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Federal Housing Finance Agency  
Office of Inspector General



**FHFA's Completion of Planned Targeted Examinations of Fannie Mae Improved from 2016 through 2018, But Timeliness Remained an Issue; With the June 2019 Issuance of the Single Security, FHFA Should Reassess its Supervision Framework for CSS**

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

Audit Report • AUD-2019-012 • September 17, 2019



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2019

## Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) is charged by the Housing and Economic Recovery Act of 2008 (HERA) with the supervision of Fannie Mae and Freddie Mac (together, the Enterprises), any affiliate of the Enterprises, and the Federal Home Loan Banks (collectively, the regulated entities). Its mission as a federal financial regulator includes ensuring the safety and soundness of its regulated entities so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA maintains that it uses a risk-based approach to supervisory examinations, prioritizing examination activities based on the risk a given practice poses to a regulated entity's safe and sound operation or to its compliance with applicable laws and regulations. Since 2008, FHFA has also served as conservator of the Enterprises.

Within FHFA, the Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises and Common Securitization Solutions, LLC (CSS), a joint venture owned by the Enterprises and charged with developing, building, and operating the Common Securitization Platform (CSP). DER has assigned responsibility for developing and implementing an annual examination plan for Fannie Mae and CSS to an Examiner-in-Charge (EIC), who oversees a team of examiners (a different EIC is assigned responsibility for developing and implementing an annual examination plan for Freddie Mac). According to FHFA guidance, for the Enterprises, DER examiners are to summarize, in an annual Report of Examination (ROE), examination results, conclusions, findings, and supervisory concerns from the supervisory activities completed during the annual examination cycle.

Because targeted examinations are a critical component of FHFA's supervisory activities, we have audited different aspects of FHFA's annual examination plans, including planned targeted examinations of Fannie Mae. Since 2016, we have issued three audit reports related to the completion of planned targeted examinations and other supervisory activities of Fannie Mae (two reports in 2016 and one report in 2017).

In light of our findings in a 2016 audit, *FHFA's Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued* (AUD-2016-006), we performed this audit to determine whether DER examiners completed the targeted examinations identified in each examination plan for Fannie Mae from 2016 through 2018, the review period for this audit, and compared the results to those of our 2016 audit. We applied the same methodology to analyze the results found in this audit as we used in our prior audit.



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Our audit found that as of July 1, 2019, of the 47 targeted examinations planned by DER for the 2016 through 2018 examination cycles, 38 targeted examinations were completed (81%). Of the 9 targeted examinations that were not completed, 8 were not conducted – either converted to ongoing monitoring, deferred, or cancelled (17%) – and 1 was commenced but not completed (2%). DER’s completion rate of 81% of its planned targeted examinations for the 2016 through 2018 examination cycles (as of July 1, 2019) is nearly double the 42% completion rate we found in our 2016 audit.

In our 2016 audit, we also found that DER could not provide documentation regarding the status for 10 of 102 planned targeted examinations. For this audit, DER could account for all planned targeted examinations of Fannie Mae. Furthermore, in our 2016 audit, DER provided risk-based justifications for only a third of the planned targeted examinations that were not conducted. For this audit, DER provided risk-based justifications for all eight examinations that were not conducted.

We also found that timely completion of targeted examinations prior to issuance of the ROE improved, but continued to be an issue. In our 2016 audit, we found that 28 of the 102 targeted examinations planned during the examination cycles for 2012 through 2015 (27%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). Applying the same methodology to this review period, we found that 21 (45%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). Seventeen (17) of the 47 (36%) were completed in a later examination cycle and were reported, as applicable, in subsequent ROEs. (As shown above, the remaining planned targeted examinations were either converted to ongoing monitoring, deferred, cancelled, or commenced but not completed.)

Our 2016 and 2017 audits included a total of 11 recommendations, 5 of which were relevant to the objective of this audit. We found that FHFA took appropriate action to address those relevant recommendations.

In performing this audit, we also identified a matter for consideration related to FHFA’s supervision of CSS. Specifically, FHFA adopted a supervision framework for CSS in 2016 that was expected to be adjusted over time, but has not been. In June 2019, CSS began issuing a single mortgage-backed security, referred to by FHFA as the Uniform Mortgage-Backed Security, for both Enterprises. As acknowledged by a DER official, the 2016 supervision framework for CSS should be reassessed given that CSS is now issuing the Single Security.



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We make one recommendation in this report related to updating the supervision framework for CSS. In a written management response, FHFA agreed with the recommendation.

We are also issuing today, a second report, *FHFA's Completion of Planned Targeted Examinations of Freddie Mac Improved from 2016 through 2018, But Timeliness Remained an Issue* (September 17, 2019) (AUD-2019-013), which undertakes the same assessment for DER's targeted examinations for Freddie Mac.

This report was prepared by Tara Lewis, Audit Director; Pamela L. Williams, Auditor-in-Charge; Terese Blanchard, Auditor-in-Charge; and Brian Maloney, Auditor; with assistance from Bob Taylor, Senior Advisor. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

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

Marla A. Freedman, Deputy Inspector General for Audits /s/

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## ABBREVIATIONS .....

CSP	Common Securitization Platform
CSS	Common Securitization Solutions, LLC
DER	Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac
FHFA or Agency	Federal Housing Finance Agency
HERA	Housing and Economic Recovery Act of 2008
IMS	Information Management System
MRA	Matter Requiring Attention
OGC	Office of General Counsel
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
ROE	Report of Examination

## BACKGROUND .....

### Effective Supervision by FHFA is Vital to Ensure Fannie Mae’s Safety and Soundness

FHFA maintains that it uses a risk-based approach to supervisory examinations, prioritizing examination activities based on the risk a given practice poses to a regulated entity’s safe and sound operation or to its compliance with laws and regulations. Within FHFA, DER is responsible for supervision of the Enterprises and CSS. The Deputy Director, DER, is responsible for developing a supervisory framework and ensuring that the planning process is fully documented and incorporated into official agency records. DER has assigned responsibility for developing and implementing an annual examination plan for Fannie Mae and CSS to an EIC, who oversees a team of examiners (a different EIC is assigned responsibility for developing and implementing an annual examination plan for Freddie Mac).

#### ***Common Securitization Solutions, LLC, an Affiliated Entity of the Enterprises Subject to FHFA’s Supervision***

In 2012, FHFA directed the Enterprises to build CSP to replace their separate “back-office” systems and to issue a single mortgage-backed security. In 2013, FHFA directed the Enterprises to establish and fund a joint venture, CSS, to develop and operate the CSP.<sup>1</sup> CSS is governed by a Board of Managers, which consists of two representatives from each Enterprise.<sup>2</sup>

FHFA’s Office of General Counsel (OGC) opined on December 21, 2015, that HERA authorizes FHFA to exercise comprehensive supervisory authority over CSS because it is an affiliated entity. According to OGC, FHFA may conduct the same types of regulatory or supervisory activities for CSS’ activities or operations that it may conduct for an Enterprise’s activities or operations, including issuing regulations, conducting annual examinations, communicating examination results, and issuing annual examination reports.

From January 1, 2016, up to the mid-year plan update in 2017, DER relied on the Fannie Mae examination team to plan and execute targeted examinations of CSS and included planned supervisory activities on the annual examination plan for Fannie Mae. Beginning with the

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<sup>1</sup> For a more comprehensive discussion of CSP, see OIG, *Special Report on the Common Securitization Platform: FHFA Lacked Transparency and Exercised Inadequate Oversight over a \$2.13 Billion, Seven-Year Project* (Mar. 29, 2019) (OIG-2019-005) (online [here](#)); OIG, *Update on the Status of the Development of the Common Securitization Platform* (Dec. 9, 2016) (COM-2017-001) (online [here](#)); and OIG, *Status of the Development of the Common Securitization Platform* (May 21, 2014) (EVL-2014-008) (online [here](#)).

<sup>2</sup> The CSS Board of Managers has authority to take all actions it deems necessary to accomplish the purposes of CSS as set forth in its LLC agreement, provided that it manages in accordance with the CSS business plan and budget, both of which are subject to FHFA approval.

mid-year plan update in 2017, DER determined to create a separate examination plan for CSS, created by a Fannie Mae examiner, approved by the Deputy Director, DER, and primarily executed by the Fannie Mae examination team.

## **FHFA's Examination Planning Process**

According to FHFA's *Examination Manual*, risk assessments provide a foundation for determining the supervisory activities to be conducted. Using the risk assessments, a supervisory strategy is prepared for each Enterprise by the DER examination teams. Once the annual supervisory strategy is approved, the strategy is implemented through an annual examination plan, prepared by the EIC for each Enterprise and approved by the Deputy Director, DER.

FHFA's annual examination plans identify the supervisory activities, both ongoing monitoring and targeted examinations, expected to be completed during that examination cycle. The purpose of ongoing monitoring is to analyze real-time information and to use those analyses to identify Enterprise practices and changes in an Enterprise's risk profile that may warrant supervisory attention. Ongoing monitoring is also "used to determine the status of the Enterprise's compliance with supervisory guidance, [Matters Requiring Attention] MRAs, and conservatorship directives[.]" Targeted examinations complement ongoing monitoring: they enable examiners to conduct "a deep or comprehensive assessment" of the areas found to be of high importance or risk. Because each of these supervisory activities has a separate purpose, they are not interchangeable.

DER examiners may identify supervisory concerns or deficiencies occurring at an Enterprise as a result of ongoing monitoring or targeted examinations. MRAs are the most serious supervisory matters.<sup>3</sup> MRAs fall into one of the following categories: (1) critical supervisory matters that pose substantial risk to the safety and soundness of the regulated entity, such as instances of noncompliance with laws or regulations of a serious nature or repeated criticisms that have escalated in importance because of insufficient attention or action; or (2) deficiencies that are supervisory concerns that FHFA believes could, if not corrected, escalate and potentially negatively affect the condition, financial performance, risk profile, operations, or reputation of the regulated entity.

Because examination planning is a continuous process, FHFA expects that each EIC will adjust the applicable examination plan to reflect changes in risk exposure. DER guidance in

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<sup>3</sup> In addition to MRAs, FHFA guidance also defines two other types of adverse examinations findings: (1) violations, which are matters in which the examination discloses non-compliance with laws, regulations, or orders; and (2) recommendations, which are advisory in nature and represent suggested changes to a policy, procedure, practice, or control that supervision staff believes would improve, or prevent deterioration in, condition, operations, or performance.

effect during the review period of this audit instructed that approved examination plans shall only be adjusted for risk-based reasons, and justifications for the adjustments must be approved by the EIC (after consultation with the Deputy Director, DER, if warranted) and fully documented in the work papers. Adjustments include adding or deleting supervisory activities, or changing the objective, scope, and methodology of a supervisory activity.<sup>4</sup>

According to FHFA guidance, DER examiners are to summarize, in an annual ROE, examination results, conclusions, findings, and supervisory concerns from the supervisory activities completed during the annual examination cycle. Each ROE, issued to the relevant Enterprise's board of directors, is intended to convey the overall condition and risk profile of the Enterprise, summarize examination activities and findings during the annual examination cycle, and discuss deficient practices and excessive risks giving rise to supervisory concerns. The ROE also includes a list of open MRAs at year-end and a list of MRAs that were closed during the previous calendar year.

## **Prior OIG Audit Reports on FHFA's Implementation of Supervisory Activities of Fannie Mae**

Because targeted examinations are a critical component of FHFA's supervisory activities, we have audited different aspects of FHFA's completion of its annual examination plan of targeted examinations of Fannie Mae.

- An audit report issued in September 2016 analyzed whether DER examiners completed the planned targeted examinations for Fannie Mae from 2012 through 2015 and, in those instances where the planned targeted examinations were not completed, whether DER documented the deviations from its plan in accordance with its policies and procedures.<sup>5</sup> We found that DER planned 102 targeted examinations for Fannie Mae from 2012 through 2015 but completed only 43. We reported that DER's official system of record lacked adequate supervisory documentation, which hampered our audit and created a significant risk exposure. We made five recommendations to address the findings identified by the audit.

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<sup>4</sup> DER's guidance is explained in its operating procedures bulletin (OPB), 2013-DER-OPB-03.1, *Supervisory Planning Process* (Oct. 29, 2013). This OPB was rescinded on January 18, 2019. DER officials explained that even though the guidance has been rescinded, the expectation is that examiners follow the previous guidance that risk-based reasons and justifications for the adjustments to examination plans must be approved by the EIC (after consultation with the Deputy Director, DER, as warranted) and are fully documented in the workpapers. On April 1, 2019, after our review period (2016 through 2018) ended, FHFA released a new OPB, *Examination Planning Process* (DER-OPB-2.5).

<sup>5</sup> OIG, *FHFA's Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued* (Sept. 30, 2016) (AUD-2016-006) (online [here](#)).

- A second audit report, also issued in September 2016, assessed whether: (1) DER supported its 2014 and 2015 high-priority planned targeted examinations identified in its annual supervisory plans with risk assessments for both Enterprises and (2) completed those planned high-priority examinations.<sup>6</sup> Of the 61 high-priority targeted examinations planned for the Enterprises for 2014 and 2015, 32 could be traced to the risk assessments. As of June 17, 2016, when our fieldwork for this audit ended, we found that only 25 of the 61 high-priority targeted examinations (41%) had been completed. We made five recommendations to address the findings identified by that audit.
- A third audit report, issued in September 2017 regarding FHFA’s supervision of Fannie Mae’s cybersecurity risks, found, among other things, that DER failed to complete any of its planned supervisory activities (apart from oversight of MRA remediation) for the 2016 examination cycle.<sup>7 8</sup> We made three recommendations to address the findings identified by the audit.<sup>9</sup>

## FACTS AND ANALYSIS .....

### **Of the Planned Targeted Examinations for the 2016 through 2018 Examination Cycles, DER Completed 81%, Commenced 2%, and Documented the Reasons for its Determinations Not to Conduct the Other 17%; Timeliness in Completing Targeted Examinations Remained an Issue**

In light of our findings in our 2016 audit (*FHFA’s Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued* (AUD-2016-006)), we performed this audit to analyze whether DER examiners completed the targeted examinations identified in each examination plan for

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<sup>6</sup> OIG, *FHFA’s Supervisory Planning Process for the Enterprises: Roughly Half of FHFA’s 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed* (Sept. 30, 2016) (AUD-2016-005) (online [here](#)).

<sup>7</sup> OIG, *FHFA Failed to Complete Non-MRA Supervisory Activities Related to Cybersecurity Risks at Fannie Mae Planned for the 2016 Examination Cycle* (Sept. 27, 2017) (AUD-2017-010) (online [here](#)).

<sup>8</sup> DER did complete ongoing monitoring of Fannie Mae’s remediation of three cybersecurity-related MRAs issued in prior years and closed them during the 2016 cycle.

<sup>9</sup> The 2017 audit report included three other findings related to DER supervisory activities. As part of the scope of this audit, we evaluated one of the three recommendations included in the 2017 audit report.

Fannie Mae from 2016 through 2018, the review period for this audit, and compared the results to those of the 2016 audit. We used the same methodology as in our prior audit.

Consistent with DER's guidance, we considered a targeted examination to be "commenced" when DER issued a request letter.<sup>10</sup> We considered a targeted examination to be "completed" when DER issued a conclusion letter.<sup>11</sup> We considered a targeted examination to be "not conducted" when DER documents demonstrated that the status of that targeted examination was converted to ongoing monitoring, deferred, or cancelled. We considered a targeted examination to be "commenced but not completed" based on DER's representation that the examination was in progress in one of three phases: fieldwork, management review, or quality control review.

As described below, we performed three tests to determine whether FHFA completed its planned targeted examinations for Fannie Mae during our review period (2016 through 2018), and if it did not, whether it documented the deviations from its plans in accordance with its policies and procedures. We also compared FHFA's performance with the review period presented in our 2016 audit report (2012 through 2015) and this review period.

***Completion of Planned Targeted Examinations Has Improved and DER Could Account for the Status of All Targeted Examinations***

As part of our audit, we assessed whether DER completed its planned targeted examinations for Fannie Mae during our review period.

Result of Test: We developed a list of Fannie Mae targeted examinations planned by DER for the review period from annual examination plans and records obtained from FHFA's Information Management System (IMS), DER's official system of record, and identified 47 targeted examinations during the three-year review period. Of these 47 planned targeted examinations, DER records show that, as of July 1, 2019: 38 targeted examinations were completed (81%), although a number were not completed during the examination cycle for which they were planned; 8 were not conducted (17%); and 1 was commenced but not completed (2%). Of the 8 that were not conducted, DER documentation established that 2 were converted to ongoing monitoring, 2 were deferred, and 4 were cancelled.

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<sup>10</sup> FHFA, OPB, *DER Supervisory Activities* (Sept. 19, 2013) (2013-DER-OPB-04). This OPB was rescinded and replaced by DER-OPB-2.1, *Examination Processes and Documentation: Targeted Examinations* (Sept. 27, 2018). FHFA's new OPB did not change the basis of our analysis.

<sup>11</sup> According to FHFA's *Examination Manual*, once the fieldwork for a targeted examination has been completed and the examination team develops its findings, the EIC communicates those findings to the affected Enterprise through issuance of a conclusion letter.

In our 2016 audits, our efforts to track the planning and execution of DER's supervision activities through documentation maintained in IMS were not successful because a significant amount of documentation was not retained in IMS. We recommended that FHFA develop and implement a control that provides for the tracking of planned targeted examinations, through disposition, in DER's official system of record. FHFA agreed with this recommendation and implemented a tracking mechanism in 2016. We also recommended that DER revise existing guidance to require examiners to prepare complete documentation of supervisory activities, maintain such documentation in its official system of record, and train DER examiners on the revised guidance. FHFA disagreed with this recommendation and we considered the recommendation to be rejected, and we closed it.

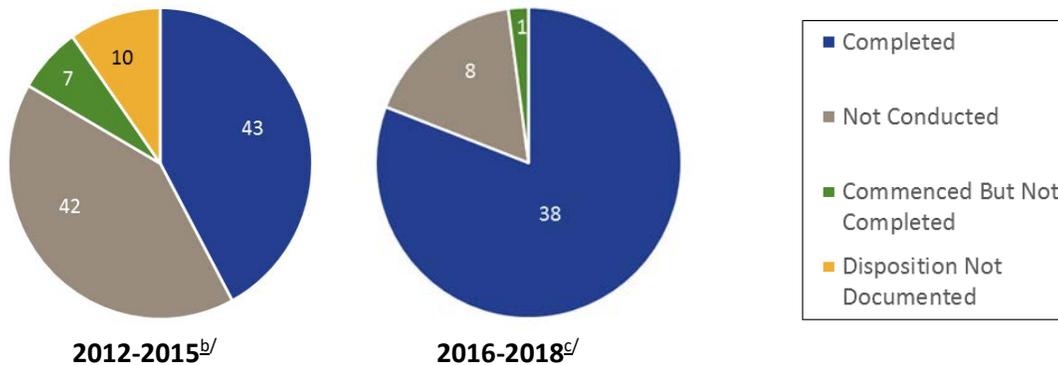
In this audit, we found documentation in DER's official system of record for each planned targeted examination showing that DER tracked the disposition for each of the 47 targeted examinations planned during the review period. Notwithstanding its rejection of the recommendation related to its guidance and training, we found that DER did revise its guidance to require examiners to prepare complete documentation of supervisory activities and trained its examiners on the revised guidance.<sup>12</sup>

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<sup>12</sup> We made five recommendations in our 2016 and 2017 audits of FHFA's supervision of Fannie Mae that were relevant to the objective of this audit. In Appendix 1, we discuss fully the actions taken by FHFA to address these recommendations, even though FHFA did not accept all of them when the audits were issued.

Figure 1 below illustrates the results as presented in our 2016 audit report (in which we found that 43 of 102 planned targeted examinations (42%) were completed) compared to the results from this audit.

**FIGURE 1. EXECUTION BY DER OF 102 PLANNED TARGETED EXAMINATIONS OF FANNIE MAE FOR 2012 THROUGH 2015 AND OF 47 PLANNED TARGETED EXAMINATIONS FOR 2016 THROUGH 2018<sup>a/</sup>**



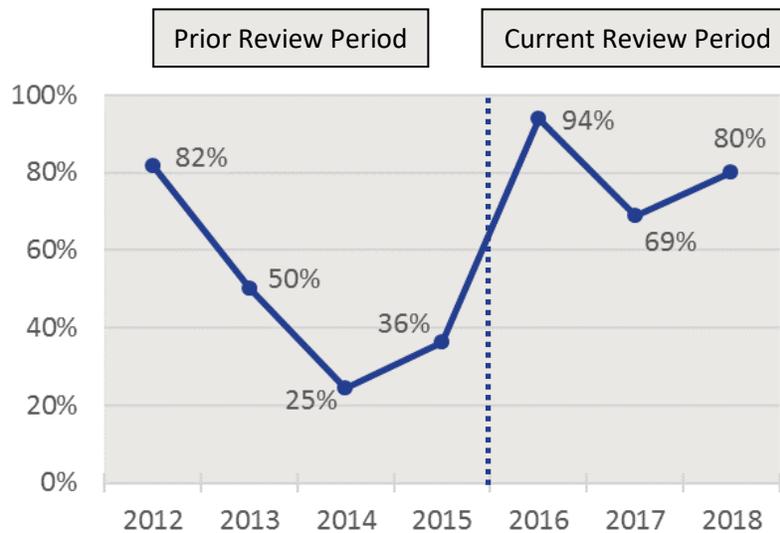
<sup>a/</sup> This chart includes planned targeted examinations that were completed before and after the respective ROE for the examination cycle issued.

<sup>b/</sup> Execution of planned targeted examinations for 2012 through 2015 is as of June 17, 2016.

<sup>c/</sup> Execution of planned targeted examinations for 2016 through 2018 is as of July 1, 2019. All planned targeted examinations for the 2016 through 2018 review period had a documented disposition.

DER’s completion rate of 81% of its planned targeted examinations for the 2016 through 2018 examination cycles (as of July 1, 2019) is nearly double the 42% completion rate we found in our prior audit covering planned targeted examinations for the 2012 through 2015 examination cycles. In our 2016 audit, we found that DER could not provide documentation regarding the status for 10 of 102 planned targeted examinations. For the 47 targeted examinations of Fannie Mae planned for the three examination cycles (2016 through 2018) covered by this audit, DER accounted for the status of all of them. Figure 2 captures graphically the percentage of targeted examinations completed from 2012 through 2018.

**FIGURE 2. DER’S PLANNED TARGETED EXAMINATIONS FOR FANNIE MAE – PERCENT COMPLETED FOR 2012 THROUGH 2018** <sup>a/, b/, c/</sup>



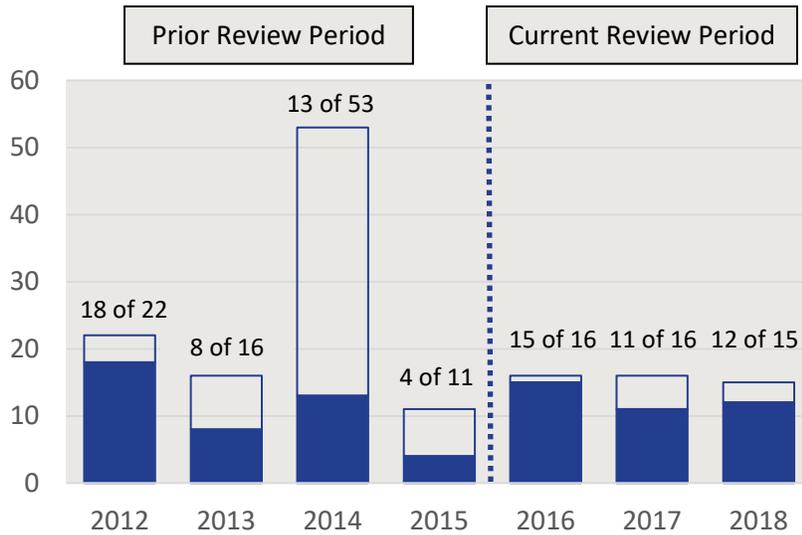
<sup>a/</sup> This chart includes planned targeted examinations that were completed before and after the respective ROE for the examination cycle issued.

<sup>b/</sup> Percent completed for 2012 through 2015 is as of June 17, 2016.

<sup>c/</sup> Percent completed for 2016 through 2018 is as of July 1, 2019.

Figure 3 below captures by year the number of targeted examinations planned and completed. For purposes of comparison, we also included the results as they were presented in our 2016 audit report.

**FIGURE 3. DER'S NUMBER OF COMPLETED, PLANNED TARGETED EXAMINATIONS FOR FANNIE MAE FOR 2012 THROUGH 2018 <sup>a/,b/</sup>**



<sup>a/</sup> This chart includes planned targeted examinations that were completed before and after the respective ROE for the examination cycle issued.

<sup>b/</sup> The performance data in this chart for the completed targeted examinations for Fannie Mae is as of June 17, 2016, for 2012 through 2015 and as of July 1, 2019, for 2016 through 2018.

***Timely Completion of Targeted Examinations Prior to Issuance of the ROE Has Improved but Continued to Be an Issue***

In our 2016 audit, we found that 28 of the 102 targeted examinations planned during the examination cycles for 2012 through 2015 (27%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). We tested here whether the planned targeted examinations for each examination cycle (2016 through 2018) were completed by DER before the respective ROE issued and compared that completion rate to the completion rate in our 2016 audit.

Result of Test: Of the 47 planned targeted examinations during the three-year review period, we found that 21 (45%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). Seventeen (17) of the 47 (36%) were completed in a later examination cycle and were

reported, as applicable, in subsequent ROEs.<sup>13 14</sup> (As discussed earlier, the remaining nine were either converted to ongoing monitoring, cancelled, or commenced but not completed.) While the rate of timely completion of planned targeted examinations improved during the review period for this audit, timely completion continued to be an issue.

Figure 4 below captures, by examination cycle, the targeted examinations (planned and completed) from 2012 through 2015, as of June 17, 2016, and 2016 through 2018, as of July 1, 2019. The figure also shows whether the targeted examinations were completed before or after the respective ROE issued.

**FIGURE 4. SUMMARY OF DER'S COMPLETED TARGETED EXAMINATIONS FOR FANNIE MAE FOR 2012 THROUGH 2018<sup>a/</sup>**

	2012	2013	2014	2015	Totals	2016	2017	2018	Totals
Planned Targeted Examinations	22	16	53	11	<b>102</b>	16	16	15	<b>47</b>
Completed Targeted Examinations	18	8	13	4	<b>43</b>	15	11	12	<b>38</b>
Number Completed During the Examination Cycle for Which They Were Planned and Before the ROE Issued	12	8	8	0	<b>28</b>	4	7	10	<b>21</b>
Number Completed During a Subsequent Examination Cycle	6	0	5	4	<b>15</b>	11	4	2	<b>17</b>

<sup>a/</sup> The performance data in this chart for the completed targeted examinations for Fannie Mae is as of June 17, 2016, for 2012 through 2015 and as of July 1, 2019, for 2016 through 2018.

***Risk-based Reasons Were Documented for Changes in the Examination Plan***

In each year of our review period, DER documented the status of its planned targeted examinations in the year-end examination plans stored in its official system of record.

As previously discussed, 8 of the 47 (17%) planned targeted examinations during our review period were not conducted. DER’s written documentation provided a justification for the change in status for each: 2 were converted to ongoing monitoring; 2 were deferred; and 4 were cancelled. We assessed the documentation with respect to these eight planned targeted

<sup>13</sup> For the 17 targeted examinations completed after the ROEs issued, all but two targeted examinations were completed during the subsequent examination cycle. Of the remaining two targeted examinations, one was planned for 2016 and commenced in April 2017. It was completed in July 2018, 16 months after the ROE issued for the 2016 examination cycle. The other targeted examination was planned for 2017, commenced in June 2018, and completed in June 2019.

<sup>14</sup> Three of the targeted examinations were completed after the 2018 ROE issued (March 29, 2019) and are expected to be included in the 2019 ROE.

examinations that were not conducted to determine if the changes were risk-based and approved by the EIC in accordance with FHFA’s policies and procedures.

Result of Test: We found that all eight changes made to the examination plans were risk-based, documented in the examination workpapers, and approved by the EIC. The eight risk-based reasons included: (1) cancelling one planned targeted examination because the subject was already covered by a then-recently completed targeted examination of a similar subject; (2) converting one planned targeted examination to an ongoing monitoring activity to gain a better understanding of the risks associated with the business area and how those risks were being managed; (3) cancelling one planned targeted examination because the tool that was to be examined was not used by Fannie Mae as initially expected; (4) cancelling one planned targeted examination because the program to be examined was not offered by Fannie Mae as initially expected; and (5) converting to ongoing monitoring, deferring, or cancelling the remaining four targeted examinations because the programs to be reviewed had not yet become effective or were too early in their implementation by Fannie Mae.

In our prior audit, DER produced documentation for 2014 and 2015 that, in our view, provided risk-based reasons for deviations from the examination plan for only 11 of the 33 planned targeted examinations that were not conducted. During the current review period, as described above, risk-based justifications were documented and approved by the EIC for all eight examinations that were not conducted.

## CONCLUSION.....

DER’s completion of planned targeted examinations has improved since our 2016 audit. Specifically, DER’s completion rate of 81% of its planned targeted examinations for the 2016 through 2018 examination cycles (as of July 1, 2019) is nearly double the 42% completion rate we found in our 2016 audit covering planned targeted examinations for the 2012 through 2015 examination cycles. Furthermore, in our 2016 audit, we found that DER could not provide documentation showing the status for 10 of 102 planned targeted examinations. For the 47 targeted examinations of Fannie Mae planned for the three examination cycles (2016 through 2018) covered by this audit, DER accounted for all of them. We also found that for each year of our review period, DER documented risk-based reasons for changes in its examination plan.

We found that while timely completion of targeted examinations prior to the issuance of the ROE has improved since our 2016 audit, it continued to be an issue. In our 2016 audit, we found that 27% of targeted examinations planned during the examination cycles for 2012

through 2015 were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). We found in this audit that 45% of the targeted examinations planned during the three-year review period were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle) and 36% were completed in a later examination cycle and were reported, as applicable, in subsequent ROEs. The remaining 19% of planned targeted examinations were either converted to ongoing monitoring, deferred, cancelled, or commenced but not completed.

Since 2016, we have issued three prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Fannie Mae. We made five recommendations in these three audits that were relevant to the objective of this audit. Even though FHFA did not accept all of the recommendations when the audits were issued, we found that FHFA took appropriate action to address the relevant findings and recommendations from these prior audit reports.

## **MATTER FOR CONSIDERATION AND RECOMMENDATION – FHFA’S SUPERVISION OF COMMON SECURITIZATION SOLUTIONS, LLC**

As discussed in the Background section of this report, FHFA is the supervisor for CSS as it is an affiliated entity of the Enterprises. Because the planned targeted examinations for CSS were, until mid-2017, included on the Fannie Mae supervisory plan, and the supervisory activities were primarily conducted by the Fannie Mae examination team and led by the Fannie Mae EIC, DER’s completion of its planned supervisory activities were included in the scope of this audit.<sup>15 16</sup>

In a November 23, 2016, memorandum entitled “CSS Supervision Framework – Close out memo,” DER summarized its supervision framework for CSS. The memorandum states, “This framework was crafted for CSS in 2016, but is designed to serve as the foundation for ongoing supervisory work as CSS operations expand. **This framework is expected to be**

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<sup>15</sup> During the review period of our audits in 2016, we found no evidence that any targeted examinations for CSS were planned or completed.

<sup>16</sup> During our review period for this audit, we found that DER planned four targeted examinations for CSS. The first targeted examination, in 2016, was included in the 2016 Fannie Mae examination plan. Beginning mid-2017, DER prepared a separate CSS examination plan which included the other three planned targeted examinations: one for 2017 and two for 2018. As of July 1, 2019, two of the four planned targeted examinations were completed (one from the 2016 Fannie Mae examination plan and one from the 2018 CSS examination plan), one was commenced but not completed, and the other was terminated.

**adjusted in 2017 and subsequent years to reflect changes in CSS activities, operations, and organization.”** (emphasis added)<sup>17</sup>

The framework outlined supervision activities, communication of supervision activities, and rating as follows: (1) Supervision Activities, Approach, and Scope – CSS examination planning, performance, and documentation should follow existing DER procedures; (2) Communication Results of Supervision Activities – Results of targeted examination(s) and any ongoing monitoring should be communicated in a manner that is consistent with DER guidance, e.g., through exit meetings and conclusion letter(s) to the CSS board of managers and chief executive officer; and (3) Rating – Given the stage of maturity of the CSS organization, this memorandum stated that DER did not intend to assign CAMELSO composite or component ratings to CSS in 2016.<sup>18 19</sup>

DER officials informed us that the framework has not been adjusted since its adoption in November 2016. In June 2019, CSS began issuing a single mortgage-backed security for both Enterprises.<sup>20</sup> According to a DER official, because CSS is now issuing the Single Security, aspects of the framework should be reassessed.

We recommend that FHFA:

1. Reassess the supervision framework for CSS and update that framework as appropriate to meet FHFA’s supervisory responsibility for this affiliated entity now that it is issuing a single mortgage-backed security for both Enterprises.

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

We provided FHFA an opportunity to respond to a draft of this audit report. FHFA provided technical comments on the draft report and those comments were considered in finalizing this

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<sup>17</sup> In April 2016, prior to the November 2016 memorandum, the framework was presented to the FHFA Policy and Management Review Committee (PMRC), which is comprised of FHFA’s Deputy Directors, General Counsel, and other senior officials. The purpose of the PMRC is to “provide collaboration, cross-agency communication, and critical review of select policies, objectives and agency actions . . . .”

<sup>18</sup> The memorandum also clearly states that the “framework encompasses all supervision activities of DER with regard to CSS but does not apply to DER supervision of the Enterprises’ activities to integrate the Common Securitization Platform.”

<sup>19</sup> For the regulated entities, the CAMELSO rating system is comprised of the following seven components: Capital, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk, and Operational risk.

<sup>20</sup> On June 3, 2019, FHFA announced the launch of the Uniform Mortgage-Backed Security.

report. FHFA also provided a management response, which is included in Appendix 2 of this report.

In its response, FHFA agreed with the recommendation and stated that DER will review the supervisory framework for CSS and issue additional internal guidance for conducting examinations of CSS operations and risk management by February 28, 2020. We consider FHFA’s planned corrective action responsive to our recommendation. FHFA also acknowledged in the response, our conclusion that DER’s completion of planned targeted examinations has improved since the 2016 audit and that FHFA took appropriate action to address the relevant findings and recommendations from prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Fannie Mae.

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

We performed this audit to determine whether FHFA completed its planned targeted examinations for Fannie Mae for the 2016, 2017, and 2018 examination cycles and, if it did not, whether it documented the deviations from its plans in accordance with its policies and procedures.

To accomplish our objective, we:

- Reviewed FHFA’s *Examination Manual*; DER’s OPB, *Supervisory Planning Process* (2013-DER-OPB-03.1); DER’s OPB, *DER Supervisory Activities* (2013-DER-OPB-04); DER’s OPB, *Guidelines for Preparing Supervisory Products and Examination Workpapers* (2014-DER-OPB-01); DER’s OPB, *Document Management Guidance* (DER-OPB-4.1); DER’s OPB, *Reports of Examination* (DER-OPB-05.2); DER’s OPB, *Reports of Examination* (DER-OPB-02.4); DER’s OPB, *Examination Processes and Documentation: Targeted Examinations* (DER-OPB-2.1); DER’s OPB, *Examination Planning Process* (DER-OPB-2.5); FHFA’s Advisory Bulletin, *Categories for Examination Findings* (AB 2012-01); FHFA’s Advisory Bulletin, *Classifications of Adverse Examination Findings* (AB 2017-01); and FHFA’s *Common Securitization Solutions Examination Manual Module*;
- Reviewed FHFA’s examination plans for 2016 through 2018 for Fannie Mae and CSS and other documentation in FHFA’s IMS to identify the universe of planned targeted examinations;
- Compared the planned targeted examinations for Fannie Mae and CSS – as described in FHFA’s examination planning documents – to the targeted examination request letters, conclusion letters, and other relevant documentation in order to determine whether FHFA performed (i.e., completed) its planned targeted examinations for the

2016, 2017, and 2018 examination cycles, and if it did not, to identify the disposition of the examinations (e.g., commenced but not completed, or not conducted);

- Compared DER execution of its planned targeted examinations for Fannie Mae for its 2012 through 2015 examination cycles (as presented in our prior report) to that for the 2016 through 2018 examination cycles;
- Assessed whether DER completed the planned targeted examinations for each examination cycle (2016 through 2018) prior to the respective ROE issued. As part of this assessment, we assessed FHFA’s criteria for reporting MRAs in ROEs;
- Reviewed FHFA’s changes to its 2016 through 2018 examination plans for targeted examinations of Fannie Mae to determine if the changes were risk-based, documented in the examination workpapers, and approved by the EIC in accordance with policies and procedures;
- Evaluated FHFA’s corrective actions for audit recommendations from the following prior OIG audit reports relevant to FHFA’s implementation of its 2016 through 2018 examination plans for targeted examinations of Fannie Mae:
  - *FHFA’s Supervisory Planning Process for the Enterprises: Roughly Half of FHFA’s 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed* (September 30, 2016) (AUD-2016-005);
  - *FHFA’s Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued* (September 30, 2016) (AUD-2016-006); and
  - *FHFA Failed to Complete Non-MRA Supervisory Activities Related to Cybersecurity Risks at Fannie Mae Planned for the 2016 Examination Cycle* (September 27, 2017) (AUD-2017-010).
- Interviewed FHFA officials regarding their implementation of the 2016 through 2018 examination plans for targeted examinations of Fannie Mae and CSS.

We conducted this performance audit between October 2018 and September 2019 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## APPENDIX 1: FHFA’S IMPLEMENTATION OF RELEVANT RECOMMENDATIONS FROM PRIOR AUDITS ON DER’S SUPERVISORY ACTIVITIES OF FANNIE MAE .....

Since 2016, we have issued three prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Fannie Mae. Those reports included a total of 11 recommendations. We determined that five of those recommendations were relevant to the objective of this audit and we evaluated DER’s actions to address the recommendations.<sup>21</sup> As discussed below, we found that FHFA took appropriate action to address the relevant findings and recommendations from our prior audit reports on the Agency’s implementation of its examination plans for Fannie Mae.

*Audit Reports: FHFA’s Supervisory Planning Process for the Enterprises: Roughly Half of FHFA’s 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed (AUD- 2016-005), and FHFA’s Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued (AUD-2016-006)*

- Recommendation 5 (AUD-2016-005) and Recommendation 1 (AUD-2016-006). Revise existing guidance to require examiners to prepare complete documentation of supervisory activities and maintain such documentation in the official system of record and train DER examiners on this guidance.

Status of Recommendation: In its response to our prior audit reports, FHFA disagreed with the recommendation stating that “DER has sufficient guidance in place for documentation of supervisory activities.” Accordingly, we reported the recommendation as closed, rejected, and FHFA recorded a “complete” (closed) date of March 22, 2017, in its OIG recommendation tracking system.

OIG Evaluation: While FHFA disagreed with this recommendation, we found that it did take actions that addressed the intent of the recommendation by revising its guidance, preparing complete documentation of supervisory activities, maintaining the documentation in its official system of records, and training DER examiners. Specifically, FHFA revised existing guidance by issuing two OPBs (one in 2017 and one in 2018), which established requirements for examiners to prepare complete

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<sup>21</sup> One recommendation was made in both audit reports issued in 2016. We are counting that recommendation once in this report.

documentation of supervisory activities and maintain such documentation in FHFA's official system of record (IMS).<sup>22 23</sup> Additionally, DER provided training to examiners on the new OPBs in division meetings held on April 6, 2017, and September 20, 2018. During this audit, we found that FHFA's documentation of the planning and execution of DER's supervisory activities for the review period were maintained in IMS. In IMS, for example, we found annual examination plans, mid-year updates to those plans, request letters, conclusion letters, and memorandums to file containing justifications for changes to the examination plans and/or the objectives of targeted examinations.

We reported in our 2016 audits that we considered the lack of DER's documentation supporting its supervisory activities, as it related to the objectives of that audit, to create a significant risk exposure. We believe that DER addressed that significant risk exposure during the review period for this audit.

*Audit Report: FHFA's Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued (AUD-2016-006)*

- **Recommendation 3.** Develop and implement guidance that clearly requires supervisory plans to identify and prioritize the planned targeted examinations that are to be completed for each examination cycle, in order to fully inform the ROE and CAMELSO ratings for that cycle.

**Status of Recommendation:** In a memorandum dated September 28, 2017, DER reported that all planned actions for this recommendation were completed. Those actions consisted of revising DER's OPB for developing its annual risk assessment for each Enterprise. Subsequently, in October 2017, DER informed our office that it no longer prioritized targeted examinations in examination plans because its expectations were that targeted examinations included in the examination plans are to be conducted during the examination cycle for which they are planned, unless there is a risk-based reason for doing otherwise.

**OIG Evaluation:** The Deputy Director, DER, informed us that she expects all planned supervisory activities to be completed within the examination cycle unless there is a risk-based or operational justification as to why it should not be completed. We found that a higher percentage of targeted examinations were completed during the

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<sup>22</sup> FHFA issued DER-OPB-4.1, *Document Management Guidance* (April 3, 2017). This OPB sets forth guidelines for the electronic creation, access, clearance, storage, and disposition of DER documents.

<sup>23</sup> FHFA issued DER-OPB-2.1, *Examination Processes and Documentation: Targeted Examinations* (September 27, 2018). This OPB describes processes and documentation requirements for DER targeted examinations.

examination cycle for which they were planned, and when they were not completed, there was a documented risk-based reason for not doing so. As presented in Figure 4, there is an increasing trend in the completion of planned targeted examinations during the examination cycle for which they were planned, 2016 through 2018. FHFA's completion rate before the respective ROE issued increased from 4 of 16 (25%) planned targeted examinations in the 2016 examination cycle to 10 of 15 (67%) planned targeted examinations in the 2018 examination cycle.

Furthermore, for those targeted examinations that were converted to ongoing monitoring, deferred, or cancelled, we found that DER did document a risk-based reason for not completing them, the reason was approved by the EIC, and the workpapers were documented. We consider the progress made by DER to complete more of its planned targeted examinations within the examination cycle during our review period and to document risk-based reasons for changes to the examination plans as responsive to the intent of the recommendation.

- **Recommendation 4.** Develop and implement a control that provides for the tracking and documentation of planned targeted examinations, through disposition, in DER's official system of record.

**Status of Recommendation:** In its response to the recommendation, FHFA agreed and stated that "DER will establish an improved mechanism for tracking the status of activities included on Enterprise examination plans, including changes resulting from the mid-year planning update process and at year-end." In an internal memorandum dated September 22, 2017, DER reported that, in 2016, it developed for beta testing a SharePoint-based tracking mechanism – an added feature to its tracking abilities – for use as part of its examination planning process. According to officials, the tracking mechanism assigns a unique identifier for each planned activity and facilitates the tracking for how each planned activity changes, if at all, from cradle to grave (i.e., from planning through disposition). Specifically, it was developed to list each planned examination activity from the examination plan at the beginning of the year, be updated to reflect additions and changes from the mid-year update planning process, and updated again at year-end to indicate the disposition of each planned activity. DER also plans to continue to assess the effectiveness of its tracking mechanism and look for opportunities for improvement.

**OIG Evaluation:** We found that DER implemented a SharePoint-based tracking mechanism and has been using some form of it since it was developed in 2016.

In each year of our review period, DER documented the status of its planned targeted examinations for the examination cycle in the year-end examination plans stored in its

official system of record. Based on the results of this audit, we found that DER could account for the status of all planned targeted examinations of Fannie Mae for the three examination cycles we reviewed.

- Recommendation 5. Reinforce and hold EICs accountable to follow DER’s requirement to fully document the risk-based justifications for changes to the supervisory plan, and that changes to supervisory plans are documented and approved by the EIC. Ensure that examiners follow DER Operating Procedures Bulletin 2013- DER-OPB-03.1 to fully document the risk-based justifications for changes to the supervisory plan, and that changes to supervisory plans are documented and approved by the EIC.

Status of Recommendation: In a memorandum dated September 28, 2017, DER reported that all planned actions for this recommendation were completed. Those actions consisted of revising DER’s OPB for developing its annual risk assessment for each Enterprise. FHFA officials reported to us in October 2017 that DER “plans to update this OPB to reflect an enhanced examination planning process that includes (but is not limited to) expectations for mid-year planning update meetings, mid-year plan updates, documentation of rationale for significant updates, and approval requirements for updates to examination plans.”

OIG Evaluation: We reviewed the updated OPB, *Examination Planning Process* (DER-OPB-2.5), issued April 1, 2019, and found that it included updated guidance regarding DER’s examination planning process. The OPB states that the examination plan may be modified during the course of the year to reflect changes in Enterprise business operations or risk exposures. Any changes should be reflected in revisions to the plan, with documentation of the basis for the revisions. Revisions to a plan must be approved by the EIC and Deputy Director and formally approved as part of the mid-year planning process.

Also, as noted in the Facts and Analysis section of the report, our tests showed that the eight changes (targeted examinations not conducted) to the examination plans (planned targeted examinations that were converted to ongoing monitoring, deferred, or cancelled) were risk-based, documented in the examination workpapers, and approved by the EIC.

Audit Report: *FHFA Failed to Complete Non-MRA Supervisory Activities Related to Cybersecurity Risks at Fannie Mae Planned for the 2016 Examination Cycle* (AUD-2017-010)

- Recommendation 3. Except for rare instances where DER has an urgent need to communicate significant supervisory concerns to an Enterprise board, ensure that all

supervisory conclusions and findings reported by DER in the Enterprise’s annual ROEs are based on completed work that has been previously communicated, when required, in writing to the Enterprise.

Status of Recommendation: In internal memoranda dated January 31, 2018, and August 30, 2018, DER reported that planned actions for this recommendation had been completed. Those actions consisted of (1) training of DER examination staff in DER quality control requirements and the content of annual ROEs and (2) issuing DER-OPB-02.4, *Reports of Examination*, in August 2018 that, among other things, states: “The ROE may include any examination conclusion (i.e., a statement supported by examination results) provided that the conclusion has been reviewed by [Quality Control].”

OIG Evaluation: Our tests during this audit found that targeted examinations that resulted in the issuance of MRAs to Fannie Mae (via conclusion letters), during the 2017 and 2018 examination cycles, were reviewed through DER’s quality control process and communicated to Fannie Mae prior to their inclusion in the respective ROE. Specifically, we found that FHFA completed seven targeted examinations before the respective ROE issued that resulted in the issuance of ■ MRAs during the 2017 and 2018 examination cycles, and the results of all seven targeted examinations were communicated to the Enterprise and reviewed through its quality control process prior to their inclusion in the respective ROE. We did not identify any significant supervisory concern identified through a targeted examination that was included in an ROE before the results of the targeted examination were communicated to the Enterprise in a conclusion letter.

We had also recommended in two of the prior reports, as Recommendation 2 in AUD-2016-006 and Recommendation 1 in AUD-2017-010, that FHFA assess whether DER had a sufficient complement of qualified examiners to conduct and complete those examinations rated by DER to be of high-priority within each supervisory cycle and address the resource constraints that have adversely affected DER’s ability to carry out its risk-based supervisory plans. We made this recommendation in those audit reports because resource constraints were cited by DER staff as a factor for not completing planned supervisory activities that were the focus of both audits (notwithstanding, as reported in our 2016 audit, a consistent position of DER leadership and FHFA senior leadership that DER had an adequate complement of examiners and its staffing levels had not adversely affected its ability to meet its supervisory responsibilities). For both audits, DER partially agreed with the recommendation. In its management response for the 2016 audit, DER did agree that it is a sound practice to regularly assess whether staffing levels are sufficient to carry out DER responsibilities for fulfillment of FHFA’s mission, and that this is done as part of the agency-wide budget process for each fiscal year. For the 2017 audit, FHFA stated, in part, that by June 1, 2018, DER would

determine whether staff be moved or additional staffing resources be requested to ensure consistency of 2019 examination coverage over cybersecurity risk. As of the date of this report, we have an audit in progress of DER's supervisory workforce planning process, which we initiated in light of these prior recommendations.

## APPENDIX 2: FHFA MANAGEMENT RESPONSE .....



# Federal Housing Finance Agency

### MEMORANDUM

TO: Marla A. Freedman, Deputy Inspector General for Audits

FROM: Nina A. Nichols, Deputy Director, Division of Enterprise Regulation (DER)<sup>NAN</sup>

SUBJECT: Draft OIG Report: *FHFA's Completion of Planned Targeted Examinations of Fannie Mae Improved from 2016 through 2018, But Timeliness Remained an Issue; With the June 2019 Issuance of the Single Security, FHFA Should Reassess Its Supervision Framework for CSS*

DATE: September 11, 2019

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Thank you for the opportunity to respond to the draft report referenced above (Report). We appreciate the Office of Inspector General's (OIG) acknowledgment that DER's completion of planned targeted examinations has improved since the OIG's 2016 audit. The OIG also concluded that FHFA took appropriate action to address the relevant findings and recommendations from prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Fannie Mae. The draft Report makes one recommendation:

**Recommendation:** *OIG recommends that FHFA reassess the supervision framework for CSS and update that framework as appropriate to meet FHFA's supervisory responsibility for this affiliated entity now that it is issuing a single mortgage-backed security for both Enterprises.*

**Management Response:** FHFA agrees with the recommendation. By February 28, 2020, DER will review the supervisory framework for Common Securitization Solutions (CSS) and issue additional internal guidance for conducting examinations of CSS operations and risk management.

cc: Chris Bosland  
Larry Stauffer  
John Major

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