

REDACTED

Federal Housing Finance Agency
Office of Inspector General



Update on the Status of the Development of the Common Securitization Platform



COM 2017 001

December 9,
2016

Executive Summary

In 2012, the Federal Housing Finance Agency (FHFA/Agency), the conservator of Fannie Mae and Freddie Mac (the Enterprises), directed them to build a Common Securitization Platform (CSP or Platform). As originally envisioned by FHFA, the CSP was intended to provide a Platform for multiple market participants to issue mortgage-backed securities (MBS) in a future housing finance reform system that had yet to be defined. FHFA believed the Enterprises' back-office systems were "outmoded" and assumed that the cost to build the CSP and integrate the Enterprises' legacy financial and information technology (IT) systems into the Platform would be less than the combined costs for the Enterprises to upgrade their back-office systems. In 2013, FHFA directed the Enterprises to establish and fund a joint venture, Common Securitization Solutions, LLC (CSS), to develop and ultimately operate the CSP.

In May 2014, after extensive discussion within FHFA and with the Enterprises, FHFA concluded that the many variables in the CSP project created extreme risks and determined to de-risk the project by breaking it down into smaller pieces. In its May 2014 Strategic Plan for the Conservatorships, FHFA clarified that the CSP's primary focus would be on supporting the Enterprises' current securitization activities, although the Platform would use standard industry technology and interfaces so that future market participants could connect to it. FHFA also announced three key goals of the conservatorships, one of which was to build a new infrastructure for the Enterprises' securitization functions and enable them to replace their separate MBS with a single, common security which would be issued and serviced via the CSP. According to FHFA, Enterprise issuance of a single common security through the CSP would improve liquidity in the housing finance system.

FHFA Has Implemented Recommendations from FHFA Office of Inspector General's 2014 Evaluation Report that Were Intended to Improve its Oversight of the CSP's Development

In a May 2014 evaluation report, we assessed the status of the CSP's development since 2012. We found that, as of December 31, 2013, the Enterprises had spent a total of \$65 million on the CSP program. FHFA and the team building the CSP had constructed a Platform prototype, and associated software testing was underway. We reported that officials from FHFA and the Enterprises recognized that the Enterprises' legacy financial and information systems were outmoded and upgrading them so they could be integrated into the Platform would be complex and risky. Unless the risks attendant to these challenges were managed properly, we cautioned that the CSP project could fail.



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We also found that FHFA had not adopted essential project management tools to enable it to effectively oversee the CSP project. Two years into the development of the CSP, we learned that FHFA had not established schedules and timelines for the completion of the project, and lacked an estimate of the cost to complete the CSP project. We recommended that FHFA take steps to address these limitations in its oversight, and it agreed to do so.

In June 2016, we closed our recommendations based on the corrective actions taken by FHFA. FHFA established timelines under which it anticipated that Freddie Mac would begin to use the CSP to issue its fixed rate securities in the fourth quarter of 2016 (referred to as Release 1) and both Enterprises would use the CSP to issue the new single security at some point during calendar year 2018 (referred to as Release 2). FHFA required CSS and the Enterprises to track the monies spent to date and to estimate the total costs to develop the Platform and integrate the Enterprises' legacy systems on to it. We also observe that FHFA put into place a system to monitor the Enterprises' efforts to finish construction of the Platform and upgrade and integrate their legacy systems into it.

FHFA Has Not Fully Met its Commitment to be Transparent about CSP's Development

When it announced its revised goals for the CSP in May 2014, FHFA committed to be transparent in its development—a commitment it reaffirmed on several occasions. From May 2014 through early July 2016, FHFA issued a number of public reports in which it discussed the status of the CSP's development. In view of FHFA's repeated commitment to transparency about the development of the CSP, we reviewed these reports to assess the extent to which they disclosed information about the project's status.

We were guided in our analysis by the transparency standards for major IT acquisition projects contained in the Federal Information Technology Acquisition Reform Act (FITARA). Federal agencies covered by FITARA are required to provide the Office of Management and Budget (OMB) with detailed information about the annual costs of their major IT projects, as well as the risks to their successful completion. OMB publishes this information on a public website called the *IT Dashboard*. The CSP is a major IT acquisition project. Although FHFA is not an agency covered by FITARA, the Act's transparency principles provide a useful standard against which to evaluate FHFA's reports on the costs and risks of the CSP project.

We found that FHFA had collected a significant amount of information on the actual and projected costs of the CSP from the Enterprises, and had conducted regular assessments of the risks to successful completion of the CSP. In our



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view, FHFA has not disclosed this information, even at a high level, in its public reports.

- *Actual and Projected Costs of the CSP:* All of the costs associated with the development of the CSP have been, and will be borne by the Enterprises. Since 2014, FHFA has collected data from the Enterprises on the costs to develop the CSP and the costs they have incurred to modify their legacy financial and information systems to integrate them into the CSP.

FHFA only disclosed specific CSP cost data once in a September 2015 status report in which it announced that, from 2012 through mid-2015, the Enterprises spent \$146 million to develop the actual CSP Platform (the Enterprises' 2015 10-Ks reveal that this amount increased to \$218 million by year end 2015). However, FHFA has never publicly reported that from 2012 through 2015 the Enterprises spent an additional \$[REDACTED] to integrate their legacy systems into the Platform, even though it had collected this data from the Enterprises. These unreported costs are [REDACTED]% higher than the \$218 million the Enterprises spent over the same period to develop the actual CSP Platform.

According to our review of internal FHFA documents and Enterprise data, the Agency projects—but has not publicly disclosed—that the Enterprises' total CSP costs from 2012 through 2018 (including Platform development and integration expenses) will be more than \$[REDACTED].

FHFA has asserted that the Enterprises' legacy financial and information systems were outmoded and in need of modernization; therefore, the Enterprises would have incurred "many" of the actual and projected Platform and integration costs without the CSP project. However, FHFA has acknowledged that the Enterprises do not have estimates of the portion of the \$[REDACTED] in costs for the CSP program which would have been incurred anyway if they had pursued separate upgrades to their securitization platforms.

- *CSP Software Development Risks:* FHFA reported publicly that the Enterprises and CSS were "making progress" in developing and testing the CSP's software. FHFA has not disclosed that since 2014 it has internally rated the risks to CSP's successful development on a monthly basis. These internal reports identify elevated risks facing CSP's development, particularly related to integrating the Enterprises' legacy systems into the Platform.



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In its technical comments on a draft of this report, the Agency asserted that the risks identified in its monthly reports were being addressed and would not affect the publicly-reported completion dates for CSP. However, the transparency principles underlying FITARA are intended to ensure that policy-makers and the public are kept informed of the risks facing major IT acquisitions and Agency efforts to remediate them. FHFA's assurance that it would address the risks it did not disclose in the first instance does not amount to transparency.

FHFA has acted as conservator of the Enterprises since September 2008 and is the steward of the \$187.5 billion investment from American taxpayers in the Enterprises. As conservator, FHFA has met its commitment to implement the recommendations in our 2014 evaluation to strengthen its oversight of the CSP project. In our view, FHFA has not fully met its commitment to transparency about the development of the CSP because it has not publicly disclosed the actual and projected costs of the project or the risks to its successful development and timely delivery.

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ABBREVIATIONS

| | |
|---------------------|--|
| Agency or FHFA | Federal Housing Finance Agency |
| CSP or Platform | Common Securitization Platform |
| CSS | Common Securitization Solutions, LLC |
| Enterprises | Fannie Mae and Freddie Mac |
| FITARA | Federal Information Technology Acquisition Reform Act |
| MBS | Mortgage-Backed Securities |
| OMB | Office of Management and Budget |
| PAR | Performance and Accountability Report |
| Progress Report | 2015 Scorecard Progress Report |
| 2012 Strategic Plan | A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending |
| 2014 Strategic Plan | The 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac |
| 2015 Update | An Update on the Common Securitization Platform |
| 2016 Update | Update on the Implementation of the Single Security and Common Securitization Platform |

BACKGROUND

Each Enterprise purchases mortgage loans from banks, mortgage companies, and other loan originators. Generally speaking, individual mortgage loans are illiquid assets. However, when individual mortgages of similar characteristics are combined into a pool, securities can be issued that represent claims on the principal and interest payments made by borrowers on the loans in the pool. The process by which mortgages are pooled is called “securitization.” Securitization turns the assets underlying illiquid mortgage loans into marketable securities that can be bought, sold, and traded on the secondary markets. Mortgage securitization allows the Enterprises to continue to purchase mortgage loans without retaining the loan assets on their books.¹

FHFA’s Initial Goal in May 2012: Development of a New Securitization Platform for the Secondary Mortgage Market

In February 2012, FHFA issued “A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending” (*2012 Strategic Plan*). In it, FHFA announced the goal of building a new securitization platform “designed to issue securities supported with or without a government guarantee.” FHFA’s proposed design objectives for the platform included “an open architecture that [would] permit multiple future issuers of mortgage-backed securities to access the platform” and sufficient flexibility “to permit a wide array of securities and mortgage structures.” FHFA also observed in the *2012 Strategic Plan* that “[i]n the intermediate term, a single platform would allow for a single mortgage-backed security.”

In that same *2012 Strategic Plan*, FHFA recognized that the back-office systems by which the Enterprises issued and serviced their MBS were ill-equipped to fulfill its vision of a new, common securitization platform:

Neither Enterprise has a securitization infrastructure capable of becoming a market utility today. Taking on that role would require substantial investment of both human capital and information technology resources. Both Enterprises would have to draw from the American taxpayer to make such a long-term infrastructure investment, so it makes more sense to do this only once. (emphasis added)

¹ For a more comprehensive discussion of the MBS process, see OIG, *Status of the Development of the Common Securitization Platform* (May 21, 2014) (EVL-2014-008) (online at www.fhfa.gov/Content/Files/EVL-2014-008.pdf).

FHFA worked with the Enterprises during 2012 to develop a plan for the design of a common securitization platform that would “serve both companies and also potentially be used in a post conservatorship market.” In its 2012 *Report to Congress*, issued in June 2013,² FHFA explained that its “basic premise is that the Enterprises’ outmoded proprietary infrastructures need to be updated and maintained and any updates should enhance value to the mortgage market with a common and more efficient model.”

In October 2013, the Enterprises established CSS as an independent, jointly-owned business entity to develop the CSP, including building the Platform software and operational capabilities, and to support the Enterprises’ use of the CSP.

FHFA’s Revised Goal in May 2014: Clarification of the Scope and Purpose of the CSP

After discussions both within FHFA and with the Enterprises, FHFA concluded that the many variables in the original CSP project created extreme risks and decided to “de-risk” the CSP project by breaking it down into smaller pieces. In its May 2014 revised Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac (2014 Strategic Plan), FHFA announced three key goals of the conservatorships, one of which was to build a new infrastructure for the Enterprises’ securitization functions which would enable them to issue a single common security. According to FHFA, the Enterprises issuance of a single, common security through the CSP would improve liquidity in the housing finance system.

Recognizing that other market participants might seek to use the CSP, FHFA instructed the Enterprises to develop the CSP with industry-standard software, systems, and data requirements. FHFA envisioned that, at a later point in time, the CSP could be configured for use by private-label securities issuers.

OIG’s May 2014 Evaluation Identified Challenges to the Successful Development of the CSP

In our May 2014 evaluation, we assessed the progress made since 2012 to develop the CSP.³ Although we found that progress had been made, we cautioned that the CSP faced considerable challenges because it was a large and complex technology project. We observed that FHFA lacked experience and expertise in overseeing such projects, and that the Enterprises did not have a good record of completing such projects on time.

² FHFA, *2012 Report to Congress*, at 13 (June 13, 2013) (online at www.fhfa.gov/AboutUs/Reports/Pages/FHFA-2012-Annual-Report-to-Congress.aspx).

³ OIG, *Status of the Development of the Common Securitization Platform* (May 21, 2014) (EVL-2014-008) (online at www.fhfa.gov/Content/Files/EVL-2014-008.pdf).

In our view, the most significant challenge to the success of the CSP was the **integration** of the Enterprises' separate IT and financial systems into the new Platform. Each Enterprise used a significant number of different systems, and upgrading, modifying or replacing those systems so they could be integrated into the CSP was likely to be complex and risky. We warned that the process, if not managed well, could result in CSP's failure to function as planned.

Integration is the process enabling the Enterprises to communicate with the CSP. In some cases, the Enterprises must modify their legacy financial and information systems to integrate with the CSP.

FHFA Met its Commitment to Implement the Recommendations in our 2014 Report which were Intended to Improve the Project's Management

Our 2014 evaluation report also found that FHFA had not adopted project management tools for its oversight of the CSP project; that is, it lacked schedules and timelines for the project's completion, cost estimates for its various stages, and an overall cost estimate. We recommended that FHFA address these limitations in its oversight of the CSP project, and it agreed to do. As discussed below, we closed this recommendation in June 2016 because FHFA has developed timelines, budgets, and cost estimates through 2018 that it tracks internally and put into place a system to monitor the Enterprises' efforts to finish construction of the Platform and upgrade and integrate their legacy systems into it.

FHFA Timelines for the CSP and the Single Security

In a March 2016 report, FHFA announced that the CSP and the single security would be completed in two phases—Release 1 and Release 2.⁴ As explained by FHFA, Release 1, during the fourth quarter of 2016, would be Freddie Mac's use of the CSP to issue its fixed-rate MBS. Release 2, during calendar year 2018, would be both Enterprises' use of the CSP to issue the new single, common security. In its July 2016 public update on the CSP, the Agency provided a list of planned software tests from 2016 through 2018, and stated that it would announce in the fourth quarter of 2016 a timeline for issuing the single security via the CSP in 2018.⁵ FHFA also stated that it would provide stakeholders with a year's notice of the single security's completion date in 2018.

⁴ FHFA, *2015 Scorecard Progress Report* (Mar. 2016) (online at www.fhfa.gov/AboutUs/Reports/ReportDocuments/Progress-Report-2015-Scorecard.pdf).

⁵ FHFA, *Implementation of the Single Security and Common Securitization Platform* (July 7, 2016).

FHFA's Public Commitment to Transparency On Development of the CSP and the Single Security

Contemporaneous with FHFA's release of its 2014 *Strategic Plan*, FHFA Director Watt discussed the manner in which each goal in that *Plan* built upon and, in some instances, reformulated past conservatorship goals.⁶ Director Watt provided a "clear sense of direction" for the conservatorships, and recognized that implementing the goals in the 2014 *Strategic Plan* would entail "ongoing analysis, evaluation and input." He committed that FHFA would "proceed with these steps in a transparent way that incorporates the feedback of the public and stakeholder groups whenever possible."⁷ Several months later, Director Watt reaffirmed FHFA's commitment to transparency in the development of the CSP. That commitment was reiterated by FHFA in its July 2016 update on the status of the CSP.

FACTS

FHFA committed to oversee the development of the CSP in a transparent manner and reaffirmed that commitment most recently in July 2016. It issued a number of public reports from May 2014 through early July 2016, in which it described the progress of the development of the CSP. By any measure, CSP is a significant IT project.⁸ We reviewed all of these reports against the transparency standards for major federal IT acquisitions enacted by Congress in FITARA. For presentation purposes, we focus our discussion below on the following three reports:⁹

⁶ See Melvin L. Watt, FHFA Director, Prepared Remarks at the Brookings Institution Forum on the Future of Fannie Mae and Freddie Mac (May 13, 2014) (online at www.fhfa.gov/Media/PublicAffairs/Pages/Watt-Brookings-Keynote-5132014.aspx).

⁷ *Id.* at Conclusion.

⁸ For example, OMB Memorandum M-15-14 defines a "major IT investment" as an acquisition requiring special management attention because it has importance to the mission or function of the government, significant program or policy implications, high executive visibility, high development, operating, or maintenance costs, an unusual funding mechanism; or is defined as major by the agency's capital planning and control process.

⁹ We reviewed the thirteen FHFA public reports issued from May 2014 through early July 2016 in which it discussed the CSP project, including the seven reports issued after OMB's memorandum of June 10, 2015, in which it encouraged federal agencies to apply the principles of FITARA in the management of their major IT acquisitions. None of these thirteen reports discussed the Enterprises' CSP integration costs or the total projected costs for the platform; nor did any of them discuss FHFA's internal assessments of the risks facing the CSP project.

- *An Update on the Common Securitization Platform (2015 Update)*, issued on September 15, 2015.
- *2015 Scorecard Progress Report (Progress Report)*, issued March 2016.
- *An Update on the Implementation of the Single Security and the Common Securitization Platform (2016 Update)* issued July 2016, and the cover letter by which it was transmitted to the Chairmen and Ranking Members of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services.

We found that FHFA's reports provide considerable information about the CSP project, such as descriptions of its systems and the manner in which the Enterprises are aligning their policies and procedures to issue the single security from the Platform. However, we found that FHFA has not fully met its commitment to transparency because it has not disclosed the integration costs to date and the projected Platform development and integration costs from 2016 through 2018; and has not disclosed, even at a high level, the status of the risks facing successful completion of the CSP.

FITARA Established Transparency Standards for Acquisition and Management of Major Federal IT Projects

In numerous reports issued from fiscal years 2010 through 2015, the Government Accountability Office (GAO) identified significant weaknesses and failures across the federal government with respect to the acquisition and management of IT projects.¹⁰ Recognizing the severity of issues related to government-wide acquisition and management of IT, Congress, in December 2014, enacted FITARA to improve the efficiency and effectiveness of federal IT acquisitions.^{11 12} To bring about these improvements, Congress established specific requirements in seven areas, one of which was enhanced transparency and improved risk management. Federal agencies covered by FITARA¹³ are required to make publicly available

¹⁰ See GAO, *Information Technology: Implementation of Reform Legislation Needed to Improve Acquisitions and Operations* (Nov. 4, 2015) (GAO-16-204T) (online at www.gao.gov/assets/680/673508.pdf); GAO, *Information Technology: OMB and Agencies Need to Focus Continued Attention on Implementing Reform Law* (May 18, 2016) (GAO-16-672T) (online at www.gao.gov/assets/680/677290.pdf).

¹¹ Federal Information Technology Acquisition Reform provisions of the Carl Levin and Howard P. 'Buck' McKeon National Defense Authorization Act for Fiscal Year 2015, Pub. L. 113-291, div. A, title VIII, subtitle D, 128 Stat. 3292, 3438-3450 (Dec. 19, 2014). See also GAO, *Information Technology: OMB and Agencies Need to Focus Continued Attention on Implementing Reform Law* (May 18, 2016) (GAO-16-672T) (online at www.gao.gov/assets/680/677290.pdf).

¹² FITARA does not apply to the Enterprises or CSS because they are not Federal agencies.

¹³ See 31 U.S.C. § 901(b)(1) and (2).

“data on cost, schedule, and performance” of major IT investments to the Office of Management and Budget (OMB).¹⁴ OMB publishes this information on its *IT Dashboard*.¹⁵

The *IT Dashboard* “provide[s] Federal agencies and the public with the ability to view details of Federal information technology (IT) investments online and to track their progress over time.” It displays detailed cost, schedule, and performance data for over 700 major IT investments. Specifically, the website shows the total expenditures for each IT project; breaks out the cost data into varying categories including development and operations and maintenance; and provides information as to the extent to which each project’s actual costs vary from its planned costs. The website also provides ratings showing the severity of the risks facing major IT investments using a traditional stoplight scale (Green, Yellow, Red); the risk ratings are displayed in graphic form on the website.

FHFA, like a number of other federal agencies, has determined that it is not covered by FITARA. In a memorandum issued on June 10, 2015, OMB issued guidance to implement the FITARA requirements, including its transparency standards.¹⁶ OMB “encouraged” “all other Executive Branch agencies ... to apply the principles described in this guidance to their management of IT, consistent with their legal authorities.” The transparency principles announced in FITARA provide a useful standard against which to evaluate the transparency of FHFA’s public reporting on the project’s costs and risks.

ANALYSIS

We found that FHFA has not been fully transparent about the CSP project. First, it has not publicly disclosed the actual and projected costs for the CSP project which exceed \$[REDACTED]. While FHFA claims, in its technical comments on a draft of this report, that some portion of these costs would have been incurred had the Enterprises simply upgraded their internal systems, it has acknowledged that the Enterprises do not have estimates of the costs that they would have incurred if they had not been directed to build the CSP. Second, FHFA has not disclosed, even at a high level, the status of the risks facing successful completion of the CSP. FHFA acknowledges in its monthly internal reports that there are elevated risks facing the CSP project; however it claims in its technical comments that these

¹⁴ See Pub. L. No. 113-291, § 832 (codified at 40 U.S.C. § 11302(c)).

¹⁵ OMB established the *IT Dashboard* in 2009. FITARA codified some of its requirements.

¹⁶ OMB Memorandum M-15-14: Management and Oversight of Federal Information Technology (June 10, 2015).

risks are being remediated and will not affect the projects’ publicly reported completion dates.

FHFA’s Reports Disclose Only the Costs Incurred by the Enterprises to Build the CSP Platform and Develop CSS Through Mid-2015

In its *2015 Update*, issued in September 2015, FHFA reported that, from 2012 through mid-2015, the Enterprises spent \$146 million, primarily to develop and test the CSP itself. FHFA explained that the \$146 million was exclusive of “spending by the Enterprises to adapt their existing IT platforms and operations to integrate with the CSP.” FHFA advised that each Enterprise reported its Platform development expenses in its 10-Ks and 10-Qs. The Enterprises’ 2015 10-Ks report that both Enterprises spent \$218 million by year-end 2015 to develop the CSP Platform itself, an increase of \$72 million from the \$146 million spent from 2012 through mid-2015.

In the *2015 Scorecard Progress Report*, issued in March 2016, the Agency provided no further information on the costs to the Enterprises to develop and test the CSP. It explained that it was “working with CSS and the Enterprises to develop an updated, multiyear CSS plan and budget” and planned to “publicly release the projected cost” of completing the CSP project, once a final plan and budget had been approved.

FHFA’s *2016 Update*, issued in July 2016, did not report any data on the Enterprises’ costs for the CSP project. In the non-public cover letter transmitting this *2016 Update* to Congress, the Agency reported that, from 2012 through the first quarter of 2016, the Enterprises spent \$[REDACTED] on the construction of the CSP. FHFA estimated that, from 2012 through 2018, the actual and projected costs to construct the CSP would total \$[REDACTED]. FHFA again explained that these costs were exclusive of the Enterprises’ integration costs, which it characterized as “large.” FHFA did not report the integration costs but stated that it would provide them on request. FHFA claimed in its letter that each Enterprise separately reported its costs in its public securities filings under “administrative expenses.” Based on our review of the Enterprises’ public securities filings, we were not able to isolate the CSP integration costs from other administrative expenses. FHFA has subsequently acknowledged that it is not possible to determine each Enterprise’s integration costs from its reported administrative expenses reported.

FHFA Collects, but Has Not Reported Upon, the Enterprises’ Actual Integration Costs, as Well as Projected Integration and Platform Development Costs

According to the senior FHFA executive responsible for CSP’s oversight, FHFA has collected integration cost data from the Enterprises since 2014. This information was not published in the Agency’s public reports on the CSP. From the data provided to us by FHFA we

calculated that from 2012 through 2015 the Enterprises spent nearly \$[REDACTED] to integrate their legacy systems into the CSP, —[REDACTED]% more than the \$218 million they incurred over the same period to build the CSP Platform. Based on the data provided by the Enterprises and FHFA, the Enterprises have spent nearly \$[REDACTED] from 2012 through 2015 to develop the CSP Platform and integrate their legacy systems into the Platform.

The Enterprises also have provided data to FHFA on their projected integration and Platform development costs. FHFA did not publish this information in its public reports on the CSP, although it reported on the costs of the CSP itself.

FIGURE 1. CSP PLATFORM DEVELOPMENT AND INTEGRATION COSTS, IN \$ MILLIONS

| | Actual | Projected | Actual + Projected |
|----------------------------|--------------|--------------|--------------------|
| Time Period | 2012-2015 | 2016-2018 | 2012-2018 |
| Platform Development Costs | \$218 | \$[REDACTED] | \$[REDACTED] |
| Integration Costs | \$[REDACTED] | \$[REDACTED] | \$[REDACTED] |
| Total | \$[REDACTED] | \$[REDACTED] | \$[REDACTED] |

Source: Enterprise reporting and FHFA.

According to data provided by FHFA, the Enterprises project that from 2016 to 2018 they will spend an additional \$[REDACTED] to develop the Platform and an additional \$[REDACTED] to integrate their legacy systems into it. Thus, the projected Platform development and integration costs for the period 2016 through 2018 are \$[REDACTED]. When the \$[REDACTED] the Enterprises spent on the Platform and integration from 2012 through 2015 is added to the \$[REDACTED] that is projected to be spent on those items from 2016 through 2018, the total projected cost to the Enterprises for the CSP project as of July 2016 amounts to nearly \$[REDACTED]. Figure 1 provides a table of this information.

On Wednesday, October 26, 2016, we provided the Agency with a draft of this report in which we criticized it for its lack of transparency in disclosing the actual and projected costs of integrating the Enterprises’ legacy systems into the CSP. We noted that it was not possible to determine the monies spent to date by each Enterprise on its integration efforts from a review of the public securities filings because those costs were reported as part of each Enterprise’s administrative expenses; they were not broken out separately.

Within days after receiving a draft of this report, the Agency received a request from a Member of Congress, for the actual and projected costs of integrating the Enterprises’ legacy systems into the CSP. On November 10, 2016, FHFA replied to the Member and provided the integration costs after acknowledging what our draft reported: that each Enterprise’s integration costs could not be ascertained from review of the Enterprise’s 10-Ks and 10-Qs because, those costs “are not broken-out from other administrative expenses in these filings”

Based on our review of FHFA’s November 10, 2016 response, we found that the Enterprises’ integration costs increased since we completed our fieldwork and collected the data for Figure 1. According to FHFA, the projected integration costs were \$[REDACTED]; in other words, they had increased by \$[REDACTED], or [REDACTED]%, since year-end 2015. If unchanged, this would cause the projected cost of the CSP from 2012 through 2018 to total \$[REDACTED]. In that same response, FHFA reported that the projected costs for development of the Platform were being refined and would likely increase above the current projection of \$[REDACTED]. In that event, the overall projected cost of the CSP would exceed \$[REDACTED].

In its technical comments on a draft of this report, FHFA maintained that the Enterprises would have incurred “many” of the Platform development and integration costs, even if they had not been directed by FHFA to develop the CSP. FHFA stated these costs would have been incurred because the Enterprises needed to upgrade their separate securitization platforms anyway. However, FHFA acknowledged that the Enterprises do not have estimates of the costs that would have been incurred if they had not been directed to build the CSP.

Finally, the Agency told Congress that it would publish, “another update on the Single Security and CSP during the first quarter of 2017 *in which we plan to include information about costs incurred through the end of 2016 and projected costs through 2018.*” We expect that FHFA’s pledge to provide actual and projected cost data in its updates will help provide transparency around development of the CSP.

FHFA Has Not Disclosed Its Assessments of the Elevated Risks to the CSP’s Successful Development Posed by Software and Technological Challenges

FHFA’s Reports Contained only General Information About Software Development and Technological Challenges

FHFA’s *2015 Update* provided a lengthy discussion of the software development and testing methodology used by CSS to build the CSP. In its *2015 Scorecard Progress Report*, FHFA reported that CSS had sent additional versions of the CSP software to the Enterprises for testing and that “(t)esting of this software continues to progress.” The *Progress Report* noted that one component of Release 1 testing had been completed, and that additional testing for both Releases 1 and 2 was ongoing or planned. Regarding integration, the *Progress Report* stated that “Fannie Mae and Freddie Mac are progressively completing the technology and operational changes that each Enterprise needs to make to enable it to use the CSP.”

In its *2016 Update*, FHFA reported that a series of software tests were planned through 2018 to ensure that Releases 1 and 2 would occur and operate as planned. This *2016 Update* explained that CSS and Freddie Mac would engage in parallel testing in 2016 to ensure that

Release 1 would be able to “go-live” as scheduled in the fourth quarter of 2016.¹⁷ Testing in support of Release 2, according to the 2016 *Update*, would be undertaken to ensure that the CSP Platform performs as expected, and that the Enterprises have successfully integrated their financial and information systems into the CSP.

FHFA’s Internal CSP Monthly Risk Rating System

Since 2014, FHFA has rated the risks to CSP’s successful development on a monthly basis using a stoplight system similar to the IT risk rating system used for agencies covered by FITARA. According to the senior FHFA executive responsible for CSP’s oversight, the Agency receives weekly reports from CSS and the Enterprises on the status of key project management topics, such as software testing results and the status of integration programs. He advised us that he communicates regularly with CSS and the Enterprises on the status of the CSP project. Based on this information, FHFA prepares a monthly report assessing the status of the CSP project, which rate the risks facing the CSP project, and these monthly reports are distributed to senior FHFA, Enterprise, and CSS officials, as well as employees in FHFA’s Division of Conservatorship. According to the same senior FHFA executive, FHFA’s monthly risk reports reflect a consensus view of FHFA, CSS and the Enterprises.¹⁸

We reviewed the monthly risk reports issued by FHFA from June 2014 through July 2016 and found that the overall risk to the CSP project was rated as Yellow, or medium risk.¹⁹ As we forecasted in our 2014 evaluation, integration of the Enterprises’ legacy systems has proved to be a complex challenge that has been a key driver of CSP’s elevated risk ratings. Based on our review of these monthly reports, we found that integration related tests have often been deferred or delayed and that the version of Release 2 under development is larger and more complex than originally planned because integration related problems that could not be fixed in earlier versions have been rolled into the current version for resolution.

Our review of FHFA’s public reports on the development of the CSP issued through July 2016 found no disclosure of these risks, even in summary form. According to FHFA, the challenges identified in its internal monthly risk reports have been, and continue to be, addressed on an on-going basis and will not affect the publicly-reported dates for Release 1 and 2. However, the transparency principles underlying FITARA are intended to ensure that

¹⁷ In parallel testing, CSS and Freddie Mac will run the CSP and Freddie Mac’s existing production systems in parallel to ensure that each system produces the expected results for Freddie Mac’s current fixed-rate MBS.

¹⁸ According to the FHFA executive in charge of the CSP project, the risk ratings are formulated initially by CSS, Fannie Mae, and Freddie Mac. The senior FHFA executive then reviews the ratings and provides his feedback. According to this executive, the monthly reports he issues contain consensus risk ratings.

¹⁹ On November 15, 2016, FHFA released its *Fiscal Year 2016 Performance and Accountability Report* (the *PAR*) which provides additional information about the CSP’s development and testing for FY 2016. The *PAR* does not discuss any of the internal risk assessments conducted subsequent to the *July 2016 Update*.

policy-makers and the public are kept informed of the risks facing major IT acquisitions and Agency efforts to remediate them. FHFA’s assurance that it will address the risks it did not disclose in the first instance does not amount to transparency.

CONCLUSION

FHFA has acted as conservator for the Enterprises since September 2008 and is the steward of the \$187.5 billion investment from American taxpayers in the Enterprises. This status report demonstrates that FHFA fulfilled its commitment to implement our 2014 evaluation report recommendations to improve its oversight of the project. However, FHFA has not fully met its commitment to transparency around the development of the CSP because it has not publicly disclosed the actual and projected costs of the CSP and the risks to its successful development and timely delivery.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objective for this special project was to assess the transparency of FHFA’s public disclosures about the CSP project from May 2014 through July 2016. The scope of our project did not include assessing FHFA’s oversight of the CSP project’s development during that period.

To meet our objective, we reviewed FHFA’s public disclosures on the project from May 2014 through July 2016 in light of FITARA’s transparency standards. We determined what the disclosures stated about the CSP project’s costs, CSP and software and integration testing results. We also requested and reviewed internal Agency documentation on the CSP project, including cost data, risk rating designations, and weekly and monthly reports on CSP testing.

We also held several interviews with the Agency executive responsible for FHFA’s oversight of the project. We also met with a representative from FHFA’s Division of Enterprise Regulation.

We conducted this special project during the period April 2016 to September 2016 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the Quality Standards for Inspection and Evaluation (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

FHFA provided technical comments on a draft of this report which were incorporated as appropriate. FHFA’s formal comments are appended hereto.

APPENDIX A

FHFA's Formal Comments



Federal Housing Finance Agency

MEMORANDUM

TO: Richard Parker, Deputy Inspector General, Compliance and Special Projects

FROM: Bob Ryan, Acting Deputy Director, Division of Conservatorship *BR*

SUBJECT: Special Report: *Update on the Status of the Development of the Common Securitization Platform.*

DATE: December 7, 2016

Thank you for the opportunity to provide comments on FHFA-OIG's Special Report: *Update on the Status of the Development of the Common Securitization Platform* (Report).

As noted in the Report, FHFA has issued numerous reports and updates to the public about the Common Securitization Platform (CSP) project and the related Single Security Initiative, including releasing the attached detailed timeline which we have updated and will continue to update until the project is completed. Updates have also been provided through regular meetings with industry stakeholders, including through the Single Security/CSP Industry Advisory Group. Further, FHFA has regularly provided additional information to Congress about the project, its status and costs, including details about the costs being incurred by the Fannie Mae and Freddie Mac (the Enterprises) to upgrade and integrate their systems with the CSP and the projected costs to complete the project and operate the project through 2018.

FHFA has consistently acknowledged, both in our oral communications and in written reports and updates, the following points that we believe are important to note:

- This is a complex multi-year project which, like any large, complex information technology project, could encounter significant challenges in meeting project milestones and timelines. However, the failure to meet any of these milestones and timelines, which have been set internally by FHFA and the Enterprises as reasonable but aspirational, will pose risks neither to the public nor to the housing finance system because the Enterprises' existing systems and processes will continue to operate and effectively perform their critical securitization functions until the CSP is completed and in operation. Consequently, we believe that the mischaracterization in the Inspector General's Report of the challenges associated with operationalizing the CSP and Single Security as "risks" rather than "challenges" substantially increases the likelihood that the Report could be misinterpreted. In light of that, we believe that it is important for us to reiterate that the Enterprises, Common Securitization Solutions, LLC, and FHFA are actively monitoring, managing, and meeting the challenges associated with this project with the objective of

insuring that the project is successfully launched and operational, whether we meet the aspirational timelines we have set or not.

- As noted in the Report, many of the expenditures incurred throughout the project would have been incurred regardless of whether development of the CSP had been undertaken because of the need for the Enterprises to update their respective single-family securitization infrastructures.
- The information provided by FHFA and contained in the Inspector General's Report is based on the best information available at the time and is subject to change as we continue to refine the cost projections and FHFA has committed to update this information throughout the implementation process.
- Any assessment of this project must take into account the significant benefits to be derived by taxpayers and the United States housing finance system from the development of the CSP and the Single Security.

CC: Larry Stauffer, Acting Chief Operating Officer
John Major, Internal Controls and Audit Follow-Up Manager

CSP / Single Security Timeline

2012

February 21, 2012

- ✓ FHFA issues "[A Strategic Plan for Enterprise Conservatorships](#)," announcing the goal of building a new securitization platform.

October 4, 2012

- ✓ FHFA issues "[Building a New Infrastructure for the Secondary Mortgage Market](#)," a white paper providing a detailed description of the new securitization platform (including scope, functionality, and design principles) and seeking industry input.

2013

April 30, 2013

- ✓ FHFA issues "[A Progress Report on the Common Securitization Infrastructure](#)," reflecting feedback received from the October 2012 white paper.

October 7, 2013

- ✓ Fannie Mae and Freddie Mac establish [Common Securitization Solutions, LLC](#) (CSS), the joint venture to build and operate the Common Securitization Platform (CSP).

November 25, 2013

- ✓ FHFA issues "[A Progress Report on the Implementation of FHFA's Strategic Plan for Enterprise Conservatorships](#)," indicating that CSP development and testing had begun.

2014

May 13, 2014

- ✓ FHFA issues "[The 2014 Strategic Plan for the Conservatorship of Fannie Mae and Freddie Mac](#)," affirming ongoing development of the CSP and announcing development of the Single Security.

August 12, 2014

- ✓ FHFA issues "[Request for Input: Proposed Single Security Structure](#)," outlining the proposed structure for the Single Security and seeking industry feedback.

November 3, 2014

- ✓ Fannie Mae and Freddie Mac [announce](#) revisions to the governance structure and operating agreement of CSS and appointment of the first CEO of CSS.

2015

March 16, 2015

- ✓ FHFA issues a [Progress Report](#) detailing continued CSP development and testing.

May 15, 2015

- ✓ FHFA issues "[An Update on the Structure of the Single Security](#)," detailing changes to the structure of the Single Security in response to feedback received from the August 2014 Request for Input.

September 15, 2015

- ✓ FHFA issues "[An Update on the Common Securitization Platform](#)," providing descriptions of the CSP functions, modules, development and testing; the status of the CSS; and announcing that Fannie Mae and Freddie Mac are planning for two releases of the CSP software.



As of July 26, 2016

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