

Federal Housing Finance Agency
Office of Inspector General



**Compliance Review of the
Timeliness of FHFA’s Assessments
of the Enterprises’ Remediation
Closure Packages for a Matter
Requiring Attention**



COM-2020-001

February 21, 2020

Executive Summary

As the regulator of Fannie Mae and Freddie Mac (the Enterprises) and of the Federal Home Loan Banks (FHLBanks), the Federal Housing Finance Agency (FHFA) is responsible for ensuring that these entities operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA's Division of Enterprise Regulation (DER) supervises the Enterprises and the Division of Federal Home Loan Bank Regulation (DBR) supervises the FHLBanks.

When DER, through its supervisory activities, identifies a critical supervisory matter of the highest priority or a deficiency at an Enterprise, it will classify that matter as a Matter Requiring Attention (MRA). All MRAs require remediation by the affected Enterprise and confirmation by DER examiners that the corrective action(s) are sufficient to address the MRA.

In 2016, we issued an evaluation report in which we found that DER did not establish milestones for examiner confirmation of MRA remediation and, as a consequence, such confirmation could occur more than a year after an Enterprise submitted its MRA closure package (closure package). We recommended that FHFA "[r]equire DER, upon acceptance of an Enterprise's remediation plan, to estimate the date by which it expects to confirm internal audit's validation, and to enter that date into a dedicated field in the MRA tracking system." In 2017, DER issued Operating Procedures Bulletin (OPB) DER-OPB-03.2, *Adverse Examination Findings Issuance and Follow-Up*. In this OPB, DER adopted a timeline of 120 days for examiners to assess an Enterprise's closure package and supporting materials and advised that such assessments "should generally be completed" within 120 days. We closed the recommendation in September 2017 based on this OPB.

We initiated this compliance review to evaluate DER's compliance with DER-OPB-03.2. For Freddie Mac, we found that DER examiners completed timely assessments of closure packages 50% of the time; for Fannie Mae, we found that DER completed timely assessments of closure packages 43% of the time. DER's adoption of the 120-day assessment period in DER-OPB-03.2 has not corrected the shortcoming identified in our evaluation report. As a result, we are re-opening our 2016 recommendation.

We provided FHFA the opportunity to respond to a draft of this compliance review. In its management response, reprinted in the Appendix, FHFA agreed to re-evaluate and, if appropriate, amend its internal guidance on MRA remediation by December 31, 2020.



COM-2020-001

February 21, 2020

This report was prepared by Karen E. Berry, Senior Investigative Counsel, and Patrice Wilson, Senior Investigative Evaluator. 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.

/s/

Brian W. Baker

Acting Deputy Inspector General for Compliance & Special Projects

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ABBREVIATIONS

| | |
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| Closure Package | MRA Closure Package |
| DBR | Federal Housing Finance Agency Division of Federal Home Loan Bank Regulation |
| DER | Federal Housing Finance Agency Division of Enterprise Regulation |
| Enterprises | Fannie Mae and Freddie Mac |
| FHFA | Federal Housing Finance Agency |
| FHLBanks | Federal Home Loan Banks |
| IA | Internal Audit |
| MRA | Matter Requiring Attention |
| OIG | Federal Housing Finance Agency Office of Inspector General |
| OPB | Operating Procedures Bulletin |
| Review Period | Compliance testing period from June 21, 2017, to June 15, 2019 |

BACKGROUND

FHFA’s Oversight of Enterprise Remediation of MRAs

As the regulator of the Enterprises and of the FHLBanks, FHFA is tasked by statute to ensure that these entities operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Examinations of its regulated entities are fundamental to FHFA’s supervisory mission. DER supervises the Enterprises and DBR supervises the FHLBanks.

When DER, through its supervisory activities, identifies a critical supervisory matter of the highest priority or a deficiency at one of the Enterprises, it will classify that matter as an MRA. All MRAs require remediation by the affected Enterprise and confirmation by DER examiners that the corrective action(s) are sufficient to address the MRA.

A 2016 Evaluation Report Found Deficiencies in DER’s MRA Tracking Systems and its Assessments of Enterprise Remediation Efforts

In 2016, we compared the MRA tracking systems used by two federal financial regulators and DBR to those used by DER’s Fannie Mae and Freddie Mac examination teams.¹ We found that DER did not establish milestones for examiner confirmation of MRA remediation and, as a consequence, examiner confirmation of MRA remediation could occur more than a year after an Enterprise submitted its MRA closure package (closure package). While this evaluation identified numerous shortcomings with DER oversight of Enterprise remediation of MRAs, this compliance review involves only one of the findings and recommendations in that evaluation.

We recommended that FHFA “[r]equire DER, upon acceptance of an Enterprise’s remediation plan, to estimate the date by which it expects to confirm internal audit’s validation, and to enter that date into a dedicated field in the MRA tracking system.” DER committed to amend its internal guidance to provide timeframes by July 1, 2017, for when an examination team must begin review of an Enterprise’s closure package and supporting documentation. We did not recommend a proposed timeline for assessment and closure of the MRAs.

¹ OIG, *FHFA’s Inconsistent Practices in Assessing Enterprise Remediation of Serious Deficiencies and Weaknesses in its Tracking Systems Limit the Effectiveness of FHFA’s Supervision of the Enterprises* (July 14, 2016) (EVL-2016-007) (online at www.fhfa.ig.gov/Content/Files/EVL-2016-007.pdf).

We Closed this Recommendation on the Basis of a July 2017 Operating Procedures Bulletin Issued by DER

On June 21, 2017, DER issued DER-OPB-03.2, *Adverse Examination Findings Issuance and Follow-Up*. In this OPB, DER adopted a timeline of 120 days for examiners to assess an Enterprise’s closure package and supporting materials and advised that such assessments “should generally be completed” within this 120-day period. Based on DER’s issuance of this OPB, we closed our recommendation in September 2017.²

FINDINGS

We sought to assess whether DER examiners completed their assessments of closure packages within 120 days of receipt of such packages, pursuant to the instruction in DER-OPB-03.2. We used an approximately two-year review period for this compliance testing from June 21, 2017 (the effective date of DER-OPB-03.2) to June 15, 2019 (review period). For this testing, we: (1) identified the dates on which DER received the closure packages, relying on FHFA’s receipt documentation;³ (2) identified the dates on which the assessments were completed from the remediation letters sent by DER; and (3) determined the length of time taken by examiners to complete their assessments of the closure packages.

Fannie Mae

During the review period, DER received 21 closure packages from Fannie Mae. Of these 21 closure packages, DER completed assessments within 120 days for nine (43%); did not complete its assessment for one (5%), which remains open after more than 500 days; and did not complete assessments within 120 days for 11 (52%). Of DER’s 11 untimely assessments, seven were completed within 150 days of receipt of the package; two were completed more

² Although DER-OPB-03.2 was superseded by OPB 2.3 on October 31, 2018, the requirement that the examiner’s assessment of the Enterprise’s MRA closure package “should generally be issued within 120 days of receipt of a closure package” is materially unchanged.

³ DER told us that the 120-day assessment period commences on the date FHFA receives the closure package from the Enterprise. In reviewing the receipt documentation, we noted that the examination teams track the receipt information differently. The Freddie Mac examination team measures receipt based on the date the Enterprise’s internal audit (IA) function completed its review and testing, as stated on the IA testing memorandum. The Fannie Mae examination team measures receipt based on the date it received by email the Fannie Mae IA testing report finding that the MRA had been remediated. FHFA confirmed the application of these different processes by the examination teams. For purposes of our analysis, we adopted FHFA’s method of identifying a relevant start date for the 120-day period. More specifically, for Freddie Mac MRAs we used the date the Enterprise’s IA function completed its review and testing, as stated on the IA testing memorandum, and for Fannie Mae MRAs we used the date the exam team received the email containing the Enterprise’s IA testing report finding that the MRA had been remediated.

than nine months after receipt of the package; and two were completed approximately one and one-half years or more after receipt of the package.

Freddie Mac

During the review period, DER received 12 closure packages from Freddie Mac. Of these 12 closure packages, DER completed assessments within 120 days for six (50%) and did not complete timely assessments within 120 days for the remaining six (50%). Of DER's 6 untimely assessments, three were completed within 155 days of receipt of the package and three were completed more than six months after receipt of the package.

CONCLUSIONS

We recommended in 2016 that FHFA “[r]equire DER, upon acceptance of an Enterprise’s remediation plan, to estimate the date by which it expects to confirm internal audit’s validation, and to enter that date into a dedicated field in the MRA tracking system.” DER issued guidance directing examiners to complete their assessment of an Enterprise’s closure package within 120 days of receiving the closure package from the Enterprise.

Over the course of an approximately two-year period, DER examiners completed timely assessments for half of Freddie Mac’s closure packages and fewer than half of Fannie Mae’s closure packages. DER’s implementation of the 120-day assessment period has not successfully corrected the shortcoming identified in our evaluation report that DER’s validation and confirmation of MRA remediation could occur more than a year after an Enterprise submits its closing package for validation. As a result, we are re-opening our 2016 recommendation.

FHFA COMMENTS.....

We provided a draft of this report to FHFA for its review and comment. In its management response, reprinted in the Appendix, DER stated that it acknowledges the importance of balancing timeliness with the ability of examiners to perform an adequate assessment to ensure sustainability of the corrective actions implemented by Enterprise management. DER said it will re-evaluate and, if appropriate, amend its internal guidance on MRA remediation by December 31, 2020.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this compliance review in November 2019 to assess whether the examiner assessments of the Enterprises' closure packages were completed within 120 days of DER's receipt. We analyzed Enterprise closure packages submitted to DER from June 21, 2017 (the effective date of DER-OPB-03.2) to June 15, 2019.

We conducted our compliance review from November 2019 through January 2020 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Brian W. Baker, Acting Deputy Inspector General
FHFA Office of Inspector General (OIG), Office of Compliance & Special Projects

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

SUBJECT: Draft OIG Report: *Compliance Review of the Timeliness of FHFA's Assessments of the Enterprises' Remediation Closure Packages for a Matter Requiring Attention*

DATE: February 20, 2020

Thank you for the opportunity to respond to the draft report referenced above (Report). As noted in the Report, the Office of Inspector General (OIG) is re-opening Recommendation 2 from EVL-2016-007, *FHFA's Inconsistent Practices in Assessing Enterprise Remediation of Serious Deficiencies and Weaknesses in its Tracking Systems Limit the Effectiveness of FHFA's Supervision of the Enterprises* (July 14, 2016).

Recommendation: *OIG recommends that FHFA require DER, upon acceptance of an Enterprise's remediation plan, to estimate the date by which it expects to confirm internal audit's validation, and to enter that date into a dedicated field in the MRA tracking system.*

Management Response: In 2017, DER issued internal guidance that established a general timeframe (i.e., 120 days) for assessing MRA closure packages in response to the OIG's recommendation. DER acknowledges the importance of balancing timeliness with the ability of examiners to perform an adequate assessment to ensure sustainability of the corrective actions implemented by Enterprise management. DER will re-evaluate and, if appropriate, amend its internal guidance on MRA remediation by December 31, 2020.

cc: Chris Bosland
Larry Stauffer
Scott Valentin
John Major

ADDITIONAL INFORMATION AND COPIES.....

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