

Annual Report of the Council of Inspectors General on Financial Oversight



JULY 2014

Message from the Chair

Continuing its work to identify, review, and share information on financial oversight, the Council of Inspectors General on Financial Oversight (CIGFO) focused its efforts during the last year on government transparency. At a time when many financial regulators rely on the collection and use of large amounts of data for decision making purposes, it is a challenge for agencies to balance the need to protect critical data with the public's right to information about what the government is doing with that critical data.

With this challenge in mind, CIGFO established a working group to audit the Financial Stability Oversight Council's (FSOC) compliance with its transparency policy. While the audit concluded that the FSOC operated in a manner consistent with the expectations outlined in its policy, it also identified certain practices that FSOC could implement in the future to improve or increase its transparency. During the audit, FSOC incorporated many of these practices into a revised transparency policy adopted unanimously by FSOC in May 2014. FSOC also agreed with the audit recommendations to provide greater detail in the meeting minutes for closed meetings and identify datasets and information that could be made publicly available.

In addition to its audit work, CIGFO worked with experts outside of the inspector general community in an effort to gain more knowledge and insight into practices that might be useful in the detection or prevention of frauds against citizens as well as government waste and abuse. For example, early in 2014, Mr. Harry M. Markopolos, a fraud expert known for warning regulators that Bernie Madoff was running a Ponzi scheme, met with CIGFO members and their staff.

At the meeting Mr. Markopolos discussed the value of publicly available information as well as techniques used by the fraud detection industry that might be applicable to inspector general investigative efforts.

In June 2014, CIGFO met with former Federal Reserve Chairman Ben Bernanke. A former FSOC member, Dr. Bernanke discussed with CIGFO his views on the 2008 financial crisis and outlined the government's challenges in defining and monitoring financial system risk.

In the coming year, CIGFO will continue its efforts by, among other things, conducting an audit of FSOC's management of interest rate risk.



Eric M. Thorson
Chair, Council of Inspectors General on Financial Oversight
Inspector General, Department of Treasury

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The Council of Inspectors General on Financial Oversight

The Council of Inspectors General on Financial Oversight (CIGFO) was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and meets on a quarterly basis to facilitate the sharing of information among Inspectors General. The CIGFO members discuss the ongoing work of each Inspector General who is a member of the Council, with a focus on concerns that may apply to the broader financial sector and talk about ways to improve financial oversight. The CIGFO publishes an annual report that includes separate sections within the exclusive editorial control of each Inspector General. Those sections describe the concerns and recommendations of each Inspector General and a discussion of ongoing and completed work, with an emphasis on issues that may apply to the broader financial sector.

During the course of the year, CIGFO continued to monitor coordination efforts among and between Financial Stability Oversight Council members. Specifically, CIGFO members discussed the following:

- FSOC implementation of CIGFO audit recommendations
- FSOC activities related to Money Market Mutual Fund reform
- FSOC financial market utility and nonbank financial company designations
- FSOC supervisory proposals for designated nonbank financial companies and financial market utilities

The general belief of each Inspector General is that the FSOC's implementation of the Dodd-Frank Act continues to progress. The Inspectors General continue to believe that more should be done to institutionalize the FSOC processes and procedures in order to ensure the law is applied in a fair, transparent, and consistent manner.

Joint Inspector General Oversight Projects

In addition to conducting CIGFO working group audits, CIGFO members work together on joint projects, which are an effective means of leveraging various Office of Inspector General resources. During the past year, Inspectors General collaborated on reviews of the transfer of the former Office of Thrift Supervision (OTS) functions to other agencies. That work is discussed below.

Transfer of Office of Thrift Supervision Functions to Other Agencies

Title III of the Dodd-Frank Act established provisions for the transfer of authorities from OTS to the Office of Comptroller of the Currency, (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (Board) within 1 year after the July 21, 2010, enactment date. The Dodd-Frank Act required that, within 180 days after its enactment, the OTS, the OCC, the FDIC, and the Board jointly submit a plan—the Joint Implementation Plan—to Congress and the Inspectors General (IGs) of the U.S. Department of the Treasury, the FDIC, and the Board that detailed the steps each agency would take to implement the title III provisions. The Joint Implementation Plan was submitted to Congress and the IGs on January 25, 2011. The Dodd-Frank Act also required the IGs to determine whether the implementation plan conformed to the title III provisions. On March 28, 2011, the Inspectors General jointly issued a report concluding that the actions described in the Joint Implementation Plan generally conformed to the provisions of title III.

Section 327 of title III requires the Inspectors General to report on the status of the implementation of the Joint Implementation Plan every six months. The Inspectors General have issued six status reports to date, the latest and final having been issued on March 26, 2014. This report concluded that all title III requirements have been met and that procedures and safeguards were in place at FDIC and OCC as outlined in the Plan to ensure that transferred employees were not unfairly disadvantaged, a key requirement in title III.

Council of Inspectors General on Financial Oversight Audits

The Dodd-Frank Act authorizes the Council of Inspectors General on Financial Oversight to convene a working group, by a majority vote, for the purpose of evaluating the effectiveness and internal operations of the Financial Stability Oversight Council.

To date, CIGFO has conducted three audits—

- 2012- *Audit of the Financial Stability Oversight Council's Controls over Non-public Information*
- 2013- *Audit of the Financial Stability Oversight Council's Designation of Financial Market Utilities*
- 2014- *Audit of the Financial Stability Oversight Council's Compliance with Its Transparency Policy*

FSOC's corrective actions, taken and planned, met the intent of our recommendations.



Office of Inspector General

Board of Governors of the Federal Reserve System and Consumer Financial Protection Bureau

The Office of Inspector General provides independent oversight by conducting audits, investigations, and other reviews of the programs and operations of the Board of Governors of the Federal Reserve System and the Consumer Financial Protection Bureau and demonstrates leadership by making recommendations to improve economy, efficiency, and effectiveness, and preventing and detecting fraud, waste, and abuse.

I. Background

Congress established the Office of Inspector General (OIG) as an independent oversight authority for the Board of Governors of the Federal Reserve System (Board), the government agency component of the broader Federal Reserve System, and the Consumer Financial Protection Bureau (CFPB).

Under the authority of the Inspector General Act of 1978, as amended (IG Act), the OIG conducts independent and objective audits, inspections, evaluations, investigations, and other reviews related to the programs and operations of the Board and the CFPB. Through its work, the OIG promotes integrity, economy, efficiency, and effectiveness; helps prevent and detect fraud, waste, and abuse; and strengthens the agencies' accountability to Congress and the public.

Through its independent oversight, the OIG supports

- the Board in fostering the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems to promote optimal macroeconomic performance
- the CFPB in implementing and enforcing federal consumer financial law to ensure that consumers have access to fair, transparent, and competitive financial markets, products, and services

In addition to the duties set forth in the IG Act, Congress has mandated additional responsibilities for the OIG. Section 38(k) of the Federal Deposit Insurance Act (FDI Act) requires that the OIG review failed financial institutions supervised by the Board that result in a material loss to the Deposit Insurance Fund (DIF) and produce a report within six months. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended section 38(k) of the FDI Act by raising the materiality threshold and requiring the OIG to report on the results of any nonmaterial losses to the DIF that exhibit unusual circumstances warranting an in-depth review.

Section 211(f) of the Dodd-Frank Act also requires the OIG to review the Board's supervision of any covered

financial company that is placed into receivership under Title II of the Act and produce a report that evaluates the effectiveness of the Board's supervision, identifies any acts or omissions by the Board that contributed to or could have prevented the company's receivership status, and recommends appropriate administrative or legislation action.

II. OIG Reports and Other Products Related to the Broader Financial Sector

In accordance with section 989E(A)(2)(B) of the Dodd-Frank Act, the following highlights the completed and ongoing work of our office, with a focus on issues that may apply to the broader financial sector.

Completed Work

Board Should Strengthen Controls Over the Handling of the Federal Open Market Committee Meeting Minutes, OIG Report No. 2013-AE-B-012, August 27, 2013

We initiated this audit at the request of the Board's Chairman. An official in the Board's Congressional Liaison Office (CLO) e-mailed the Federal Open Market Committee (FOMC) meeting minutes to an e-mail distribution list (CLO contact list) on April 9, 2013, one day earlier than the scheduled release date. As a result, the Board issued the FOMC minutes at 9:00 a.m. on April 10, 2013, rather than the scheduled 2:00 p.m. release time. Our audit objectives were to evaluate the Board's processes for distributing the approved FOMC minutes to Board staff prior to their public release and the Board's management controls to prevent the early distribution of those minutes.

During the three-week period following an FOMC meeting, the meeting minutes are drafted, edited, and approved prior to public release. The FOMC minutes are finalized approximately 24 hours prior to publication and loaded into the Board's publication system. FOMC Secretariat staff notify Office of Board Members staff that the FOMC minutes are ready for publication. Subsequently, Office of Board Members staff prepare the minutes to be released to the public. The *Program for Security of FOMC Information* describes who is responsible for ensuring that FOMC information, including the FOMC minutes, is safeguarded and how it should be handled.

While CLO and the Board's Public Affairs Office staff are required to properly safeguard FOMC information in accordance with the *Program for Security of FOMC Information*, the Office of Board Members has not established formal written management controls to ensure that the Division Director's directives regarding the CLO contact list and publication of the FOMC minutes are implemented. We noted that the CLO did not have written policies and procedures related to the dissemination of information to the CLO contact list. In addition, neither the CLO nor the Public Affairs Office had written policies and procedures regarding the business processes that require access to the FOMC minutes.

Public Affairs Office and CLO staff also did not handle the FOMC minutes in accordance with the *Program for Security of FOMC Information*. Before being given access to confidential FOMC information, including the FOMC minutes, Board staff members agree to abide by *the Program for Security of FOMC Information*, which incorporates the Board's Information Classification and Handling Standard. Although the Board provides

required annual training that covers the *Information Classification and Handling Standard*, training on FOMC-specific information-handling requirements is not provided.

The *Program for Security of FOMC Information* requires that access to FOMC information be limited to those with a strict need to know. However, the access control list for the publication system included two Board staff members who may not have needed access to the system, and Division of Monetary Affairs staff did not limit access to the FOMC minutes to a subset of users on the publication system access control list with a need to know.

We made four recommendations designed to strengthen the Board's controls over the handling of the approved FOMC minutes prior to public release. Management concurred with the recommendations and has initiated steps to implement them. Management also stated that it has taken actions to improve compliance with the *Program for Security of FOMC Information*.

The CFPB Can Improve the Efficiency and Effectiveness of Its Supervisory Activities, OIG Report No. 2014-AE-C-005, March 27, 2014

We conducted this evaluation to assess the operational efficiency and effectiveness of the CFPB's supervision program. The CFPB's supervision activities include prioritizing, scheduling, planning, and executing examinations and reporting findings in the form of reports of examination or supervisory letters. Our objectives for this evaluation included (1) reviewing key program elements, such as policies and procedures, examination guidance, and controls to promote consistent and timely reporting; (2) assessing the approach for staffing examinations; and (3) assessing the training program for examination staff.

Since it began operations in July 2011, the CFPB has made significant progress toward developing and implementing a comprehensive supervision program for depository and nondepository institutions. The agency has implemented this program on a nationwide basis across its four regional offices. While we recognize the considerable efforts associated with the initial development and implementation of the program, we believe that the CFPB can improve the efficiency and effectiveness of its supervisory activities. Specifically, we found that the CFPB needs to (1) improve its reporting timeliness and reduce the number of examination reports that have not been issued, (2) adhere to its unequivocal standards concerning the use of standard compliance rating definitions in its examination reports, and (3) update its policies and procedures to reflect current practices.

We completed our fieldwork in October 2013, using data as of July 31, 2013. Following the completion of our fieldwork, senior CFPB officials indicated that management had taken various measures to address certain findings in our report, including streamlining the report review process and reducing the number of examination reports that had not been issued. As part of our future follow-up activities, we will assess whether these actions, as well as the planned actions described in management's response, address our findings and recommendations.

We made 12 recommendations designed to assist the CFPB in strengthening its supervision program. We recommended that the CFPB create and update relevant policies and procedures; track and monitor examination processes for staffing examinations and producing examination products; and finalize its

examiner commissioning program. Management concurred with our recommendations and outlined actions that have been taken or will be implemented to address our recommendations.

The CFPB Should Reassess Its Approach to Integrating Enforcement Attorneys Into Examinations and Enhance Associated Safeguards, OIG Report No. 2013-AE-C-021, December 16, 2013

We conducted an evaluation of the CFPB's integration of enforcement attorneys into its examinations of depository and nondepository institutions' compliance with applicable laws and regulations. Our objectives were to assess (1) the potential risks associated with the CFPB's approach to integrating enforcement attorneys into examinations and (2) the effectiveness of any safeguards that the CFPB adopted to mitigate the potential risks associated with this examination approach.

We found that the CFPB should determine the appropriate level of enforcement attorney integration into examinations by reassessing the potential risks associated with the practice against the potential benefits and document the results of the assessment. Our evaluation results indicated that the CFPB's February 2012 policy describing the general principles of the integrated approach did not sufficiently detail how the approach should be implemented and was not uniformly distributed to CFPB supervision and enforcement staff. As a result, CFPB supervision and enforcement staff's awareness, understanding, and execution of the policy, as well as their messaging to supervised institutions concerning the role of enforcement attorneys, varied considerably.

During our evaluation, we also learned that enforcement attorneys did not receive formal training on the CFPB's examination process and that the CFPB lacked a policy on enforcement attorneys' access to institutions' systems during examinations. In addition, we learned that the CFPB reorganized its supervision function in December 2012 and established points of contact within the Office of Supervision Policy to address legal questions that arise during examinations, in part to ensure more consistent interpretations of applicable laws or regulations. As of the end of our fieldwork, August 2013, the CFPB had not updated its February 2012 policy describing the integrated approach to reflect changes to the process for resolving legal questions.

When we commenced our evaluation, the CFPB informed us that it had initiated an internal review to evaluate its approach to integrating enforcement attorneys into examinations. During our evaluation, we routinely met with CFPB senior officials and shared our preliminary observations concerning the integrated approach, including its potential risks. In October 2013, when our draft report was nearing completion, CFPB senior officials informed us that the agency had finalized its internal review and had reconsidered its approach regarding integrating enforcement attorneys into examinations. According to CFPB senior officials, new policies and procedures reflecting the revised approach became effective in November 2013, which was outside the scope of our evaluation. Thus, our report reflects our assessment of the CFPB's February 2012 policy related to the integrated approach.

We made seven recommendations. The CFPB indicated that it had taken actions or has planned activities to address our recommendations.

Ongoing Work

Review of the Federal Reserve's Supervisory Activities Related to the Loss at JPMorgan Chase & Co's Chief Investment Office

We continued fieldwork for our evaluation of the Federal Reserve's supervisory activities related to the multibillion-dollar loss at JPMorgan Chase's Chief Investment Office. Our objectives for this evaluation are to (1) assess the effectiveness of the Board's and the Federal Reserve Bank of New York's consolidated and other supervisory activities regarding JPMorgan Chase's Chief Investment Office and (2) identify lessons learned for enhancing future supervisory activities.

In-Depth Review of the Failure of Waccamaw Bank

On June 8, 2012, the North Carolina Office of the Commissioner of Banks closed Waccamaw Bank and appointed the FDIC as receiver. According to the FDIC's press release, as of March 31, 2012, Waccamaw Bank had approximately \$533.1 million in total assets and \$472.7 million in total deposits. On June 8, 2012, the FDIC estimated that the cost to the DIF from Waccamaw Bank's closure will be \$51.1 million, which did not meet the materiality threshold as defined under section 38(k) of the FDI Act.

Based on the results of its failed bank review, the OIG determined that the failure of Waccamaw Bank was due to circumstances that have been covered in past OIG reports. However, the failed bank review also identified three unusual circumstances that warranted an in-depth review of Waccamaw Bank: (1) Waccamaw Bank appears to have misinformed regulators about key aspects of an asset swap transaction that significantly changed its risk profile and financial condition; (2) Waccamaw Bank initiated a series of appeals related to the examiners' recommended regulatory capital treatment of a transaction, which ultimately reached the highest level of appellate review by a Board Governor; and (3) there were unique circumstances surrounding the retirement of Waccamaw Bank's former President and Chief Executive Officer. As a result, we initiated an in-depth review that focuses on these three unusual circumstances.

Evaluation of the Board's Oversight of Mortgage Servicing Enforcement Actions and Settlement Agreements

We are conducting an evaluation of the Board's oversight of a settlement with mortgage servicers for alleged deficient mortgage foreclosure practices. In January 2013, the Board and the OCC announced a settlement with mortgage servicers to compensate borrowers who were potentially harmed. The settlement covers borrowers who had a mortgage on their primary residence that was in any stage of foreclosure in 2009 or 2010 and that was serviced by one of the participating servicers. The settlement required mortgage servicers to slot the borrowers into various categories based on possible harm. The Board and the OCC assigned payment amounts to each category. The amounts range from \$300 to \$125,000. A paying agent was hired by the servicers to mail checks, totaling about \$3.6 billion, to approximately 4.2 million borrowers. Our objectives are to (1) evaluate the Board's overall approach to oversight of the settlement, (2) determine the effectiveness of the Board's oversight of the slotting process, and (3) determine the effectiveness of the Board's oversight of the payment process executed by the paying agent.

Audit of the Division of Reserve Bank Operations and Payment Systems' Oversight of Reserve Banks' Wholesale Financial Services

We initiated an audit of the Division of Reserve Bank Operations and Payment Systems' (RBOPS) oversight of Reserve Banks' wholesale financial services. Our objective is to assess the extent and effectiveness of RBOPS's oversight of those services. Specifically, we will review how RBOPS assesses wholesale services against the standards defined in the Federal Reserve Policy on Payment System Risk to determine whether the payment and settlement systems incorporate (1) an appropriate risk-management framework and (2) the internationally accepted guidelines in their policies and procedures.



Office of Inspector General Commodity Futures Trading Commission

The CFTC OIG acts as an independent Office within the CFTC that conducts audits, investigations, reviews, inspections, and other activities designed to identify fraud, waste, and abuse in connection with CFTC programs and operations, and makes recommendations and referrals as appropriate.

Background

The CFTC OIG was created in 1989 in accordance with the 1988 amendments to the Inspector General Act of 1978 (P.L. 95-452). OIG was established as an independent unit to:

- Promote economy, efficiency and effectiveness in the administration of CFTC programs and operations and detect and prevent fraud, waste and abuse in such programs and operations;
- Conduct and supervise audits and, where necessary, investigations relating to the administration of CFTC programs and operations;
- Review existing and proposed legislation, regulations and exchange rules and make recommendations concerning their impact on the economy and efficiency of CFTC programs and operations or the prevention and detection of fraud and abuse;
- Recommend policies for, and conduct, supervise, or coordinate other activities carried out or financed by such establishment for the purpose of promoting economy and efficiency in the administration of, or preventing and detecting fraud and abuse in, its programs and operations; and
- Keep the Commission and Congress fully informed about any problems or deficiencies in the administration of CFTC programs and operations and provide recommendations for correction of these problems or deficiencies.

CFTC OIG operates independently of the Agency and has not experienced any interference from the CFTC Chairman or Commissioners in connection with the conduct of any investigation, inspection, evaluation, review, or audit, and our investigations have been pursued regardless of the rank or party affiliation of the target. The CFTC OIG consists of the Inspector General, the Acting Assistant Inspector General for Auditing, a Senior Auditor, two attorneys, and one support staff. The CFTC OIG obtains additional audit and administrative assistance through contracts.

Role in Financial Oversight

The CFTC OIG has no direct statutory duties related to oversight of the futures, swaps and derivatives markets; rather, the CFTC OIG acts as an independent Office within the CFTC that conducts audits, investigations, reviews, inspections, and other activities designed to identify fraud, waste, and abuse in connection with CFTC programs and operations, and makes recommendations and referrals as appropriate. The CFTC's yearly financial statement and Customer Protection Fund audits are conducted by an independent public accounting firm, with OIG oversight.

Recent, Current or Ongoing Work in Financial Oversight

In addition to our work on CIGFO projects described elsewhere in this report, CFTC OIG worked on the following projects during the past year:

- Review of the Commodity Futures Trading Commission's Response to Allegations Pertaining to the Office of the Chief Economist

The Commodity Futures Trading Commission has supported an economic research program almost continuously since its creation in 1976. The CFTC's Office of Chief Economist has produced over 100 independent economic research papers on topics relating to the functioning of the futures markets. Each paper has been published as the work of the author, with CFTC employment or affiliation listed as a biographical detail and with a disclaimer stating that the research represents the views of the authors and does not state the views of the Commission. CFTC economists are expected "to present and review papers at professional meetings and conferences and to contribute to the literature in the field," and this expectation is stated in their position descriptions.

In December 2012, the CFTC received a complaint suggesting that confidential trade information protected under section 8(a)(1) of the Commodity Exchange Act, 12 U.S.C. § 12(a)(1), had been misused by CFTC economists working in the Office of Chief Economist, and questioning the Agency's authority to permit confidential trade information to be used for economic research. In January 2013, then Chairman Gensler asked OIG to review these issues, as well as controls on the use of confidential trade information, and onboarding documentation for economists in OCE. The CFTC OIG issued its final report on February 21, 2014.

CFTC OIG determined that the use of confidential trade information for economic research purposes was authorized under section 18 of the Commodity Exchange Act, 7 U.S.C. §22(a), which requires the Agency to "establish and maintain" a "research and information program" that disseminates "educational and other informational materials" to market users and the public. CFTC OIG further determined that, while onboarding documentation for various economists serving at CFTC as employees, consultants, and contractors did contain errors, the errors were administrative and, looking to Comptroller General opinions addressing payment issues arising from onboarding errors, found in dicta uniform indication that work performed while an employee lacked proper onboarding due to administrative error can and usually should be ratified. The OIG noted that administrative onboarding was considered only within OCE, with onboarding status for employees in other divisions not addressed by Agency management.

CFTC OIG did not find sufficient evidence to permit any conclusion that confidential trade information had been used or disclosed in violation of the Commodity Exchange Act. While witness statements uncovered no instances where information was misused; CFTC OIG ultimately concluded that the absence of controls on use and removal of confidential trade information rendered it impossible to determine conclusively that information was not misused. CFTC OIG found that the same lack of information security controls over the use of confidential trade information may be found Agency-wide. (During this reporting period, CFTC OIG also completed an audit which addressed information security controls and made recommendations.)

CFTC OIG criticized a new review process for OCE economic research publications instituted by the Agency. Management's desire to detect instances where aggregated confidential trade data may be combined with publicly available data and reverse-engineered to permit the reader to ascertain the identity of a trader, or of the revelation of a trade secret – is warranted. However, CFTC OIG found that the length of time the review process was taking was unacceptable. Taking more than eight months to review economic research papers, including papers that contained no aggregated confidential trade data at all, raised potential legal issues as well as more important issues going to efficiency and effectiveness of the CFTC economic research program. Economic research may be instrumental in detecting systemic risk and other government-wide and market-wide issues of concern. Delaying the publication of research thwarts the goals of public education and notification of important economic research issues. Our report recommended restarting the economic research program, improving Agency-wide controls over the use and disclosure of confidential trade information, and shortening the time for any review process for economic research papers (while assuring the legality of any research process). We included a management response with our paper. The Commission did not issue a response to the final report and management response.

The final report and the management response may be found here: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/cftc_046841.pdf.

- Compliance Audit of Futures Commission Merchants and Retail Foreign Exchange Dealers Compliance with CFTC Reporting Requirements

Futures commission merchants (FCMs) and retail foreign exchange dealers (RFEDs) must comply with financial reporting requirements as mandated by the Commodity Exchange Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act. Specifically, FCMs and RFEDs must file monthly financial reports with the CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) within 17 business days after the end of each month. Selected financial information from these reports is published on CFTC's website.

DSIO is responsible for developing and monitoring controls and procedures for evaluating FCM and RFED financial statements. During the reporting period, CFTC OIG began a compliance audit to review the CFTC DSIO examination staff's stated methodology for evaluating FCM and RFED financial statements for adherence to CFTC regulatory requirements. Work on this audit was ongoing as of July 10, 2014.



Office of Inspector General Federal Deposit Insurance Corporation

The Office of Inspector General (OIG) promotes the economy, efficiency, and effectiveness of FDIC programs and operations, and protects against fraud, waste, and abuse. In doing so, the OIG assists and augments the FDIC's contribution to stability and public confidence in the nation's financial system.

Background

The Federal Deposit Insurance Corporation (FDIC) was created by the Congress in 1933 as an independent agency to maintain stability and public confidence in the nation's banking system by insuring deposits and independently regulating state-chartered, non-member banks. Federal deposit insurance protects depositors from losses due to failures of insured commercial banks and thrifts. According to most recent data, the FDIC insured approximately \$6.0 trillion in deposits at about 6,800 banks and savings associations, and promoted the safety and soundness of these institutions by identifying, monitoring, and addressing risks to which they are exposed. The FDIC was the primary federal regulator for about 4,300 of the insured institutions. An equally important role for the FDIC, especially in light of the financial crisis, is as receiver for failed institutions—that is, upon closure of an institution by its chartering authority—the state for state-chartered institutions, and the Office of the Comptroller of the Currency (OCC) for national banks and federal savings associations—the FDIC is responsible for resolving the institution and managing and disposing of its remaining assets.

The FDIC OIG is an independent and objective unit established under the Inspector General (IG) Act of 1978, as amended. The FDIC OIG mission is to promote the economy, efficiency, and effectiveness of FDIC programs and operations, and protect against fraud, waste, and abuse. In doing so, we can assist and augment the FDIC's contribution to stability and public confidence in the nation's financial system. We have continued to undertake a comprehensive body of work during the past year to carry out that mission.

Unprecedented events and turmoil in the economy and financial services industry during the financial crisis affected every facet of the FDIC and its operations, posing challenges both to the Corporation and our office. Changes in economic conditions more recently have stabilized the financial services sector and, along with the July 2010 passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), have served to lessen our failed bank-related workload and allow us a bit more discretion in planning and conducting our work. While a portion of our work continues to focus on activities in connection with the crisis, we have also taken steps to examine the post-crisis environment at the FDIC and related risks. We are focusing our efforts on current corporate priorities and ongoing core mission activities as the FDIC looks to the future.

During the past year, we completed a review of the FDIC's progress in implementing systemic resolution authorities under the Dodd-Frank Act. We also conducted work to determine whether the FDIC's controls for safeguarding sensitive information in resolution plans submitted under section 165(d) of the Dodd-Frank Act are consistent with applicable information security requirements, policies, and guidelines. With respect to failed bank work, we conduct material loss reviews in cases where losses to the Deposit Insurance Fund (DIF) meet the threshold outlined in the Dodd-Frank Act, and we perform failed bank reviews of all failures of FDIC-supervised institutions, as required by the Act. From June 1, 2013 through June 1, 2014, we completed 12 failed bank reviews.

We continued ongoing coordination with our financial IG counterparts on issues of mutual interest. Of special note, we collaborated in the conduct of a review of enforcement actions and professional liability claims taken by the regulators against institution-affiliated parties or individuals. We also issued two reports on the status of the transfer of Office of Thrift Supervision (OTS) functions, concluding our work in that area, as required by the Dodd-Frank Act. Also in connection with the Dodd-Frank Act, as a member of CIGFO, the FDIC OIG participated in the joint project related to FSOC's compliance with its transparency policy. As this annual report was going to press, we were also coordinating with OIG colleagues to review coordination efforts among the Consumer Financial Protection Bureau and prudential regulators.

In addition to audit and evaluation work, we sustained strong investigative efforts to combat financial institution fraud at both open and closed institutions. Further discussion of selective FDIC OIG audit, evaluation, and investigative efforts follows.

The FDIC's Progress in Implementing Systemic Resolution Authorities Under the Dodd-Frank Act

Among other things, the Dodd-Frank Act gave the FDIC broad new authorities to mitigate the risk of systemically important financial institutions (SIFIs) to the financial stability of the United States and, if necessary, to effect an orderly liquidation. The ability to mitigate risk and resolve SIFIs is critical to fulfilling the FDIC's primary mission of upholding public confidence in the nation's financial system. For that reason, the FDIC Chairman requested that the FDIC OIG review the Corporation's progress in implementing its systemic resolution authorities under the Dodd-Frank Act. We issued the results of our review in November 2013. The objective of our work was to determine the progress made by the FDIC in implementing the Dodd-Frank Act authorities associated with monitoring SIFIs, and resolving one, should that be necessary.

Title I of the Dodd-Frank Act provides tools for regulators to impose enhanced supervision and prudential standards on SIFIs. Title II of the Dodd-Frank Act includes a new orderly liquidation authority that can be invoked when the liquidation of a financial company under the Bankruptcy Code or other applicable law would have serious adverse effects on financial stability in the United States. In August 2010, the FDIC's Board of Directors (FDIC Board) established the Office of Complex Financial Institutions (OCFI) to serve as the focal point for implementing the Corporation's systemic resolution authorities.

The FDIC Board intended for OCFI to coordinate with other FDIC divisions and offices for critical expertise and support in certain functional areas to implement the Corporation's systemic resolution authorities.

We reported that the FDIC had made significant progress over the past 3 years towards implementing its systemic resolution authorities under the Dodd-Frank Act. Among other things, the FDIC had:

- issued a joint regulation and met established timeframes for completing reviews of resolution plans submitted by covered financial companies,
- entered into agreements with certain foreign regulatory authorities to promote cross-border cooperation, and
- developed a single-point-of-entry resolution strategy that could be implemented if the exercise of Title II liquidation authority becomes necessary.

While these accomplishments were notable, we pointed out that more work needed to be done to establish a robust corporate-wide capability for this critical responsibility. In this regard, we made six recommendations to the FDIC Chairman that were intended to better position the FDIC to face future challenges and successfully carry out its systemic resolution authorities under the Dodd-Frank Act. In general, the recommendations were aimed at enhancing the FDIC's long-term strategic planning efforts, strengthening coordination among FDIC divisions, and building out OCFI's infrastructure to support systemic resolution activities.

In responding to our report, the FDIC Chairman concurred with all six of the report's recommendations. We will continue to monitor the FDIC's progress in fully implementing these actions and will re-evaluate the Corporation's readiness, as warranted.

The FDIC's Controls for Safeguarding Sensitive Information in Resolution Plans Submitted Under the Dodd-Frank Act

Another Dodd-Frank Act-related assignment that we recently issued addressed potential security control enhancements to mitigate the risk of unauthorized disclosure of sensitive information pertaining to systemically important financial institutions.

Section 165(d) of the Dodd-Frank Act and the FDIC's Final Rule, entitled Resolution Plans Required, dated November 1, 2011, require large, systemically important financial companies to submit resolution plans, sometimes referred to as "living wills," to the FDIC and to the Board of Governors of the Federal Reserve System (FRB). The intent of this requirement is for a large financial company to describe how it could be resolved under the U.S. Bankruptcy Code without serious adverse effects on U.S. financial stability. The resolution plans required by section 165(d) and the Final Rule contain sensitive information.

The Final Rule established a staggered schedule for submitting resolution plans based on the amount of total nonbank assets that financial companies own. The first group of filers consisted of 11 companies with \$250 billion or more in non-bank assets. Nine of these companies submitted initial resolution plans by July 1, 2012, and the remaining two companies submitted initial plans by October 1, 2012.

The FDIC and FRB jointly review the resolution plans to determine whether they would facilitate an orderly resolution of the company under the U.S. Bankruptcy Code. Within the FDIC, OCFI has primary responsibility for reviewing the resolution plans submitted by the first group of financial company filers. The results of

the FDIC's reviews, including findings and analyses, are contained in electronic and hard-copy documents referred to as Review Materials. The FDIC has determined that Review Materials constitute sensitive information.

We conducted an audit to determine whether the FDIC's controls for safeguarding sensitive information in resolution plans submitted under section 165(d) are consistent with applicable information security requirements, policies, and guidelines. Our audit focused on the controls that the FDIC had in place to safeguard resolution plans submitted by the first group of financial company filers, as described above.

We conducted our work in two phases. During the first phase, we assessed the FDIC's controls over sensitive resolution plan information and briefed FDIC management in February 2013 on our preliminary observations. During the second phase, we determined the status of actions that had been taken to address our preliminary observations as of February 2014.

Initially, we found that the FDIC's controls for safeguarding sensitive information in resolution plans submitted under section 165(d) of the Dodd-Frank Act were not fully consistent with applicable information security requirements, policies, and guidelines. Among other things, we found that the security level of sensitive resolution plan information had not been formally categorized in accordance with federal standards, key OCFI security policies and procedures needed to be updated and finalized, access controls needed to be strengthened, and the role and level of resources allocated to OCFI's internal review and information security functions needed to be assessed.

Throughout 2013, and prior to the close of our audit in February 2014, the FDIC was taking actions to address our preliminary observations and strengthen security controls. Of particular note, the FDIC:

- formally categorized sensitive resolution plan information, including Review Materials, consistent with federal standards;
- assigned an Information Security Manager from another FDIC division to help establish and implement security controls over sensitive information maintained by OCFI;
- updated and formally approved key OCFI security policies and procedures;
- strengthened controls over the management of hard-copy resolution plans and Review Materials;
- began requiring security guards to use individual access codes when entering secured workspaces where resolution plans and Review Materials are stored to promote accountability; and
- developed a formal internal review manual and plan that address information security.

Our final report noted that the actions taken by the FDIC since the start of our audit significantly improved security over sensitive resolution plan information. We did, however, make seven recommendations related to access management, encryption and authentication, internal control reviews, and personnel suitability.

In their responses, the Director, OCFI, and the Acting Chief Information Officer concurred with all recommendations and described ongoing and planned actions to address our findings.

Ongoing Work to Address Cyber Attack Risks

As for additional FDIC OIG work, cyber attacks against financial institutions have become increasingly widespread, and these attacks are often sophisticated, complex, and harmful. Despite controls and practices implemented by financial institutions, the methods for disrupting operations, stealing personal data, and committing fraud continue to evolve. We have a review underway to assess the FDIC's efforts for ensuring that financial institutions and technology service providers are prepared to prevent, detect, respond to, and recover from cyber attacks; providing sufficient and qualified resources to examine and monitor information technology risk management practices of financial institutions and technology service providers; and promoting information sharing about computer security/cybersecurity incidents to appropriate authorities.

FDIC OIG Investigations Target Financial Institution Fraud

FDIC OIG investigative work at both open and closed banks over the past year continued to complement our audit and evaluation work. Our criminal investigations provide additional insights into the control weaknesses that allowed perpetrators of fraud to commit illegal acts. We are particularly concerned when individuals inside the bank—officers, directors, and others—conspire to circumvent controls and commit crimes that harm their banks and cause losses to the DIF, thus undermining the integrity of the banking system as a whole.

Our office is committed to partnerships with other OIGs, the Department of Justice, the Federal Bureau of Investigation, and other state and local law enforcement agencies in pursuing criminal acts in open and closed banks and helping to deter fraud, waste, and abuse. The OIG also actively participates on numerous mortgage fraud and other financial fraud working groups nationwide to keep current with new threats and fraudulent schemes that can undermine the integrity of the FDIC's operations and the financial services industry as a whole. These include the Bank Fraud Working Group, Mortgage Fraud Working Group, and Financial Fraud Enforcement Task Force, all spearheaded by the Department of Justice. The OIG is also a member of the National Cyber Investigative Joint Task Force, the focal point for all government agencies to coordinate, integrate, and share information related to all domestic cyber-threat investigations.

Our caseload as of early June 2014 included 249 active investigations. Of these, 135 relate to open bank matters and 100 to closed bank matters. These cases involve fraud and other misconduct on the part of senior bank officials, and include mortgage and commercial loan fraud exposed by turmoil in the housing, commercial real estate, and lending industries. The perpetrators of such crimes can be those very individuals entrusted with governance responsibilities at the institutions—directors and bank officers. In other cases, parties providing professional services to the banks and customers, others working inside the bank, and customers themselves are principals in fraudulent schemes. Other investigations include cases involving misrepresentations of FDIC insurance or affiliation, concealment of assets, and computer crimes. We are coordinating closely with the FDIC to ensure the continued safety and soundness, and integrity of the nation's banks and to preserve public confidence in the banking system.

A priority initiative for our office during the past year involved enhanced coordination with the FDIC Legal Division, Division of Risk Management Supervision, and Division of Resolutions and Receiverships on matters related to enforcement actions. Specifically, we established an on-going program to share information

to ensure that the OIG's investigative results are available to FDIC management in its consideration of civil and administrative enforcement activities, and that information developed by the FDIC is effectively communicated to OIG criminal investigators, when warranted.

FDIC OIG investigative results over the past year include the following: 109 indictments; 57 arrests; 89 convictions; potential monetary recoveries (fines, restitution, and asset forfeitures) of more than \$560 million; and 54 referrals to the Department of Justice.



Office of Inspector General Federal Housing Finance Agency

The Federal Housing Finance Agency Office of Inspector General (FHFA-OIG) conducts, supervises, and coordinates audits, evaluations, investigations, and other activities relating to the programs and operations of the Federal Housing Finance Agency (FHFA or the Agency), which regulates and supervises the housing-related government-sponsored enterprises (GSEs): the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBanks). Since September 2008, FHFA has also served as conservator for Fannie Mae and Freddie Mac (collectively, the Enterprises).

Over the past year, FHFA-OIG has recorded significant accomplishments relating to financial oversight, many of which are discussed below. These and other accomplishments are discussed further in FHFA-OIG's Sixth and Seventh Semiannual Reports to the Congress, which are available at www.fhfaig.gov.

SELECTED EXAMPLES OF FHFA-OIG'S RECENT FINANCIAL OVERSIGHT WORK

Reports

Report No. AUD-2013-010: FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies (September 24, 2013)

In October 2012, FHFA-OIG issued a report that found FHFA had an opportunity to provide the Enterprises guidance about pursuing and collecting deficiencies from borrowers who may be able to repay. In this follow-up audit, FHFA-OIG found first that Freddie Mac did not refer nearly 58,000 foreclosures with estimated deficiencies of \$4.6 billion to its deficiency collection vendors to evaluate the borrowers' ability to repay. Second, delays in the vendors' evaluation process limited Freddie Mac's opportunity to pursue deficiencies related to more than 6,000 foreclosed mortgages for which state statutes of limitations had expired. Third, Fannie Mae's vendors generally did not pursue deficiencies on foreclosure sales when, in their view, applicable statutes of limitation for filing deficiency claims against borrowers provided insufficient time to obtain the information necessary to evaluate if deficiency balances existed. In general, FHFA-OIG recommended that FHFA use its authority to help Freddie Mac improve its deficiency recovery strategies, deficiency counterparty monitoring, controls to ensure timely document delivery, and prioritization of deficiency recovery with respect to statutes of limitation. FHFA provided comments agreeing with FHFA-OIG's recommendations.

Report No. AUD-2014-003: Fannie Mae's Controls Over Short Sale Eligibility Determinations Should be

Strengthened (November 20, 2013)

For borrowers determined eligible (e.g., under financial hardship) by its servicers, short sales are part of Fannie Mae's loss mitigation strategy to pursue foreclosure alternatives to help minimize the severity of losses it incurs because of loan defaults. In this report, based on a review of 41 short sale transactions involving multiple Fannie Mae servicers, FHFA-OIG found that Fannie Mae's servicers did not always collect all of the required documents before determining eligibility or forwarding the information to Fannie Mae. In addition, servicers did not always conduct adequate reviews supporting borrower eligibility. Further, FHFA-OIG found that borrowers with potentially significant financial resources sold multiple non-owner-occupied properties through one of Fannie Mae's programs. FHFA-OIG recommended that FHFA direct Fannie Mae to strengthen controls over its short sale eligibility processes, including: enforce servicer submission of all required documentation; ensure sufficient servicer eligibility reviews; consider quality in compensating servicers for their eligibility reviews; and improve controls over borrower data collected and considered in the eligibility decision. Additionally, FHFA-OIG recommended FHFA consider whether one of Fannie Mae's short sale programs should be available for non-owner-occupied properties, along with increasing its examination coverage of short sales. FHFA provided comments agreeing with FHFA-OIG's recommendations.

Report No. AUD-2014-004: FHFA Oversight of Fannie Mae's Remediation Plan to Refund Contributions to Borrowers for the Short Sale of Properties (January 15, 2014)

Based on FHFA-OIG's prior work identifying potentially improper collections of borrower contributions as part of short sale transactions, Fannie Mae developed a remediation plan to return the contributions as appropriate—mainly to borrowers in California (\$3.1 million) and under a foreclosure alternative program (\$53,000). Fannie Mae stated that the decision to pursue refunds rests with each servicer that reviews the identified cases where improper borrower contributions may have been collected. If the servicer validates that a contribution was not collected or if the servicer has a reasonable basis to support the contribution, Fannie Mae may not require a borrower refund. As a result, FHFA-OIG concluded that the current remediation plan may not provide for consistent treatment of borrowers. FHFA is currently reviewing Fannie Mae's remediation plan to ensure that borrowers are protected and made whole, and the Agency will determine if similar conditions exist at Freddie Mac. FHFA-OIG recommended that the Agency review that contributions are refunded according to a good faith effort and in a consistent manner for borrowers. In addition, FHFA-OIG recommended that FHFA issue guidance for Fannie Mae to execute the remediation plan, if necessary, and that the Agency review Freddie Mac's controls over borrower contributions in California and issue guidance, if appropriate. FHFA stated it agreed with FHFA-OIG's three recommendations, but FHFA-OIG considers one unresolved.

Report No. AUD-2014-008: FHFA's Oversight of the Enterprises' Use of Appraisal Data Before They Buy Single-Family Mortgages (February 6, 2014)

Before loans are presented for the relevant Enterprise to buy, appraisal and appraiser information is collected through a uniform collateral data portal system. If the portal finds signs that the appraisals violate the Enterprises' requirements, it alerts them and the lenders to the problem(s). In this

report, FHFA-OIG concluded that increased FHFA oversight can enhance the Enterprises' use of the portal's data before they buy single-family mortgages and can reduce collateral risk. Specifically, the Enterprises spent \$19.7 billion buying over 85,000 loans despite warnings the portal generated concerning underwriting violations and property valuations. In addition, the Enterprises bought nearly \$88 billion in loans although system logic errors in the portal did not allow them to determine if the appraiser was properly licensed. Based on FHFA-OIG's work and the Enterprises' responsive actions, 23 loans valued at \$3.4 million may be repurchased based on the "suspended" status of the appraiser. In general, FHFA-OIG's recommendations were geared to help FHFA improve oversight of how the Enterprises use the portal. FHFA-OIG also recommended that the Enterprises require lenders to resolve key portal warning messages before buying the associated loans. FHFA provided comments agreeing with FHFA-OIG's recommendations.

Report No. AUD-2014-009: FHFA Oversight of Enterprise Handling of Aged Repurchase Demands (February 12, 2014)

FHFA directed the Enterprises to develop consistent practices for assessing and collecting fees, penalties, and remedies for institutions that did not timely repurchase mortgage loans that were found to be deficient. However, the Agency essentially let each Enterprise establish its own model. As a result, Fannie Mae did not pursue repurchase late fees while Freddie Mac did. Fannie Mae's reluctance derived from its analysis that the program could cost up to \$5.4 million, but FHFA-OIG concluded it did not consider program benefits, such as a continuous stream of penalty fees. As an indication of the program's potential, Freddie Mac could have assessed as much as \$284 million from 2009 through 2012 using its existing right to assess late fees; however, the Enterprise also did not maximize its collection potential by inconsistently waiving, enforcing, and excepting late fees through 2012. Finally, FHFA is not including any uncollected repurchase late fees in settlement negotiations with seller-servicers over defective loans that were sold to or serviced for the Enterprises. Increased Agency oversight can result in additional future recoveries as repurchases are settled. Overall, FHFA-OIG recommended that FHFA should quantify the cost/benefit of a late fee program at Fannie Mae and proceed as the analysis directs, and that Freddie Mac should report its late fee collection to the Agency. FHFA-OIG also recommended that FHFA consider late fees assessed but uncollected by Freddie Mac in its settlement negotiations. FHFA provided comments agreeing with FHFA-OIG's recommendations.

Report No. AUD-2014-012: FHFA's Oversight of Enterprise Controls over Pre-Foreclosure Property Inspections (March 25, 2014)

Fannie Mae's servicers use pre-foreclosure property inspections when borrowers become delinquent to help minimize Fannie Mae's losses and identify safety hazards. In this report, FHFA-OIG found that there is limited assurance that the Enterprises have effective controls in place to ensure the quality of inspections conducted and that inspectors issue reports consistent with contractual requirements. Specifically, FHFA-OIG identified inspection reports with inconsistent and inaccurate information; missing or blurry photographs; and manipulated date and time stamps on the photographs. FHFA-OIG also identified unnecessary inspections that did not provide useful information about the properties. Further, the servicers reviewed by FHFA-OIG inconsistently adopted requirements for inspectors to complete and pass criminal background checks. These deficiencies occurred, in part, because

of minimal attention and oversight by both FHFA and the Enterprises along with limited quality standards.

FHFA-OIG recommended that FHFA direct the Enterprises to assess jointly their inspection processes, and that the Agency then direct the Enterprises to establish uniform inspection standards and quality control processes for inspectors. FHFA identified corrective actions that address FHFA-OIG's recommendations.

Report No. EVL-2013-04: FHFA's Oversight of the Federal Home Loan Banks' Affordable Housing Programs (April 30, 2013)

Since 1990, the FHLBanks' Affordable Housing Program (AHP) has provided over \$4 billion to subsidize low-income housing. FHFA-OIG's evaluation found that FHFA conducts annual examinations and collects data regarding each FHLBank's AHP, but generally relies on the FHLBanks, their member institutions, and various private and public entities to monitor projects. As their regulator, FHFA is well positioned to provide cross-cutting feedback and analyses to the FHLBanks to improve oversight of their programs, but it typically has not published such data. Unbiased analyses from FHFA could better inform the FHLBanks' AHP policy and administrative decisions. The Agency noted staffing and resource constraints in monitoring site visits and conducting analyses. Accordingly, FHFA-OIG recommended that FHFA: (1) develop a policy for FHLBank site visits of AHP projects that includes guidance on their frequency, scope, and administration; (2) conduct and report cross-cutting analyses of common issues across the FHLBanks; and (3) analyze staffing levels needed to implement these recommendations, and meet those targets. FHFA agreed with the recommendations and noted specific steps it will undertake to address them.

Report No. EVL-2013-006: Home Affordable Refinance Program (HARP): A Mid-Program Assessment (August 1, 2013)

FHFA-OIG conducted this program evaluation to assess FHFA's administration and oversight of HARP, a refinance program designed to help borrowers who are current on their Freddie Mac or Fannie Mae owned or guaranteed loans but have not been able to refinance because they have little or no equity in their homes. When HARP was announced in 2009, Treasury estimated that it would help 4 to 5 million borrowers, but, as of September 2011, fewer than 1 million of those borrowers had refinanced. FHFA directed the Fannie Mae and Freddie Mac to modify the program; this resulted in HARP 2.0, which has led to a substantial increase in refinances. As of March 2013, 2.4 million HARP refinances had been completed. It is difficult, however, to project how many HARP-eligible loans will ultimately be refinanced. Several unknown variables, including interest rates, lender participation, and borrowers' willingness to refinance, make any estimate uncertain. Additionally, challenges to the program's success remain, including educating borrowers and encouraging their participation. Accordingly, FHFA is planning to implement a nationwide public education campaign.

Report No. EVL-2013-008: FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit (August 6, 2013)

In June 2012, FHFA-OIG reported that some FHLBanks followed risky credit practices through their loan-making in the financially troubled Eurozone, and that some FHLBanks violated FHFA's limits

on extending unsecured credit. In this followup evaluation, FHFA-OIG assessed FHFA's progress in implementing the resulting recommendations to determine the extent of the violations and to consider revising its regulations to mitigate associated risks. FHFA-OIG found that FHFA conducted a proactive and thorough review that identified over 900 unsecured credit violations at 7 FHLBanks and risk management deficiencies at the other 5. FHFA-OIG also found that FHFA's responses to the violations at the seven FHLBanks were consistent with its policy. The Agency issued matters requiring attention, among other actions, requiring the banks to remediate deficiencies within specified time periods. FHFA-OIG recommended that FHFA assess the FHLBanks' compliance with its unsecured credit supervisory requirements in its 2013 and 2014 examinations, and take appropriate enforcement actions. FHFA agreed with these recommendations.

Report No. EVL-2013-009: FHFA's Oversight of Fannie Mae's 2013 Settlement with Bank of America (August 22, 2013)

In January 2013, FHFA approved an \$11.6 billion settlement with Bank of America that resolved issues involving repurchase claims and servicing penalties. In addition, FHFA allowed the transfer of servicing rights on about 1.1 million mortgages from Bank of America to other servicers.

FHFA reviewed the repurchase claim settlement under a new policy governing the review of such settlements. Since the policy only applied to a portion of the settlement, FHFA-OIG evaluated FHFA's oversight in the context of matters outside the policy. FHFA-OIG found that FHFA adhered to its new policy when reviewing the settlement of the repurchase claims. However, the resolution of claims related to servicing penalties and the transfer of mortgage servicing rights did not benefit from an established review process. FHFA-OIG recommended that FHFA establish a formal review process for claims related to servicing deficiencies and significant mortgage servicing rights transfers. FHFA agreed with this recommendation and committed to establish guidelines by January 31, 2014.

Report No. EVL-2013-012: Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses (September 18, 2013)

Fannie Mae relies on servicers to make payments on behalf of delinquent borrowers, and uses a contractor to administer much of the servicer reimbursement function, including manually processing claims. FHFA-OIG's evaluation concluded that Fannie Mae's oversight of its contractor focuses on measuring contractual performance rather than minimizing overpayments. Neither FHFA nor Fannie Mae aggregates the amount of overpayments to servicers that result from its contractor's processing errors. FHFA-OIG estimates that, in 2012, the Enterprise's contractor incorrectly approved 3.1% of servicer reimbursements for \$89 million in overpayments. FHFA-OIG recommended that FHFA: (1) ensure Fannie reduce processing errors, including utilizing its process accuracy data in a more effective manner and implementing a red flag system; (2) require Fannie Mae to quantify and aggregate its overpayments to servicers regularly and implement a plan to reduce these overpayments; and (3) publish Fannie Mae's reduction targets and overpayment findings. FHFA agreed with the first and second recommendations.

Report No. EVL-2014-003: FHFA's Oversight of the Servicing Alignment Initiative (February 12, 2014)

As the Enterprises' conservator, FHFA established the Servicing Alignment Initiative (SAI) in April 2011 to improve servicers' performance and limit the Enterprises' financial losses.

FHFA-OIG's evaluation focused on FHFA's monitoring of the Enterprise servicers' compliance with SAI. FHFA-OIG found that the responsible FHFA unit—the Division of Housing Mission and Goals (DHMG)—neither reviewed nor evaluated the servicers' overall compliance with SAI's numerous requirements, and it has not reviewed Enterprise reports of servicer compliance. On FHFA-OIG analysis, these reports identified servicer compliance deficiencies in key SAI areas, such as responding to borrower requests for assistance and executing loan modifications. Accordingly, FHFA-OIG recommended that FHFA: (1) continually evaluate servicers' SAI compliance and the effectiveness of the Enterprises' remediation efforts; (2) direct the Enterprises to provide their internal reports and reviews for DHMG's assessment; and (3) regularly review SAI-related guidelines for enhancements or revisions based on servicers' performance. FHFA partially agreed with all recommendations, but FHFA-OIG concluded from the Agency's response that it did not plan to substantively alter its limited oversight and FHFA-OIG remains concerned as to the Agency's practices in this regard.

Report No. EVL-2014-004: Update on FHFA's Oversight of the Enterprises' Non-Executive Compensation Practices (February 25, 2014)

In December 2012, FHFA-OIG evaluated FHFA's oversight of the Enterprises' compensation of their nearly 2,100 highest paid employees. FHFA-OIG observed that FHFA had increased its control and oversight of the Enterprises' executive compensation practices in 2012, but its oversight of non-executive pay practices was comparatively limited. In the subsequent report, FHFA-OIG found that in accordance with the 2012 recommendation to strengthen oversight of senior professionals' compensation, FHFA conducted examinations in 2013 of the Enterprises' compliance with the Agency's directive to freeze employee pay during 2011 and 2012. FHFA found deficiencies in the Enterprises' compliance with the directive and with their controls over senior professional compensation. In response to these deficiencies, the Agency issued binding directives to the Enterprises.

The Agency also now reviews quarterly reports prepared by the Enterprises in which the salaries paid to new hires and recently promoted employees are compared to the median pay offered to similar private-sector positions. FHFA-OIG observed that this procedure is a step in the right direction in that it provides FHFA with some ability to assess Enterprise senior professional compensation practices going forward.

Investigations

Defendant Sentenced to 14 Years in Colorado Adverse Possession Scheme, Denver, Colorado

On January 16, 2014, Alfonso Carrillo was found guilty of racketeering, conspiracy to commit theft, criminal trespass, burglary, forgery, and attempts to influence public servants. These charges stemmed from Carrillo's and other unindicted co-conspirators' illegal use of adverse possession of distressed homes, foreclosed homes, and real estate owned (i.e., properties owned by the Enterprises or REO) in order to rent or sell the homes to unwitting victims. Many of these properties were owned by or had

mortgages secured by the Enterprises. The total harm to the victims including the Enterprises was approximately \$150,000. On February 28 Carrillo was sentenced to 14 years imprisonment. This was a joint investigation with the Denver District Attorney's Office.

Fraud at Failed FHLBank Member Bank, San Diego, California

On October 8, 2013, Annand Sliuman pled guilty to bank bribery charges in the U.S. District Court for the Southern District of California. A few weeks later, on October 22, 2013, Laura Ortuondo was indicted by a grand jury in the same district for alleging false statement. From late 2007 to early 2008, Sliuman loaned \$10,000 to a La Jolla Bank manager in an endeavor to corruptly increase a loan from La Jolla Bank to Sliuman's company by \$100,000. Sliuman then gave the same manager an additional \$15,000, and forgave the previous \$10,000 loan, to try to increase a second loan from La Jolla Bank to a Sliuman company by approximately \$600,000. During 2008, Ortuondo worked as Sliuman's assistant and allegedly helped prepare fraudulent tax lien releases to help Sliuman obtain the La Jolla Bank loans. Ortuondo then allegedly lied to investigators about preparing the lien releases and the destruction of a laptop that contained incriminating information. La Jolla Bank was a member of the FHLBank of San Francisco until February 2010, when it failed and was taken over by the Federal Deposit Insurance Corporation. At the time of failure, La Jolla Bank had outstanding debt of over \$1 billion, including approximately \$700 million in outstanding advances from the FHLBank of San Francisco. This was a joint investigation with the FBI, IRS-Criminal Investigation (IRS-CI), Small Business Administration OIG, and Treasury Inspector General for Tax Administration.

Fannie Mae REO Realtor Defrauds Enterprises, Detroit, Michigan

On October 1, 2013, in a court of the State of Michigan, Samer Salami pled nolo contendere (i.e., no contest) to one count each of conducting a criminal enterprise, embezzlement, and computer crimes and two counts of false pretenses. On January 29, 2014, Salami was ordered to pay \$1 million in restitution, and on February 19, 2014, he was sentenced to 1 year in the Wayne County Jail and 5 years of probation. From 2006 to 2010, Salami, an REO broker for the Enterprises, misrepresented the value of foreclosed properties he sold for the Enterprises. He sold them to companies his family and friends owned or controlled before flipping them to legitimate purchasers and keeping the illicit profit. He also collected an extra round of real estate commissions in this scheme. In addition, Salami falsely billed the Enterprises for maintenance services not rendered and collected kickbacks from real estate brokers for steering properties to them. Enterprise losses in this scheme were \$989,400. This was a joint investigation with the FBI and the Wayne County Prosecutor's Office.

Seven Indicted in Condo Conversion Scheme, Miami, Florida

On March 13, 2014, Luis Mendez, Luis Michael Mendez, Stavroula Mendez, Lazaro Mendez, Marie Mendez, Enrique Angulo and Wilkie Perez were indicted in U.S. District Court for the Southern District of Florida with bank and wire fraud, and conspiracy to commit bank and wire fraud. Between mid-2006 and December 2010, Luis Mendez, and co-conspirators owned or controlled various real estate properties in the Miami area. They allegedly enlisted mortgage brokers and other individuals, including Perez and Angulo, to recruit straw buyers to act as qualifying mortgage applicants to fraudulently purchase condominiums at various properties. The defendants prepared and caused to be prepared

loan documents containing false statements and representations relating to the buyers' income, assets and other information necessary to enable lenders to assess the buyers' qualifications to borrow money, which induced the lenders to make loans to finance the condominiums. Luis Michael Mendez and Marie Mendez are alleged to have submitted their own fraudulent loan applications for two condominiums, and they, as well as Luis Mendez and Stavroula Mendez, advanced the buyers cash to close the transactions. After the loans were funded, the defendants allegedly caused fraudulent payments to be made from the loan proceeds to pay kickbacks through shell companies to the brokers, recruiters and straw buyers, as well as to pay the mortgages to conceal the conspiracy. Eventually, the conspirators were unable to make mortgage payments, causing many of the condominium units to go into foreclosure and leading to losses by the lenders. In total, the scheme caused losses of over \$20 million including loss exposure to Fannie Mae at approximately \$5.2 million, and loss exposure to Freddie Mac at approximately \$5.6 million. This is a joint investigation with the Department of Housing and Urban Development (HUD) OIG.

Defendant Sentenced to Over 16 Years in \$39 Million Florida Builder Bailout Fraud, Ft. Lauderdale, Florida

On October 16, 2013, in the U.S. District Court for the Southern District of Florida, Quelyory Rigal was sentenced to 16 years and 8 months of incarceration and 3 years of supervised release.

Rigal and others participated in condo conversion schemes in the Florida cities of Ft. Lauderdale, Orlando, and Tampa. Of the 165 transactions involved in their schemes, 131 have been foreclosed and another 26 are in foreclosure. The targeted lenders have lost \$34 million of the \$39 million loaned. Freddie Mac's loss exposure is \$8.5 million.

Defendant Sentenced to 14 Years in Colorado Adverse Possession Scheme, Denver, Colorado

On January 16, 2014, Alfonso Carrillo was found guilty of racketeering, conspiracy to commit theft, criminal trespass, burglary, forgery, and attempts to influence public servants. These charges stemmed from Carrillo's and other unindicted co-conspirators' illegal use of adverse possession of distressed homes, foreclosed homes, and REO in order to rent or sell the homes to unwitting victims. Many of these properties were owned by or had mortgages secured by the Enterprises. The total harm to the victims including the Enterprises was approximately \$150,000. On February 28 Carrillo was sentenced to 14 years imprisonment. This was a joint investigation with the Denver District Attorney's Office.

Defendants Plead Guilty in \$5 Million Loan Origination Fraud Scheme, Newark, New Jersey

On February 4, 2014, Carmine Fusco pled guilty to one count of conspiracy to commit wire fraud. On February 19, 2014, Kenneth Sweetman pled guilty to one count of conspiracy to commit wire fraud. Both pleas occurred in the U.S. District Court for the District of New Jersey. From March 2011 to July 2012, Fusco and other defendants conspired to submit false mortgage loan applications to mortgage lenders. They produced and submitted false gift letters, false appraisal reports, and false closing documents to the lenders to support the applications. They also formed limited liability companies to conceal the identities of defendants, as well as the receipt and distribution of fraudulently obtained mortgage loan proceeds. Fusco and other defendants were involved in fraudulent short sale closings and fraudulent appraisals. Fannie Mae purchased or secured over 100 loans from mortgage lenders that were associated with this

scheme. The scheme involved at least 16 properties and defrauded financial institutions of approximately \$5 million. This was a joint investigation with the FBI, HUD-OIG, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), IRS-CI, the U.S. Postal Inspection Service, and the Hudson County Prosecutor's Office. This was a joint investigation with the FBI and IRS.

\$100 Million Nationwide Loan Origination Fraud, San Diego, California

On December 2, 2013, Audrey Yeboah was sentenced to 3 years of probation, 15 months of home confinement, and was ordered to pay a \$2,500 fine. On December 9, 2013, Justin Mensen was sentenced to 5 years of probation and ordered to pay \$532,687 in restitution. On January 3, 2014, Teresa Rose was sentenced to 15 months of incarceration, 36 months of probation, and ordered to pay \$532,687 in restitution. The pleas occurred in the U.S. District Court for the Southern District of California. Rose (a realtor), Yeboah, and Mensen (a loan broker) participated in a nationwide loan origination fraud and kickback scheme, defrauding lenders through the sale of \$100 million of real estate at inflated prices. Purchasers of the fraudulently originated loans, including the Enterprises, suffered losses of up to \$20 million. This was a joint investigation with the FBI.

Realtor Sentenced to 10 Years in \$7 Million Loan Origination Fraud, Sacramento, California

On October 21, 2013, James Lee Lankford pled guilty to seven counts of mail fraud. On January 27, 2014, Lankford was sentenced to 10 years and 1 month in prison, 36 months of supervised release, and ordered to pay \$986,826 in restitution. Also on January 27, 2014, Jon McDade was sentenced to 5 years of supervised release and ordered to pay \$1,443,826 in restitution after his conviction for bank fraud. All proceedings took place in the U.S. District Court for the Eastern District of California. In his plea, Lankford admitted that, while working as a realtor and broker, he fraudulently induced elderly property owners to sell their homes to him and provide seller-backed financing. Unbeknownst to the elderly sellers, Lankford would also obtain mortgages from lending institutions by making material misstatements on the loan applications. Lankford caused an estimated loss to lending institutions of more than \$7 million. In his plea, McDade admitted to knowingly submitting a loan application containing materially false and fraudulent information including inflated income. As a result of the false statements, a loan was funded for \$880,000. One property in this case was sold to Fannie Mae, which lost approximately \$185,000 on the transaction. This was a joint investigation with the FBI and the Stanislaus County District Attorney's Office.

Nine Charged in Short Sale Fraud, Denver, Colorado

On November 7, 2013, Wendy Thomas, Christina Nicole Smith, Kurt Smith, Sheila Gaston, Sheila Giberti, Duane Thomas, Christopher Consol, Janice Gardner, and Joseph Slowey were indicted by a grand jury sitting in the state of Colorado for the Denver District Court, on charges of theft, forgery, and violations of the Colorado Organized Crime Control Act. From 2008 to 2013, Wendy Thomas, operator of Home Support Solutions, and her co-conspirators are alleged to have devised a scheme to acquire control of distressed properties and negotiate with the respective mortgage servicers using fraudulent documents to acquire the properties at less than full market value. The defendants then allegedly flipped the properties for profit through the use of straw buyers. Some properties were held in the Enterprises' portfolios while others were insured by the Federal Housing Administration. Overall, 18 properties flipped by the defendants were held in the Enterprises' portfolios. The alleged fraud resulted in over \$500,000 in

losses on the properties including over \$100,000 in theft of commissions for the fraudulent short sales. This was a joint investigation with the Colorado State Attorney General's Office, the Colorado Bureau of Investigation, and HUD-OIG.

Mortgage Company Owner Sentenced for Diverting Over \$18 Million Owed to Enterprises, Ft. Lauderdale, Florida

On October 17, 2013, in the U.S. District Court for the Southern District of Florida, Patrick Mansell was sentenced to five years of imprisonment to be followed by three years of supervised release. Starting in April 2007, Mansell used his position as vice president, secretary, and director of Coastal States Mortgage Corporation to defraud the Enterprises. Through February 2012, Coastal States withheld mortgage loan payoffs owed to the Enterprises for extended periods. Coastal States used these funds for their own business purposes and to make monthly mortgage payments on paid-off loans, misrepresenting them as performing loans. Payoffs fraudulently retained by Coastal States were also used to remit funds owed to the Enterprises for previously withheld payoffs. Daily and monthly servicing reports were supplied to the Enterprises containing false information and altered loan identifying numbers, which enabled the scheme to go undetected. The Enterprises lost more than \$18 million as a result. The Florida Office of Financial Regulation provided assistance to FHFA-OIG during the initial stages of the investigation.

Defendant Sentenced in \$1.3 Million Mortgage Rescue Scheme, Los Angeles, California

On November 5, 2013, Stephen Benjamin (also known as Steven Benjamin) was sentenced in the U.S. District Court for the Central District of California to 3 years of probation and 40 hours of community service. On February 24, 2014 Jeremy Lloyd was sentenced in U.S. District Court for the Central District of California to 6 months home confinement, 5 years probation, 100 hours of community service, and a \$4,000 fine. From July 2011 through August 2012, Benjamin, Lloyd, and others, conspired to commit bankruptcy fraud and operated businesses that falsely purported to provide assistance to homeowners seeking to delay or avoid foreclosure and/or eviction proceedings. They would advise homeowners that, for a fee, they could assist the clients in delaying such proceedings. After receiving fees from clients, Benjamin and others would cause false documents to be prepared in order to make it appear as if a tenant resided at the property owned by the client/homeowner. Benjamin would also cause false bankruptcy petitions to be prepared, signed, and filed in the names of the fictitious tenants with the bankruptcy court. In total, Benjamin, and others, collected over \$1.3 million in upfront fees and targeted approximately 250 homeowners, including homeowners whose mortgages were owned by Fannie Mae. This is a joint investigation with the FBI and the U.S. Attorney's Office for the Central District of California.

\$13 Billion Settlement for the Residential Mortgage Backed Securities Working Group

During the reporting period, FHFA-OIG continued to actively participate in the Residential Mortgage-Backed Securities (RMBS) Working Group, which was established by the President in 2012 to investigate those responsible for misconduct contributing to the financial crisis through the pooling and sale of RMBS. The Working Group is a collaborative effort of dozens of federal and state law enforcement agencies. FHFA-OIG's participation has included acting as a source of information about the secondary finance market, providing strategic litigation advice, supporting witness interviews, and obtaining and reviewing documents and other evidence. To date, FHFA-OIG has played a significant role in investigations undertaken by members of the Working Group. On November 1, 2013, JPMorgan Chase

agreed to pay a total of \$13 billion in order to settle charges of fraud in the RMBS markets brought by the U.S. Attorneys for the Eastern District of California and the Eastern District of Pennsylvania, the Civil Division of DOJ, FHFA, the New York Attorney General, and others.

FHFA-OIG'S PLANNED FINANCIAL OVERSIGHT WORK AND RELATED ACTIVITIES

Audit and Evaluation Plan

FHFA-OIG has developed an Audit and Evaluation Plan that focuses on the areas of greatest risk to FHFA and the GSEs. The plan responds to current events and feedback from FHFA officials, members of Congress, and others. The plan is available for inspection at FHFA-OIG's website, www.fhfaoig.gov.

Investigations Strategy

FHFA-OIG investigators have participated in numerous criminal, civil, and administrative investigations, which during the reporting period resulted in the indictment of 81 individuals, 58 convictions, and restitution of over \$44 million. During this work, FHFA-OIG has developed and intends to further develop close working relationships with other law enforcement agencies, including DOJ and the U.S. Attorneys' Offices; state attorneys general; mortgage fraud working groups; the Secret Service; the FBI; HUD-OIG; SIGTARP; the Financial Crimes Enforcement Network (FinCEN); and other federal, state, and local agencies. Further, FHFA-OIG investigative counsels have been appointed as Special Assistant U.S. Attorneys and supported prosecutions.

Civil Fraud Initiative

In June 2013, with support by FHFA-OIG's offices of investigations and counsel, FHFA-OIG's office of audits launched its Civil Fraud Initiative through which it conducts civil fraud reviews to identify fraud and make referrals for civil actions and administrative sanctions against entities and individuals who commit fraud against FHFA, Fannie Mae, Freddie Mac, or the FHLBanks. Currently, FHFA-OIG's Office of Audits is working with various assistant U.S. Attorneys on reviews of lenders' loan origination practices to determine their compliance with Enterprise requirements. Lenders are considered for review through the use of data-mining techniques and requests from government agencies.

Hotline

FHFA-OIG's Hotline (1-800-793-7724) allows concerned parties to confidentially report information regarding possible fraud, waste, or abuse related to FHFA or the GSEs. FHFA-OIG honors all applicable whistleblower protections. FHFA-OIG promotes the Hotline through its website, posters, emails targeted to FHFA and GSE employees, and its Semiannual Reports to the Congress.

Regulatory Review

Consistent with the Inspector General Act, FHFA-OIG considers whether proposed legislation and regulations related to FHFA are efficient, economical, legal, and susceptible to fraud and abuse. FHFA-OIG

makes recommendations to FHFA as necessary and monitors its compliance with recommended courses of action.

Coordinating with Other Oversight Organizations

FHFA-OIG actively participates in the Financial Fraud Enforcement Task Force (“FFETF”), a broad coalition of state and federal law enforcement agencies, prosecutors, and other entities. FHFA-OIG is a member of several FFETF task forces and working groups, including: (1) the Mortgage Fraud Working Group; (2) the Securities and Commodities Fraud Working Group; (3) the Residential Mortgage Backed Securities Working Group; and (4) the Recovery Act,

Procurement, and Grant Fraud Working Group.

FHFA-OIG continues to participate in the Federal Housing Inspectors General working group, which includes the Offices of Inspector General for federal agencies with responsibility for housing, including FHFA, HUD, the Department of Veterans Affairs, and the Department of Agriculture. The Federal Housing Inspectors General have collaborated on multiple joint initiatives.

FHFA-OIG actively participates in the Council of the Inspectors General on Integrity and Efficiency (“CIGIE”), including representation on CIGIE’s Inspection and Evaluation Committee, which supports and promotes evaluation and inspection practice in the OIG community. FHFA-OIG also co-chairs CIGIE’s Suspension and Debarment Working Group, which is charged with improving the effectiveness of federal suspension and debarment practices.

FHFA-OIG has also partnered with FinCEN, SIGTARP, HUD-OIG, the FBI, and the Secret Service to share data, analyze internal complaints, and identify trends. Doing so allows the partnering entities to leverage their combined investigative resources towards identifying, investigating, and prosecuting those involved in fraud and other illegal activities related to their respective statutory authorities.



Office of Inspector General

U.S. Department of Housing and Urban Development

The HUD Office of Inspector General (OIG) strives to make a difference in HUD's performance and accountability and has a strong commitment to its statutory mission of detecting and preventing fraud, waste, and abuse and promoting the effectiveness and efficiency of government operations.

Background

The U.S. Department of Housing and Urban Development (HUD) Inspector General is one of the original 12 Inspectors General authorized under the Inspector General Act of 1978. The HUD Office of Inspector General (OIG) strives to make a difference in HUD's performance and accountability. HUD OIG has a strong commitment to its statutory mission of detecting and preventing fraud, waste, and abuse and promoting the effectiveness and efficiency of government operations.

While organizationally located within HUD, HUD OIG operates independently with separate budget authority. Its independence allows for clear and objective reporting to HUD's Secretary and Congress. HUD's primary mission is to improve housing and expand opportunities for families seeking to improve their quality of life. HUD does this through a variety of housing and community development programs aimed at helping Americans nationwide obtain affordable housing. These programs are funded through a \$45 billion annual congressional budget.

Also, within HUD are the Federal Housing Administration (FHA) and Government National Mortgage Association (Ginnie Mae). FHA provides mortgage insurance for single-family and multifamily properties, nursing homes, and hospitals. FHA receives limited congressional funding because it is self-funded through mortgage insurance premiums. FHA's single-family insured portfolio, as of December 31, 2013, was \$1.1 trillion.

Ginnie Mae guarantees the timely payment of principal and interest on mortgage-backed securities (MBS) to institutional investors worldwide. The underlying mortgages in these securities, or "pools" of mortgage loans, are used as collateral for the issuance of securities. MBS are commonly referred to as "pass-through" certificates because the principal and interest of the underlying loans are passed through to investors. Ginnie Mae guarantees only securities backed by mortgage loans insured by government agencies, including FHA, the U.S. Department of Veterans Affairs (VA), HUD's Office of Public and Indian Housing, and the U.S. Department of Agriculture's Rural Development.

There are many programs at HUD that are used in a significant way to help stimulate the economy (for example, billions of dollars in new funding for Community Development Block Grants, increased public housing assistance, etc.). Although these programs are also vulnerable to fraudulent and abusive activities, our focus has remained on the FHA program due to the mortgage crisis and an increased reliance on HUD to resolve foreclosure matters at this critical juncture.

While receding from a market share of 27.1 percent at the height of the mortgage crisis, fiscal year 2013's 17.1 percent market share is still greater than its historic norms and has stressed operational capabilities. To put FHA's operational concerns into perspective, we have stated in past testimony to Congress that OIG continues to have concerns regarding the ability of FHA's systems and infrastructure to adequately meet its requirements and perform its services. These concerns were expressed by OIG to FHA before the program's influx of loans and before considering the many proposals that expanded its reach. OIG remains concerned regarding FHA's ability and capacity to oversee the increased volume of loans in recent years. Some of these are longstanding concerns that go back to unresolved issues highlighted in our work products from as far back as the early to mid-1990s.

Due to the continuing impact of the housing market conditions on FHA's business activities, the FHA Mutual Mortgage Insurance (MMI) fund has not met the statutory 2 percent capital ratio requirement for the last 5 years. In addition, for the first time, FHA called on the U.S. Department of the Treasury to cover a shortfall in the capital reserve account of \$1.686 billion.

In fiscal year 2013, the MMI fund's net worth increased \$15 billion, growing from -\$16.3 billion to -\$1.3 billion. The capital ratio improved to -0.11 percent from last year's -1.44 percent. As a result, HUD expects to have sufficient reserves for fiscal year 2014 to not require an appropriation.

OIG continues to be concerned that increases in demand on the FHA program will have collateral implications for the integrity of the Ginnie Mae MBS program, including the potential for increases in fraud in that program. Ginnie Mae securities are the only MBS to carry the full faith and credit guaranty of the United States. If an issuer fails to make the required pass-through payment of principal and interest to MBS investors, Ginnie Mae is required to assume responsibility for it. Typically, Ginnie Mae defaults the issuers and assumes control of the issuers' MBS pools. Like FHA, Ginnie Mae has seen an increase in its market share. From a different vantage point, the industry has noted that Ginnie Mae's struggle to keep pace with FHA could also reduce liquidity in the housing market at a critical moment.

Although housing prices have begun to recover, we continue to see a significant problem facing FHA and the lenders because of the fallout from decreased home values. This condition increases the risk of default, abandonment, and foreclosure and makes it difficult for FHA to resell the properties. A major cause for concern is that even as FHA's endorsement levels meet or exceed previous peaks in its program history, FHA defaults have already exceeded those of previous years. This issue reinforces the importance for FHA-approved lenders to maintain solid underwriting standards and quality control processes to withstand severe adverse economic conditions.

Over the years, HUD OIG has continued to report on FHA-approved lenders' underwriting and quality control processes that did not meet HUD requirements. These violations contributed to loan defaults and

large losses incurred by the FHA loan insurance fund. HUD OIG joined forces with the U.S. Department of Justice's Civil Division, HUD's Office of General Counsel, and U.S. Attorneys Offices around the country to facilitate possible litigation under the False Claims Act or other statutes against FHA-approved lenders. Our reviews focus on FHA's largest mortgage lenders, their compliance with FHA's underwriting requirements, and their quality control processes. HUD OIG continues in this effort.

FHA is beginning to benefit from these joint efforts. In January 2014, JPMorgan Chase Bank, N.A., and JPMorgan Chase & Co. (Chase) took responsibility for failing to follow certain HUD rules under the FHA loan insurance program. Chase agreed to pay the Federal Government \$614 million to settle allegations that it did not follow applicable requirements when insuring government loans under the FHA and VA residential mortgage programs. Of the \$614 million settlement, about \$565 million was related to FHA business.

Chase participates in HUD's direct endorsement lender program. The program authorizes private-sector mortgage lenders to approve mortgage loans for insurance and refinancing by FHA. As a participant in the program, approved lenders must comply with the requirements of the program. Those requirements include submitting loan-level certifications that each insured loan was underwritten according to FHA requirements and implementing quality control measures to ensure compliance with the program rules.

The Federal Government's review of Chase's FHA lending practices showed that Chase had failed to follow FHA rules and caused significant losses to the FHA insurance fund. Under the False Claims Act and common law, the Government filed suit against Chase, alleging that from January 2002 through January 2014, Chase failed to follow FHA underwriting requirements. The Government further alleged that Chase had falsely certified to HUD that it had followed FHA requirements and, therefore, misled HUD into believing that thousands of loans had been properly underwritten and were eligible for government insurance or refinancing when the loans were high risk and did not qualify for such insurance or refinancing. Based on the false certifications, HUD accepted thousands of loans for government insurance and refinancing when it otherwise would not have done so. When these deficient loans ultimately defaulted, HUD was left to cover the losses.

As part of the settlement agreement, Chase admitted, acknowledged, and accepted responsibility for certain conduct alleged in the Government's complaint. Chase's admissions included that (1) it failed to report to HUD hundreds of FHA loans that it had identified as having been affected by borrower or correspondent (broker) fraud or other material deficiencies; (2) it approved for FHA insurance or refinancing thousands of loans that did not meet one or more FHA program rules and, therefore, were not eligible for FHA insurance or refinancing; and (3) certain Chase employees submitted loan evaluation data to HUD systems, to gain loan approval, that lacked integrity. Chase further admitted that as a result of its conduct, it had induced FHA to accept thousands of loans for government insurance or refinancing that were not eligible under the program rules. If FHA had known of the underwriting deficiencies, it would not have accepted the loans for insurance or refinancing, and Chase's conduct resulted in substantial losses to the Government when the loans defaulted.

Chase also agreed to comply with all rules applicable to participants in the direct endorsement lender program in carrying out its FHA lending practices in the future.

Many “traditional” fraud schemes continue to affect FHA and are described below.

Loan Origination Fraud:

This fraud includes fraudulent and substantially inaccurate income, assets, and employment information; false loan applications, credit letters, and credit reports; false gift letters; seller-funded downpayments; concealed cash transactions; straw buyers; flipping; kickbacks; cash-out schemes; fraud rings; and inadequate or fraudulent underwriting activities. While these types of mortgage fraud schemes continue to exist, changing market conditions have generated new or variant schemes.

Attorney Pleads Guilty to Mail and Bank Fraud

A licensed attorney pled guilty to conspiracy to commit mail and bank fraud and one count of conspiracy to commit money laundering. Between June 2005 and November 2008, the defendant, along with other indicted coconspirators, engaged in a scheme to obtain millions of dollars in residential real estate loans, including loans insured by FHA, through the use of straw borrowers, false mortgage applications, false forms HUD-1 (Settlement Statement), fraudulent down payments, and false verification forms. The mortgage fraud scheme involved approximately 40 properties with loan values totaling approximately \$12 million. Current losses from the scheme are estimated to be at least \$5 million. This investigation was conducted by HUD OIG with the Federal Bureau of Investigation (FBI), U.S. Postal Inspection Service (USPIS), and Internal Revenue Service-Criminal Investigation (IRS-CI).

Property Speculator and Real Estate Broker Is Sentenced

A property speculator and real estate broker was sentenced to 70 months incarceration and 36 months supervised release for his earlier guilty pleas to bank fraud, wire fraud, and mail fraud. The defendant was ordered to pay FHA approximately \$1.5 million in restitution and a court-ordered forfeiture of more than \$7.5 million. Further, he was ordered to pay \$2.7 million in damages and penalties in a related civil case. From 2008 to 2011, the defendant purchased distressed properties, made minor repairs, and sold the properties at inflated prices through his real estate business to new home buyers. The defendant paid off buyers’ debts to make them appear more creditworthy and eligible to obtain mortgages. HUD OIG conducted this investigation.

Appraisal Fraud:

This fraud is typically central to every loan origination fraud and includes deliberately fraudulent appraisals (substantially misrepresented properties, fictitious properties, bogus comparables), inflated appraisals (designed to “hit the numbers”), or both; appraiser kickbacks; and appraiser coercion.

Former Real Estate Appraiser Is Sentenced for Overvalue of FHA Properties

A former real estate appraiser was sentenced to 12 months incarceration and 24 months probation and ordered to pay restitution following his earlier guilty plea to five counts of false statements. The defendant overvalued five properties by misrepresenting square footage, age, number of rooms, and other details

of the subject properties and the comparable sales. Losses to HUD and a Federal credit union exceeded \$500,000. This investigation was conducted by HUD OIG and the FBI.

Former Real Estate Agent Pleads Guilty to False Statements and Property Inflation

A former real estate agent pled guilty to conspiracy to commit wire fraud and aggravated identity theft in connection with 10 residential mortgage loans. From March 2007 through November 2008, the defendant conspired with others to defraud FHA, the Federal Housing Finance Agency (FHFA), and other lenders by making false statements during the loan application and approval process, including using stolen or false identities and falsified IRS forms W-2, earnings statements, bank statements, and credit information. The defendant inflated the value of each property and created false addenda to the sales contracts and false repair invoices so that settlement funds could be disbursed to the defendant's shell company for alleged repairs to the property. The defendant used these funds for personal gain. The total loss to date is more than \$1.5 million, with additional losses pending. This investigation was conducted by HUD OIG, FHFA OIG, the U.S. Secret Service, the U.S. Department of Homeland Security-Investigations, the U.S. Department of the Treasury OIG, and IRS-CI.

Home Equity Conversion Mortgage (Reverse Mortgage) Fraud:

FHA reverse mortgages are a new and potentially vulnerable area for fraud perpetrators. We are aware that the larger loan limits can be attractive to exploiters of the elderly, whether third parties or family members, who seek to strip equity from senior homeowners.

Counselor Used Reverse Mortgages To Scam Elderly

The owner of an unapproved housing counseling service was sentenced to 5 months home confinement and 24 months probation and ordered to pay more than \$68,000 in restitution after an earlier guilty plea to false statements. Using her counseling service, the defendant recruited seniors for the purpose of initiating home equity conversion mortgage transactions. The defendant would then manipulate the seniors into placing second deeds on their properties, which would allow the defendant to fraudulently obtain the reverse mortgage proceeds intended for the seniors. This investigation was conducted by HUD OIG, the FBI, and USPIS.

Rescue or Foreclosure Fraud:

Recent trends show that certain individuals in the industry are preying on desperate and vulnerable homeowners who face foreclosure. Some improper activities include equity skimming (whereby the homeowner is approached and offered an opportunity to get out of financial trouble by the promise to pay off the mortgage or to pay the homeowner a sum of money when the property is sold; the property is then deeded to the unscrupulous individual, who may charge the homeowner rent and then fail to make the mortgage payment, thereby causing the property to go into foreclosure) and lease or buy-back plans (in which the homeowner is deceived into signing over the title with the belief that he or she may remain in the house as a renter and eventually buy back the property; however, the terms are so unrealistic that buy-back is impossible, and the homeowner loses possession, with the new title holder walking away with most or all of the equity).

Loan Modification Telemarketer Scams Victims Looking for Relief

The former owner of a mortgage loan modification telemarketing business was sentenced to 57 months incarceration and 3 years parole and ordered to pay \$1.1 million in restitution to various victims seeking assistance through the Home Affordable Modification Program, an official HUD program administered by the Federal National Mortgage Association to help homeowners modify mortgage loans and avoid foreclosure. Between 2009 and 2011, an estimated 124 individuals were victimized through the telemarketing business. This investigation was conducted by HUD OIG and USPIS.

Former Mortgage Bailout Company Owner Is Sentenced in Bailout Scheme

The former owner of a mortgage bailout company was sentenced to 60 months incarceration and 3 years supervised release and ordered to pay \$1.4 million in restitution following his guilty plea in July 2013. The defendant was originally indicted on multiple counts, including mail fraud, money laundering, and wire fraud. Additional charges were later filed for bankruptcy fraud for his role in concealing more than \$200,000 from the U.S. Trustee Office and multiple creditors. The defendant was sentenced to 60 months imprisonment, which was to be served concurrently with the additional activity. The defendant devised a scheme to collect funds from thousands of distressed borrowers, many of whom were FHA insured, by falsely promising to provide loan modifications. This was a HUD OIG investigation.

The tasks before HUD OIG continue to be daunting, addressing the elements of fraud that were involved in the collapse of the mortgage market; monitoring the rollout of new FHA loan products to reduce exploitation of program vulnerabilities; and combating perpetrators of fraud, including those who have migrated from the subprime markets, who would exploit FHA loan programs.

The consequences of the mortgage crisis, its worldwide economic implications, and the resulting pressures placed on HUD and OIG came at a time when HUD had significant new leadership responsibilities. Over the last 7 years, HUD has also been focused on rebuilding communities devastated by disasters (for example, lower Manhattan post-September 11; the Gulf Coast region after hurricanes Katrina, Rita, and Wilma; the Galveston area after recent hurricanes; California fires; and Midwest flooding) that have added tens of billions of dollars in new program funds that require quick distribution and keen oversight. Recently, Congress appropriated \$16 billion to assist States and people affected by Superstorm Sandy. HUD OIG continues to work closely with HUD as it implements the funding for Superstorm Sandy.



Office of Inspector General

National Credit Union Administration

The NCUA OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste and abuse, thereby supporting the NCUA's mission of providing, through regulation and supervision, a safe and sound credit union system which promotes confidence in the national system of cooperative credit.

Agency Overview

The National Credit Union Administration (NCUA) is responsible for chartering, insuring, and supervising Federal credit unions and administering the National Credit Union Share Insurance Fund (NCUSIF). The NCUA also manages the Operating Fund (OF),¹ the Temporary Corporate Credit Union Stabilization Fund (TCCUSF),² the Community Development Revolving Loan Fund (CDRLF),³ and the Central Liquidity Facility (CLF).⁴

Credit unions are member-owned, not-for-profit cooperative financial institutions formed to permit members to save, borrow, and obtain related financial services. NCUA charters and supervises federal credit unions, and insures accounts in federal and most state-chartered credit unions across the country through the NCUSIF, a federal fund backed by the full faith and credit of the United States government.

The NCUA's mission is to provide through regulation and supervision, a safe and sound credit union system that promotes confidence in the national system of cooperative credit. The agency also has a vision to protect consumer rights and member deposits. Finally, the NCUA is further dedicated to upholding the integrity, objectivity, and independence of credit union oversight. NCUA continually implements initiatives designed to continue meeting these goals.

¹ The OF was created by the Federal Credit Union Act of 1934. The OF was established as a revolving fund in the United States Treasury under the management of the NCUA Board for the purpose of providing administration and service to the Federal credit union system. A significant majority of the OF's revenue is comprised of operating fees paid by Federal credit unions. Each Federal credit union is required to pay this fee based on its prior year asset balances and rates set by the NCUA Board.

² The TCCUSF was established as a revolving fund in the U.S. Treasury under the management of the NCUA Board. The purposes of the TCCUSF are to accrue the losses of the corporate credit union system and, over time, assess the credit union system for the recovery of such losses.

³ The NCUA's CDRLF, which was established by Congress, makes loans and Technical Assistance Grants to low-income designated credit unions.

⁴ The CLF is a mixed-ownership government corporation the purpose of which is to supply emergency loans to member credit unions.

Major NCUA Programs

Supervision

NCUA's supervision program ensures the safety and soundness of the credit union system. Identifying and resolving risk concerns such as credit risk, concentration risk, and strategic risk continue to be the primary focus of the agency's supervision program. NCUA supervises natural person credit unions through annual examinations, regulatory enforcement, providing guidance in regulations and Letters to Credit Unions, and taking supervisory and administrative actions as necessary to manage credit union risk.

On January 1, 2013, the NCUA established the Office of National Examinations and Supervision (ONES) to oversee the unique examination and supervision issues related to consumer credit unions with assets greater than \$10 billion and all corporate credit unions. Large consumer credit unions pose unique challenges in light of their size in comparison to the NCUSIF. Corporate credit unions touch the operations of thousands of consumer credit unions through the critical services they provide. ONES staff includes examiners, lending specialists, capital markets specialists, information systems specialists, and payment systems specialists to focus on key areas of potential risk. ONES is positioned to adapt its examination and supervision process and procedures to keep pace with a changing financial and operational environment.

Insurance

The NCUA administers the NCUSIF, which provides insurance for deposits held at federally-insured natural person and corporate credit unions nationwide. The fund is capitalized by credit unions. NCUA manages the fund to ensure members' deposits are insured. In 2010, Congress permanently increased the insurance limit from \$100,000 to \$250,000 per depositor.

Small Credit Union Initiatives

The NCUA fosters credit union development, particularly the expansion of services provided by small credit unions to eligible consumers. NCUA fulfills this goal through training, partnerships and assistance. A major source of assistance is the CDRLF, which provides loans and grants to credit unions which serve low-income customers. CDRLF assistance enables these credit unions to provide basic financial services and stimulate economic activities in their communities. NCUA's Office of Small Credit Union Initiatives (OSCU) is also responsible for assisting the agency's risk mitigation program.

Consumer Protection

NCUA protects credit union members through effective enforcement of consumer protection regulations and requirements. NCUA's Office of Consumer Protection (OCP), created in 2010, is responsible for consumer protection in the areas of fair lending examinations, member complaints, and financial literacy. OCP consults closely with the Consumer Financial Protection Bureau (CFPB). CFPB has direct supervisory authority over credit unions with assets of \$10 billion or more, but can request to accompany NCUA on examinations of other credit unions. In addition to consolidating consumer protection examination functions within NCUA, OCP responds to inquiries from credit unions, their members, and consumers involving consumer protection and share insurance matters. Additionally, OCP processes member complaints filed against federal credit unions.

Asset Management

The NCUA's Asset Management and Assistance Center (AMAC) conducts credit union liquidations and performs management and recovery of assets. AMAC assists NCUA regional offices with the review of large, complex loan portfolios and actual or potential bond claims. AMAC also participates extensively in the operational phases of conservatorships and records reconstruction. AMAC's purpose is to minimize costs to the NCUSIF and to credit union members.

Office of Minority and Women Inclusion

NCUA formed the Office of Minority and Women Inclusion (OMWI) in January 2011, in response to the "Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010" (Dodd-Frank). OMWI is responsible for all matters relating to measuring, monitoring and establishing policies for diversity in the agency's management, employment and business activities. OMWI is also responsible for measuring, monitoring, and providing guidance about diversity for NCUA's regulated entities, excluding the enforcement of statutes, regulations and executive orders pertaining to civil rights.

The NCUA Office of Inspector General

The 1988 amendments to the *Inspector General Act of 1978* (IG Act), 5 U.S.C. App. 3, established IGs in 33 designated Federal entities (DFEs), including the NCUA.⁵ The NCUA Office of Inspector General (OIG) was established in 1989. The NCUA IG is appointed by, reports to, and is under the general supervision of, a three-member presidentially-appointed Board. The OIG staff consists of nine (9) FTEs: the IG, the Deputy IG, the Counsel to the IG/Assistant IG for Investigations, the Director of Investigations, four (4) senior auditors, and an office manager. The OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste and abuse, thereby supporting the NCUA's mission of facilitating the availability of credit union services to all eligible consumers through a regulatory environment that fosters a safe and sound credit union system. The OIG supports this mission by conducting independent audits, investigations, and other activities, and by keeping the NCUA Board and the Congress fully and currently informed of its work.

Role in Financial Oversight

During the past year we continued to conduct and report on material loss reviews (MLR) where losses to the NCUSIF met the threshold outlined in Dodd-Frank.⁶ Dodd-Frank also requires the OIG to conduct an in-depth review of any loss to the share insurance fund where unusual circumstances exist. In the past year, we conducted four (4) MLRs of failed credit unions: two (2) credit unions where the loss to the NCUSIF met

⁵ 5 U.S.C. App. 3, §8G.

⁶ The *Federal Credit Union Act* (FCUA), 12 U.S.C. 1790d(j) likewise requires that the OIG conduct a MLR when the NCUSIF has incurred a material loss with respect to a credit union. In the aftermath of Dodd-Frank, a material loss is now defined as (1) exceeding the sum of \$25 million and (2) an amount equal to 10% of the total assets of the credit union at the time at which the Board initiated assistance or was appointed liquidating agent.

Dodd-Frank further amended the FCUA to require the OIG to (1) perform limited reviews of all credit union losses under the \$25 million threshold to assess whether an in-depth review (consistent with the scope of a MLR) is warranted; and (2) report to the NCUA Board and the Congress every six months on: (a) the results of the limited reviews; and (b) the timeframe for performing any in-depth reviews the OIG determines should be subsequently conducted.

the statutory threshold and two (2) where unusual circumstances prompted our review.

We also reviewed closely NCUA's rulemaking efforts under Dodd-Frank regarding the following: (1) share insurance on various kinds of treasury accounts (Treasury Tax and Loan Depositories: Depositories and Financial Agents of the Government);⁷ (2) the use of credit ratings to assess creditworthiness (Alternatives to the Use of Credit Ratings)⁸; and (3) interchange transaction fees for electronic debit transactions (Electronic Funds Transfer Act).⁹

Moreover, in 2013 we continued coordination with our financial IG counterparts in CIGFO on issues of mutual interest, including participation in two separate working groups to review FSOC's: (1) process to designate financial market utilities (FMUs) as "systemically important;" and (2) commitment to conducting its business as openly and transparently as possible.

With regard to the former review, a CIGFO working group, which included a representative from this office, convened to assess the application of the rules, procedures, and practices established by FSOC and its members to determine which FMUs should be designated as systemically important and therefore subject to the requirements of Title VIII of Dodd Frank—Payment, Clearing and Settlement Supervision (Title VIII). Title VIII authorizes FSOC to designate FMUs as systemically important if FSOC determines that the failure of or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets, thereby threatening the stability of the U.S. financial system. FSOC-designated FMUs are then subject to the enhanced risk management and enhanced supervision requirements under Title VIII. To accomplish its review objective, the CIGFO working group reviewed the processes and procedures FSOC established to designate eight FMUs as systemically important.¹⁰ Specifically, the working group reviewed (1) how FSOC established the universe of FMUs for consideration; and (2) FSOC processes going forward to review FMU activity, to designate additional FMUs and, when appropriate, to rescind an FMU designation. In July 2013, CIGFO issued a report recommending that FSOC (1) establish a formal structure for the FMU Committee; (2) determine a course of action with regard to foreign-based FMUs consistent with the authorities of Title VIII; (3) continue deliberations on the process and rules regarding possible future designation of payment, clearing, and settlement activities conducted by financial institutions; (4) define the nature, frequency, and communication of updates on designated FMUs from the FMU regulators; and (5) establish a timeline for periodic reviews of non-designated FMUs that may be systemically important.

In December 2013, CIGFO convened another working group to assess: (1) the extent to which FSOC is operating in a manner consistent with the expectations outlined in its Transparency Policy; and (2) FSOC's compliance with requirements outlined in its Transparency Policy. While the Department of Treasury OIG is coordinating the review, NCUA is participating in the working group, which will report the results of the review to FSOC. The review could result in recommendations to FSOC for improvements to the policy.

⁷ 12 CFR Part 701.

⁸ 12 CFR Parts 703, 704, 709, 741.

⁹ 15 U.S.C. § 1693b(a)(2). Section 1075 of Dodd-Frank requires the Board of Governors of the Federal Reserve System to consult with NCUA and other relevant agencies on this rulemaking.

¹⁰ As authorized in Title VIII, on July 18, 2012, FSOC voted unanimously to designate eight FMUs as systemically important.

Finally, we maintained our focus on NCUA's efforts to address recommendations from the FSOC 2013 Annual Report which remain relevant to the credit union industry. In this regard, we monitored NCUA's supervision-related work, especially in the areas of operational risk and interest rate risk, respectively. In the operational risk area, we monitored guidance NCUA issued in 2013 related to emerging cyber-security risks and related threats. In addition, in several MLRs we examined how poor internal controls increase credit union risk, especially the risk of fraud occurring, and what the agency is doing to guide examiners and credit unions in detecting and deterring these deficiencies. We also continued to focus on ongoing agency efforts to address how changes in interest rates can affect risk profiles.

In accordance with section 989(a)(2)(B) of Dodd-Frank, the following highlights the completed, ongoing, and projected work of our office, with a focus on issues particular to NCUA as well as those that may apply to the broader financial sector.

Recent, Current, or Projected Work in Financial Oversight

Failed Credit Unions

To a lesser extent than during the height of the financial crisis, we continued to conduct our mandatory and discretionary reviews of NCUA supervised and insured institutions causing material losses to the share insurance fund, as defined by Dodd-Frank. We issued four MLR reports in 2013: two of credit unions whose failures met the statutory loss threshold outlined in the Act, and two whose failures involved unusual circumstances. In the latter two MLRs, discussed in more detail below, we found indications of fraud which led to the credit unions' respective failures. Consequently, we sustained strong monitoring throughout the year of NCUA's efforts to assist credit unions and consumers in recognizing, preventing, and reporting fraud as well as to train examiners to identify fraud within credit unions.

NCUA Supervision-Related Work

As credit unions continue to evolve and face various economic and operational challenges, we remained focused on the agency's efforts to improve the capacity of these institutions to manage risk. Throughout the year we monitored the supervision and guidance NCUA provided, respectively, to examiners and credit unions, as well as consistency in agency practices, with particular emphasis on operational risk and interest rate risk, respectively.

1. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Two primary areas where NCUA examiners focused on operational risk in 2013 were:

- *Technology*—Credit unions are adopting new technology to meet evolving member service needs and to leverage automation for increased efficiencies. Remote deposit capture, online banking, mobile banking, and social media are just a few examples of new technologies credit unions are increasingly employing to serve members. NCUA has begun providing guidance on the need for credit unions to implement controls commensurate with the risks involved, in particular ensuring the security and stability of these service delivery channels.

- *Internal Controls*—A sound system of internal controls is essential to ensure credit unions are operated in a safe manner. An effective system of controls deters and mitigates the risk of fraud, errors, and other operational problems. NCUA is advising and providing guidance to credit unions and examiners regarding the need to detect and deter these deficiencies. It is also emphasizing the need for a strong supervisory committee and audit function that is commensurate with the size and complexity of the credit union.

a. Technology

As credit unions adopt new technology to meet member service needs, they and their members are exposed to a growing volume and sophistication of cyber-attacks. The global inter-connectedness of today's networks raises operational risks and exposes credit unions of all sizes to cyber-criminals and cyber-terrorists who have acquired programs to compromise data, steal identities, block transactions, and crash financial systems.

Cybersecurity threats are no longer limited to large credit union targets. Smaller institutions have been identified as vulnerable entry points for cyber-terrorists to infiltrate larger networks in stealth operations designed to disrupt the entire United States economy. As a result, NCUA has instructed field staff to evaluate credit unions' ability to assess and mitigate cybersecurity risk and respond to cyber-attacks. The agency has emphasized that credit unions of all sizes will be expected to implement appropriate risk mitigation controls—including vendor due diligence, strong password processes, proper patch management and network monitoring—to better prevent, detect, and recover from cyber-attacks. Moreover, NCUA has committed to work with a newly formed interagency working group to promote cybersecurity throughout the financial industry.

The OIG will continue to monitor NCUA's progress in this critical area. In particular, we intend to initiate an audit in 2014 that will examine NCUA's subject matter expert program, under which examiners review credit unions' Information Systems and Technology (IS&T) programs.

b. Internal Controls

One of the supervisory areas where NCUA focused much of its attention in 2013 was on the need for strong internal control systems and processes for credit unions, recognizing that lax internal controls can cause major disruptions in individual credit unions as well as to the entire credit union industry. In particular, the agency emphasized that an effective system of controls deters and mitigates the risk of fraud, errors, and other operational problems. In this regard, NCUA communicated to credit unions the need for a strong supervisory committee and audit function that is commensurate with the size and complexity of the credit union.

In one of the MLRs we conducted in 2013, where management's fraudulent actions caused the credit union to fail,¹¹ we found that poor internal controls, *inter alia*, allowed the fraud to go undetected. Specifically, we found that neither NCUA examiners nor the external CPA firm considered the credit union's poor internal control environment to be a significant fraud risk area despite numerous and repeated findings. To specifically address this deficiency, we recommended that NCUA update policies and procedures to require that credit unions obtain third party confirmations for all accounts

¹¹ <http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG-13-09-MLREIPasosFCU.pdf>

where the balance or activity is significant to its operations. In addition, we recommended that NCUA require the same as part of agreed-upon procedures conducted by external CPA firms.

In the second MLR we conducted where fraud was a primary determinant of the credit union's failure,¹² we found that NCUA examiners failed to require the credit union Board and management to build a functioning supervisory committee, despite repeated findings that the supervisory committee was ineffective. Without an effective supervisory committee, examiners cannot be certain that internal controls at a credit union are functioning as intended, placing member funds and the NCUSIF at risk. In the case of this particular credit union, the supervisory committee failed to obtain required external audits. Based on our recommendation, NCUA management agreed to review policies and procedures to require direct communication with the external auditor in cases where the audit is past due or unacceptable, internal controls are weak or insufficient, or the audit firm is unknown or has limited experience working with credit unions.

2. Interest Rate Risk

Because interest rate risk¹³ is the most significant risk the credit union industry faces right now, we continued to focus on how NCUA examiners are evaluating a credit union's ability to mitigate interest rate and liquidity risk. This focus is especially necessary where there are high levels of long-term assets funded by short-term, less stable funds. As interest rates have risen above record lows, many credit unions' unrealized gains have swung to unrealized losses. These unrealized losses may foreshadow the actual losses credit unions will face if continuing rate increases eventually result in more compression of net interest margins.

Several of the MLRs the OIG conducted over the past several years noted that credit unions without an appropriate interest rate risk policy, and a program to effectively implement that policy as part of their asset liability management responsibilities, caused losses to the NCUSIF and/or contributed to the credit union's failure. The MLR reports we issued further identified where improvements could be made in NCUA's monitoring of interest rate risk.

Incorporating lessons learned from some of the earlier MLR reports, in January, 2012, the NCUA Board adopted a final amendment to the agency's insurance rules requiring certain federally-insured credit unions to have a written policy to address interest rate risk management as well as an effective interest rate risk program for successful asset liability management.¹⁴ In the past year, we observed how NCUA impressed upon credit unions that it is imperative for them to make the necessary adjustments to account for a rising

¹² <http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG-13-13-MLR-GICFCU.pdf>

¹³ The term "interest rate risk" refers to the vulnerability of a credit union's financial condition to adverse movements in market interest rates. For example, changes to a credit union's funding costs generally are considered part of the inherent rate risk associated with a fixed-rate mortgage loan. A borrower with a fixed-rate mortgage loan is unaffected by increases in market interest rates because his payment is based on a "fixed" rate. The credit union that originated the mortgage loan, however, is subject to losses in the market value of these mortgages from the increases in the market interest rates. Furthermore, as market interest rates rise, there is a concomitant increase in the credit union's funding costs, or the interest rate the credit union pays on the money it uses to "fund" the mortgage loan.

¹⁴ <http://www.ncua.gov/Legal/Documents/Regulations/FIR20120126InterestRateRiskProg.pdf>

rate environment. Indeed, as part of its 2013 supervisory focus, the agency emphasized that even a slow, gradual increase in rates could have significant consequences for credit unions with high concentrations in certain long-term investments and loans.

The OIG will continue its oversight of this critical area, monitoring how NCUA is working to ensure credit unions are mitigating any inordinate exposure. In particular, the OIG has tentatively planned a 2014 audit to determine whether NCUA's interest rate risk policies and procedures are helping to effectively reduce interest rate risk in credit unions.

OIG Fraud Hotline

As noted above, in previous and current MLRs we found and reported on recurring instances of fraud which led to a material loss to the NCUSIF and/or the credit union's failure. In addition to the value placed on MLR findings and reports within NCUA, there has been significant public interest in these reports, which we make publicly available on the OIG website. The OIG maintains a robust fraud Hotline, which receives allegations from NCUA and other federal employees, credit unions and their members, contractors, and the public. While our investigative jurisdiction extends only to fraudulent activity in liquidated or conserved credit unions, we nonetheless analyze all fraud-related information obtained through the Hotline. As appropriate, we refer potential cases of fraud to the appropriate NCUA regional office, the Office of Examination and Insurance, and the Office of General Counsel for immediate review and action. We also consult closely with the FBI in cases where that office is actively involved in fraud investigations in credit unions.



Office of Inspector General U. S. Securities and Exchange Commission

The U.S. Securities and Exchange Commission (SEC or agency) Office of Inspector General (OIG) promotes the integrity, efficiency, and effectiveness of the critical programs and operations of the SEC and operates independently of the agency to help prevent and detect fraud, waste, and abuse, through audits, evaluations, and investigations.

Background

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity. The SEC's goals are to foster and enforce compliance with the Federal securities laws; establish an effective regulatory environment; facilitate access to the information investors need to make informed investment decisions; and enhance the SEC's performance by effectively aligning and managing human resources, information, and financial capital.

The SEC oversees about 11,000 investment advisers, almost 10,000 mutual funds, 4,450 broker-dealers, 450 transfer agents, as well as the Public Company Accounting Oversight Board, the Financial Industry Regulatory Authority, the Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, and the Financial Accounting Standards Board. The SEC also has responsibility for reviewing the disclosures and financial statements of approximately 9,000 reporting companies. The agency has new or expanded responsibilities over the derivatives markets, an additional 2,500 exempt reporting advisers to hedge funds and other private funds, more than 1,000 municipal advisors, 10 registered credit rating agencies, and 7 registered clearing agencies. And, the agency has nearly 100 new rulemaking responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Jumpstart Our Business Startups Act.

The SEC OIG is an independent office within the SEC. It was established in 1989 under the Inspector General Act of 1978, as amended. The SEC OIG prevents and detects fraud, waste, and abuse through audits, evaluations, and investigations related to SEC programs and operations.

The SEC OIG Office of Audits n conducts, coordinates, and supervises independent audits and evaluations of the SEC's internal programs and operations at its headquarters and 11 regional offices. These audits and evaluations are based on risk and materiality, known or perceived vulnerabilities and inefficiencies, and information received from the Congress, SEC staff, the Government Accountability Office, and the public.

The SEC OIG Office of Investigations performs investigations into allegations of criminal, civil, and administrative violations, involving SEC programs and operations, by SEC employees, contractors, and outside entities.

During the reporting period, the Office of Audits and the Office of Investigations in the SEC OIG performed various oversight work designed to protect the SEC's sensitive and nonpublic information and to prevent and detect the unauthorized disclosure of that information. In addition, the SEC OIG Office of Audits is reviewing the agency's oversight of employee securities holdings, and the SEC OIG Office of Investigations has examined whether SEC staff members complied with the SEC's Supplemental Ethics Rules governing personal securities holdings and trading. This work is described below.

Audits and Evaluations

Review of the SEC's Practices for Sanitizing Digital Information System Media (Report No. 521, May 2014)

The SEC generates and collects commercially valuable, market sensitive, proprietary, and other nonpublic information. To safeguard against unauthorized disclosure of such information, the National Institute of Standards and Technology recommends that Federal agencies sanitize digital information system media before its disposal or release outside the organization. And, the SEC requires that the agency's digital information system media, including hard drives, compact discs, and data tapes used to process and store information, be sanitized before disposal. Effective sanitization minimizes the risk of inadvertent releases of information that are potentially damaging to the agency, its employees and contractors, and the entities the SEC regulates. To determine whether the SEC effectively sanitizes surplus media before its disposal, the SEC OIG hired a contractor to evaluate the agency's media sanitization practices.

The final report contained eight recommendations designed to provide reasonable assurance that the SEC's obsolete and surplus media containing sensitive information are properly safeguarded and sanitized before disposal. The recommendations addressed surplus media storage, laptop encryption, inventorying and tracking of surplus hard drives, sanitization of failed hard disks used in disk arrays, certificates of destruction, media sanitization policies and procedures, and implementation of verification activities. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action. The SEC OIG's Office of Audits expects to issue a final report summarizing the contractor's findings by the end of fiscal year 2014.

Audit of Controls Over the SEC's Inventory of Laptop Computers (Ongoing)

SEC employees and contractors use laptop computers, some of which store sensitive, nonpublic information, to support the agency's mission. In March 2008, the SEC OIG reported that the SEC's property management guidance did not identify laptops as sensitive property and the Office of Information Technology (OIT) did not have effective accountability for laptops. The SEC OIG also found that an SEC-wide inventory of laptops had not been performed since 2003. Finally, because there was no baseline inventory of laptops, the SEC OIG was unable to trace custody of laptops to specific individuals.

In the 2008 report, the SEC OIG made five recommendations to strengthen controls over the SEC's laptop inventory, and SEC management concurred that its accountability for laptops needed improvement. All five recommendations were closed; however, an investigation conducted by the SEC OIG Office of Investigations revealed that the OIT did not maintain accurate inventory records to properly track laptops. As a result, the

SEC OIG Office of Investigations referred information learned through the investigation to the SEC OIG Office of Audits.

The objective of the audit is to evaluate the effectiveness of the OIT's inventory program and its controls over laptops. The audit is focusing on the OIT's policies and procedures for the inventory and accountability for laptops, the accuracy and completeness of the current inventory procedures for reporting lost or stolen laptops, and controls over information systems used to track the laptop inventory. The SEC OIG's Office of Audits expects to issue a final audit report by the end of fiscal year 2014.

Audit of the Office of the Ethics Counsel's Oversight of Employee Securities Holdings (Ongoing)

Because of the nature of the agency's mission (e.g., protecting investors and regulating the financial markets), SEC employees are subject to heightened ethics rules about their own securities transactions. These rules both prohibit certain trading by SEC employees and require reporting of employee securities transactions and holdings. As a result of several investigations, the SEC OIG Office of Investigations recommended that the SEC OIG Office of Audits review the SEC Office of Ethics Counsel's (OEC) oversight of employee securities holdings.

On April 15, 2014, the SEC OIG Office of Audits initiated an audit of the SEC OEC's oversight of employee securities holdings. The overall objective of the audit is to evaluate the OEC's efforts to ensure that SEC members and employees comply with the regulations that prohibit certain securities holdings and restrict trading. Specifically, we will determine whether the OEC has adequate controls to prevent, detect, and correct SEC members' and employees' noncompliance with provisions of Section 4401.102 of the Supplemental Standards of Ethical Conduct for Members and Employees of the Securities and Exchange Commission. The SEC OIG Office of Audits expects to issue a final report summarizing its findings by the end of calendar year 2014.

Investigations

Investigation of Alleged Leak of Information Contained in an SEC OIG Report (Case No. OIG-590, July 2013)

The SEC OIG investigated an alleged leak of information contained in a report of investigation that the SEC OIG had previously issued to the SEC about the mismanagement of a computer security lab in the agency's Division of Trading and Markets. Specifically, articles published by a third-party media outlet discussed information that SEC management considered to be nonpublic and had redacted from the version of the investigative report that was made available outside the SEC.

The SEC OIG found that the articles published by the media outlet contained information that had been redacted from the SEC OIG's report and was not publicly available. However, through its review of emails and interviews of SEC staff, the SEC OIG did not identify the individual who had provided the information to the media outlet. In July 2013, the SEC OIG issued an investigative memorandum to management (IM-13-002), which made four recommendations for improvements in controls over nonpublic and sensitive information. SEC management has implemented all four recommendations.

Allegations of Improper Disclosure of Nonpublic and Personally Identifiable Information by an SEC Contractor (Case No. OIG-574, November 2013)

The SEC OIG investigated allegations that an SEC contractor allowed employees of a subcontractor located outside the United States to access an SEC computer system that contained personal information of SEC employees, including their financial holdings. The SEC had entered into this contract for a computer system to support the SEC's ethics program in June 2009.

The SEC OIG found that employees of the subcontractor located outside the United States appeared to have accessed the SEC computer system and its data, potentially including personally identifiable information. On learning that the subcontractor employees appeared to have accessed the system in September 2011, the SEC had notified all its employees that this access occurred and offered them 12 months of credit monitoring paid for by the agency.

The SEC OIG also found that the contractor had failed to inform the SEC that the subcontractor employees had access to the SEC computer system and may have misled the SEC about this issue. The SEC OIG further found that the contractor had not provided the names of the subcontractor employees to the SEC for background checks, as required by the contract, and had failed to provide the SEC with executed nondisclosure agreements for those employees.

The SEC OIG referred information from its investigation about the conduct of the SEC contractor and its principal to the Department of Justice (DOJ) as possible violations of civil and criminal law. The DOJ declined to open a civil or criminal matter as a result of the SEC OIG's investigation, and the SEC OIG closed its investigation.

Departing SEC Employee's Attempt to Remove Nonpublic Information from the SEC (Case No. OIG-600, March 2014)

The SEC OIG investigated allegations that a departing SEC employee may have stolen sensitive documents. Specifically, the SEC OIG learned that the SEC's Office of Records Management Services (ORMS) had identified sensitive information in materials that were being shipped from the SEC to the employee's new employer, a private firm, and that SEC management was concerned about the potential release of nonpublic information.

The SEC OIG reviewed the employee's documents, identified nonpublic information, prevented information from leaving the SEC, and recovered other nonpublic information from the employee's residence. The SEC OIG did not uncover criminal violations and, therefore, did not refer the matter to the DOJ for possible prosecution. Further, because the employee had left the SEC, the SEC OIG determined that a referral to management for administrative action was not warranted. However, the SEC OIG identified certain areas that the SEC could improve in its employee exit process.

To address those issues, the SEC OIG issued Investigative Memorandum IM-14-001 to SEC management in March 2014. After the SEC OIG's investigation, ORMS released a new directive that included information about the types of documents employees could not keep or remove upon their departure from the SEC and required employees to complete a records clearance form. However, the SEC OIG found that the directive did not require a departing employee's division or office to review the documents the departing employee planned to remove from the SEC and to determine which documents the employee was authorized to remove. Therefore, the SEC OIG recommended in IM-14-001 that the agency's exit procedures and policies

be revised to include these requirements. The SEC OIG also recommended that the division's or office's determination be documented in the SEC's Electronic Exit Program before the employee's departure and that management advise employees, through training, correspondence, and other means, about the revised exit procedures and their obligation to ensure that nonpublic information is not improperly disclosed. Management action on these recommendations is pending.

Unauthorized Disclosure of Nonpublic Information From Executive Session Commission Meeting (Report No. OIG-601, March 2014)

The SEC OIG opened an investigation into concerns about the unauthorized disclosure of nonpublic information from an Executive Session of a "closed" (nonpublic) Commission meeting. Specifically, the SEC OIG was notified that information about the Commission's deliberations and voting during the closed Commission meeting had been disclosed, without authorization, to a news reporter. Later, nonpublic information was included in a news article by several reporters that was published before information about the closed Commission meeting was made public.

During its investigation, the SEC OIG interviewed numerous staff members and Commissioners who had attended or had information about the closed Commission meeting. The SEC OIG also reviewed SEC emails, telephone and BlackBerry records, and records showing the news reporters' access to the SEC headquarters building around the time of that closed meeting. The SEC OIG was unable to determine which specific individual or individuals had improperly disclosed information from the closed Commission meeting. However, the SEC OIG determined that an SEC employee may have confirmed to one of the news reporters certain nonpublic information. The SEC OIG also learned during its investigation that certain Commission-related information was transmitted using personal, nonsecure email. The SEC OIG provided the results of its investigation to the agency for appropriate action.

Former SEC Employee's Possession of SEC Documents Containing Nonpublic Information (Case No. OIG-610, March 2014)

The SEC OIG investigated allegations that a former SEC employee, who was a candidate for a position with an SEC regional office, possessed documents containing SEC nonpublic information that the former employee had obtained through his prior employment with the SEC.

During its investigation, the SEC OIG interviewed the former employee, who admitted possessing copies of SEC examination reports that he had worked on while employed with the SEC. The former employee agreed to cooperate with the investigation, and the SEC OIG recovered from that former employee the documents containing nonpublic information. The SEC OIG determined that one of the documents that the former employee had copied and taken with him when he left the SEC was marked "Privileged & Confidential."

The SEC OIG referred the matter to the United States Attorney's Office (USAO) for possible prosecution, and the USAO declined prosecution. The SEC OIG provided a report of its findings to SEC management for informational purposes and closed its investigation.

Violations of SEC Ethics Rules (Report No. OIG-594, September 2013)

The SEC OIG investigated the failure of an SEC Senior Officer (SO) to report, on financial disclosure statements, the securities holdings of the SO's spouse and to comply with the SEC's supplemental ethics rules about employee financial transactions.

Through its investigation, the SEC OIG found evidence that the SO had not complied with various provisions of the SEC's Supplemental Ethics Rules because, for example, 1) the SO's spouse held a security interest ("imputed" to the SO because of their marriage) in entities directly regulated by the SEC; 2) the SO did not preclear, report, or certify the vast majority of the spouse's financial holdings; and 3) the SO did not report all assets required to be disclosed on the financial disclosure forms. The SEC OIG also identified evidence that the SO had worked on one matter that involved former employees of a company in which the SO's spouse owned stock. Further, the SEC OIG found that the SO had disclosed nonpublic information to the SO's spouse.

The SEC OIG referred the matter to the USAO, which declined prosecution. The SEC OIG then reported the findings of its investigation to SEC management. In response to the SEC OIG's report, management suspended the SO for 14 days.

Violations of SEC Supplemental Ethics Rules by an SEC Staff Accountant (Case No. OIG-585)

The SEC OIG investigated whether an SEC staff accountant held certain securities that SEC employees were prohibited from owning under the SEC's Supplemental Ethics Rules and failed to report those holdings on government financial disclosure forms.

The SEC OIG found that the staff accountant held several securities that became prohibited in August 2010, when the Supplemental Ethics Rules went into effect. The SEC OIG learned during its investigation that the staff accountant had purchased additional shares of a prohibited holding and had failed to obtain prior clearance of those transactions as required by the Supplemental Ethics Rules. The SEC OIG also found that the staff accountant did not report this prohibited holding on government financial disclosure forms even though the value of the holding exceeded the reporting threshold.

The SEC OIG referred the matter to the USAO for possible prosecution and also reported the findings of its investigation to SEC management. The staff accountant then resigned from the SEC and, in February 2014, the USAO declined prosecution of the matter.

False Statements Related to Prohibited Financial Holdings (Case No. OIG-598)

The SEC OIG investigated an SEC staff accountant's certifications that the securities he owned were in compliance with the SEC's Supplemental Ethics Rules, including rules that prohibit SEC employees from owning securities in entities that are directly regulated by the SEC. The SEC OIG also investigated whether the staff accountant had later divested the prohibited holdings as he claimed he had done.

Through its investigation, the SEC OIG found evidence that the staff accountant had 1) falsely certified that his holdings were in compliance with the SEC's regulations when he held stock in several prohibited companies; and 2) falsely claimed that he had divested certain prohibited holdings when he had transferred

them to a brokerage account that he controlled. The SEC OIG referred the matter to the USAO, which accepted the case for prosecution.

The USAO filed a criminal complaint against the staff accountant, charging him with three counts of making false statements to the SEC about his ownership of prohibited securities, and the staff accountant was arrested in November 2013. The criminal complaint alleged that in January 2013, the staff accountant falsely certified—through the SEC’s electronic system for preclearing and reporting securities transactions—that he was in compliance with the SEC’s ethics rules as of December 31, 2012, when he in fact held stocks that were prohibited under the SEC’s ethics rules. The complaint also alleged that on two occasions in February 2013, the staff accountant falsely stated that he no longer held certain prohibited securities.

In April 2014, the USAO entered into a deferred prosecution agreement with the staff accountant. Under the agreement, the USAO will delay prosecution of the staff accountant for 6 months from the time of signing the agreement. If the staff accountant complies with all the terms and conditions of the agreement for those 6 months, the USAO will not further prosecute the staff accountant for the offenses described above. Special conditions of the agreement required the staff accountant to cooperate fully with the USAO and to resign from the SEC. The staff accountant resigned from the SEC after signing the agreement.



Special Inspector General for the Troubled Asset Relief Program

The Special Inspector General for the Troubled Asset Relief Program has the duty, among other things, to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program ("TARP") or as deemed appropriate by the Special Inspector General.

Background

The Special Inspector General for TARP ("SIGTARP") was created by Section 121 of the Emergency Economic Stabilization Act of 2008 ("EESA") as amended by the Special Inspector General for the Troubled Asset Relief Program Act of 2009 ("SIGTARP Act"). Under EESA and the SIGTARP Act, SIGTARP has the responsibility, among other things, to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program ("TARP") or as deemed appropriate by the Special Inspector General. SIGTARP is required to report quarterly to Congress to describe SIGTARP's activities and to provide certain information about TARP over that preceding quarter. EESA gives SIGTARP the authorities listed in Section 6 of the Inspector General Act of 1978, including the power to obtain documents and other information from Federal agencies and to subpoena reports, documents, and other information from persons or entities outside the Government.

SIGTARP Investigations Activity

SIGTARP is a white-collar law enforcement agency. As of April 2, 2014, SIGTARP had more than 150 ongoing criminal and civil investigations, many in partnership with other agencies. SIGTARP takes its law enforcement mandate seriously, working hard to deliver the accountability the American people demand and deserve. SIGTARP's investigations have delivered substantial results, including:

- criminal charges against 188 individuals, including 123 senior officers (CEOs, owners, founders, or senior executives) of their organizations
- criminal convictions of 129 defendants
- prison sentences for 80 defendants (others are awaiting sentencing)
- civil cases and other actions against 64 individuals (including 50 senior officers) and 55 entities (in some instances an individual will face both criminal and civil charges)

- orders temporarily suspending or permanently banning 94 individuals from working in the banking or financial industry, working as a contractor with the Federal Government, or working as a licensed attorney
- orders of restitution and forfeiture and civil judgments and other orders entered for \$4.77 billion. This includes restitution orders entered for \$4.2 billion, forfeiture orders entered for \$241.6 million, and civil judgments and other orders entered for \$353 million. Although the ultimate recovery of these amounts is not known, SIGTARP has already assisted in the recovery of \$227.4 million. These orders happen only after conviction and sentencing or civil resolution and many SIGTARP cases have not yet reached that stage; accordingly, any recoveries that may come in these cases would serve to increase the \$227.4 million
- savings of \$553 million in TARP funds that SIGTARP prevented from going to the now-failed Colonial Bank

SIGTARP's investigations concern a wide range of possible wrong-doing, and result in charges including: bank fraud, conspiracy to commit fraud or to defraud the United States, wire fraud, mail fraud, making false statements to the Government (including to SIGTARP agents), securities fraud, money laundering, and bankruptcy fraud, among others.

SIGTARP Oversight Activities

SIGTARP continues to fulfill its oversight role on multiple parallel tracks: investigating allegations of fraud, waste, and abuse related to TARP; conducting oversight over various aspects of TARP and TARP-related programs and activities through 22 published audits and evaluations, and 130 recommendations; and promoting transparency in TARP and the Government's response to the financial crisis as it relates to TARP.

SIGTARP RECOMMENDATIONS CONCERNING HOMEOWNERS REDEFAULTING ON MODIFIED MORTGAGES UNDER HOME AFFORDABLE MORTGAGE MODIFICATION PROGRAM ("HAMP")

SIGTARP has made a series of recommendations to Treasury regarding TARP's signature housing program, HAMP. These recommendations address SIGTARP's concerns about the process by which a homeowner gets into HAMP, the treatment of the homeowner while in HAMP, and the long-term sustainability of homeowners' HAMP permanent mortgage modifications. In April, 2013, SIGTARP made the following recommendations regarding HAMP:

- Treasury should conduct in-depth research and analysis to determine the causes of redefaults of HAMP permanent mortgage modifications and the characteristics of loans or the homeowner that may be more at risk for redefault. Treasury should require servicers to submit any additional information that Treasury needs to conduct this research and analysis. Treasury should make the results of this analysis public and issue findings based on this analysis, so that others can examine, build on, and learn from this research.
- As a result of the findings of Treasury's research and analysis into the causes of HAMP redefaults, and characteristics of redefaults, Treasury should modify aspects of HAMP and the Treasury should require servicers to develop and use an "early warning system" to identify and reach out to homeowners

that may be at risk of redefaulting on a HAMP mortgage modification, including providing or recommending counseling and other assistance and directing them to other TARP housing programs.

- In the letter Treasury already requires servicers to send to homeowners who have redefaulted on a HAMP modification about possible options to foreclosure, Treasury should require the servicers to include other available alternative assistance options under TARP such as the Hardest Hit Fund and HAMP Tier 2, so that homeowners can move forward with other alternatives, if appropriate, in a timely and fully informed manner. To the extent that a servicer does not follow Treasury's rules in this area, Treasury should permanently withhold incentives from that servicer.

Following SIGTARP's April 2013 recommendations, Treasury initially expressed its commitment to assessing and reducing redefault rates as much as possible, including by conducting research on the causes of redefaults. Following that, however, on July 22, 2013, Treasury posted a blog: "Understanding HAMP Re-default Rates," explaining that "mortgage modification programs include an inherent risk of homeowner default, given the difficult situations homeowners face when they seek assistance (like job loss)." Treasury stated that a challenge of HAMP's design was "giving as many struggling homeowners as possible the chance to keep their home while recognizing that not all will succeed." But, despite Treasury's understanding that redefaults would be likely, as SIGTARP indicated in April, 2013, Treasury still does not understand well the reason the permanent modifications in HAMP actually failed. Instead, Treasury merely noted that "homeowners in HAMP consistently exhibit lower delinquency and re-default rates than those in private industry modifications."

As a result, on September 3, 2013, SIGTARP made three additional recommendations related to HAMP to encourage Treasury to uncover and address the root causes of HAMP redefaults.

First, SIGTARP recommended:

- To ensure that homeowners in HAMP get sustainable relief from foreclosure, Treasury should research and analyze whether and to what extent the conduct of HAMP mortgage servicers may contribute to homeowners redefaulting on HAMP permanent mortgage modifications. To provide transparency and accountability, Treasury should publish its conclusions and determinations.

In responding to the above recommendation, Treasury stated that it agrees with SIGTARP's broad points and indicated that Treasury will monitor servicer performance with respect to income calculation, publish the results, and exercise the appropriate remedies as necessary. It is Treasury's responsibility to conduct meaningful oversight of its own program and of those that are participating in it.

Second, SIGTARP recommended:

- Treasury should establish an achievable benchmark for a redefault rate on HAMP permanent mortgage modifications that represents acceptable program performance and publicly report against that benchmark.

Treasury initially had predicted that four out of every ten (40%) HAMP modifications (trial and permanent) would fail. More than three years after SIGTARP's 2010 recommendation, Treasury has still not identified benchmarks or set goals and performance measures for each metric, particularly relating to redefaults

of HAMP permanent modifications. During that time, more than half (54%) of homeowners' HAMP modifications (trial or permanent) failed, and over a quarter (26%) of homeowners who received a HAMP permanent modification have fallen out of the program. Had Treasury measured and reported on HAMP modification performance, at least, against its initial prediction – that 40% of HAMP modifications would fail homeowners, the public would have been made aware that homeowners had modifications (trial and permanent) that were failing at a rate exceeding 40 percent, and Treasury could have interceded to improve performance and lower the redefault rate.

Third, SIGTARP recommended:

- Treasury should publicly assess and report quarterly on the status of the ten largest HAMP servicers in meeting Treasury's benchmark for an acceptable homeowner redefault rate on HAMP permanent mortgage modifications, indicate why any servicer fell short of the benchmark, require the servicer to make changes to reduce the number of homeowners who redefault in HAMP, and use enforcement remedies including withholding, permanently reducing, or clawing back incentive payments for any servicer that fails to comply in a timely manner.
- Treasury responded to this SIGTARP recommendation agreeing that establishing appropriate benchmarks and publishing servicer performance against those benchmarks is important. However, Treasury seems unwilling to specifically implement this important measure, reasoning that the lack of an industry-wide metric prevents it from doing so. First, the absence of any industry metric to measure servicer impact on redefault does not prevent Treasury from implementing SIGTARP's recommendation. In fact, SIGTARP's recommendation actually called on Treasury to establish an achievable benchmark for a redefault rate on HAMP permanent mortgage modifications. As Treasury has been managing HAMP for nearly five years now and is familiar with servicers' participation in the program, it surely has gained some valuable expertise and knowledge that could be useful in developing this benchmark. Second, Treasury's argument appears contrary to Treasury's July blog post in which Treasury compared HAMP redefaults to the redefault rate of private sector mortgage modifications, suggesting that could serve as a valid benchmark for HAMP permanent modification redefault rates. Treasury also suggests that it cannot establish a benchmark without SIGTARP's guidance. Again, it is up to Treasury to set performance standards for its own program and measure the participants' performance in Treasury's program against a benchmark that Treasury believes is achievable and sustainable.

SIGTARP RECOMMENDATIONS CONCERNING APPOINTING DIRECTORS TO CAPITAL PURCHASE PROGRAM BANKS

Treasury's responsibility did not end on the day it injected TARP funds into banks participating in TARP's Capital Purchase Program ("CPP"). Indeed, one of the stated purposes of CPP is "to enable lenders to meet the credit needs of our nation and local communities." Treasury has many tools available to protect taxpayers' investments in all TARP recipients, and ensure their contribution was not wasted or in vain. Among those tools, Treasury established a contractual right to nominate directors to boards of TARP recipients who miss required dividends payments, including in TARP's bank programs: CPP and the Community Development Capital Initiative ("CDCI").

SIGTARP is concerned that Treasury has rarely exercised its right to appoint directors and appears to be

abandoning its efforts to enforce that right. As of March 31, 2014, Treasury has only appointed directors at 16 CPP banks, even though there have been at least 143 banks that had missed five or more dividend payments throughout the history of TARP, not including those banks that had missed five dividends and then caught up. As of March 31, 2014, even though 48 of the 71 CPP banks with remaining principal investments had missed at least six payments, only three of those institutions had a Treasury-appointed director.

TARP's purpose for ensuring that local communities have access to loans from community banks in TARP must continue to be fulfilled while the bank remains in TARP, and Treasury-appointed directors can assist in ensuring that this purpose is met. Treasury has stated that its decision to appoint directors will be based on "Treasury's evaluation of the condition and health of the institution and the functioning of its board of directors, including the information provided by the [Treasury] observers." To help it do so, Treasury often first requests permission to send Treasury officials to observe certain CPP institutions once they miss five dividend (or interest) payments, a "proactive step" which according to Treasury's Fact Sheet, "will help Treasury determine where the appointment of directors would be most effective." According to Treasury, these observers are assigned to "gain a better understanding of the institution's condition and challenges and to observe how the board is addressing the situation." In addition, if Treasury is continuing to send observers to these board meetings, it clearly recognizes the benefits of attending the meetings. However, these Treasury officials have no voting rights or ability to impact the board's decisions.

Despite the current and ongoing value these independent directors could provide, Treasury officials recently told SIGTARP that Treasury currently has no intention of appointing directors to banks that remain in TARP's CPP, instead focusing on auctioning its interests in the remaining CPP banks. It's unclear why Treasury believes that the appointment of directors and its selloff of its investments in TARP's CPP program, which could take some time and are typically at a loss, are mutually exclusive. Treasury does not need to focus solely on selling off its investments in struggling banks in TARP. Even while it continues to pursue that path, Treasury could simultaneously appoint directors who could protect taxpayers' investment and ensure that TARP's purpose of injecting funds in community banks to ensure that communities have access to loans continues to be met while the banks remain in TARP. Treasury should not give up this valuable tool just because over the next year or so, it has plans to sell its interests in TARP's CPP banks.

In CDCI, although at least two institutions have failed to pay more than eight quarterly payments, Treasury has not appointed directors to the boards of those institutions. As of March 31, 2014, 69 institutions remained in the CDCI program. Moreover, Treasury is not selling its investments in the CDCI program. Accordingly, Treasury should continue to support struggling CDCI recipients, including by enforcing its right to appoint directors.

After making such an important investment in community banks for nearly five years, Treasury must not turn its back on TARP banks still struggling to lend to communities. Based on SIGTARP's concerns that Treasury is not enforcing its contractual right to appoint directors to the boards of TARP banks or under CDCI, on September 30, 2013, SIGTARP made the following recommendations:

- To protect the investment taxpayers made through TARP in community banks and to ensure that these banks continue to lend in their communities which is a goal of TARP's Capital Purchase Program,

Treasury should enforce its right to appoint directors for CPP institutions that have failed to pay six or more quarterly TARP dividend or interest payments.

- In enforcing its right to appoint directors to the board of CPP institutions that have failed to pay six or more quarterly dividend or interest payments, Treasury should prioritize appointing directors to the board of those CPP institutions that meet one or more of the following criteria: (1) rejected Treasury's request to send officials to observe board meetings; (2) have failed to pay a large number of TARP dividend payments or that owe the largest amount of delinquent TARP dividends; or (3) is currently subject to an order from their Federal banking regulator, particularly orders related to the health or condition of the bank or its board of directors. In addition, Treasury should use information learned from Treasury officials that have observed the bank's board meetings to assist in prioritizing its determination of banks to which Treasury should appoint directors.
- To protect the investment taxpayers made in TARP and to ensure that institutions continue to lend in low and moderate income communities which is the goal of TARP's Community Development Capital Initiative, Treasury should enforce its right to appoint directors to CDCI institutions that have failed to pay eight or more TARP quarterly dividend (or interest) payments.

On October 28, 2013, Treasury responded to SIGTARP, rejecting SIGTARP's recommendations, instead insisting that its current processes for director appointments are sufficient, noting that it is focused on winding down its TARP investments, and that the purchasers of Treasury's CPP shares continue to have the right to appoint directors. Although Treasury was never meant to hold its TARP investments forever, Treasury should not forget the reason it invested taxpayers' dollars in community banks through CPP: to maintain and support their ability to lend to the local communities that depended on them. For that reason, when Treasury invested in CPP banks it took on various roles and responsibilities beyond getting taxpayers' money back. Although TARP did not require CPP banks to submit a lending plan as a condition of receiving TARP support, Treasury put some safeguards in place to protect the banks' financial health and stability, along with taxpayers' investment. This included Treasury creating the right to appoint directors if banks continued to demonstrate difficulty in recovering from the financial crisis.

However, rather than focusing on whether TARP's goals have been met before selling its CPP investments, Treasury instead now seems more concerned with its role as a money manager, and particularly with maximizing TARP profits and divesting from its CPP investments as soon as possible. As part of this effort to wind down TARP, as of March 31, 2014, Treasury lost a total of \$991 million in the auctions, which includes \$772.2 million lost on principal investments sold at a discount and \$218.8 million on forfeited missed dividends and interest owed by these institutions. Treasury has incurred investment losses on principal for all but 13 of the 172 CPP bank investments it sold at auction as of March 31, 2014.

Although Treasury indicated it will continue to appoint directors, it rejected SIGTARP's recommendations. Instead of accepting SIGTARP's recommendations as a means of ensuring that CPP's goals are met, Treasury seems content to follow its unsuccessful approach, focusing on appointing directors at banks that received taxpayer investments of \$25 million or more. In some cases, Treasury suggested, it will appoint directors for banks with investments of \$15 million or more. Either way, this approach again focuses on dollars and cents rather than CPP's goals.

Because it may not be cost efficient to appoint directors at all of the eligible CPP banks, Treasury should prioritize its decisions, based on the goals of TARP and CPP, as SIGTARP recommended. Treasury should aggressively enforce its contractual right to appoint directors in order to protect the investments of taxpayers, and to preserve the strength of these community banks and their ability to make credit available to their communities. As SIGTARP recommended, Treasury should also continue to consider appointing directors to struggling CDCI institutions. SIGTARP looks forward to working with Treasury on implementing these recommendations.

SIGTARP AUGUST 2013 REPORT ON TREASURY'S ROLE IN THE DECISION FOR GM TO PROVIDE PENSION PAYMENTS TO DELPHI EMPLOYEES

On August 15, 2013, SIGTARP issued a report examining Treasury's role in the decision for GM to provide pension payments to certain Delphi employees. Treasury's injection of TARP funds in General Motors Corporation ("GM") and Chrysler Group LLC ("Chrysler") was the only bailout with a President's Designee overseeing the companies' restructurings – the Presidential Task Force on the Auto Industry ("Auto Task Force"). The Auto Task Force delegated the responsibility for GM's restructuring to four primary officials who were part of an Auto Team led by Steven Rattner. GM's bankruptcy would be one of the largest and fastest bankruptcies in our nation's history. A new company, "New GM," emerged from GM's bankruptcy in July, 2009, with Treasury owning 61% of its common stock. New GM purchased substantially all of GM's assets while leaving behind many of its liabilities. One of the liabilities that New GM agreed to honor related to the pensions of certain former GM employees paid an hourly wage and represented by certain unions, and who had worked in GM's automobile parts division that was spun off into Delphi Corporation ("Delphi"). The four Treasury Auto Team officials made it clear to SIGTARP that the decisions made and Treasury's role related to Delphi pensions had to be viewed in the broader context of GM's restructuring.

The existence of Treasury's Auto Team and the role these Treasury officials played sharply contrasted with the role played by Treasury officials under other TARP programs. The four Treasury Auto Team officials played a direct role in GM's decisions and operations up to and through GM's bankruptcy. As GM's only lender and later GM's largest investor, Treasury's Auto Team had significant leverage and influence on GM's decisions.

SIGTARP found that the Auto Team used their leverage as GM's largest lender to influence GM to make decisions in areas that did not require Treasury's consent, in line with Treasury's preferences. Auto Team officials told SIGTARP that they "had to carefully manage GM," that "we, the Government, were ultimately holding the purse strings" and "GM realized that there was no other available source of money." When an Auto Team official was asked by SIGTARP how they conveyed their preference, given that ultimately GM could do its own thing, the official said, "Well they could, but then they couldn't exist. I mean, as I said, as the lender we had a fair amount of leverage."

Driven by broader concerns about the auto industry, Treasury's Auto Team directed GM's restructuring toward bankruptcy and created a condition on funding GM's bankruptcy that would serve as pressure on GM and would drive pre-bankruptcy negotiations and decisions. Treasury conditioned giving GM \$30.1 billion in TARP funds on a "quick-rinse bankruptcy" that would end in 40 days because Auto Team officials thought that was the best way to save the automobile industry, concerned that GM could not survive a lengthy bankruptcy and GM's failure would have broader systemic consequences.

As the purchaser of GM's assets in bankruptcy, Treasury's Auto Team had significant influence on GM to make specific decisions that were in line with Treasury's preferences. Treasury used its significant financial leverage to get GM to reach agreement with the two stakeholders that Treasury believed could hold up GM's bankruptcy – the bondholders and the International Union, United Automobile, Aerospace, and Agricultural Implement Workers of America ("UAW").

Treasury's December 2008 TARP loan agreement with GM required GM to reach a new deal with the UAW. The Auto Team made it clear to GM that they wanted an agreement with the UAW prior to bankruptcy (which had to be before a June 1, 2009, bond payment due date) and the Auto Team actively negotiated and made the overall deal. The UAW understood that GM could not walk away from the May 18-19 negotiations and had to reach an agreement to be able to survive, and those same facts put pressure on GM. GM only had a couple of weeks to come to agreement with the UAW, and if they did not come to agreement, GM risked the UAW objecting to and prolonging the bankruptcy beyond 40 days, which GM believed would lead to liquidation. The UAW came to the negotiations with a "hit list" of priority items including the top-up. The top-ups were never discussed in the negotiations.

The Auto Team's role in the decision to top up the pensions of Delphi's UAW workers was not advisory. Consistent with the Auto Team's practice, it would have been Treasury's decision as the buyer to assume or reject the top-up liability. GM could not decide on its own to agree to the new collective bargaining agreement that included the top-up because Treasury's consent was required under the TARP loan agreement and Treasury was the purchaser in bankruptcy. The decision that New GM would honor the top-up was a joint decision by Treasury and GM with Treasury deciding to approve the UAW collective bargaining agreement with the top-up.

Even though the top-up was never discussed in the negotiations with the UAW, it became a foregone conclusion that it would be included in the new UAW agreement with New GM. Auto Team leader Rattner told SIGTARP that GM had the option of honoring or not honoring the top-up, but GM needed UAW workers and UAW's consent was necessary for the bankruptcy. Auto Team leader Rattner and another Auto Team official told SIGTARP that, because the UAW included it on their list, it was clear that the UAW expected the top-up to be part of the overall deal. Treasury had the power to object to New GM taking on the top-up obligation as part of the larger UAW agreement, but had no desire to blow up the larger deal. Although the Auto Team was concerned about the threat of a strike, they were also concerned with the UAW prolonging the bankruptcy, calling not having an agreement like "shooting yourself in the head." Auto Team leader Rattner told SIGTARP that getting more on pensions "was a game of chicken we didn't want to play. We were under incredible time pressure," adding "it was not a ridiculous request, and one that we could have honored and needed to honor."

Treasury's Auto Team and GM did not agree to top up the pensions of other former GM employees at Delphi, which did not have active employees at GM, and therefore had no leverage to hold up GM's bankruptcy. This included Delphi employees who were paid a salary and employees who were paid an hourly wage who were members of the International Union of Electronic, Electrical, Salaried, Machine and Furniture Workers ("IUE") and the United Steelworkers of America ("USW"). Although in GM's bankruptcy New GM did not assume the other top-up agreements with Delphi IUE and USW employees because those unions did not have leverage, subsequently New GM agreed to top up the smaller unions because of the leverage those unions had to prolong Delphi's bankruptcy or strike, which GM believed would significantly impact its ability to survive.

Two important lessons were learned from the role that Treasury played in the decision for GM to provide pension payments to certain Delphi employees. First, the Auto Team's deep involvement and significant influence on GM's decisions leading up to and through GM's bankruptcy led to expectations that Treasury would not act as a private investor, but as the Government. However, Treasury's Auto Team did not always act as a private investor and at times acted as the Government to prevent GM from failing, concerned about financial stability in the auto industry. Although the Auto Team tried to view issues through a "commercially reasonable" lens like a private investor, they often did not act as a private investor, nor should they have. Without policies or procedures to define commercial reasonableness, Treasury used commercial reasonableness as a justification for all of its actions, even when those actions were based on other concerns. No private investor holds the responsibility Treasury has to protect taxpayers and to promote financial stability in the economy. Treasury made the TARP injections in GM when no other private investor would lend or invest the money that GM needed, according to GM's then CFO. Treasury's Auto Team acted based on concerns of the consequences of a GM failure on other companies in the American automotive industry, concerns not held by private investors. Even though the Auto Team tried to act as a private investor, they had considerations that no private investor would ever have had, blurring the lines between Treasury's role as the investor and as the Government. Second, the additional leverage Treasury gave to certain stakeholders, such as the UAW, contributed to criticism of the disparate treatment between Delphi salaried and union employees.

It is very difficult for Treasury to act as only a private investor and still fulfill its greater governmental responsibilities. Treasury entered the TARP investments as the Government, and must continue to act as the Government the whole time it holds these investments, protecting taxpayers' investment and fulfilling Treasury's responsibility to promote financial stability in the economy. An important lesson Government officials should learn from the Government's unprecedented TARP intervention into private companies is that the actions and decisions taken must represent the overarching responsibilities the Government owes to the American public.

SIGTARP APRIL 2013 REPORT ON BANKS THAT USED THE SMALL BUSINESS LENDING FUND ("SBLF") TO EXIT TARP

On April 9, 2013, SIGTARP issued a report conducted to determine whether Treasury and regulators consistently evaluated applications submitted by TARP banks to refinance into SBLF, a program Congress created SBLF as part of the Small Business Jobs Act of 2010, which permitted Treasury to invest up to \$30 billion in eligible small banks to increase "the availability of credit for small businesses."

Viewed by members of Congress as a fix for TARP's failure to require or incentivize banks to lend the money, SBLF provided participating banks with incentives to increase small-business lending. Although Congress allowed TARP banks to participate, Congress intended that the banks would increase their loans to small businesses, and as a safeguard, required that applicant banks submit to their Federal banking regulator a "small business lending plan" detailing how the bank would increase lending.

However, former TARP banks in SBLF have not effectively increased small-business lending and are significantly underperforming compared to non-TARP banks. As of the date of the report, twenty-four former TARP banks have not increased their lending. The remaining former TARP banks have increased lending by \$1.13 for each SBLF dollar they received. By comparison, banks that did not participate in TARP but received

SBLF funding have increased small-business lending by more than three times that amount – \$3.45 for each \$1 in SBLF funds.

The 132 of 137 former TARP banks remaining in SBLF at the time of the report had not effectively increased small-business lending because they used approximately 80% of SBLF funds (\$2.1 billion of the \$2.7 billion) to repay TARP. Although as a group, the former TARP banks remaining in SBLF increased lending by \$1.13 for each \$1 in SBLF funds received, there was a significant difference in lending depending on whether the bank received only enough SBLF funds to repay TARP or received additional funds. TARP banks that received only enough SBLF funds to repay TARP have lent out significantly less than they received in SBLF funds – increasing lending by only 25¢ for each \$1 in SBLF funds. TARP banks that received additional SBLF money beyond the outstanding TARP balance have increased lending by \$1.67 for every \$1 in SBLF funds. TARP banks had much to gain and little to lose from refinancing into SBLF irrespective of their small-business lending capability or willingness to lend. If the former TARP banks fail to increase lending, there is no meaningful penalty. Congress' safeguard of requiring that banks submit a small-business lending plan did not have the intended effect because Treasury and the Federal banking regulators – Federal Reserve Board ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC") – did not adequately assess whether the banks' plans to increase small-business lending were achievable – they did not focus on whether the TARP banks were prepared to lend SBLF capital. SIGTARP found that Treasury and the Federal banking regulators did not effectively communicate with each other, each claiming that the other had responsibility to assess the banks' lending plans. Treasury's SBLF program director told SIGTARP that Treasury did not perform an independent analysis of the projections in the lending plans, and that analysis of the lending plans was the regulators' responsibility because the law required that the lending plans be submitted to regulators. Regulators did not agree with Treasury's view.

The result of this lack of effective communication was an overall lack of scrutiny by Treasury and regulators to determine whether the banks' plans were credible. Regulators did not consistently take action to preserve the intent of Congress by meaningfully reviewing the banks' proposals to increase lending. Instead, regulators generally focused on the banks' viability, in a process described by one regulator as "left over" from TARP. Treasury's review of the lending plans was superficial, merely filling in a "check-the-box" review form, despite obvious questions about TARP banks' ability to meet the SBLF program's lending goals for those banks that would use SBLF funds to repay TARP. Treasury and regulators did not deny SBLF funding to any TARP bank based on its lending plan.

By not developing and implementing meaningful SBLF application review procedures that would achieve the intended purpose of promoting lending, Treasury and the regulators lost sight of Congress' primary goal of the program – to increase lending to small businesses. Treasury and the regulators should have assessed the credibility of the information provided by each applicant TARP bank in its lending plan to ensure that those banks exiting TARP through SBLF were well positioned and well prepared to meet SBLF's sole purpose to increase lending to small businesses. At a minimum, Treasury and the regulators should have required TARP bank applicants to identify another source of capital to increase lending when the institutions sought to use all of the SBLF capital they received to repay TARP. If these TARP banks had been unable to demonstrate a credible source of capital to lend, regulators and Treasury may have identified some of the applicants as unsuited to exit TARP using SBLF funds. Had these banks remained in TARP, they would have been subject to TARP's limitations on executive compensation, luxury expenditures, and cumulative dividends at a higher

payment to taxpayers. Instead, SBLF served as a vehicle for a significant number of TARP banks to exit TARP using Government funds with more favorable terms than TARP with little resulting benefit for small businesses.

SIGTARP's report recommended:

- (1) Treasury and the Federal banking regulators should improve coordination when collaborating on current and future initiatives by (1) defining the roles of all participants at the outset of collaborative efforts by creating precise and directed governing documents (i.e., charters) that clearly address the responsibilities of each entity; and (2) jointly documenting processes and procedures, including flowcharts, risk management tools, and reporting systems to ensure that objectives are met. Each participant should sign off to demonstrate their understanding of, and agreement with, these procedures;
- To increase small-business lending by former TARP banks participating in SBLF, Treasury should work with the banks to establish new, achievable plans to increase lending going forward; and
- To preserve the amount of capital former TARP banks participating in SBLF have to lend, the primary Federal banking regulators (the Federal Reserve, FDIC, or OCC) should not approve dividend distributions to common shareholders of former TARP banks that have not effectively increased small-business lending while in SBLF.

SIGTARP RECOMMENDATIONS CONCERNING NOT COUNTING SBLF FUNDS AS TARP REPAYMENTS

Throughout 2011, 137 banks exited TARP by refinancing Treasury's TARP investment into a separate taxpayer-funded investment under SBLF. Those TARP banks in SBLF did not use their money to repay the \$2.1 billion in TARP funds, but instead used taxpayer money to refinance. As a result, Treasury did not recover the funds by selling its TARP investment in these banks to third parties. In 2011, Senator Charles E. Grassley expressed concerns about these TARP funds, asking then-Treasury Secretary Geithner to ensure that TARP funds received through banks refinancing into SBLF "not be counted as funds 'repaid' to the Government." Senator Grassley added, "To claim that TARP funds are being 'repaid' by government-lent SBLF funds would be an egregious example of budget gimmickry..." In response, Secretary Geithner promised, "We will also break out and report separately any TARP investments repaid using SBLF funds."

However, despite Treasury's assurance, SIGTARP remains concerned that Treasury counts the \$2.1 billion in SBLF funds as TARP funds repaid or recovered. Doing so inaccurately implies that these funds are no longer owed. SIGTARP's April 9, 2013 report concerning SBLF, stressed, "when discussing in press releases and blog posts how much Treasury has received in TARP repayments, Treasury includes the more than \$2 billion of SBLF funds that banks used to repay TARP." It is confusing for Treasury to imply that the SBLF funding used to exit TARP has been fully recovered or repaid to taxpayers, when the funds were merely refinanced into another taxpayer-funded program. Other TARP repayments or recoveries reflect actual repayments by TARP recipients or proceeds from Treasury's sale of the TARP investment to a non-Government third party investor.

As of August 20, 2013, Treasury had made few changes, only adding an explanation to its CPP press releases, blog posts, and Treasury's Transaction Report. For example, Treasury's May 29, 2013, press release on CPP warrant sales stated:

“Taxpayers have already earned a significant profit from TARP’s bank programs. Through the CPP, Treasury has recovered \$271 billion to date through repayments, dividends, interest, and other income — compared to the \$245 billion initially invested. Approximately \$2 billion of the repayments were refinanced under the Small Business Lending Fund. Congress created the SBLF outside of TARP and required Treasury to let CPP institutions repay TARP funds by borrowing under that program.

Treasury’s explanation that some “repayments” came from SBLF does not remedy the concerns Senator Grassley and SIGTARP raised. Treasury should not count the \$2.1 billion in TARP repayment/recovery totals or call these funds “repayments” or “recoveries.” Treasury owes taxpayers fundamental, clear and accurate transparency and reporting on monies actually repaid.

Although Treasury could easily decrease the amount of TARP funds repaid/ recovered by \$2.1 billion in its reporting, it still has not done so. In addition, Treasury can note in its Transaction Report and in other statements discussing the amount of disbursed CPP funds that the funds are no longer outstanding under TARP because they were refinanced, rather than calling them “repayments” or “recoveries.” This is also a necessary change to bring full transparency and accuracy to Treasury’s reporting on TARP.

Accordingly, SIGTARP made the following recommendation in an August 20, 2013, letter to Treasury:

In order to prevent confusion, promote transparency, and present taxpayers who funded TARP with clear and accurate reporting, when Treasury discusses the amount of TARP funds (or CPP funds) recovered or repaid, Treasury should not count the \$2.1 billion in TARP investments that Treasury refinanced into the Small Business Lending Fund, which is outside of TARP.

Treasury responded agreeing with the goals of SIGTARP’s recommendation, stressing that it is in the public interest to make clear the amount of TARP investments that were repaid with SBLF funds. Treasury’s also noted, “Congress specifically directed that SBLF not be a part of TARP, and thus SBLF and TARP accounts are kept separate.” However, Treasury has not agreed to implement SIGTARP’s recommendation.

First, although Treasury claims to have taken steps to achieve the goals of the recommendation, SIGTARP does not believe those steps are adequate. If they were, SIGTARP’s recommendation would not have been necessary. Second, Treasury claims that it is actually prohibited from providing this additional transparency because it is required to count SBLF refinancings as “repayments” in its financial statements. Despite Treasury’s acknowledgement that adequate transparency is necessary, Treasury does not, however, explain what prevents Treasury from being wholly transparent in its various representations to the public. But Treasury does not limit itself to talking about these payments to its financial statements, and Treasury should be more transparent about the costs to taxpayers in its other statements, including in its CPP press releases, blog posts, and Treasury’s Transaction Report, as SIGTARP explained. In fact, Treasury even describes these refinances in various ways in those instances, often referring to those amounts as being “recovered” rather than solely labeling them as “repayments” or amounts “repaid.”



Office of Inspector General Department of the Treasury

The Department of the Treasury Office of Inspector General performs independent, objective reviews of specific Treasury programs and operations with oversight responsibility for one federal banking agency- the Office of the Comptroller of the Currency. That federal banking agency supervises approximately 1,800 financial institutions.

Introduction

The Department of the Treasury Office of Inspector General (OIG) was established pursuant to the 1988 amendments to the Inspector General Act of 1978. The Treasury Inspector General is appointed by the President, with the advice and consent of the Senate. Treasury OIG performs independent, objective reviews of Treasury programs and operations, except for those of the Internal Revenue Service (IRS) and the Troubled Asset Relief Program (TARP), and keeps the Secretary of the Treasury and Congress fully informed. Treasury OIG is comprised of five divisions: (1) Office of Audit, (2) Office of Investigations, (3) Office of Small Business Lending Fund Program Oversight, (4) Office of Counsel, and (5) Office of Management. Treasury OIG is headquartered in Washington, DC, and has an audit office in Boston, MA.

Treasury OIG has oversight responsibility for one federal banking agency--the Office of the Comptroller of the Currency (OCC). OCC is responsible for the supervision of 1,245 national banks, 515 federal savings associations, and 48 federal branches of foreign banks. The total assets under supervision are \$10.4 trillion, making up 69 percent of the total U.S. commercial banking assets. Treasury OIG also oversees several offices created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) which are (1) the Office of Financial Research, (2) the Federal Insurance Office, and (3) the Offices of Minority and Women Inclusion within Treasury's Departmental Offices and OCC. Additionally, Treasury OIG oversees Treasury's role related to the financial solvency of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation under the Housing and Economic Recovery Act of 2008, to include Treasury's Senior Preferred Stock Purchase Agreements established for the purpose of maintaining the positive net worth of both entities (\$258 billion funding capacity available as of as of March 31, 2014, covering future net worth deficiencies). Finally, Treasury OIG oversees Treasury's administration of approximately \$25 billion in non-IRS funding provided by the American Recovery and Reinvestment Act of 2009.

Completed and In-Progress Work on Financial Oversight

OCC Oversight of Foreclosure Related Consent Orders

We completed an audit of OCC's oversight of foreclosure-related consent orders that OCC issued in April 2011 in conjunction with the Board of Governors of the Federal Reserve System (FRB) and the former Office of Thrift Supervision. These consent orders were issued against 14 major mortgage servicers for unsafe and unsound practices in residential mortgage servicing and foreclosure processing. Among other things, the consent orders required the servicers to implement an independent foreclosure review process using independent consultants to determine financial injury to affected borrowers. Our audit objectives were to assess OCC's: (1) oversight of servicers' efforts to comply with consent orders; (2) determination of qualifications and independence of consultants hired by servicers; (3) oversight of consultants' efforts to perform outreach, conduct file reviews, and review homeowner claims of financial harm; and (4) oversight of the single integrated claims process established by OCC, servicers, and the consultants. In January 2013, OCC negotiated a change to the terms of the consent orders for 12 of the 14 mortgage servicers. The other two mortgage servicers did not agree to change the consent orders and were planning at the time to continue the independent foreclosure review process. We closed our audit effort for the above objectives by issuing a report on our findings at the time the consent orders were amended and started a separate audit focusing on the new process to provide payments to potentially harmed borrowers under the amended consent orders.

Our audit related to the original consent orders found that OCC needed to (1) develop and implement examiner guidance defining the timing and scope of OCC's direct testing of individual foreclosure reviews at the two OCC-supervised servicers who were continuing the independent foreclosure review process to ensure compliance and consistency and (2) improve documentation of OCC oversight activities. OCC agreed with our recommendations to address these matters.

OCC Supervision of Banks Use of Third Party Service Providers

We reviewed the sufficiency and effectiveness of OCC's procedures for supervising the use of third-party service providers (third parties) by national banks and federal saving associations.

We reported that OCC provided guidance to banks on managing risks related to the use of third parties. Although the guidance in effect during our audit was generally comprehensive, the guidance needed to be updated. Subsequent to the end of our field work, OCC issued new risk-management guidance. We also found that OCC examiners conclude upon the adequacy of bank processes for managing risks related to the use of third parties. However, examination workpapers related to the use of third parties by smaller financial institutions often do not leave a clear enough audit trail to enable a reviewer to determine how the conclusions were reached.

OCC has planned corrective actions that are responsive to our recommendation that OCC reinforce to examination staff the need for workpapers to contain essential information to support conclusions about banks' governance of third parties.

OCC Supervision of Financial Institutions Trading Activities

We determined and assessed OCC's process of supervising bank trading activities, primarily focusing on OCC's supervision of trading activities at the JPMorgan Chase Bank, N.A. (JPMC) Chief Investment Office (CIO). The audit was prompted by the media attention and congressional hearings related to the 2012 trading losses at JPMC CIO in London.

We reported that OCC had many opportunities to address weaknesses in JPMC CIO's risk management of trading activities but did not act strongly or timely enough to address those weaknesses. In some cases, OCC failed to act at all. Further, we determined that (1) the Comptrollers Handbook lacked comprehensive guidance on supervision of bank trading activities and (2) OCC's coordination of its dual supervision responsibilities with FRB needs improvement.

OCC has taken or planned actions that are responsive to our recommendations that OCC (1) ensure that examiners review bank reports and obtain satisfactory explanations when those reports show significant signs of increasing risk in trading activities; (2) amend OCC policies and procedures to clarify that examiners should follow up on matters requiring attention no later than the next supervisory cycle or sooner as dictated by the urgency of the examination finding; (3) ensure that examiners follow up on findings or concerns with a bank's internal audit office and expand the review of the internal audit function, as necessary, to determine its effectiveness; (4) improve supervisory coordination with regulatory agencies and consider formalizing any understanding or agreement; and (5) ensure that revisions to the Handbook for supervision of trading activities communicate to examiners all activities required to be performed during both ongoing supervision and targeted examinations.

Survey of Small Business Lending Fund (SBLF) Participants on Use of Program Funds, Repayment Plans, and Satisfaction with Treasury's Program Administration

Treasury OIG auditors working for the Office of Small Business Lending Fund Program Oversight surveyed SBLF participants to determine how they used the funds awarded to them, their plans for repaying Treasury's investment, and their satisfaction with Treasury's administration of the program.

Treasury OIG reported that most participants used their SBLF capital for small business loans, but only an estimated 55 percent of the capital provided was used for that purpose. Respondents also attributed 58 percent of the small business lending gains achieved from the time of Treasury's investment to March 31, 2013, to their SBLF capital, and reported \$22.8 billion in new small business loans and credit commitments from all capital sources for that same time period.

Respondents that used their SBLF capital to repay their Troubled Asset Relief Program (TARP) securities reported performing as well as other participants in new loans and commitments to small businesses even though they netted substantially less SBLF capital following the repayment of their TARP securities.

The survey revealed that most respondents plan to repay Treasury's investment and exit the program when the variable dividend rate becomes fixed, or when cheaper capital is available. Finally, over 89 percent of respondents were satisfied overall with Treasury's administration of the SBLF program, except for the handling of fees and penalties for non-compliance.

OCC Oversight of Amended Foreclosure Consent Orders (In Progress)

As mentioned above, upon the 2013 amendments to the April 2011 foreclosure consent orders, with 10 OCC-supervised mortgage servicers, we initiated a separate audit. The amended orders required that the servicers cease work on the independent foreclosure reviews required by the original orders and provide relief to potentially harmed borrowers in the form of cash payments and foreclosure prevention actions. Our objectives are to: (1) report on the circumstances and processes used to determine that the foreclosure consent orders issued in April 2011 should be amended, including how the settlement amounts were derived; and (2) assess OCC's oversight of servicers' compliance with the amended foreclosure consent orders, including the servicers' categorization of the population of borrowers due payment, the payment of funds to the borrowers, and the servicers' loss mitigation or other foreclosure prevention actions.

Review of Treasury's Controls over the Separation of Funds and Activities (In Progress)

House Report 112-550, Report on the Financial Services and General Government Appropriations Bill, 2013, contained a committee recommendation directing Treasury OIG to report on the separation of funds and activities between mandatory-funded offices, such as the Office of Financial Research, and discretionary-funded offices that carry out related or overlapping work, such as the Office of Domestic Finance or Office of Economic Policy. To address this congressional interest, we are conducting a review to assess Treasury Departmental Offices' controls over the separation of funds.

OCC Financial Institution Assessment Process (In Progress)

We initiated a review to assess OCC's authority and decision-making process to waive the assessment and collection of certain fees erroneously under-assessed and the actions taken by OCC to identify and correct internal control deficiencies in the financial institution assessment process.

Failed Bank Reviews

In 1991, Congress enacted the Federal Deposit Insurance Corporation Improvement Act (FDICIA) amending the Federal Deposit Insurance Act. Following the failures of about a thousand banks and thrifts from 1986 to 1990, FDICIA required that federal banking agencies take specified supervisory actions when they identify unsafe or unsound practices or conditions. FDICIA also required that the Inspector General for the primary federal regulator of a failed financial institution conduct a material loss review (MLR) when the estimated loss to the Deposit Insurance Fund is "material." As part of the MLR, OIG auditors determine the causes of the failure and assess the supervision of the institution, including the implementation of the prompt corrective action provisions of the act. As appropriate, Treasury OIG also makes recommendations for preventing any such loss in the future.

Prior to the enactment of the Dodd-Frank Act in July 2010, FDICIA defined a material loss as a loss to the Deposit Insurance Fund that exceeded the greater of \$25 million or 2 percent of the institution's total assets. The Dodd-Frank Act redefined the loss threshold amount to the Deposit Insurance Fund triggering a material loss review to a loss that exceeds \$150 million for 2012 and 2013, and \$50 million for 2014 and thereafter (with a provision to temporarily raise the threshold to \$75 million in certain circumstances). The Dodd-Frank Act also requires a review of all bank failures with losses under these threshold amounts for the purposes of (1)

ascertaining the grounds identified by OCC for appointing FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. This provision applies to bank failures from October 1, 2009, forward.

From the beginning of the economic crisis in 2007 through June 2014, FDIC and other banking regulators closed 502 banks and thrifts. One hundred and thirty-five (135) of these were Treasury-regulated financial institutions. Of these 135 failures, 55 resulted in a material loss to the Deposit Insurance Fund, and our office performed the required MLRs of the failures. In total, the estimated loss to FDIC's Deposit Insurance Fund for these 55 failures was \$33.6 billion.

Treasury Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, the Treasury Inspector General annually provides the Secretary of the Treasury with his perspective on the most serious management and performance challenges facing the Department. In a memorandum to the Secretary dated November 14, 2013, the Inspector General reported two management and performance challenges that were specifically directed towards financial regulation and economic recovery. Those challenges were: (1) Continued Implementation of Dodd-Frank and (2) Management of Treasury's Authorities Intended to Support and Improve the Economy. An abbreviated discussion of these challenges and other matters noted by the Treasury Inspector General follow.

Continued Implementation of the Dodd-Frank Act

With the intention to prevent, or at least minimize, the impact of a future financial sector crisis on the U.S. economy, the Dodd-Frank Act placed a great deal of responsibility within Treasury and on the Treasury Secretary. Accordingly, this challenge, among other things, primarily focused on a number of Dodd-Frank Act mandates related to Treasury. The memorandum broadly addressed the challenge of the Financial Stability Oversight Council (FSOC) and its federal agency members continuing to work to meet all of FSOC's responsibilities. Additionally, it recognized FSOC's accomplishments over the previous year including the designation of nonbank financial institutions for consolidated supervision.

This management and performance challenge also included the other regulatory challenges that the Treasury Inspector General had previously reported. Specifically, it acknowledged the number of Treasury-regulated financial institutions that had failed since the beginning of the current economic crisis and their multi-billion losses to FDIC's Deposit Insurance Fund. The challenge noted that the number of failures had dramatically decreased since 2010. With respect to those failures and associated losses, it stated that although many factors contributed to the turmoil in the financial markets, our work found that OCC and the former Office of Thrift Supervision did not force timely correction of unsafe and unsound practices by numerous failed institutions under their supervision. It also addressed deficiencies in mortgage servicers' foreclosure processing that resulted in the federal banking regulators issuing formal enforcement actions against 14 mortgage servicers and 2 third party providers. As noted above, we reviewed OCC's oversight of the servicers' efforts to comply with these enforcement actions and are currently reviewing OCC's oversight of the amended enforcement actions.

Management of Treasury's Authorities Intended to Support and Improve the Economy

This challenge, among other things, focused on a number of broad authorities the Congress provided to Treasury to address the financial crisis under the Housing and Economic Recovery Act and the Emergency Economic Stabilization Act, both enacted in 2008; the American Recovery and Reinvestment Act of 2009; and the Small Business Jobs Act of 2010. It acknowledged that certain authorities in the Housing and Economic Recovery Act and the Emergency Economic Stabilization Act expired, but pointed out the fact that challenges remain in managing Treasury's outstanding investments. To a large extent, Treasury's program administration under these acts have matured, however, the long-term impact on small business lending resulting from investment decisions under the Small Business Jobs Act of 2010 are still not clear.

Another challenge that the Treasury Inspector General reported for a number of years is Treasury's anti-money laundering and terrorist financing/Bank Secrecy Act enforcement efforts. Among other things, this challenge pointed out our particular concern with respect to ensuring continued cooperation and coordination of all organizations involved in anti-money laundering and combating terrorist financing efforts.

As a final note, the Treasury Inspector General highlighted an area of concern – cyber security. Information security remains a constant area of concern and potential vulnerability for Treasury. Accordingly, Treasury management must continuously monitor its systems for vulnerabilities and ensure all employees and others connected to those systems maintain a heightened awareness of their roles in protecting these critical assets. The cyber attacks facing banking institutions continue to evolve at an accelerated rate, ranging from distributed denial of service attacks on bank websites to phishing attacks to fraudulent wire payments. Organized hacking groups leverage known and new vulnerabilities and use different methods to make attacks hard to detect and even harder to prevent. Given the evolving cyber-threat environment, Treasury will need to continue to strengthen partnerships among law enforcement, financial institutions, regulators, and private entities in the financial sector, to address these threats.

Abbreviations and Acronyms

CFPB	Consumer Financial Protection Bureau
CIGFO	Council of Inspectors General on Financial Oversight
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FMU	financial market utility
FSOC or Council	Financial Stability Oversight Council
GAO	U.S. Government Accountability Office
MMF	money market fund
OFR	Office of Financial Research
OMB	Office of Management and Budget
Title I	Dodd-Frank Wall Street Reform and Consumer Protection Act, Title I—Financial Stability
Treasury	The Department of the Treasury

**Appendix A:
Audit of the Financial Stability Oversight Council's
Compliance with Its Transparency Policy**

Prepared by the Council of Inspectors General on Financial Oversight

2014



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 1, 2014

The Honorable Jacob J. Lew
Chair, Financial Stability Oversight Council
Washington, D.C. 20220

Dear Mr. Chairman:

I am pleased to present you with the Council of Inspectors General on Financial Oversight (CIGFO) audit report titled *Audit of the Financial Stability Oversight Council's Compliance with Its Transparency Policy*.

As its transparency policy is one of the Financial Stability Oversight Council's (FSOC) key governance documents, I proposed convening a working group to assess the Council's compliance with the transparency policy, and to determine if improvements could be made to the policy. The proposal was approved, and a CIGFO Working Group completed an audit.

In our report, we recommend that FSOC continue its efforts to (1) provide greater detail in the meeting minutes for closed meetings and (2) identify datasets and information that could be made publicly available; ensure such datasets and information are posted to its website, while continuing to protect market-sensitive or confidential information; and implement a permanent process for continuous, proactive identification, preparation and release of data on an ongoing basis.

I would like to take this opportunity to thank the FSOC members for their support, especially those Treasury officials who assisted with this effort.

CIGFO looks forward to working with you on this and other issues. In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act, CIGFO is also providing this report to Congress.

Sincerely

Eric M. Thorson
Chair
Council of Inspectors General on Financial Oversight

Executive Summary

Why and How We Conducted this Audit

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created a comprehensive regulatory and resolution framework designed to reduce the severe economic consequences of economic instability. The Dodd-Frank Act established the Financial Stability Oversight Council (FSOC or Council) and charged it with identifying risks to the nation's financial stability, promoting market discipline, and responding to emerging threats to the stability of the nation's financial system. Among other things, Title I of the Dodd-Frank Act (Title I) requires the Council to meet at least quarterly. On October 1, 2010, at its first meeting, FSOC voted to approve a transparency policy that pertains to the openness and transparency of its meetings.

The Dodd-Frank Act also established the Council of Inspectors General on Financial Oversight (CIGFO). CIGFO's statutory functions include oversight of FSOC. In this regard, the law authorizes CIGFO to convene a working group, by a majority vote, for the purpose of evaluating the effectiveness and internal operations of FSOC. In September 2013, Eric Thorson, CIGFO Chair and Department of the Treasury (Treasury) Inspector General, proposed convening a working group to assess the extent to which FSOC is operating in a manner consistent with expectations outlined in its transparency policy, and to consider whether improvements to FSOC's transparency policy could be made. CIGFO approved the proposal and formed a Working Group.

To accomplish its objective, the CIGFO Working Group conducted a review of FSOC's transparency policy and tested whether FSOC was compliant with its own policy. The working group also assessed FSOC's transparency policy by analyzing laws, directives, and other organizations' policies or practices related to transparency. Appendix I provides a more detailed description of the working group's objective, scope, and methodology.

What We Learned

Based on our review of documents from October 2010 through December 2013, we determined FSOC operated in a manner consistent with the expectations outlined in its transparency policy. Specifically, FSOC:

- held at least two open meetings each year;
- made all open meetings available to the public via a live web stream;
- released minutes of each meeting;
- recorded all votes of Council members in the meeting minutes;
- voted on proposed and final rules during open meetings; and
- reported on its compliance with the transparency policy in its annual report to Congress.

FSOC's transparency policy outlined eight specific reasons why a meeting or portion of a meeting could be closed, and stated that the decision to close a meeting is determined by the Chairperson based on the agenda, or upon an affirmative vote of a majority of the voting members. However, when a meeting or portion thereof was closed, we found that FSOC did not inform the public which of the eight reasons applied to the determination.

While we concluded that FSOC complied with its transparency policy, we identified practices in place during the time of our fieldwork related to meetings that, if incorporated into the policy, would make it stronger. Specifically, the policy did not include FSOC's practices of (1) posting public notices for upcoming meetings to its website 7 days in advance of a regularly scheduled meeting, (2) issuing a press readout upon completion of Council meetings, and (3) posting minutes to its website immediately following approval.

We also identified certain additional practices that FSOC should implement to increase transparency: (1) providing more detailed minutes for closed meetings, while protecting market-sensitive or confidential information; (2) posting meeting agendas to its website in advance of Council meetings; and (3) identifying additional data and information that could be made available to the public and posting such data and information to its website. By doing these things, we believe FSOC will enhance public confidence in the accountability and integrity of Council activities.

On May 7, 2014, subsequent to the completion of our fieldwork, FSOC unanimously approved a revised transparency policy. Work on this revised transparency policy started before our audit and considered matters we brought to the attention of FSOC staff during the audit. The revised policy includes the following new provisions: (1) providing not less than 7 days advance notice of any regularly scheduled meeting on its website, including information about the agenda, the reason(s) for closing a meeting, if applicable, and the time and place of any open meeting; (2) as soon as practicable after each meeting, making information about the meeting available on FSOC's website; and (3) when practicable, releasing meeting minutes immediately following the next regularly scheduled meeting. The revised policy also includes a ninth specific reason why a meeting or portion of a meeting could be closed. See appendix II for FSOC's October 2010 transparency policy and appendix III for the May 2014 revised transparency policy.

In considering our recommendations to FSOC, we also note recent concerns expressed by certain Members of Congress about the transparency of FSOC's activities.

Recommendations

We acknowledge FSOC's efforts to improve its transparency through its revised transparency policy. We recommend the Council continue its efforts to (1) provide greater detail in the meeting minutes for closed meetings and (2) identify datasets and information that could be made publicly available; ensure such datasets and information are posted to its website, while continuing to protect market-sensitive or confidential information; and implement a permanent process for continuous, proactive identification, preparation and release of data on an ongoing basis.

FSOC Response

In a written response, FSOC stated that the Council has recognized the importance of transparency since its first meeting in 2010, when it voluntarily adopted a transparency policy. Since then, the Council has considered how to open up more of its work to the public, while at the same time respecting its need to discuss supervisory and other market-sensitive data, including information about individual firms, transactions, and markets that require confidentiality. As the CIGFO report noted, Council staff had already begun, before the CIGFO review started, a broad review of the Council's governance practices, including its transparency policy, to identify ways to further strengthen the Council's commitment to openness. As a result

of this internal review, the Council voted in an open session on May 7, 2014, to adopt enhancements to its transparency policy.

With respect to the recommendation to provide greater detail in the meeting minutes for closed meetings, the Council is fully committed to maintaining the practice of incorporating additional detail in its minutes, while still protecting the confidentiality of market-sensitive or supervisory information that are often the subject of Council discussions. With respect to the recommendation to identify datasets and information that could be made publicly available, FSOC noted that it already provides on its website a significant amount of information. Also, as a collaborative body that brings together the independent financial regulators, much of the data relied upon by the Council is provided by those agencies and the Office of Financial Research, which maintain the responsibility for determining whether to make their data available to the public. However, to the extent that the Council considers data and information during Council meetings, Council staff will routinely evaluate whether such materials could be made available to the public, in light of any applicable confidentiality restrictions.

CIGFO Working Group Comments

We consider FSOC's commitments and planned actions responsive to our recommendations. We recognize that the Council considers market-sensitive and confidential data and information from multiple entities. To the extent FSOC staff identifies materials that could be made public, the Council should ensure those materials are posted to its website in a timely manner.

Results of CIGFO Working Group Audit

Introduction

In 2010, FSOC approved a transparency policy intended to provide for openness and transparency of Council meetings.¹⁵ This report presents the results of the CIGFO Working Group's audit of FSOC's compliance with its transparency policy. This is the third audit that a CIGFO Working Group has issued to the Council and the Congress as part of CIGFO's responsibility to oversee FSOC under the Dodd-Frank Act. CIGFO issued its first two audits in June 2012¹⁶ and July 2013.¹⁷

Background

The Dodd-Frank Act established FSOC to create joint accountability for identifying and mitigating potential threats to the stability of the nation's financial system. By creating FSOC, Congress recognized that protecting financial stability would require the collective engagement of the entire financial regulatory community. As shown in the following table, FSOC consists of 10 voting members and 5 nonvoting members and brings

¹⁵ Title I requires the Council to meet at least quarterly.

¹⁶ CIGFO, *Audit of the Financial Stability Oversight Council's Controls over Non-public Information*, (June 22, 2012)

¹⁷ CIGFO, *Audit of the Financial Stability Oversight Council's Designation of Financial Market Utilities*, (July 12, 2013)

together the expertise of federal financial regulators, state regulators, and an insurance expert appointed by the President with Senate confirmation.

Table 1: FSOC Membership

Federal and Independent Members	State Members
<ul style="list-style-type: none"> • Secretary of the Treasury, Chairperson (v) • Chairman of the Board of Governors of the Federal Reserve System (v) • Comptroller of the Currency (v) • Director of the Consumer Financial Protection Bureau (v) • Chairman of the Securities and Exchange Commission (v) • Chairperson of the Federal Deposit Insurance Corporation (v) • Chairperson of the Commodity Futures Trading Commission (v) • Director of the Federal Housing Finance Agency (v) • Chairman of the National Credit Union Administration Board (v) • Director of the Office of Financial Research • Director of the Federal Insurance Office • Independent member with insurance expertise (v) <p>(v) Indicates Voting Member</p>	<ul style="list-style-type: none"> • State Insurance Commissioner • State Banking Supervisor • State Securities Commissioner

The purposes of FSOC are to:

- identify risks to the financial stability of the U.S. that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;
- promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the U.S. Government will shield them from losses in the event of failure; and
- respond to emerging threats to the stability of the U.S. financial system.

Within Treasury, a dedicated policy office, led by a Deputy Assistant Secretary, functions as the FSOC Secretariat and serves as a mechanism to bring issues to the Council through a coordinated process. The voting members of FSOC provide a federal regulatory perspective as well as an independent insurance expert's view. The nonvoting members offer different insights as state-level representatives from bank, securities, and insurance regulators or as the directors of offices within Treasury – the Office of Financial Research and the Federal Insurance Office.

FSOC Secretariat staff developed a transparency policy in 2010 with input from FSOC member agencies. On October 1, 2010, at its first meeting, the Council voted on and unanimously approved the policy. The policy was intended to provide for transparency of Council meetings. The transparency policy is provided as Appendix II.

FSOC Secretariat staff told us they recently reviewed the Council's governance framework, including its transparency policy, to identify potential improvements. These potential improvements included (1) revising

the policy to formally adopt the practice of posting notices to FSOC's website for upcoming meetings at least 7 days in advance, when possible; (2) including in the notices a high-level, preliminary agenda for each meeting, and the time and place of open meetings; (3) requiring the posting of a statement with basic information to FSOC's website after each Council meeting (prior to the meeting minutes being available); and (4) providing additional detail in meeting minutes while protecting market-sensitive or confidential information.

Audit Approach

Our audit objective was to assess the extent to which FSOC is operating in a manner consistent with the expectations outlined in its transparency policy. Our audit scope included the period from October 2010 through December 2013. We also considered whether improvements to FSOC's transparency policy could be made.

To accomplish our objective, we reviewed relevant FSOC records to determine compliance with its transparency policy. In addition, participating Offices of Inspector General collected information from FSOC federal members regarding FSOC's transparency policy and practices. We collected similar information from the FSOC Secretariat and FSOC non-federal members. Furthermore, we reviewed laws, directives, and other organizations' policies or practices relevant to transparency.

We conducted our audit fieldwork from January through March 2014 in accordance with generally accepted government auditing standards. We provided an exit briefing on the overall results of our work to FSOC representatives on May 8, 2014.

FSOC COMPLIED WITH ITS TRANSPARENCY POLICY

We determined that FSOC complied with its October 2010 transparency policy. The policy requirements and what we found are described below.

Hold two open meetings each year

FSOC's transparency policy committed FSOC to holding two open meetings each year. We determined that from October 2010 through December 2013, the Council met 36 times, either in person (27) or telephonically (9).¹⁸ Of the 27 meetings held in person, 11 meetings included a portion that was open to the public via a live web stream. As shown below, FSOC held at least two open meetings each year.

- 2010 – 2 open meetings
- 2011 – 4 open meetings
- 2012 – 3 open meetings
- 2013 – 2 open meetings

¹⁸ These FSOC meetings conducted by conference call were held to discuss single-issue emerging matters that could impact the financial sector.

Open meetings to the press and public via a live web stream

The policy stated that FSOC will make its meetings open to the press and to the public via a live web stream except when supervisory and market-sensitive information is being discussed and for certain other enumerated reasons. Council meetings were either closed entirely or consisted of closed and open sessions. If a meeting consisted of both types of sessions, the closed session was held first, followed by the open session.

We determined that for each of the 11 meetings that included a portion open to the public, there was a live web stream made available for that portion of the meeting. Videos of all 11 web streams are maintained on FSOC's website.

Minutes of meetings

The policy stated that FSOC will release meeting minutes after each meeting, and that the minutes are subject to redactions, as determined by the Chairperson. We determined that minutes were (1) prepared for each of the 36 Council meetings, (2) approved at the next meeting, and (3) posted to FSOC's website within a day of being approved.

FSOC does not keep detailed transcripts of Council meetings. An FSOC Secretariat official stated that the meeting minutes are sufficient for the needs of the Council and serve as the Council's internal record. This official also stated that there have not been any redactions to the meeting minutes, although in some instances, certain sensitive materials attached to the minutes as appendices have been omitted from the minutes posted on FSOC's website.

Votes of Council members

The transparency policy stated that all votes of Council members will be recorded and reflected in the minutes of the Council. In addition to votes to approve meeting minutes and annual reports, examples of votes included resolutions to appoint the Chairperson of the Deputies Committee, Rules of Organization of the Council, and various proposed and final rules. We determined that for all scheduled Council votes (i.e., votes included as agenda items), the results of the votes were recorded in the minutes of the corresponding Council meetings.

Votes on proposed or final rules

FSOC's policy stated that when FSOC members are asked to vote on a draft FSOC proposed or final rule, FSOC will make those agenda items open to the public. We determined that FSOC members voted on nine proposed or final rules, and all of the votes were conducted during the open portion of the meetings.

Reporting compliance with transparency policy

FSOC's transparency policy stated that, as part of FSOC's annual report to Congress, it will report on its compliance with its transparency policy. We determined that FSOC's 2011 through 2014 annual reports to Congress stated that FSOC complied with its transparency policy.

Opening or closing of Council meetings

The transparency policy stated that meetings will be open or may be closed, in whole or in part, as determined by the Chairperson based on the agenda, or upon an affirmative vote of a majority of the voting members. The reasons that a meeting or portion thereof would be closed included circumstances where holding an open meeting could:

3. result in the disclosure of information contained in or related to investigation, examination, operating, or condition reports prepared by, on behalf of, or for the use of, an agency responsible for the regulation or supervision of financial markets or financial institutions;
4. result in the disclosure of information that would lead to significant financial speculation, significantly endanger the stability of any financial market or financial institution, or significantly frustrate implementation of a proposed agency action;
5. result in the disclosure of information exempted from disclosure by statute or by regulation; or authorized under criteria established by an Executive Order to be kept secret;
6. result in the disclosure of trade secrets and commercial or financial information obtained from a person and privileged or confidential;
7. result in the disclosure of information of a personal nature that would constitute an unwarranted invasion of personal privacy or be inconsistent with Federal privacy laws, or the disclosure of information that relates solely to internal personnel rules or practices;
8. result in the disclosure of investigatory records compiled for law enforcement or supervisory purposes;
9. result in the disclosure of inter-agency or intra-agency memoranda or letters that would not otherwise be available by law; or
10. necessarily and significantly compromise the mission or purposes of the FSOC, as determined by the Chairman with the concurrence of a majority of the voting member agencies or by a majority of the voting member agencies.

We reviewed the agendas and meeting minutes for all 36 Council meetings held from October 2010 through December 2013, and found no mention of the specific reason why a meeting or portion of a meeting was closed. Nevertheless, based on our review of the minutes from the closed meetings, we were able to link the discussions documented in the minutes to one or more of the reasons for closure listed above.

When asked about the decision-making process on whether to close a Council meeting, FSOC Secretariat personnel told us that typically 2 weeks in advance of each meeting, the FSOC Deputies Committee¹⁹ considers potential Council meeting agendas and whether the meetings should be open or closed. Based on the consensus of the FSOC Deputies Committee, FSOC Secretariat staff prepare and send the Chairperson and all other Council members a copy of the proposed agenda that indicates whether each agenda item is proposed for discussion in an open or closed session in advance of each Council meeting. According to FSOC Secretariat personnel, to date, the Chairperson has accepted all the Deputies Committee's proposals and no Council votes have occurred on the subject of opening or closing a meeting.

¹⁹ The Deputies Committee coordinates and oversees the work of the interagency staff committees and is made up of senior officials representing each FSOC member.

On May 7, 2014, subsequent to the completion of our fieldwork, FSOC unanimously approved a revised transparency policy. Among other things, the revised policy includes a new provision that states FSOC will provide not less than 7 days advance notice of any regularly scheduled meeting on its website, including information about the reason(s) for closing a meeting, if applicable. We believe this new provision will enhance FSOC's transparency.

ASSESSMENT OF FSOC'S TRANSPARENCY POLICY

FSOC's transparency policy did not incorporate current practices

FSOC's transparency policy focused on the transparency of Council meetings. While we concluded that FSOC complied with its transparency policy, we identified key FSOC practices related to meetings that were not incorporated into the policy. These practices are discussed below and were separately identified by the FSOC Secretariat staff and the FSOC Deputies Committee as potential revisions to the Council's transparency policy.

We noted that FSOC's practices included posting public notices for upcoming meetings on its website 7 days in advance of a regularly scheduled meeting. These notices provided the date of the meeting, whether the meeting would be open or closed and, when applicable, the expected start time for the open session. Soon after each meeting, the meeting notice was removed from FSOC's website and replaced with language notifying the public that the meeting had occurred. FSOC's practices also included providing a press readout to the media after each meeting held in closed session, which included a high level description of the meeting. We noted that the transparency policy did not require providing public notifications of regularly scheduled upcoming Council meetings or press readouts to the media. We also noted FSOC did not post the information from these press readouts to its website. The May 2014 revised policy includes the following new provisions: (1) providing not less than 7 days advance notice of any regularly scheduled meeting on its website, including the time and place of any open meeting; and (2) as soon as practicable after each meeting, making information about the meeting available on FSOC's website. We believe these new provisions address our concerns that the transparency policy did not include key practices related to FSOC meetings, and that FSOC did not post information about its meetings to its website soon after the meetings.

The October 2010 transparency policy stated that FSOC will release minutes of meetings after each meeting, but did not specify when the minutes would be released. The May 2014 transparency policy specifies that when practicable, the Council will release its meeting minutes immediately following the next regularly scheduled meeting. We believe the new policy gives more specificity about when the meeting minutes will be released.

FSOC should increase the level of detail in its closed meeting minutes

As noted earlier, the majority of FSOC meetings were closed to the public. Meeting minutes for closed meetings give general information about agenda items and presenters. Discussion in the minutes of specific agenda items is high-level and lacks detail. We noted that in some instances, portions of agenda item topics were already in the public domain; therefore those portions could have been covered more fully in meeting minutes. For example, during the closed session of a meeting on December 9, 2013, the Director of the Consumer Financial Protection Bureau (CFPB) gave a presentation on certain CFPB housing finance rules. The meeting minutes stated that the Director provided an overview of the ability-to-repay/qualified mortgage

rule and also presented on the servicing rules, which apply to both banks and nonbanks, and were to take effect on January 10, 2014. Because the rules were final and publicly available, FSOC could have included more details about the presentation in its meeting minutes.

In our July 12, 2013 audit, we noted that during the financial market utilities (FMU) designation process, FSOC identified certain foreign-based FMUs as potential candidates for designation as systemically important. However, FSOC decided not to consider possible designation at the time pending further deliberations.²⁰ According to the FSOC Secretariat, this matter was, and continues to be, still under review. We reviewed FSOC meeting minutes and annual reports and did not find any mention of this matter. We believe that because this information is important, FSOC should have included it in its meeting minutes.

In a September 2012 report, the U.S. Government Accountability Office (GAO) noted the lack of detail in FSOC's closed meeting minutes, and how this made it difficult to assess FSOC's performance.²¹ Since that GAO report, meeting minutes for some closed agenda items have improved. For example, the October 11, 2011, meeting included an agenda item on money market fund (MMF) reform. The meeting minutes noted that a presentation was given that covered actions taken since the last time MMF reform was before the Council, the reform options under consideration, and next steps, but no further details were provided. In contrast, the meeting minutes for a July 16, 2013, meeting with another MMF reform agenda item contained greater detail about a presentation on a proposed rule for MMF reform. The minutes explained that the proposed rule set forth two alternatives for amending the rules that govern MMFs and contained the details of the new requirements each alternative would impose on MMFs.

While we have seen some improvement in the level of detail included in the minutes for closed Council meetings, the December 9, 2013, meeting minutes regarding a presentation on certain CFPB housing finance rules described above indicates that there is still room for improvement. While we agree that closed meetings are required for discussions of supervisory and other market-sensitive data, there may be information and presentations from closed meetings that do not contain supervisory or market-sensitive data. FSOC should as a practice include this information for all agenda items in its meeting minutes.

FSOC did not make meeting agendas available to the public on its website

As discussed earlier, FSOC's Deputies Committee considers potential Council meeting agendas typically 2 weeks before each meeting, and FSOC posts meeting notices to its website at least 7 days in advance, when possible. However, FSOC did not post meeting agendas to its website. Two FSOC members stated that posting meeting agendas would improve FSOC's transparency. As previously mentioned, FSOC Secretariat personnel identified providing high-level, preliminary agendas to the public before each meeting as potentially improving its transparency. We note that the May 2014 transparency policy includes a new provision that provides for not less than 7 days advance notice of any regularly scheduled meeting on its website, including information about the meeting agenda. We believe this new provision addresses our concern the FSOC was not posting meeting agendas on its website.

²⁰ CIGFO, *Audit of the Financial Stability Oversight Council's Designation of Financial Market Utilities*, page 12.

²¹ GAO, *Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions* (GAO12886; Sept. 2012). In the report, GAO stated that minutes describe general agenda items for the meetings and information on the presenters for each agenda item and lack additional detail. GAO recommended that FSOC keep detailed minutes of closed sessions.

FSOC should continue to identify datasets and information to make available to the public

FSOC is subject to the Office of Management and Budget (OMB) Memorandum M-10-06, Open Government Directive.²² According to an FSOC Secretariat official, FSOC complies with the directive through Treasury's Open Government Plan.²³ In its Open Government Plan, Treasury has committed to identifying current datasets and information to make available to the public and implementing a permanent process for continuous, proactive identification, preparation and release of data on an ongoing basis. We noted that following its designations of FMUs and nonbank financial companies, FSOC posted information supporting these designations on its website and in its annual reports. FSOC also included significant amounts of economic and financial information in its annual reports, and posted the corresponding datasets on its website. In the future, to the extent that FSOC considers datasets and information during Council meetings, FSOC should (1) identify which of those datasets and information could be made available to the public, and ensure the identified datasets and information are posted to FSOC's website; and (2) implement an ongoing process for continuous, proactive identification, preparation, and release of data. We believe this is important to meet the objectives of the Open Government Directive.

Conclusion And Recommendations

We determined that FSOC complied with its transparency policy. However, when a Council meeting or portion thereof was closed, FSOC did not inform the public which of eight possible reasons for closing the meeting applied. In addition, FSOC's transparency policy did not require FSOC's practices of (1) posting public notices for upcoming meetings to its website 7 days in advance of a regularly scheduled meeting, (2) issuing a press readout upon completion of Council meetings, and (3) approving meeting minutes and then posting minutes to its website immediately following the approvals. We also identified certain practices that FSOC should improve upon or implement to increase transparency, namely (1) providing greater detail in minutes for closed meetings, while protecting market-sensitive or confidential information; (2) posting meeting agendas to its website in advance of Council meetings; and (3) continuing to identify datasets and information that could be made available to the public and posting it to its website.

On May 7, 2014, after we completed our fieldwork, FSOC approved a revised transparency policy. The revised policy includes the following new provisions: (1) providing not less than 7 days advance notice of any regularly scheduled meeting on its website, including information about the agenda, the reasons for closing a meeting, if applicable, and the time and place of any open meeting; (2) as soon as practicable after each meeting, making information about the meeting available on its website; and (3) when practicable, releasing meeting minutes immediately following the next regularly scheduled meeting.

In considering our recommendations below, we also note recent concern expressed by certain Members of Congress about the transparency of FSOC's activities. For example, H.R. 4387, the FSOC Transparency and Accountability Act, was proposed on April 3, 2014, that would, among other things, make FSOC subject to the

²² Issued in December 2009, the OMB Memorandum directs executive departments and agencies to take specific actions to implement the principles of transparency, participation, and collaboration, including developing an Open Government Plan that describes how it will improve transparency and integrate public participation and collaboration into its activities.

²³ Department of the Treasury Open Government Plan 2.1, September 2012

Government in the Sunshine Act.²⁴ While the fate of this legislation is unknown at this time, it does underscore the need for FSOC to maintain its commitment to transparency. Accordingly, while we acknowledge FSOC's efforts to improve its transparency through its revised policy, we recommend the Council continue its efforts in the following areas.

1. Provide greater detail in the meeting minutes for closed meetings.

FSOC Response

Recent minutes of Council meetings have already begun to incorporate greater detail. This increased detail is the result of the Council's effort to provide the public with as much information as possible about its confidential deliberations, while still protecting the confidentiality of market-sensitive or supervisory information that are often the subject of Council discussions. The Council is fully committed to maintaining this practice of incorporating additional detail in its minutes.

CIGFO Working Group Comment

FSOC's commitment to incorporating additional detail in its meeting minutes is responsive to our recommendation.

2. In the future, to the extent that FSOC considers datasets and information during Council meetings, identify datasets and information that it could make publicly available; ensure such datasets and information are posted to its website, while continuing to protect market-sensitive or confidential information; and implement a permanent process for continuous, proactive identification, preparation and release of data on an ongoing basis.

FSOC Response

The Council already provides on its website a significant amount of information, including financial and economic data used in the preparation of its annual reports and information about the basis for each of its designations of financial market utilities and nonbank financial companies. As a collaborative body that brings together the independent financial regulators, much of the data relied upon by the Council is provided by those agencies and the Office of Financial Research, which maintain the responsibility for determining whether to make their data available to the public. However, to the extent that the Council considers data and information during Council meetings, Council staff will routinely evaluate whether such materials could be made available to the public, in light of any applicable confidentiality restrictions.

CIGFO Working Group Comment

FSOC's commitment to routinely evaluate materials it considers for potential public disclosure is responsive to our recommendation. We recognize that the Council considers market-sensitive and confidential data and information from multiple entities. To the extent FSOC staff identifies materials that could be made public, the Council should ensure those materials are posted to its website in a timely manner.

²⁴ Codified as 5 USC 552b, this act prescribes that except as provided in the statute, every portion of every meeting of an agency shall be open to public observation. There are 10 exceptions to this requirement, including 2 exceptions related to sensitive financial institution information.

Appendix I: Objective, Scope, and Methodology

Objective

The audit objective was to assess the extent to which the Financial Stability Oversight Council (FSOC or Council) is operating in a manner consistent with expectations outlined in its transparency policy, and to consider whether improvements to FSOC's transparency policy could be made.

Scope and Methodology

The scope of this audit included the FSOC meetings from October 2010 through December 2013.

To accomplish our objective, we:

- reviewed FSOC's transparency policy, Council meeting minutes, Council meeting agendas, meeting webcasts, FSOC's website, FSOC's annual reports, and other documentation provided by the FSOC Secretariat;
- interviewed officials of the FSOC Secretariat and FSOC member agencies;
- reviewed and analyzed laws, directives, and other organizations' transparency policies and practices; and
- compared other organizations' transparency policies, practices and websites to FSOC's transparency policy and website.

The organizations included in our review were the Millennium Challenge Corporation, International Monetary Fund, the Federal Reserve System's Federal Open Market Committee, Federal Deposit Insurance Corporation, Federal Financial Institutions Examination Council, Department of the Treasury, and the General Services Administration.

We performed audit fieldwork from January through March 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix II: October 2010 FSOC Transparency Policy

Transparency Policy for the Financial Stability Oversight Council

The Financial Stability Oversight Council (“FSOC”) was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).

The FSOC is committed to conducting its business in an open and transparent manner. Accordingly, the FSOC will make its meetings open to the press and to the public via a live web stream, except as necessary in the circumstances described below. The FSOC will also release minutes of meetings after each meeting. Minutes are subject to redactions, as determined by the Chairperson. As part of its annual report to Congress under the Dodd-Frank Act (§112(a)(2)(N)), the FSOC will report on compliance with its transparency policy.

The FSOC will open its meetings to the public whenever possible. At the same time, the central mission of the FSOC is to monitor systemic and emerging threats. This will require discussion of supervisory and other market-sensitive data, including information about individual firms, transactions, and markets that may only be obtained if maintained on a confidential basis. Protection of this information will be necessary in order to prevent destabilizing market speculation that could occur if that information were to be disclosed.

Accordingly, meetings will be open or may be closed, in whole or in part, as determined by the Chairperson based on the agenda, or upon an affirmative vote of a majority of the voting members. An FSOC member may request a vote on a decision of the Chairperson to close a meeting in whole or in part. The FSOC commits to holding two open meetings each year. In addition, when FSOC Members are asked to vote on a draft of an FSOC proposed or final rule, the FSOC will make those agenda items open to the public. All votes of Council members will be recorded and reflected in the minutes of the Council.

The reasons that a meeting or portion thereof would be closed include circumstances where holding an open meeting could:

- result in the disclosure of information contained in or related to investigation, examination, operating, or condition reports prepared by, on behalf of, or for the use of, an agency responsible for the regulation or supervision of financial markets or financial institutions;
- result in the disclosure of information which would lead to significant financial speculation, significantly endanger the stability of any financial

market or financial institution, or significantly frustrate implementation of a proposed agency action;

- result in the disclosure of information exempted from disclosure by statute or by regulation; or authorized under criteria established by an Executive Order to be kept secret;
- result in the disclosure of trade secrets and commercial or financial information obtained from a person and privileged or confidential;
- result in the disclosure of information of a personal nature that would constitute an unwarranted invasion of personal privacy or be inconsistent with Federal privacy laws, or of information that relates solely to internal personnel rules or practices;
- result in the disclosure of investigatory records compiled for law enforcement or supervisory purposes;
- result in the disclosure of inter-agency or intra-agency memoranda or letters which would not otherwise be available by law; or
- necessarily and significantly compromise the mission or purposes of the FSOC, as determined by the Chairman with the concurrence of a majority of the voting member agencies or by a majority of the voting member agencies.

Appendix III: May 2014 FSOC Transparency Policy

Transparency Policy for the Financial Stability Oversight Council

The Financial Stability Oversight Council (“Council”) was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).

The Council is committed to conducting its business in an open and transparent manner. The Council will open its meetings to the public whenever possible. At the same time, the central mission of the Council is to monitor systemic and emerging threats. This will require discussion of supervisory and other market-sensitive data, including information about individual firms, transactions, and markets that may only be obtained if maintained on a confidential basis. Protection of this information will be necessary in order to prevent destabilizing market speculation that could occur if that information were to be disclosed. As part of its annual report to Congress under the Dodd-Frank Act (§ 112(a)(2)(N)), the Council will report on compliance with its transparency policy.

Council meetings may be open or closed, in whole or in part, based on the agenda and the reasons described below, as determined by the Chairperson or by an affirmative vote of a majority of the voting members. A Council member may request a vote on a decision of the Chairperson to open or close a meeting in whole or in part. The Council commits to holding at least two open meetings each year. In addition, when the Council is asked to vote on a draft of a Council proposed or final rule, the Council will make those agenda items open to the public.

The Council will provide not less than seven days’ advance notice of any regularly scheduled meeting on its website, including information about the agenda, the reasons for closing a meeting, if applicable, and the time and place of any open meeting. The Council will make its open meetings open to the press and to the public via a live web stream. As soon as practicable after each meeting, the Council will make information about the meeting available on its website. The Council will also release minutes of meetings. All votes of Council members will be recorded and reflected in the minutes of the Council. When practicable, the Council will release its minutes immediately following its next regularly scheduled meeting. Minutes may be subject to redactions, as determined by the Chairperson.

The reasons that a meeting or portion thereof would be closed include circumstances where holding an open meeting could:

- result in the disclosure of information contained in or related to investigation, examination, operating, or condition reports prepared by, on behalf of, or for the use of, an agency responsible for the regulation or supervision of financial markets or financial institutions;
- result in the disclosure of information which would lead to significant financial speculation, significantly endanger the stability of any financial market or financial institution, or significantly frustrate implementation of a proposed agency action;
- result in the disclosure of information exempted from disclosure by statute or by regulation, or authorized under criteria established by an Executive Order to be kept

secret;

- result in the disclosure of trade secrets and commercial or financial information obtained from a person and privileged or confidential;
- result in the disclosure of information of a personal nature that would constitute an unwarranted invasion of personal privacy or be inconsistent with Federal privacy laws, or of information that relates solely to internal personnel rules or practices;
- result in the disclosure of investigatory records compiled for law enforcement or supervisory purposes;
- result in the disclosure of inter-agency or intra-agency memoranda or letters which would not otherwise be available by law;
- involve the conduct solely of administrative business of the Council; or
- necessarily and significantly compromise the mission or purposes of the Council, as determined by the Chairperson with the concurrence of a majority of the voting members or by a majority of the voting members.

Source: FSOC website,
<http://www.treasury.gov/initiatives/fsoc/Documents/The%20Council%27s%20Transparency%20Policy.pdf>

Appendix IV: FSOC Response



UNDER SECRETARY

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C.

May 30, 2014

The Honorable Eric M. Thorson
Chair, Council of Inspectors General
on Financial Oversight (CIGFO)
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Response to CIGFO's Draft Audit Report: *Audit of the Financial Stability Oversight Council's Compliance with Its Transparency Policy*

Dear Mr. Chairman:

Thank you for the opportunity to review and respond to your draft audit report, *Audit of the Financial Stability Oversight Council's Compliance with Its Transparency Policy*, dated May 2014 (the Draft Report). The Financial Stability Oversight Council (Council) and its members and member agencies appreciate the CIGFO working group's review of the Council's adherence to its transparency policy. This letter responds, on behalf of the Secretary of the Treasury as Chairperson of the Council, to the Draft Report. The staffs of Council members and member agencies previously provided comments and technical suggestions to CIGFO staff.

CIGFO found that the Council fully complied with its transparency policy, including by holding two or more open meetings per year; by making those meeting available to the public via a live and archived web stream; by releasing minutes for all of its meetings within a day of approval; by recording all Council votes in meeting minutes; by voting on all proposed and final rules at meetings that are open to the public; and by opening or closing Council meetings based on the reasons described in the transparency policy.

The Council has recognized the importance of transparency since its first meeting in 2010, when it voluntarily adopted a transparency policy. Since then, the Council has considered how to open up more of its work to the public, while at the same time respecting its need to discuss supervisory and other market-sensitive data, including information about individual firms, transactions, and markets that require confidentiality. As the Draft Report notes, before the beginning of CIGFO's review, the Council's staff had already begun a broad review of the Council's governance practices, including its transparency policy, to identify ways to further strengthen the Council's commitment to openness. As a result of this internal review, on May 7, 2014, the Council voted in an open session to adopt enhancements to its transparency policy, as well as bylaws for its Deputies Committee. Those actions were based on the internal review but addressed many of the same improvements identified by CIGFO's working group during its field work. The transparency practices formally adopted by the Council included providing public notice on its website at least seven days before all regularly scheduled meetings; providing preliminary information about the agenda in the notice for each upcoming meeting; and posting

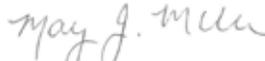
to our website immediately after each meeting information about that meeting in advance of the release of formal meeting minutes.

The Draft Report also makes two recommendations. First, the Draft Report recommends that the Council continue to provide greater detail in its meeting minutes for closed meetings. As the Draft Report notes, recent minutes of Council meetings have already begun to incorporate greater detail. This increased detail is the result of the Council's effort to provide the public with as much information as possible about its confidential deliberations, while still protecting the confidentiality of market-sensitive or supervisory information that are often the subject of Council discussions. The Council is fully committed to maintaining this practice of incorporating additional detail in its minutes.

Second, the Draft Report recommends that the Council identify datasets and information that it could make publically available; ensure such datasets and information are posted to its website, while continuing to protect market-sensitive or confidential information; and implement a permanent process for continuous, proactive identification, preparation and release of data on an ongoing basis. As noted in the Draft Report, the Council already provides on its website a significant amount of information, including financial and economic data used in the preparation of its annual reports and information about the basis for each of its designations of financial market utilities and nonbank financial companies. As a collaborative body that brings together the independent financial regulators, much of the data relied upon by the Council is provided by those agencies and the Office of Financial Research, which maintain the responsibility for determining whether to make their data available to the public. However, to the extent that the Council considers data and information during Council meetings, Council staff will routinely evaluate whether such materials could be made available to the public, in light of any applicable confidentiality restrictions.

Thank you again for the opportunity to review and comment on the Draft Report. We value CIGFO's input and recommendations and look forward to working with you in the future.

Sincerely,



Mary J. Miller

Appendix V: CIGFO Working Group

Department of the Treasury – Lead Agency

Eric M. Thorson, Inspector General, Department of the Treasury, and CIGFO Chair

Theresa Cameron

Susan Marshall

Jeff Dye

Maria McLean

Patrick Gallagher

Federal Deposit Insurance Corporation

Jill Lennox

Federal Housing Finance Agency

Tara Lewis

Andrew W. Smith

National Credit Union Administration

Marvin Stith

Securities and Exchange Commission

Kelli Brown-Barnes

Special Inspector General for the Troubled Asset Relief Program

Erika Szatmari

Porsha Brower

