

Federal Housing Finance Agency
Office of Inspector General



Compliance Review of Fannie Mae's Conflicts of Interest Policies and Procedures Regarding its Senior Executive Officers



COM-2020-005

August 26, 2020

Executive Summary

The Federal Housing Finance Agency (FHFA or Agency), as conservator for Fannie Mae and Freddie Mac (collectively, the Enterprises), has delegated to each Enterprise responsibility for a significant portion of day-to-day management and risk management controls. The Board of Directors (Board) of each Enterprise retains authority for oversight of Enterprise operations. The Boards and Board committees must fulfill their delegated responsibilities for the Enterprises to be governed effectively. In a 2018 evaluation, we found failures by Fannie Mae's Nominating and Corporate Governance Committee (NGC) in its oversight of conflicts of interest (COI) involving the Enterprise's senior executive officers (SEO), including its Chief Executive Officer (CEO). We made eight recommendations to correct these deficiencies, and FHFA agreed with all of them. In response to four of our recommendations, the Agency issued a directive (Directive) to Fannie Mae requiring it to review its governance documents for clarity and consistency; specify Board and management authorities and roles to align with FHFA's expectations; revise its governance documents as necessary; and create reporting relationships among the NGC, Fannie Mae's Office of Compliance and Ethics (FM Ethics), and the Chief Compliance Officer (CCO) as necessary.

We initiated this compliance review to test whether Fannie Mae amended its governance documents to comply with FHFA's Directive. We reviewed its current COI Policy and COI Procedure and found that they were revised to be consistent with the Agency's Directive.

This report was prepared by Alisa Davis, Senior Policy Advisor. We appreciate the cooperation of FHFA and Fannie Mae 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.fhfa.org.

/s/

Brian Baker

Acting Deputy Inspector General for Compliance and Special Projects

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ABBREVIATIONS

Board	Board of Directors
CCO	Chief Compliance Officer
CEO	Chief Executive Officer
COI	Conflict of Interest
Directive	FHFA April 23, 2018, Conflict of Interest Directive to the Enterprises
Enterprises	Fannie Mae and Freddie Mac, collectively
Fannie Mae	Federal National Mortgage Association
FM Ethics	Fannie Mae’s Office of Compliance and Ethics
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
NGC	Nominating and Corporate Governance Committee
NGC Charter	Charter for Fannie Mae Board of Directors’ Nominating and Corporate Governance Committee
OIG	Federal Housing Finance Agency Office of Inspector General
SEO	Senior Executive Officer

BACKGROUND.....

In September 2008, FHFA placed the Enterprises into conservatorship, because FHFA determined that their financial condition threatened their ability to operate in a safe and sound manner. As conservator, FHFA succeeded to all rights, titles, powers, and privileges of the company, and of any stockholder, officer, or director of the company with respect to the Enterprises and their assets.

By order issued in November 2008, FHFA, as conservator, established the NGC as one of four standing committees for each Enterprise’s Board. Subsequently, the Fannie Mae Board approved the charter for its NGC (NGC Charter). The NGC Charter defines the NGC’s duties and responsibilities as they relate to COI matters involving members of the Board and “Designated Executive Officers,” which is synonymous with the term SEOs.¹ Among other duties, the NGC reviews SEO activities and interprets the COI Policy and COI Procedure in instances where the interpretation relates to the CEO regarding actual, potential, and apparent COIs, subject to conservator approval for those activities that are likely to cause “significant reputation risk.”

FM Ethics is responsible for assisting the NGC in fulfilling its duties and is headed by the CCO.²

A 2018 Evaluation Found Deficiencies in Fannie Mae’s Resolution of COIs Involving SEOs, Including its CEO, and FHFA’s Oversight of That Process

In a January 2018 evaluation report, we reviewed FHFA’s oversight, as conservator, of the Board’s execution of its responsibilities to administer Fannie Mae’s Employee Code of Conduct and COI Policy for SEOs.³ We found failures by FM Ethics, the NGC, and FHFA, which created a weakness in Fannie Mae’s risk management structure.

¹ Fannie Mae’s SEOs include the CEO, President, Chief Financial Officer, Chief Operating Officer, Chief Risk Officer, General Counsel, the Executive Vice Presidents for the company’s single-family and multifamily business lines, the Chief Audit Executive, and the CCO.

² Fannie Mae’s CCO is responsible for multiple duties, and her full title is Senior Vice President and Chief Compliance and Ethics Officer and Chief Office of Minority and Women Inclusion Officer.

³ Previously, we issued Management Alerts reporting on COI issues with SEOs. *See Administrative Investigation of Hotline Complaints: Conflicts of Interest Issue* (OIG-2017-004) (Mar. 23, 2017); *Administrative Review of a Potential Conflict of Interest Matter Involving a Senior Executive Officer at an Enterprise* (OIG-2018-001) (July 26, 2018); *Corporate Governance: Review and Resolution of Conflicts of Interest Involving Fannie Mae’s Senior Executive Officers Highlight the Need for Closer Attention to Governance Issues by FHFA* (EVL-2018-001) (Jan. 31, 2018).

Fannie Mae's NGC has long been tasked with carrying out Board-related governance responsibilities. The NGC Charter placed broad responsibility over COI issues involving the CEO and all other SEOs solely with the NGC. Two of these responsibilities were directly pertinent to COIs involving the CEO:

- “Administering and overseeing compliance with the [Director Code]”; and
- “Interpreting Fannie Mae’s [COI Policy and COI Procedure] in instances where the interpretation relates to the [CEO], subject to the Conservator’s approval for activities that in the reasonable business judgment of the Board are likely to cause significant reputation risk.”

Fannie Mae’s Director Code required directors to disclose: “*Any* situation that involves, or appears to involve, a [COI]” to the NGC Chair or a member of the NGC (emphasis added). Similarly, Fannie Mae’s COI Policy, in Section 6.3, titled “Potential Conflicts of Interest that Require Review and Approval,” mandated (at Section 6.3.6) that all employees, including the CEO, disclose “outside activities that could be construed to have an intersection with Fannie Mae” that were not otherwise covered under the Policy to FM Ethics as a potential conflict of interest. Fannie Mae had no provision in its COI Policy and COI Procedure relating solely to resolution of COIs involving the CEO. The NGC Charter vested authority solely with the NGC to determine whether a COI exists for the affected director and the CEO.

For SEOs other than the CEO, the NGC, pursuant to its Charter, was charged with “[r]eviewing other activities engaged in by [SEOs] that may result in a potential or actual conflict of interest under the Employee Code of Conduct or [COI] Policy and [COI] Procedure, subject to the Conservator’s approval for activities that in the reasonable business judgment of the Board are likely to cause significant reputation risk.”

Fannie Mae’s ethics program was comprised of a number of interrelated codes, policies, and procedures that include the Employee Code of Conduct, the COI Policy, and the COI Procedure. Fannie Mae’s COI Policy and COI Procedure were drafted and revised by FM Ethics and approved by the CCO, who oversees FM Ethics. The COI Policy established “more detailed Company-wide requirements for avoiding [COIs]” than what is specified in the Employee Code of Conduct. The COI Policy instructed employees to disclose such activities to FM Ethics for review and approval in accordance with the COI Procedure. Section 5 of the COI Policy directed that the NGC was responsible for “approving Conflict requests of Senior Executive Officers as outlined in the accompanying Procedure.” The COI Procedure established the process employees must follow to raise and resolve potential, apparent, and actual COIs outlined in the COI Policy. To assist the NGC in fulfilling these responsibilities, Section 10.2.7 of the COI Procedure established a clear procedure required to be used by FM Ethics to escalate all COI requests involving SEOs to the NGC.

We mapped the resolution of 57 potential, actual, and apparent COIs involving SEOs, including the CEO, that were disclosed during a five-year review period. Of these 57 potential conflicts, we found that FM Ethics determined, on its own, whether a COI existed for 16 of the 57 and subsequently notified the NGC of its determinations, which ran afoul of the mandates in the COI Policy and COI Procedure; FM Ethics determined, on its own, whether a potential COI existed for 17 of the 57 in violation of the COI Policy and COI Procedure; and no documentary evidence showed that FM Ethics notified the NGC of any of its unilateral COI determinations, which deprived the NGC of its ability to satisfy its duties under its Charter.

For 24 of the 57 COIs where the NGC was asked by FM Ethics to resolve potential SEO conflicts, we found from review of the written record that NGC members failed to: diligently understand the facts underlying these matters; demand accurate, timely, and sufficient information from management about the matters; participate in candid discussions about the matters; actively press management on the basis for its representations; and vet management's recommendations. We also found, based on our review of NGC meeting minutes, that NGC members did not exercise reasonable inquiry commensurate with the reputational risk to Fannie Mae (and to FHFA) from possible COIs involving SEOs. We made eight recommendations regarding the identified deficiencies. FHFA accepted all eight recommendations. Among the eight recommendations, we recommended that FHFA take the following four actions to address the shortcomings pertaining to COI:

- Provide guidance to Fannie Mae on the Agency's governance expectations regarding authority to review and resolve actual, potential, and apparent COIs involving SEOs;
- Direct Fannie Mae to review its governance documents regarding assignment of authority and the process to review and resolve such conflicts;
- Direct the Board to determine whether a Board committee or management should retain authority for COIs, and establish reporting relationships as necessary between management and the Board based on that decision; and
- Counsel the Board to amend the relevant governance documents as needed to reflect any changes in reporting relationship between the NGC, FM Ethics, and the CCO.

FHFA committed to issue a conservator directive to Fannie Mae to implement the four recommendations that pertain to COI.

Closure of the First Four Recommendations in Our 2018 Evaluation Report

In response to these four recommendations, FHFA issued a conservatorship directive (Directive)⁴ to Fannie Mae and Freddie Mac on April 23, 2018, regarding actual, potential, or apparent COIs involving SEOs. The Directive includes expectations for how the Enterprises should handle COIs, some of which were already in place at Fannie Mae (discussed below). However, the Directive articulated additional expectations for Fannie Mae to put into place regarding disclosures and resolution of COIs involving SEOs:

- For potential COIs involving an Enterprise CEO, who is also an Enterprise director, the “CEO must follow both the employee and board COI requirements. If there is a conflict between the employee and board COI requirements, the CEO should follow the more restrictive requirement.” (The CEO is expected to make timely, fulsome proactive disclosures of potential COIs under the Directive, but, according to Fannie Mae Policy, others may also disclose potential COIs involving the CEO.) FM Ethics also is expected to “make a written recommendation to the Board for resolving all CEO COI issues, including matters where [it] recommends a determination that no COI issue exists, and provides documentation of all relevant facts to the Board. The Board makes the final decisions on all CEO COI matters.”
- The Directive requires all SEOs “on an ongoing basis,” to “proactively make full disclosure to [FM Ethics] on all COI issues that arise throughout the year. ... Disclosure to [FM Ethics] is made on a timely basis, i.e., whenever possible, before the involved action or decision occurs.”⁵ (According to Fannie Mae Policy, others may also disclose potential COIs involving SEOs.) The Directive tasks FM Ethics with reviewing “each COI issue proactively disclosed by SEOs. ... If after full review [FM Ethics] determines that there is no COI issue raised by the matter, [FM Ethics] informs the SEO of its determination. [FM Ethics] will not make this determination in matters involving the CEO, which will go to the Board for resolution. ... [FM Ethics] reports such determinations to the [NGC] for the [NGC]’s information, not approval, during the next scheduled briefing.”⁶ Where FM Ethics determines that a COI issue may exist, it is required to “provide[] a written recommendation for resolving the COI issue and provide[] documentation of all relevant facts to the [NGC]. ... Disclosure by [FM Ethics] to the [NGC] is [to be] made on a timely basis, i.e., whenever possible,

⁴ The conservatorship directive was accompanied by a conservator policy. For presentational purposes, these are collectively referred to herein as the Directive.

⁵ Directive § 1(a)(iii).

⁶ Directive § 1(a)(iv)(1)(a).

before the involved action or decision occurs. If that is not possible, [FM Ethics] will provide timely notice to the [NGC].”⁷

- The Directive also reaffirmed an existing requirement in place at Fannie Mae that all SEOs, including the CEO, “file annual disclosure forms with [FM Ethics].”⁸ “[FM Ethics] reviews the completed forms for COI issues ... [and] provides a summary memorandum regarding the completed disclosure forms and the results of its review for COI issues to the [NGC]. ... The completed disclosure forms do not require [NGC] action except where such disclosure raises a COI issue[.]”⁹
- The Directive announced FHFA’s expectation that FM Ethics “will report at least quarterly to the [NGC] on all COI issue disclosures for SEOs and resolutions in accordance with [Fannie Mae’s COI procedures], whether or not [FM Ethics] determined that there was a COI issue.”¹⁰

Based on the Agency’s actions, we closed the four recommendations on January 31, 2019.¹¹ The closure was not premised upon whether Fannie Mae had taken any steps in response to the Directive.

FINDINGS

We initiated this review to test if Fannie Mae amended its governance documents to comply with FHFA’s Directive. We reviewed its current COI Policy and COI Procedure and found that they were revised to be consistent with the Agency’s Directive.

1. Fannie Mae Revised its COI Policy, COI Procedure, and NGC Charter to be Consistent with FHFA’s Directive

a. For COIs Involving the CEO

Fannie Mae reviewed its existing COI policies and procedures and amended them to be consistent with the Directive. Fannie Mae amended its COI Policy (Amended COI Policy) to

⁷ Directive § 1(a)(iv)(2)(a)-(b).

⁸ Directive § 1(a)(ii).

⁹ Directive § 1(a)(1)-(3).

¹⁰ Directive § 3(b).

¹¹ On that same date, we closed an additional three recommendations, which are outside of the scope of this compliance review.

specify that the NGC shall “[a]pprove [FM Ethics] conflict analyses and recommended mitigation activities (if any) relating to the [CEO].”¹² Fannie Mae also updated its COI Procedure (Amended COI Procedure) to provide that FM Ethics, in the first instance, will review disclosures of potential COIs involving the CEO, and then will “submi[t] its documented assessment and recommended mitigation activities to the [NGC] for approval as timely as possible...”¹³ The NGC, in turn, will review both the potential COI disclosures and the recommended determination from FM Ethics and will approve, deny, or impose conditions for resolution of the potential COI.

The Fannie Mae Board also amended the NGC Charter to charge the NGC with “approving all matters regarding the [CEO] in accordance with the [Amended COI] Policy.”¹⁴

We find that Fannie Mae’s Amended COI Policy, Amended COI Procedure, and revised NGC Charter mirror FHFA’s Directive on issues involving the CEO.

b. For COIs Involving SEOs Other Than the CEO

Fannie Mae’s Amended COI Policy and Amended COI Procedure require SEOs to disclose potential COIs to FM Ethics for review and resolution.¹⁵ Where FM Ethics determines that no actual, potential, or apparent COI exists, FM Ethics may make a finding of no COI, without presenting a recommended determination to the NGC.¹⁶ Where FM Ethics finds no COI, it must provide the NGC with its decision no later than at the next scheduled meeting.¹⁷

In those instances where FM Ethics determines that an actual, potential, or apparent COI may exist, the Amended COI Policy and Amended COI Procedure require FM Ethics to notify the NGC of the matter on a timely basis and to make a written recommended determination, including proposed steps for resolving the COI.¹⁸ The NGC will approve, deny, or further condition the recommended determination and then FM Ethics will notify the SEO.

¹² Amended COI Policy § 5, 2nd row from the top, 2nd column from left, 2nd bullet.

¹³ Amended COI Procedure § 4.5; quoted language in steps 10 and 11, under the subheadings “For the CEO” and “For DEOs, including the CEO,” respectively.

¹⁴ Revised NGC Charter §§ 4 xv; *see also* § 4 viii (“Overseeing implementation of and compliance with the Corporation’s Code of Conduct for the Board of Directors (the ‘Director Code’) and recommending to the Board any changes as necessary”; CEO is a Board member).

¹⁵ Amended COI Policy § 5; Amended COI Procedure §§ 1, 2, 4.2.

¹⁶ Amended COI Procedure § 4.5, step 10.

¹⁷ Amended COI Policy § 6.5; Amended COI Procedure § 4.5, step 10.

¹⁸ Amended COI Policy § 6.5; Amended COI Procedure § 4.5, steps 10-11. For disclosures by the CCO, and consistent with an exception to the general rules permitted by the Directive, the General Counsel reviews

The Fannie Mae Board also amended the NGC Charter, tasking it with “[a]pproving all matters disclosed to the Chief Compliance Officer or his or her designee in accordance with the [Amended COI] Policy with respect to [SEOs],” and “[r]eviewing regular reports regarding all activities engaged in by [SEOs] as disclosed in accordance with the... [Amended COI] Policy.”¹⁹

To implement the requirement in the Directive for quarterly reporting by FM Ethics to the Board of all COI disclosures for SEOs and their resolutions, “whether or not [FM Ethics] determined there was a COI issue,” Fannie Mae revised the Amended COI Policy to provide that [FM Ethics] and the [CCO] will “provide periodic reporting to the [NGC] on all [COI] disclosures received from, or directly involving, [SEOs], regardless of whether [FM Ethics] and/or the [CCO] determined the disclosures presented a [COI]. Generally, this periodic reporting will be sent at least quarterly (i.e., during the next scheduled briefing), unless the [CCO] determines that more immediate reporting is required.”²⁰

Our testing found that Fannie Mae’s Amended COI Policy and Amended COI Procedure and revised NGC Charter implement the Directive’s expectations for resolution of potential COIs involving SEOs.

2. One Element of Fannie Mae’s Existing COI Procedure Aligned with FHFA’s Directive

Prior to issuance of the Directive, Fannie Mae required all SEOs to file an annual disclosure with FM Ethics identifying all actual, apparent, and potential COIs with FM Ethics, for its review. Fannie Mae’s current annual COI questionnaire retains this requirement. FM Ethics is required to provide the NGC with a summary memorandum regarding the results of its COI reviews.

CONCLUSION.....

Based on our review, we conclude that Fannie Mae revised its COI Policy and COI Procedure to be consistent with the Agency’s Directive.

whether the CCO’s disclosures constitute a COI issue, and if so, recommends a determination to the NGC. The General Counsel provides its conclusions to FM Ethics for reporting purposes.

¹⁹ Revised NGC Charter §§ 4(xvi) & (xvii).

²⁰ Amended COI Policy § 6.5.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this review in February 2020 to determine whether Fannie Mae amended its governance documents as necessary to comply with FHFA’s Directive. To accomplish our objective we reviewed Fannie Mae’s COI policy and procedure, as well as revisions to those governance documents.

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

We provided a draft of this report to FHFA for its review and comment.

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Brian Baker, Acting Deputy Inspector General, Office of Compliance & Special Projects

FROM: Robert Fishman, Deputy Director, Division of Resolutions **Fishman, Robert**
Digitally signed by Fishman, Robert
Date: 2020.08.20 15:31:19 -04'00'

SUBJECT: Draft Compliance Review: *Compliance Review of Fannie Mae's Conflicts of Interest Policies and Procedures Regarding its Senior Executive Officers*

DATE: August 20, 2020

Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft compliance review, *Compliance Review of Fannie Mae's Conflicts of Interest Policies and Procedures Regarding its Senior Executive Officers* (Report). As discussed in the Report, the Agency, as conservator, issued a directive in April 2018 to Fannie Mae in response to an OIG evaluation.

The objective of this compliance review was to determine whether Fannie Mae amended its governance documents, as necessary, to comply with the April 2018 directive. I am pleased that the review concluded that Fannie Mae revised its policy and procedures to be consistent with the directive.

I would like to acknowledge the dedicated OIG staff that worked with the Agency during this compliance review. If you have any questions related to our response, please do not hesitate to contact me.

cc: Chris Bosland
Kate Fulton
John Major

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