained in supervisory correspondence. We found that DER did not keep its commitment.

DER's delegation to Enterprise management of the task of communicating MRAs "contemporaneously" to the Boards' audit committee chairs over a four and one-half year period has not worked. Neither Enterprise's management has consistently provided "contemporaneous, written notification" to its audit committee chair of each MRA, remediation of which is overseen by the Boards. These repeated failures by Enterprise management do not augur well for effective corporate governance of the Enterprises once they are released from conservatorship.

Our March 2016 recommendation with which FHFA concurred, and which was reopened in 2018, remains open. That recommendation states: FHFA should "[r]evis[e] its supervision guidance to require DER to provide the Chair of the Audit Committee of an Enterprise Board with each conclusion letter setting forth an MRA[.]" This recommendation places the MRA notification burden squarely on DER, the supervisor that issued the MRA. The re-opened



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2016 recommendation will not be closed as completed until FHFA demonstrates that DER has adopted and implemented the examination practice that it shall contemporaneously notify the audit committee chair directly of each MRA issued, rather than rely upon Enterprise management to notify the audit committee chair of MRAs.

In its written management response, FHFA contends that the speed with which audit committee chairs receive notice of MRAs from Enterprise management is reasonable, even if not “contemporaneous” as it requires. It maintains that existing “compensating controls” mitigate the manifest risks associated with DER’s continued reliance upon Enterprise management to notify the audit committee chairs of MRAs. FHFA asserts that DER will take no further action in response to the 2016 recommendation. FHFA’s comments and our responses are included in the body of this report.

We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, [www.fhfaoig.gov](http://www.fhfaoig.gov).

/s/

Brian Baker  
Deputy Chief Counsel

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## ABBREVIATIONS .....

Board	Enterprise Board of Directors
DER	Division of Enterprise Regulation
Enterprises	Fannie Mae and Freddie Mac, collectively
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
Review Period	January 1, 2019 – June 30, 2020

## BACKGROUND.....

As the federal regulator of the Enterprises and of the Federal Home Loan Banks (FHLBanks), FHFA is tasked by statute with ensuring that these regulated entities operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Critical to FHFA’s supervision of the Enterprises and FHLBanks are on-site examinations, including ongoing monitoring and targeted examinations into strategically selected areas of high importance. FHFA conducts safety and soundness examinations, reports on examination findings, and, when necessary, issues findings identifying deficiencies.

After FHFA placed the Enterprises into conservatorships in September 2008, it delegated to each Enterprise’s Board the responsibility for overseeing general corporate matters. FHFA’s corporate governance regulation makes each Board responsible for having policies in place to assure oversight of the Enterprise’s risk management program and of “[t]he responsiveness of executive officers ... addressing all supervisory concerns of FHFA in a timely and appropriate manner.”

### **Our 2016 Evaluation Found that DER Did Not Communicate MRAs Directly to Each Board**

In March 2016, we published an evaluation on the Agency’s standards for the communication of serious deficiencies to each Board.<sup>1</sup> We explained that DER issued MRAs for serious supervisory concerns or deficiencies that require prompt correction. At that time, only “the most serious supervisory matters,” such as non-compliance with laws or regulations that could result in significant risk of financial loss or damage, or in a regulated entity’s being in an unsafe or unsound condition, were categorized as MRAs. FHFA “regulations and requirements make clear that Enterprise boards are charged with understanding the ‘serious deficiencies’ in practices, policies, procedures, and controls adopted by management that gave rise to an MRA and overseeing management’s efforts to correct these deficiencies in a timely and effective manner.” Each Board is responsible for ensuring that the conditions and practices that gave rise to any supervisory concerns are corrected, ensuring that executive officers have been “responsive[.]...in addressing all of FHFA’s supervisory concerns in a timely and appropriate manner,” and holding management accountable for remediating those conditions and practices.

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<sup>1</sup> OIG, *FHFA’s Supervisory Standards for Communication of Serious Deficiencies to Enterprise Boards and for Board Oversight of Management’s Remediation Efforts are Inadequate* (Mar. 31, 2016) (EVL-2016-005).



We found, however, that FHFA’s supervisory practices significantly limited a Board’s ability to execute its responsibilities. We determined that “DER did not communicate MRAs directly to [the Board of the affected Enterprise]; rather, [a Board] receive[d] information concerning the most serious deficiencies through a management filter.” To learn about an MRA and understand the deficiencies that gave rise to it, a Board was forced to rely upon the very management team responsible for the MRA. We explained that FHFA’s reliance on Enterprise management to communicate MRAs to the Board “creates a significant risk that management will put its own spin on the deficiencies giving rise to the MRA or will filter the information it provides to the Board[.]” and frames the Board’s view of MRAs through management’s lens. “For directors to be held responsible for ensuring that the conditions and practices giving rise to an MRA are effectively and timely corrected by management,” an essential precondition is that the Board “must be aware that an MRA has issued and the specific deficiencies identified in it.”

To remediate this shortcoming, we recommended that FHFA “[r]evise its supervision guidance to require DER to provide the Chair of the Audit Committee of an Enterprise Board with each conclusion letter setting forth an MRA[.]”<sup>2</sup> FHFA agreed with our recommendation.

### **We Closed the Recommendation Once DER Committed to Send a Copy to the Audit Committee Chair of Each MRA Sent to Enterprise Management**

FHFA committed to “amend its guidance to require that the chair of each Board’s audit committee also receive a copy of any conclusion letter that includes an MRA.” DER issued and subsequently revised a new OPB, DER-OPB-03.1, *Examination Documentation and Report of Examination Guidance*, requiring its Examiners-in-Charge to “address all supervisory correspondence to responsible Enterprise management official(s), with copies to the chief audit executive, the head of compliance, the head of enterprise risk management, and the chair of the [B]oard audit committee[.]” These requirements, according to DER-OPB-03.1, applied to the following categories of supervisory correspondence:

- a. Conclusion letters that communicate findings and conclusions resulting from targeted examinations.
- b. Supervisory letters that communicate matters requiring attention (MRAs) resulting from ongoing monitoring.
- c. Non-objection or objection letters that provide DER’s written response to a remediation plan.

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<sup>2</sup> We made three other recommendations in the evaluation, but this compliance review addresses only this one.



- d. Remediation letters that communicate closure of MRAs.

After review of this OPB, we closed our recommendation in November 2016.

### **First Compliance Review in 2018: DER Ignored its OPB and Continued to Rely on Enterprise Management to Notify the Boards of MRAs**

Twenty-two months after we closed this recommendation, we issued a compliance review in September 2018 reporting on the testing of the Agency’s implementation of DER-OPB-03.1.<sup>3</sup> We determined that DER, “[i]nstead of implementing our recommendation ... preserved the status quo.”

We found that DER disregarded the clear requirements of its OPB. While it addressed supervisory correspondence with MRAs to the chair of the affected Board’s audit committee, it sent such correspondence only to Enterprise management and continued to rely on Enterprise management to transmit the correspondence to the audit committee chairs. DER acknowledged that its examiners neither requested nor obtained any confirmation that the audit committee chairs had ever received such supervisory correspondence. For that reason, we found that DER lacked any internal control to verify whether management had transmitted such correspondence.

Based upon these findings, we re-opened the March 2016 recommendation. We made clear that FHFA should “direct DER either to amend its guidance to implement the recommendation, or require that DER put into place an internal control to ensure that it receives contemporaneous, written certification from Enterprise management that each supervisory correspondence containing MRAs has been timely provided to the Audit Committee Chair of the affected Enterprise.” As generally understood, the word “contemporaneous” means things that happen, occur, or exist at the same time or within the same period of time.

In December 2018, DER advised us that it had determined to obtain contemporaneous notification from Enterprise management. It subsequently provided emails dated January 10, 2019 to management of each Enterprise directing them to provide DER with documentation that each audit committee chair received “contemporaneous, written notification” of MRAs.

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<sup>3</sup> OIG, *Compliance Review of FHFA’s Communication of Serious Deficiencies to the Enterprises’ Boards of Directors* (Sept. 5, 2018) (COM-2018-005). The compliance review also tested the Agency’s implementation of a recommendation that it identify all open MRAs in its annual, written reports of examination of the Enterprises, as well as the timetable for completion of outstanding remediation activities. We found that the Agency had successfully implemented that recommendation.

## FINDINGS .....

More than four and a half years after we issued our evaluation, we sought to determine, in a second compliance review, whether DER kept its commitment to ensure that Enterprise management contemporaneously notified each audit committee chair, in writing, of MRAs contained in supervisory correspondence. Regrettably, our testing found that DER failed to ensure that Enterprise management executed this straightforward requirement.

As we have previously explained, DER is the supervisor of the Enterprises and direct, clear communications with the Boards is fundamental to effective supervision. From the outset, DER elected not to directly notify the audit committee chairs when it issues MRAs. According to FHFA, DER did not notify the audit committee chairs because those individuals lacked secure email addresses. Assuming that DER insisted on using electronic means to share supervisory correspondence, emails could be sent with password-protected information, or encrypted, to ensure confidentiality. Alternatively, DER could use the secure portal used by Enterprise management to share highly sensitive information with its Board to send supervisory correspondence. We note that hard copies of confidential information are regularly sent by courier, express mail, and certified mail without incident. DER provided no explanation why it elected not to transmit supervisory correspondence by any of these means.

After we reopened our recommendation in September 2018, DER advised us that it directed Enterprise management, in January 2019, to provide “contemporaneous, written notification” of MRAs to the audit committee chairs. While we recognized that DER’s approach was less efficacious than the March 2016 recommendation to which FHFA agreed, we considered it to be acceptable, provided that it was implemented by the Enterprises.

### Compliance Testing Methodology

From January 1, 2019, through June 30, 2020 (review period), DER records show that DER issued 43 conclusion letters, containing a total of 75 MRAs (■■■ for Freddie Mac, ■■■ for Fannie Mae). For each of the 43 conclusion letters, we obtained and reviewed documentation reflecting whether Enterprise management provided “contemporaneous, written notification” of the MRA(s) in that letter to the audit committee chair.

### Freddie Mac

Freddie Mac management, in response to DER’s directive in January 2019, implemented an internal protocol requiring all supervisory correspondence from DER – including but not limited to those with MRAs – to be provided to Freddie Mac’s audit committee chair within

24 hours of receipt by management.<sup>4</sup> DER documentation shows that DER issued 22 separate pieces of supervisory correspondence to Freddie Mac during the review period. Each of these 22 pieces of supervisory correspondence contained at least one MRA, while others contained more than one; in total, DER issued ■ MRAs to Freddie Mac in these 22 pieces of supervisory correspondence.

Of the 22 pieces of supervisory correspondence, 19 (86%) were forwarded by Freddie Mac management to the audit committee chair within one day of receipt. Three pieces of supervisory correspondence (14%) were not forwarded contemporaneously: one was forwarded by management within two days of receipt; one was forwarded within three days; and one was forwarded 18 days later. With respect to this one piece of supervisory correspondence forwarded 18 days later, Freddie Mac management reported that it received the supervisory correspondence on December 23, 2019, and that transmission to the audit committee chair was delayed for 18 days due to the holidays.

### **Fannie Mae**

Unlike Freddie Mac, Fannie Mae did not adopt an internal protocol to transmit supervisory correspondence containing MRAs to the audit committee chair contemporaneously. During the review period, DER issued 21 pieces of supervisory correspondence to Fannie Mae. Each of these 21 pieces of supervisory correspondence contained at least one MRA, while others contained more than one; in total, DER issued ■ MRAs to Fannie Mae in these 21 pieces of supervisory correspondence.

Of the 21 pieces of supervisory correspondence, Fannie Mae management transmitted only two (10%) to the audit committee chair within one day of receipt. It transmitted two more (10%) within two days. Of the remaining 17, five (24%) were transmitted within five days after receipt; an additional seven (33%) were transmitted within 10 days; three more (14%) were transmitted within 11 to 14 days; and a further two (10%) were transmitted more than 15 days later.

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<sup>4</sup> In its technical comments on a draft of this compliance review, FHFA asserts that Freddie Mac’s internal protocol requires that supervisory correspondence be provided to the audit committee chair within 48 hours of receipt by Freddie Mac management, rather than within 24 hours. FHFA’s contention is inconsistent with the written guidance provided by Freddie Mac during this compliance review, which states that once DER issues a piece of supervisory correspondence to Freddie Mac management, the Board liaison must “[p]rovide a copy of the Letter to the Board (Chair of the Audit and Risk Committees), within 24 hours of receipt.” Should Freddie Mac, or FHFA, interpret this written guidance to provide a 48-hour window, any notification within 48 hours fails to meet FHFA’s requirement for “contemporaneous” notification.

When asked to explain its failure to notify its audit committee chair contemporaneously of all supervisory correspondence containing MRAs, Fannie Mae management provided the following written statement:

When we receive an MRA requiring transmittal, if we anticipate that additional MRA letters will be arriving soon, we will wait for the additional letters and bundle all together in one communication to concentrate attention on areas of focus.

When we transmit MRAs to the committee chairs, **we include a summary to provide context and background. A two day turnaround time would put this in a priority order above other notices and deliverables. Given the 60 day MRA response timeline, this is unreasonable short.** (Emphasis added)

Fannie Mae's explanation makes plain the risk of which we warned in our March 2016 evaluation: DER's reliance on Enterprise management to communicate MRAs to an Enterprise Board creates a significant risk that management will put its own spin on the deficiencies giving rise to the MRA or will filter the information it provides to the Board. That is exactly what has happened at Fannie Mae, as its management seeks to provide "context and background" to its audit committee chair on the deficiencies giving rise to the MRA. Over the past four years, FHFA has acquiesced to Fannie Mae management controlling the flow of information to its Board regarding MRAs issued by DER, notwithstanding FHFA's commitment to end this practice. Fannie Mae's explanation also shows a clear disregard for DER's express instruction to transmit written notice of MRAs "contemporaneously." This instruction does not contemplate management delaying transmission of FHFA's conclusion letters until management gets around to providing "context and background" for each MRA.

## Results

Notwithstanding FHFA's commitment in March 2016 to direct DER to notify the Boards' audit committee chairs of all MRAs, DER consistently, for the past four and one-half years, has failed to execute that responsibility. Until January 2019, DER relied on Enterprise management to transmit MRAs, without any follow-up to determine whether the MRAs were, in fact, timely transmitted. Beginning in January 2019, it instructed Enterprise management to transmit MRAs "contemporaneously" upon receipt of supervisory correspondence containing an MRA. Experience over the past four and one-half years has conclusively demonstrated that Enterprise management has not provided the Boards with the MRAs contemporaneously.

After four and one-half years, both Enterprises should be in full compliance with the instructions from their supervisor. Transmission is a ministerial act that can be accomplished

in minutes: for example, it requires pushing the “forward” button to transmit by email or scanning a hard copy of the correspondence into an electronic format and sending an email. Our compliance testing found one Enterprise met the directive’s requirement only 86% of the time and the other met it only 10% of the time. Management of that Enterprise objected to the “contemporaneous” requirement as “unreasonably short.” It insisted on more time so that it could provide “context and background”: in other words, to provide it with the opportunity to frame the MRA differently than its supervisor to its Board’s audit committee chair.

In its management response, FHFA asserts that “that the Audit Committee Chairs received all 43 conclusion letters, with over 85 percent sent within five business days and over 90 percent sent within ten business days of receipt from FHFA, which seems reasonable given the required timeframes for the Enterprises to provide remediation plans in response to MRAs.” FHFA is the supervisor of the Enterprises and, through DER, requires “contemporaneous” notification of MRAs to the audit committee chairs. “Reasonable” is not a synonym for the “contemporaneous” requirement.

Under FHFA’s supervisory guidance, an Enterprise Board is responsible for ensuring timely and effective correction of significant supervisory deficiencies. Actions or inactions by Enterprise management often give rise to MRAs. As we found in March 2016, DER’s supervisory practices – which leave to Enterprise management the communication of MRAs to an audit committee chair – significantly limit the ability of an Enterprise Board to execute its responsibilities.

FHFA’s characterization of Enterprise management’s timeliness as “reasonable” should be seen for what it is: capitulation to Enterprise management which made the same claim.<sup>5</sup> This is hardly the action of a “world class” regulator, which FHFA aspires to be.

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<sup>5</sup> FHFA maintains that the risks associated with entrusting Enterprise management to notify the audit committee chairs of new MRAs are mitigated by the following “[c]ompensating controls”:

First, DER receives email correspondence from the Enterprises after each conclusion letter has been distributed to the Audit Committee Chair. Furthermore, the Examiners-In-Charge meet with the Audit Committee Chairs on a quarterly basis, which provides further assurance that FHFA concerns are communicated directly to the boards without a management filter, and examiners review the Audit Committee materials that describe open MRAs.

DER’s notion that delayed notification of MRAs can be mitigated by “compensating controls” is undermined by these controls’ operation.

None of the controls invoked by FHFA remove the risk that Enterprise management will provide information concerning the most serious deficiencies through a management filter. The first control – “email correspondence from the Enterprises after each conclusion letter has been distributed to the Audit Committee Chair” – only notifies DER that distribution has occurred. It does not ensure that Enterprise management forwarded the MRA to the audit committee chair without its spin. This supposed control fails to address the risk we highlighted in our March 2016 report. The second control cited by FHFA – a quarterly meeting of the Examiners in Charge

## CONCLUSION.....

As the testing results from two compliance reviews have shown, DER’s delegation to Enterprise management of the task of communicating MRAs “contemporaneously” to the Boards’ audit committee chairs over a four and one-half year period has not worked. Neither Enterprise’s management has consistently provided “contemporaneous, written notification” to its audit committee chair of each MRA, remediation of which is overseen by the Boards. These repeated failures by Enterprise management do not augur well for effective corporate governance of the Enterprises once they are released from conservatorship.

Our March 2016 recommendation with which FHFA concurred, which was reopened in 2018, remains open. It recommends that FHFA “[r]evis[e] its supervision guidance to require DER to provide the Chair of the Audit Committee of an Enterprise Board with each conclusion letter setting forth an MRA.” This recommendation places the MRA notification burden squarely on DER, the supervisor that issued the MRA. The re-opened 2016 recommendation will not be closed as completed until FHFA demonstrates that DER has adopted and implemented the examination practice and that it shall contemporaneously notify the audit committee chair directly of each MRA issued, rather than rely upon Enterprise management to notify the audit committee chair of MRAs.

## FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this compliance review. DER provided technical comments that were incorporated into the final report as appropriate. FHFA also provided a management response, which is included in the Appendix to this report.

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and the audit committee chairs – is ineffective to ensure Enterprise management promptly forwards each MRA to the audit committee chairs. The third control is that DER’s examiners “review the Audit Committee materials that describe open MRAs.” Like the other controls, this control is wholly post-hoc, and does not compel Enterprise management to contemporaneously notify the audit committee chairs of new MRAs. Review by DER examiners of open MRAs in audit committee materials does not inform these examiners when Enterprise management provided notice of these MRAs, and whether such notice was timely.

We note that any discussion of DER’s compensating controls is only necessary because it has continued, for more than four years, to refuse to notify the audit committee chairs of new MRAs when it notifies Enterprise management.

## OBJECTIVE, SCOPE, AND METHODOLOGY .....

We initiated this compliance review in July 2020 to determine whether FHFA had successfully implemented the corrective action it had undertaken in response to OCom’s decision in COM-2018-005 to reopen a recommendation from a 2016 evaluation that the Agency “require DER to provide the Chair of the Audit Committee of an Enterprise Board with each conclusion letter setting forth an MRA.” Specifically, we sought to determine whether DER received written confirmations from the Enterprises that conclusion letters containing MRAs issued from January 1, 2019 through June 30, 2020, had been distributed to the Audit Committee Chairs.

To accomplish our objective, we obtained a list of all supervisory correspondence containing MRAs from DER to the Enterprises during the review period. For each such piece of supervisory correspondence, we then obtained documentation reflecting the Enterprise’s certification to the Agency that the correspondence had been transmitted to the Board.

We then determined, for each item of supervisory correspondence containing an MRA, how much time elapsed between the Enterprise’s receipt of the MRA and its transmittal of the MRA to the Board.

We conducted our compliance review from July 2020 through November 2020 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the Quality Standards for Inspection and Evaluation (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment. FHFA’s management response is addressed above.



## APPENDIX: FHFA MANAGEMENT RESPONSE.....



### Federal Housing Finance Agency

#### MEMORANDUM

TO: Brian W. Baker, Deputy Chief Counsel, Office of Inspector General (OIG)

FROM: Paul J. Miller, Deputy Director, Division of Enterprise Regulation (DER) *PJM*

SUBJECT: Draft OIG Report: *After Four and a Half Years, DER Still Fails to Ensure that Enterprise Boards are Notified of Serious Deficiencies in a Timely Manner*

DATE: January 13, 2021

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Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft report referenced above. The objective of the compliance review was to determine whether DER received written confirmations from the Enterprises that conclusion letters containing Matters Requiring Attention (MRAs) issued from January 1, 2019 through June 30, 2020 had been distributed to the Audit Committee Chairs.

The OIG's compliance review tested a 100 percent sample of the 43 conclusion letters containing MRAs that were transmitted from January 2019 to June 2020. The documentation demonstrates that the Audit Committee Chairs received all 43 conclusion letters, with over 85 percent sent within five business days and over 90 percent sent within ten business days of receipt from FHFA, which seems reasonable given the required timeframes for the Enterprises to provide remediation plans in response to MRAs.

Compensating controls are in place that help mitigate the potential risks. First, DER receives email correspondence from the Enterprises after each conclusion letter has been distributed to the Audit Committee Chair. Furthermore, the Examiners-In-Charge meet with the Audit Committee Chairs on a quarterly basis, which provides further assurance that FHFA concerns are communicated directly to the boards without a management filter, and examiners review the Audit Committee materials that describe open MRAs. DER believes that these compensating controls mitigate the potential risks raised in the OIG's compliance review regarding the practice of Enterprise management transmitting DER's conclusion letters to the Audit Committee Chairs. Therefore, DER plans to take no further action on the OIG's recommendation.

We would like to thank the OIG staff that worked with the Agency during this compliance review. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Chris Bosland  
Kate Fulton  
Scott Valentin  
Eric Wilson  
John Major

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