

**REDACTED**

Federal Housing Finance Agency  
Office of Inspector General



**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**

This report contains redactions of information that is protected under the Privacy Act of 1974 (Pub.L. 93-579, 88 Stat. 1896, enacted December 31, 1974, 5 U.S.C. § 522a).

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## Executive Summary

As we have explained in prior reports, the Federal Housing Finance Agency (FHFA), 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. For this governance approach to succeed, FHFA must be confident that the Enterprises' directors and committees are properly exercising the powers they have been given and fulfilling their responsibilities. Otherwise, there is a substantial risk that the Enterprises will operate in an unsafe and unsound manner, suffer losses, and expose U.S. taxpayers to further financial risks.

During a recent administrative investigation, we reviewed the Charter for the Nominating and Corporate Governance Committee (NGC Charter or the Charter), Fannie Mae's Code of Conduct for Employees (Employee Code), Conflict of Interest Policy (COI Policy) and Conflict of Interest Procedure (COI Procedure), and Code of Conduct for Directors and Conflict of Interest Policy. We found that Fannie Mae, in adopting these governance authorities, recognizes that potential, actual, or apparent, conflicts of interest, when not disclosed or addressed properly, pose significant risk to its reputation and undermine its goal of operating in accordance with "the highest ethical standards." The purpose of this evaluation was to assess FHFA's oversight, as conservator, of the Fannie Mae Board of Directors' (Board) execution of its responsibilities regarding potential conflicts of interest involving Senior Executive Officers (SEOs).

We first sought to understand whether Fannie Mae's governance documents reserve to either the Board or the Nominating and Corporate Governance Committee (NGC or Committee) the authority to resolve conflict of interest issues involving SEOs. The NGC Charter, adopted by the Board, charges the NGC with reviewing activities by Designated Executive Officers (also called SEOs) that "may result in a potential or actual conflict of interest" under the COI Policy or COI Procedure and interpreting Fannie Mae's COI Policy and COI Procedure where the interpretation relates to Fannie Mae's Chief Executive Officer (CEO), who is also an SEO. According to FHFA, the NGC's duty to "review" those activities does not vest the NGC with the exclusive authority to resolve whether those activities constitute a conflict of interest for SEOs.

From time to time, the Board has updated and clarified its delegation of duties to Fannie Mae's CEO who, in turn, updated and clarified the authorities delegated to subordinate employees. Delegations of authority from the CEO to his subordinates are recorded in the Executive Officer Delegations of Authority (EDoA), as amended, which is drafted by Fannie Mae management.



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We identified provisions in the NGC Charter, approved by the Board, and the EDoA, approved only by Fannie Mae management, that are in tension and create interpretive challenges regarding the responsibilities of the NGC. The EDoA contains Annex A, titled “Matters Requiring Approval of the Board of Directors, a Committee thereof, or FHFA and/or the Conservator,” which was approved by the Board. Annex A does not identify resolution of conflict of interest matters involving SEOs as requiring Board approval which, according to FHFA, means that the NGC is not vested with sole authority to resolve such matters.

Fannie Mae’s COI Policy and COI Procedure were drafted and revised by Fannie Mae’s Office of Compliance and Ethics, the office responsible for assisting the NGC in fulfilling its duties (and known within Fannie Mae and throughout this report as FM Ethics) and approved by Fannie Mae’s Chief Compliance and Ethics Officer (CCO). The COI Policy establishes “more detailed Company-wide requirements for avoiding Conflicts” than what is specified in the Employee Code. It directs that the NGC is responsible for “approving Conflict requests of Senior Executive Officers as outlined in the accompanying Procedure.” Likewise, the COI Procedure contemplates no role for FM Ethics and the CCO to review and resolve conflicts of interests involving SEOs and directs that the NGC “is responsible for reviewing and approving all [conflicts] requests made by Senior Executive Officers.” To assist the NGC in fulfilling these responsibilities, Section 10.2.7 of the COI Procedure sets forth a clear, unambiguous procedure that must be used by FM Ethics to escalate all conflicts requests involving SEOs to the NGC for resolution by the NGC.

According to FHFA, Fannie Mae’s relevant governance documents are internally inconsistent with respect to responsibility for resolution of conflicts of interest involving SEOs. To understand the practice followed by the NGC for conflicts involving SEOs, we interviewed the NGC Chair, who has been an NGC member since December 2008 and chair since October 2015; however, he provided two conflicting explanations of the NGC’s practice. We sought to determine what practice, if any, had been consistently followed by the NGC over a five-year period (January 2012 – December 2016) (Review Period) with respect to SEO conflicts. We identified a total of 57 potential conflicts involving SEOs, which were documented in the company’s Case Management System (CMS), NGC meeting materials, and/or minutes. Using minutes of NGC meetings related to these matters and CMS entries, we mapped how each potential conflict was ultimately resolved. Of these 57 potential conflicts involving SEOs, we found:



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- For 24 of the 57 potential conflicts (42%), minutes for relevant NGC meetings reported that FM Ethics presented the potential conflict involving the SEO and its recommended determination to the NGC for its determination;
- For 16 of the 57 (28%), minutes for relevant NGC meetings showed that FM Ethics determined, on its own, whether a conflict of interest involving an SEO existed, and, where it found a conflict, took steps to address it and subsequently notified the NGC of its determinations. We found no evidence that any NGC member: asked FM Ethics to explain why it presented some SEO potential conflicts to the NGC for its resolution, but retained and resolved other potential SEO conflicts and subsequently notified the NGC of its determination; pressed FM Ethics to explain the basis of its authority to resolve conflicts determinations for SEOs; provided direction to FM Ethics about its role in resolving SEO conflicts; or raised the potential inconsistencies between its duties under the Charter and its duties under the COI Procedure with the Board and asked the Board to clarify its responsibilities.
- For 17 of the 57 (30%), CMS entries showed that FM Ethics determined, on its own, whether a potential conflict of interest involving an SEO existed and took steps to resolve any conflict that it identified. However, neither CMS entries nor NGC meeting minutes report that FM Ethics ever notified the NGC of any of these 17 conflicts disclosures or determinations, which deprived the NGC of its ability to satisfy its duties under its Charter.

We also looked at FHFA's oversight of NGC's review of conflict of interest matters involving SEOs. While we found that FHFA employees attended NGC meetings at which FM Ethics presented conflicts questions involving SEOs to the NGC for its determinations and notified the NGC of its decisions regarding SEO conflicts requests, we found no evidence that FHFA employees identified the lack of consistent approach and process in the resolution of these conflicts or escalated those issues to senior FHFA management. We also found no evidence that FHFA's senior management was aware of these issues until we brought them to FHFA's attention.

This evaluation found failures, both by Fannie Mae's NGC and by FHFA, which created a weakness in Fannie Mae's risk management structure. Without enhancements to the NGC's oversight, there is a significant risk that the NGC will continue to fall short in exercising its governance responsibilities.



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We made eight recommendations to FHFA to address these shortcomings. FHFA agreed with all of our recommendations.

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).

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## ABBREVIATIONS .....

Board	Fannie Mae Board of Directors
CCO	Chief Compliance & Ethics Officer
CEO	Chief Executive Officer
█	█
CMS	Case Management System
COI Policy	Conflict of Interest Policy
COI Procedure	Conflict of Interest Procedure
EDoA	Executive Officer Delegations of Authority
Employee Code	Code of Conduct for employees
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
FM Ethics	Fannie Mae's Office of Compliance and Ethics
Freddie Mac	Federal Home Loan Mortgage Corporation
NGC	Fannie Mae Board of Directors' Nominating and Corporate Governance Committee
OIG	Federal Housing Finance Agency Office of Inspector General
Review Period	January 2012 – December 2016
SEO	Senior Executive Officer

## BACKGROUND.....

In September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by FHFA because FHFA determined that their financial condition threatened their ability to operate in a safe and sound manner.<sup>1</sup> 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 companies and their assets.

After it placed the Enterprises into conservatorship, FHFA reconstituted the boards of directors. FHFA, as conservator, established a delegated approach to managing the Enterprises' operations, which it believes is the most efficient way to manage their conservatorships. FHFA has delegated to the board of each Enterprise a significant portion of day-to-day management and risk controls and its regulations authorize the boards to delegate execution of day-to-day operations to Enterprise employees.

FHFA views operational risk management as an important financial safety and soundness challenge facing the Enterprises. The Agency defines operational risk as the exposure to loss from inadequate or failed internal processes, people, and systems, or from external events. FHFA views effective corporate governance to be one element of an acceptable operational risk management program. Pursuant to FHFA's governance regulations, Enterprise boards retain "ultimate responsibility" for oversight of Enterprise operations and that responsibility is "non-delegable."<sup>2</sup> For its delegated governance model to succeed, FHFA recognizes that Enterprise directors and board committees must fulfill their delegated responsibilities.

In a recent report to Congress, FHFA emphasized that the Agency "oversees and monitors" Enterprise activities as one of its four key approaches to managing the conservatorships of Fannie Mae and Freddie Mac.<sup>3</sup> The FHFA Director has stated that FHFA is involved in "virtually every decision" that each Enterprise makes.<sup>4</sup> Consistent with those representations,

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<sup>1</sup> See Statement of FHFA Director James B. Lockhart at News Conference Announcing Conservatorships of Fannie Mae and Freddie Mac (Sept. 7, 2008) (online at [www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-FHFA-Director-James-B--Lockhart-at-News-Conference-Announcing-Conservatorship-of-Fannie-Mae-and-Freddie-Mac.aspx](http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-FHFA-Director-James-B--Lockhart-at-News-Conference-Announcing-Conservatorship-of-Fannie-Mae-and-Freddie-Mac.aspx)); Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008) (online at [www.treasury.gov/press-center/press-releases/Pages/hp1128.aspx](http://www.treasury.gov/press-center/press-releases/Pages/hp1128.aspx)).

<sup>2</sup> See 12 C.F.R. § 1239.4(a) (2017).

<sup>3</sup> See FHFA, *2017 Report to Congress*, at 18-19 (online at [www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA-2017-PAR.pdf](http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA-2017-PAR.pdf)).

<sup>4</sup> See House Committee on Financial Services, Testimony of FHFA Director Melvin L. Watt, *Hearing on Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency*, 114th Cong. (Jan. 27, 2015).



FHFA reported to us that employees from its Division of Conservatorship attend meetings of the Enterprise boards and their committees.

## **Duties of Enterprise Directors and Board Committees Under FHFA Regulations and the Conservator’s Delegations**

FHFA’s governance regulations direct that the management of each Enterprise “shall be by or under the direction of its board of directors.”<sup>5</sup> These regulations direct that each Enterprise director shall carry out his or her duties “in good faith, in a manner such director believes to be in the best interests” of the Enterprise and exercise “reasonable inquiry” in the execution of these duties.<sup>6</sup>

FHFA governance regulations require each Enterprise board to “adopt a formal written charter for each committee that specifies the scope of a committee’s powers and responsibilities, as well as the committee’s structure, processes, and membership requirements.”<sup>7</sup> By order issued in November 2008, FHFA, as conservator, established the “Nominating/Governance Committee” as one of four standing committees for the board of each Enterprise. FHFA’s governance regulations permit each Enterprise board to determine the authority reserved to each of its committees, provided that Enterprise directors serving on board committees “comply with the charter, independence, composition, expertise, duties, responsibilities, and other requirements set forth under rules issued by the [New York Stock Exchange].”<sup>8</sup> Those regulations charge the Enterprises with establishing and administering “a written code of conduct and ethics that is reasonably designed to assure that its directors, officers, and employees discharge their duties and responsibilities in an objective and impartial manner.”<sup>9</sup> Effective execution of those responsibilities requires that committee members ensure they receive accurate, timely, and sufficient information about the matters for which they are responsible, robustly participate in candid discussions about the possible conflict, diligently seek to understand the facts underlying the possible conflict, actively press management on the basis for its representations, and vet management’s recommendations.

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<sup>5</sup> See 12 C.F.R. § 1239.4(a) (2017).

<sup>6</sup> See 12 C.F.R. § 1239.4(b)(1) (2017).

<sup>7</sup> See 12 C.F.R. § 1239.5(c) (2017).

<sup>8</sup> See 12 C.F.R. § 1239.5(b) (2017). See also Section 4.15, Fannie Mae Bylaws (online at [www.fanniemae.com/resources/file/aboutus/pdf/bylaws.pdf](http://www.fanniemae.com/resources/file/aboutus/pdf/bylaws.pdf)).

<sup>9</sup> By regulation, Fannie Mae is required to establish and administer a written code of conduct and ethics that is reasonably designed to assure that its directors, officers, and employees discharge their duties and responsibilities in an objective and impartial manner that “promotes honest and ethical conduct,” adherence to the code, and prompt internal reporting of violations of the code. See 12 C.F.R. § 1239.10 (Code of Conduct and Ethics).

## ***Duties and Responsibilities of NGC Members Under the NGC Charter***

The NGC Charter was approved by the Board. That Charter defines the NGC’s duties and responsibilities as they relate to conflict of interest matters involving members of the Board and “Designated Executive Officers.” The term Designated Executive Officer includes the company’s most senior executive officers, such as the CEO, Chief Financial Officer, General Counsel, the Executive Vice Presidents for the company’s single-family and multifamily business lines, the Chief Audit Executive, and the CCO. While management’s COI Policy and COI Procedure use the term “Senior Executive Officers” (SEOs), not Designated Executive Officers, Fannie Mae confirmed to us that the two terms refer to the same set of executives and are interchangeable. For purposes of our report, we refer to this group as SEOs.

Section 4 of the NGC Charter, titled “Duties and Responsibilities of the Committee,” charges the NGC with specific duties, which include:

- “Reviewing directorships in other public companies . . . held by or offered to senior management of Fannie Mae, specifically [SEOs].”<sup>10</sup>
- “Reviewing other activities engaged in by [SEOs] that may result in a potential or actual conflict of interest under the Employee Code of Conduct or Conflict of Interest Policy and Conflict of Interest 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.”<sup>11</sup>
- “Interpreting Fannie Mae’s Conflict of Interest Policy and Conflict of Interest Procedure in instances where the interpretation relates to the Chief Executive Officer, subject to the Conservator’s approval for activities that in the reasonable business judgment of the Board are likely to cause significant reputation risk.”<sup>12</sup>

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<sup>10</sup> NGC Charter, Section 4.xii.

<sup>11</sup> *Id.*, Section 4.xiii. Fannie Mae’s Board has adopted an Employee Code which directs that “it is essential that we act with the highest ethical standards in everything we do.” The Employee Code sets forth “the guiding principles” for all Fannie Mae employees. One of these guiding principles is “We Avoid Conflicts of Interest.” According to that principle:

Each of us has interest and responsibilities outside of work, but we seek to avoid any conflict or the appearance of a conflict between Fannie Mae’s business interests and our own personal interest or those of our family members.

Employee Code, at 10. The Employee Code directs that all employees must “review and follow the Conflict of Interest Policy and Conflict of Interest Procedure in order to address a conflict or the appearance of a conflict.” *Id.*

<sup>12</sup> NGC Charter, Section 4.xiv.

- “Approving transactions with any director, nominee for director, or executive officer of Fannie Mae, or . . . immediate family members that are required to be disclosed pursuant to Item 404 of Regulation S-K.”<sup>13</sup>
- “Approving any loan agreement, credit agreement or similar agreement with an employee of Fannie Mae.”<sup>14</sup>

In a Management Alert issued on March 23, 2017, we reported that the NGC Charter vests exclusive authority in the NGC (1) to interpret Fannie Mae’s COI Policy and COI Procedure in instances where the interpretation relates to [REDACTED] and (2) to resolve conflict of interest issues involving Fannie Mae directors.<sup>15</sup> In our fieldwork for that Management Alert, we interviewed [REDACTED] for Fannie Mae, who did not take issue with that understanding of the authority reserved to the NGC. We also interviewed the current NGC Chair, who has been an NGC member since December 2008 and chair since October 2015, to obtain his understanding. The NGC Chair asserted that the authority to resolve conflicts of interest involving [REDACTED] was reserved to the NGC and stated that the NGC never delegated that authority to the CCO. After receipt of our Management Alert, FHFA did not question our understanding of the authority reserved to the NGC with respect to conflicts of interest involving [REDACTED].

Subsequently FHFA commented to us that Sections 4.xv and 4.xvi of this Charter expressly task the NGC with the duty to approve two specific categories of action while the remaining sections do not. According to FHFA, the NGC’s duty to “review” certain activities, pursuant to Section 4.xiii, does not vest the NGC with the exclusive authority to resolve whether certain activities constitute a conflict of interest for SEOs. FHFA was unclear whether the NGC’s obligation to “interpret” the COI Policy and COI Procedure where the interpretation relates to the CEO, in Section 4.xiv, was intended to be triggered upon the CEO’s disclosure of a potential conflict of interest or only when FM Ethics (which reports to the CCO who, in turn, reports to the CEO) seeks an interpretation from the NGC.

### ***The Committee’s Duties and Responsibilities Under the EDoA and the Annex to the EDoA***

Prior to 2012, the Board delegated certain authorities to the CEO and authorized the CEO to delegate certain of his delegated authorities to subordinate Fannie Mae employees. From time

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<sup>13</sup> *Id.*, Section 4.xv.

<sup>14</sup> *Id.*, Section 4.xvi.

<sup>15</sup> See *OIG, Administrative Investigation into Anonymous Hotline Complaints Concerning Timeliness and Completeness of Disclosures Regarding a Potential Conflict of Interest by a Senior Executive Officer of an Enterprise* at 8, 10 (Mar. 23, 2017) (OIG-2017-004) (online at [www.fhfa.ig.gov/reports/managementalerts](http://www.fhfa.ig.gov/reports/managementalerts)).

to time, the Board has updated and clarified its delegation to the CEO who, in turn, updated and clarified the authorities delegated to subordinate employees. Delegations of authority from the CEO to his subordinates are recorded in the Executive Officer Delegations of Authority (EDoA), as amended, and the applicable annex to the EDoA. Version 11.1 of the EDoA, dated February 17, 2016, is the most current version provided to us. Pursuant to Part V, Section H, this EDoA states:

The CCO-SVP is delegated broad authority by the CEO to manage the Compliance and Ethics organization, including overseeing legal and regulatory compliance: promotion of compliance with federal, state, and local laws and regulations; ethics; privacy; anti-fraud; mortgage fraud; investigations; records management; delegations of authority; and Company-wide mandatory training. The CCO-SVP reports to the CEO and independently to the Audit Committee of the Board on matters related to compliance and ethics.

There are tensions between the NGC Charter, approved by the Board, and the EDoA, approved only by Fannie Mae management, that create interpretive challenges, such as the following examples:

- As discussed, the NGC Charter tasks the NGC with responsibilities to review conflicts matters involving SEOs. The EDoA, which tasks the CCO to manage the Compliance and Ethics “organization,” does not explain whether that delegation includes the authority to resolve actual and potential conflicts of interest involving SEOs, many of whom are senior to the CCO, including the CEO to whom the CCO reports on compliance matters.<sup>16</sup>
- Notwithstanding the conflicts responsibilities reserved to the NGC in its Charter, the EDoA directs that the CCO’s duty is to report independently to the Audit Committee

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<sup>16</sup> In its management response to our recent Management Alert involving the lack of clarity in the charter for the Nominating and Governance Committee of the board of directors of Freddie Mac, FHFA maintained that the broad delegation by Freddie Mac’s CEO to its CCO of authority for all activities related to maintaining an ethics program acted to authorize the CCO and the Freddie Mac Ethics Office to review and resolve executive officers’ conflicts of interest matters. FHFA Response to Management Alert, *Need for Increased Oversight by FHFA to Ensure Freddie Mac’s Policies and Procedures for Resolution of Executive Officer Conflicts of Interest Align with the Responsibilities of the Nominating and Governance Committee of the Freddie Mac Board of Directors* (Sept. 27, 2017) (OIG-2017-005) (online at [www.fhfa.ig.gov/Content/Files/OIG-2017-005%20%28Redacted%29.pdf](http://www.fhfa.ig.gov/Content/Files/OIG-2017-005%20%28Redacted%29.pdf)). Because the EDoA for Fannie Mae contains similar language, FHFA may take the same view. That interpretation would mean that an Enterprise Board, through a delegation of authority to the CEO and, in turn, by the CEO to the CCO, could render meaningless the duties and obligations of the Board and its committees, which would violate FHFA’s governance regulation.

on matters “related to” compliance and ethics but contains no duty to present conflicts matters involving SEOs to the NGC.<sup>17</sup>

The Board approved Annex A of the EDoA, titled “Matters Requiring Approval of the Board of Directors, a Committee thereof, or FHFA and/or the Conservator.” Annex A sets forth specific matters for which such approvals are required.<sup>18</sup> Resolution of conflict of interest matters involving SEOs is not identified on Annex A. According to FHFA, the failure to include resolution of conflict of interest matters involving SEOs on Annex A should be understood to mean that the NGC is not vested with exclusive authority to resolve such conflicts.

### **The NGC’s Duties Under the COI Policy and COI Procedure Adopted by Fannie Mae Management**

Fannie Mae’s ethics program is comprised of a number of interrelated codes, policies, and procedures that include the Employee Code, the COI Policy, and the COI Procedure. Fannie Mae’s COI Policy and COI Procedure were drafted and revised by FM Ethics, the office responsible for assisting the NGC in fulfilling its duties, and approved by Fannie Mae’s CCO, who oversees FM Ethics.<sup>19</sup>

The COI Policy establishes “more detailed Company-wide requirements for avoiding conflicts of interest” than what is specified in the Employee Code. The COI Policy explains, with far greater granularity than the Employee Code, the types of activities that give rise to potential conflicts of interest and instructs employees to disclose such activities to FM Ethics for review and approval in accordance with the COI Procedure.<sup>20</sup> Section 5 of the COI Policy, captioned “Roles and Responsibilities,” states that the NGC is responsible for

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<sup>17</sup> Whatever authority was intended to be delegated to the CCO by this provision, which is unclear, that authority does not exist in a vacuum. Because the NGC Charter requires the NGC to review “activities engaged in by [SEOs] that may result in a potential or actual conflict of interest under the Employee Code of Conduct or Conflict of Interest Policy and Conflict of Interest Procedure,” this provision of the EDoA cannot be understood to relieve the CCO of the obligation to present such situations to the NGC for its review.

<sup>18</sup> In November 2015, the Board approved an update to its delegation of authority that resulted in the list of matters requiring Board, Committee, or FHFA and/or conservator approval to become “Annex B” of the EDoA.

<sup>19</sup> During all but the last month of the Review Period, the CCO was the Policy Approver for the COI Policy. As of December 2016, the Enterprise’s Management Committee replaced the CCO as the Policy Approver. The Management Committee consists of twelve members of Fannie Mae senior management, most of whom are SEOs, including the CEO and CCO.

<sup>20</sup> The COI Policy instructs employees to avoid “situations” that could, among other things: (1) impair the employee’s objectivity in performing duties and responsibilities at Fannie Mae; (2) otherwise interfere with the employee’s ability to perform duties and responsibilities at Fannie Mae; or (3) “embarrass” Fannie Mae. See COI Policy, Section 6.1 (Overview).

“approving Conflict requests of Senior Executive Officers as outlined in the accompanying Procedure.”<sup>21</sup>

The COI Procedure establishes the process employees must follow to raise and resolve potential, apparent, and actual conflicts of interest outlined in the COI Policy. Section 7 of the COI Procedure contemplates no role for FM Ethics and the CCO to review and resolve conflicts of interests involving SEOs:

The [NGC] is responsible for reviewing *and approving* all [conflicts] requests made by Senior Executive Officers. (emphasis added)

To assist the NGC in fulfilling these responsibilities, Section 10.2.7 of the COI Procedure sets forth a clear procedure that must be used by FM Ethics to escalate all conflicts requests involving SEOs to the NGC.<sup>22</sup> It instructs:

With respect to *all* Conflict of Interest requests received from Senior Executive Officers, FM Ethics *will* present such requests along with a recommended determination to the [NGC]. The recommended determination will state whether or not a Conflict exists and will outline any steps that should be taken to address the Conflict. *The [NGC] will approve, deny, or further condition the recommended determination*, and forward the final determination to FM Ethics, which, in turn, will forward the final determination to the Senior Executive Officer. (emphasis added)

Both the COI Policy and COI Procedure, which were drafted by FM Ethics, the management function responsible for assisting the NGC in fulfilling its duties, reflect the same understanding of the NGC’s responsibilities under its Charter: that the NGC is obligated to review and resolve conflicts of interest involving SEOs.

## FACTS AND ANALYSIS .....

We sought to determine what practice, if any, had been consistently followed by the NGC during the five-year Review Period with respect to SEO conflicts. We interviewed the current

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<sup>21</sup> COI Policy, Section 5.

<sup>22</sup> Relying on Section 10.2.3 of the COI Procedure, FHFA maintains that FM Ethics is authorized to determine that a matter disclosed by an SEO, including the CEO, is not a conflict of interest requiring review and approval by the NGC. That interpretation, however, would negate two other provisions of the COI Procedure: Section 7, which directs that the NGC “is responsible for reviewing and approving all requests made by Senior Executive Officers” and Section 10.2.7, which requires FM Ethics to “present . . . all Conflict of Interest requests received from Senior Executive Officers” to the NGC.



NGC Chair, who has been an NGC member since December 2008 and chair since October 2015, to understand the practice followed by the NGC for SEO conflicts. He provided two conflicting explanations of the NGC’s practice. First, he explained that the NGC has not delegated authority to the CCO to resolve SEO conflicts of interest and that the NGC relies on the CCO to bring to it all information related to potential conflicts of interest disclosed by SEOs. That explanation essentially tracks the procedure set forth in Section 10.2.7 of the COI Procedure. However, he also reported that the NGC relies on the CCO to determine whether a matter disclosed by the CEO (or any other SEO)<sup>23</sup> constitutes a potential conflict of interest under Fannie Mae’s COI Policy and expects that the CCO will bring to the NGC only those matters where a potential conflict may exist.

We identified a total of 57 potential conflicts involving SEOs,<sup>24</sup> which were documented in Fannie Mae’s CMS,<sup>25</sup> NGC meeting materials, and/or minutes of NGC meetings. Using minutes of NGC meetings related to these matters<sup>26</sup> and CMS entries, we mapped how each potential conflict was ultimately resolved.

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<sup>23</sup> We understood that the NGC Chair’s description of the conflicts practice followed by the NGC applied to all SEOs.

<sup>24</sup> This total of 57 includes matters disclosed during an SEO’s onboarding process and includes matters involving SEOs who subsequently left Fannie Mae after the matter was resolved.

<sup>25</sup> CMS is FM Ethics’ system of record. According to the COI Procedure, “To ensure that Fannie Mae consistently applies the [Employee] Code, the [COI] Policy, and this Procedure, FM Ethics maintains a confidential file of requests and determinations. All Conflict determinations, recusal notifications, and supporting documents are maintained in [CMS].” See COI Procedure Section 10.5. CMS contains log entries that track, in chronological order, the details of actions taken by FM Ethics and other Fannie Mae personnel, and also by FHFA and outside counsel, in conjunction with each matter.

<sup>26</sup> Under Delaware law, minutes of a meeting of a board of its directors, or board committee, are considered to be prima facie evidence of actions taken by the board or committee. See *Young v. Janas*, 34 Del. Ch. 287, 103 A.2d 299, 303 (1954). See also *Brehm v. Eisner* (In re Walt Disney Co. Derivative Litig.), 906 A.2d 27, 56-57 (Del. 2006) (court relies on compensation committee minutes for evidence of whether members were adequately informed); *Third Point LLC v. Ruprecht*, C.A. No. 9469-VCP, slip. op. 29-30 (Del. Ch. Ct. May 2, 2014) (court recites the minutes as evidence of what board considered and deliberated upon during board meeting); *In re Netsmart Techs., Inc. S’holders Litig.*, 924 A.2d 171, 187 (Del. Ch. 2007) (court notes that, in the absence of minutes, one cannot determine who was at a meeting or what specifically was said or done). Fannie Mae has elected to follow Delaware corporate governance law. See Section 1.05, Fannie Mae Bylaws (as amended through July 21, 2016); see also Section 7, Fannie Mae’s Corporate Governance Guidelines (minutes “will reflect the deliberative process and actions taken in those meetings”) (online at [www.fanniemae.com/resources/file/aboutus/pdf/corpgovguidelines.pdf](http://www.fanniemae.com/resources/file/aboutus/pdf/corpgovguidelines.pdf)). While such minutes are not stenographic records or transcripts of meetings, Delaware courts have treated them as reflecting the level of review and deliberation by the board or its committee. Like Delaware, both Fannie Mae and FHFA recognize that minutes of meetings of a board of directors (or a board committee) provide the record of what occurred at that meeting. See Fannie Mae’s Corporate Governance Guidelines; FHFA Examination Module, “Board of Directors and Senior Management,” (online at [www.fhfa.gov/SupervisionRegulation/Documents/Board\\_of\\_Directors\\_and\\_Senior\\_Management\\_Oversight\\_Module\\_Final\\_Version\\_1.0\\_508.pdf](http://www.fhfa.gov/SupervisionRegulation/Documents/Board_of_Directors_and_Senior_Management_Oversight_Module_Final_Version_1.0_508.pdf)) at 5 (“Each board committee must keep minutes of its meetings documenting the discussions of each item considered at the meeting”) and 6 (“The board of directors should

NGC minutes reflect that the NGC was asked by FM Ethics to resolve 24 of the 57 potential SEO conflicts (42%).<sup>27</sup> Typically, FM Ethics provided the NGC with a written analysis of the possible conflicts issue and recommended a determination for these 24 matters for decision by the NGC. That practice was consistent with the process set forth in Section 10.2.7 of the COI Procedure and in the duties reserved to the NGC in the COI Policy and COI Procedure, drafted by the function responsible with assisting the NGC in carrying out its Charter responsibilities.

For 16 of the 57 (28%), CMS entries show that (1) FM Ethics determined, on its own, whether a conflict of interest existed, (2) where it found a conflict, took steps to address it, and (3) subsequently notified the NGC of its determinations to facilitate the NGC’s “review” of SEO activities “that may result in a potential or actual conflict of interest” under the COI Policy and COI Procedure. We found no evidence that any NGC member: asked FM Ethics to explain why it presented some SEO potential conflicts to the NGC for its resolution, but retained and resolved other potential SEO conflicts and subsequently notified the NGC of its determination; pressed FM Ethics to explain the basis of its authority to resolve conflicts determinations for SEOs; provided direction to FM Ethics about its role in resolving SEO conflicts; or raised the potential inconsistencies between its duties under the Charter and its duties under the COI Procedure with the Board and asked the Board to clarify its responsibilities.

For the remaining 17 (30%), CMS entries reflect that FM Ethics determined, on its own, whether a potential conflict of interest existed and took steps to resolve any conflict that it identified. We found no evidence that FM Ethics ever notified the NGC of any of these 17 conflict disclosures or determinations. Those actions by FM Ethics ran afoul of clear provisions in the COI Policy and COI Procedure, drafted by FM Ethics and approved by the CCO, which mandate NGC review and resolution of SEO conflicts. Even had FM Ethics come to the view, currently held by FHFA, that Section 4.xiii of the NGC Charter did not require the NGC to resolve conflicts involving SEOs, including the CEO, Section 4.xiii of the Charter requires the NGC to “review” activities engaged in by SEOs “that may result in a potential or actual conflict of interest” under the COI Policy and COI Procedure. Failure by FM Ethics to notify the NGC of its resolution of these 17 conflict requests by SEOs deprived the NGC of its ability to satisfy its duties under its Charter.

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ensure that an accurate record of its actions is maintained in the form of minutes of each board and committee meeting. . . . Minutes should document the board’s review and discussion of all agenda items”).

<sup>27</sup> For 17 of these 24 matters, FM Ethics, in a written memorandum to the NGC, analyzed the potential conflicts issue and reported that it recommended approval by the NGC. For 7 of the 24, FM Ethics analyzed, in a written memorandum to the NGC, potential conflicts issues that arose during the on-boarding process, and presented its “determination” for review by the NGC.



Because the composition of the NGC changed over the Review Period, we sought to determine whether the NGC consistently followed the same process with respect to potential conflicts of interest disclosed by SEOs during a 10-month period in 2016 (February 2016 through November 2016). Of the four directors who served on the NGC during this period, two [REDACTED] and remains a member. Of the 57 potential conflicts involving SEOs, including the CEO, that we identified during the Review Period (and discussed earlier), 11 potential conflicts arose during this 10-month period. Minutes of NGC meetings and CMS entries reflect that the inconsistent practice in resolving SEO potential conflicts remained unchanged during this 10-month period.

- [REDACTED], minutes for an NGC meeting show that a potential conflict disclosed by an SEO was presented to the NGC, pursuant to the process set forth in Section 10.2.7 of the COI Procedure, and the CMS entry reports that the CCO notified FM Ethics that the NGC approved the requested activity.
- According to Fannie Mae, [REDACTED] disclosed to FM Ethics, [REDACTED], [REDACTED] Fannie Mae counterparty and FM Ethics determined that no conflict of interest existed. There is no contemporaneous CMS entry memorializing the conflict of interest analysis by FM Ethics or its decision [REDACTED] that no conflict existed. There is also no evidence that FM Ethics followed Section 10.2.7 of the COI Procedure and presented this conflicts question to the NGC for its resolution or notified the NGC of its determination for NGC review at the NGC's [REDACTED] meetings.
- [REDACTED], minutes for an NGC meeting show that a potential conflict disclosed by an SEO to FM Ethics arising from the employment of an adult relative by a Fannie Mae counterparty was presented to the NGC for its resolution, pursuant to the process set forth in Section 10.2.7 of the COI Procedure.
- [REDACTED], minutes for an NGC meeting show that four potential conflicts involving three SEOs were presented by FM Ethics to the NGC for its resolution, pursuant to the process set forth in Section 10.2.7 of the COI Procedure.<sup>28</sup>
- Minutes for an [REDACTED], NGC meeting report that [REDACTED] notified the NGC that FM Ethics previously determined, [REDACTED], that [REDACTED] disclosure of [REDACTED] Fannie Mae counterparty did not constitute a

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<sup>28</sup> Of these four potential conflicts, [REDACTED].

conflict. Minutes for the [REDACTED] NGC meeting do not reflect that any NGC member:

- Asked [REDACTED] to articulate the reasons that FM Ethics presented a potential conflict disclosed by a different SEO arising from the employment of an adult relative at a Fannie Mae counterparty for NGC review and resolution in [REDACTED] but did not present a potential conflict disclosed by [REDACTED] arising from [REDACTED] counterparty for NGC review and resolution in [REDACTED];
  - Pressed [REDACTED] to explain why FM Ethics resolved in [REDACTED] the potential conflict arising from [REDACTED] counterparty but presented different potential conflicts involving [REDACTED] to the NGC for its resolution in [REDACTED];
  - Sought to understand the reasons why FM Ethics presented to the NGC for its resolution all potential conflicts involving SEOs between February and July 2016 except the one arising from [REDACTED] counterparty;
  - Questioned [REDACTED] to explain why FM Ethics failed to follow Section 10.2.7 of the COI Procedure, which it had drafted and [REDACTED] had approved, with respect to this one potential conflict involving [REDACTED];
  - Asked [REDACTED] to articulate the basis of authority for FM Ethics to resolve a potential conflict of interest involving [REDACTED] when it presented other potential conflicts involving [REDACTED] for NGC resolution;
  - Questioned whether [REDACTED], was sufficiently independent of [REDACTED] to analyze whether [REDACTED] counterparty constituted a potential conflict of interest; and/or
  - Challenged [REDACTED] to justify the failure to notify the NGC of this potential conflict of interest involving [REDACTED] prior to [REDACTED], which impaired its ability to meet its responsibilities under the NGC Charter.
- [REDACTED], minutes for an NGC meeting show that FM Ethics informed the Committee of two potential conflicts of interest involving [REDACTED] negotiations with prospective employers. FM Ethics presented one matter to the NGC for its resolution, consistent with the process set forth in Section 10.2.7 of the COI Procedure. For the second matter, FM Ethics notified the NGC that it determined that Fannie Mae had no

business relationship with the prospective employer. Minutes from this meeting do not reflect that FM Ethics followed the process set forth in Section 10.2.7 for this second matter and we found no written analysis by FM Ethics to support the determination it apparently made. The minutes do not reflect that any NGC member pressed FM Ethics to explain its inconsistent approach or questioned FM Ethics why it presented one potential conflict involving [REDACTED] discussion with a potential employer, pursuant to the process set forth in Section 10.2.7 of the COI Procedure, but resolved the second potential conflict involving [REDACTED] discussions with a different potential employer on its own.

- [REDACTED], FM Ethics notified the NGC by email that FM Ethics had become aware of “potential issues” relating to [REDACTED] prior disclosure of [REDACTED] Fannie Mae counterparty and “concluded that an appearance of a conflict of interest may be presented under the circumstances.” FM Ethics further reported to the NGC that it had prepared a recusal agreement that [REDACTED] executed. In this same email, FM Ethics invited NGC members to contact FM Ethics with any questions. Fannie Mae reported to us that the NGC took no action in response to this notification. We found no documentation that any NGC member:
  - Sought or received details from FM Ethics regarding the “potential issues” that it identified arising out of [REDACTED] prior disclosure;
  - Requested a written or oral analysis of the “potential” conflicts issues;
  - Asked FM Ethics to explain why it failed to follow Section 10.2.7 of the COI Procedure, which it had drafted and [REDACTED] had approved, with respect to this one potential conflict;
  - Pressed FM Ethics to explain the reasons why FM Ethics presented to the NGC, pursuant to Section 10.2.7, all potential conflicts involving SEOs [REDACTED] [REDACTED] between February and October 2016, but treated three potential conflicts, two of which involved [REDACTED] [REDACTED] counterparty, differently;
  - Required FM Ethics to explain the basis of its authority to determine that a “potential” conflict involving [REDACTED] should be addressed with a recusal agreement, rather than presented to the NGC, pursuant to Section 10.2.7; and/or

- Flagged to the Board the inconsistent approach in handling potential conflicts of interest involving [REDACTED] and asked the Board to clarify its responsibilities.
- [REDACTED], minutes for an NGC meeting show that a potential conflict of interest disclosed by an SEO was presented to the NGC for its resolution, pursuant to Section 10.2.7 of the COI Procedure.

As discussed earlier, FHFA views operational risk management as an important financial safety and soundness challenge facing the Enterprises and considers effective corporate governance to be one element of an acceptable operational risk management program. FHFA has delegated to the board of each Enterprise a significant portion of day-to-day management and risk controls, and under its regulations, Enterprise boards retain “ultimate responsibility” for oversight of Enterprise operations that is “non-delegable.” For this delegated governance model to succeed, FHFA understands that Enterprise directors and board committees must fulfill their delegated responsibilities. For many of the 57 potential conflicts of interest involving SEOs raised during the Review Period, the record shows 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. Minutes for NGC meetings show that NGC members did not exercise reasonable inquiry commensurate with the reputational risk to Fannie Mae (and to FHFA) from possible conflicts of interest involving SEOs.

### **FHFA’s Oversight**

We confirmed that employees from FHFA’s Division of Conservatorship attended most NGC meetings at which FM Ethics discussed potential conflicts involving SEOs but the minutes of those meetings do not reflect participation by those employees in such discussions. Similarly, the minutes of those NGC meetings do not report any concerns raised by FHFA employees about inconsistencies in Fannie Mae’s corporate governance documents regarding responsibility to resolve potential conflicts of interest raised by SEOs or about inconsistent practices by FM Ethics and the NGC to resolve such conflicts. We found no evidence that FHFA’s senior management was aware of these inconsistencies until we brought them to FHFA’s attention.

## FINDINGS .....

1. According to FHFA, the NGC’s duty to “review” certain activities, pursuant to Section 4.xiii, does not vest the NGC with the exclusive authority to resolve whether certain activities constituted a conflict of interest for SEOs.
2. FM Ethics, which reports to Fannie Mae’s CCO, is the office responsible for assisting the NGC in fulfilling its duties. The COI Policy, drafted by FM Ethics and approved by the CCO, establishes “more detailed Company-wide requirements for avoiding Conflicts” than what is specified in the Employee Code. Section 5 of the COI Policy, captioned “Roles and Responsibilities,” states that the NGC is responsible for “approving Conflict requests of Senior Executive Officers as outlined in the accompanying Procedure.”
3. The COI Procedure, similarly drafted by FM Ethics and approved by the CCO, establishes the process employees must follow to raise and resolve potential, apparent, and actual conflicts of interest outlined in the COI Policy. Similar to the COI Policy, the COI Procedure contemplates no role for FM Ethics and the CCO to resolve conflicts of interest involving SEOs but requires them to “present” all such conflict of interest requests to the NGC for its resolution.
4. Analysis of 57 potential conflicts involving SEOs, which were documented in CMS, NGC meeting materials, and/or minutes, during the five-year Review Period found: the NGC was asked by FM Ethics to resolve 24 of the 57 potential SEO conflicts (42%); FM Ethics determined, on its own, whether a conflict of interest existed for 16 of the 57 (28%) and subsequently notified the NGC of its determinations, which ran afoul of the mandates in the COI Policy and COI Procedure; and FM Ethics determined, on its own, whether a potential conflict of interest existed for 17 of the 57 (30%), in violation of the COI Policy and COI Procedure, and no documentary evidence shows that FM Ethics notified the NGC of any of its unilateral conflict determinations, which deprived the NGC of its ability to satisfy its duties under its Charter.
5. For many of these 57 potential conflicts of interest involving SEOs, the record shows 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. Minutes for NGC meetings show that NGC members did not

exercise reasonable inquiry commensurate with the reputational risk to Fannie Mae (and to FHFA) from possible conflicts of interest involving SEOs.

6. Because the composition of the NGC changed over the Review Period, we sought to determine whether the NGC consistently followed the same process with respect to 11 potential conflicts of interest disclosed by SEOs during a 10-month period in 2016 (February 2016 through November 2016). Of the four directors who served on the NGC during this period, [REDACTED], and remains a member. Minutes of NGC meetings and CMS entries reflect that the inconsistent practice in resolving SEO potential conflicts remained unchanged during this 10-month period.
7. Analysis of those 11 actual or apparent conflicts involving SEOs, which were documented in the CMS, NGC meeting materials, and/or minutes, during this 10-month period found that the NGC was asked by FM Ethics to resolve 8 of the 11 (73%). For the remaining 3, all of which involved [REDACTED], FM Ethics determined, on its own, whether a conflict of interest existed, took steps to address any conflict it identified, and subsequently notified the NGC of its determinations. According to Fannie Mae governance documents, FM Ethics reports to the CCO who, in turn, reports to the CEO. For each of the 3 conflicts involving [REDACTED] that FM Ethics resolved and subsequently notified the NGC, no documentary evidence was found to reflect that any NGC member:
  - a. Asked FM Ethics and/or the CCO to explain why FM Ethics failed to follow Section 10.2.7 of the COI Procedure, which it had drafted and the CCO had approved, but followed Section 10.2.7 for the remaining 8 potential conflicts;
  - b. Pressed FM Ethics to explain the reasons why FM Ethics presented to the NGC, pursuant to Section 10.2.7, all potential conflicts involving SEOs [REDACTED] between February and October 2016, but treated three potential conflicts, two of which involved [REDACTED] [REDACTED] counterparty, differently;
  - c. Asked [REDACTED] and/or FM Ethics to articulate the basis of authority for FM Ethics to resolve 3 potential conflicts of interest involving [REDACTED] when it presented other potential conflicts involving [REDACTED] for NGC resolution;
  - d. Required FM Ethics to explain the basis of its authority to determine that a “potential” conflict involving [REDACTED] should be addressed with a recusal agreement, rather than presented to the NGC, pursuant to Section 10.2.7;

- e. Questioned whether [REDACTED], was sufficiently independent of [REDACTED] to analyze and make any determinations respecting potential conflicts involving [REDACTED]; and/or
  - f. Flagged to the Board the inconsistent approach by FM Ethics in handling potential conflicts of interest involving [REDACTED] and asked the Board to clarify the responsibilities of the NGC, FM Ethics, and the CCO.
8. While FHFA employees attended NGC meetings at which many of these 57 potential conflicts of interest were discussed, we found no evidence that these FHFA employees raised questions or concerns about inconsistencies in Fannie Mae’s corporate governance documents regarding responsibility to resolve potential conflicts of interest raised by SEOs or about inconsistent practices by FM Ethics and the NGC to resolve such conflicts. We found no evidence that FHFA’s senior management was aware of these inconsistencies until we brought them to FHFA’s attention.

## CONCLUSIONS .....

Fannie Mae, in adopting its governance authorities, recognizes that potential, actual, or apparent conflicts of interest, when not disclosed or addressed properly, pose significant risk to its reputation and undermine its goal of operating in accordance with “the highest ethical standards.” According to FHFA, Fannie Mae’s relevant governance documents are internally inconsistent with respect to responsibility for resolution of conflicts of interest involving SEOs.

We mapped the resolution of 57 potential, actual, and apparent conflicts of interest involving SEOs that were disclosed during the five-year Review Period. Of these 57 potential conflicts involving SEOs, we found: the NGC was asked by FM Ethics to resolve 24 of the 57 potential SEO conflicts (42%); FM Ethics determined, on its own, whether a conflict of interest existed for 16 of the 57 (28%) and subsequently notified the NGC of its determinations, which ran afoul of the mandates in the COI Policy and COI Procedure; and FM Ethics determined, on its own, whether a potential conflict of interest existed for 17 of the 57 (30%), in violation of the COI Policy and COI Procedure, and no documentary evidence shows that FM Ethics notified the NGC of any of its unilateral conflict determinations, which deprived the NGC of its ability to satisfy its duties under its Charter.

We also looked at FHFA’s oversight of NGC’s review of conflict of interest matters involving SEOs and found that FHFA employees attended NGC meetings at which FM Ethics presented conflicts questions involving SEOs to the NGC for its determinations and notified the NGC of its decisions regarding SEO conflicts requests. We found no evidence that FHFA employees

identified the internal inconsistencies or lack of clarity in Fannie Mae’s governance documents or escalated those issues to senior FHFA management. We also found no evidence that FHFA’s senior management was aware of these issues until we brought them to FHFA’s attention.

This evaluation found failures, both by Fannie Mae’s NGC and by FHFA, which created a weakness in Fannie Mae’s risk management structure. Without enhancements to the NGC’s oversight, there is a significant risk that the NGC will continue to fall short in exercising its governance responsibilities.

## RECOMMENDATIONS.....

To address the shortcomings identified in this evaluation, we recommend that FHFA:

1. Provide guidance to Fannie Mae on FHFA governance expectations regarding authority to review and resolve actual, potential, and apparent conflicts of interest involving SEO positions;
2. Direct Fannie Mae to conduct a comprehensive internal review of its governance documents (both board and management generated) for consistency and clarity, with specific emphasis on the assignment of authority to review and resolve conflict of interest matters involving SEO positions, by seniority and rank, and the process to be used to review and resolve such conflicts;
3. Direct the Fannie Mae Board of Directors to review the results of the comprehensive internal review and determine whether authority to review and resolve conflict of interest matters involving specific SEO positions, by seniority and rank, should be vested in a Board committee or delegated to Fannie Mae management, and determine the process to be used to review and resolve such conflicts. Should the Board determine to delegate to management authority to review and resolve all potential, actual, or apparent conflicts of interest involving the CEO and the CEO’s direct reports, counsel the Board on the process that should be put into place to require management to report its resolution of all such conflicts to a Board committee for its review;
4. To the extent that the Fannie Mae Board of Directors determines to delegate authority to the CCO and FM Ethics to review and resolve certain conflicts of interest involving SEOs, counsel the Board to amend the relevant governance documents and establish a reporting relationship between the NGC, FM Ethics, and the CCO;



5. Direct FHFA employees to monitor the review and resolution of SEO disclosures of potential, actual, or apparent conflicts of interest to ensure that revised Board committee charter(s) and management policies and procedures are being followed.
6. Direct the NGC to use its authority to retain, as appropriate, independent outside corporate governance experts to assist it in fulfilling its obligations under the NGC Charter.
7. Direct the Fannie Mae Board of Directors to assess the skills and professional experiences of current board members and, as vacancies occur, prioritize candidates with demonstrable expertise in corporate governance;
8. Require the NGC to fully document, in meeting minutes, its discussions, deliberations, and actions at each meeting to ensure an effective flow of information between the NGC and other directors and to provide FHFA with sufficient information to enable it to assess whether the NGC is meeting the responsibilities and obligations set forth in its Charter.

OIG provided FHFA an opportunity to respond to a draft report of this evaluation. In its management response, which is reprinted in its entirety in the Appendix, FHFA agreed with the recommendations.

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

We conducted this evaluation to assess FHFA’s oversight, as conservator, of the Fannie Mae Board of Directors’ execution of its responsibilities to administer Fannie Mae’s Employee Code and COI Policy for Senior Executive Officers of Fannie Mae. To achieve this objective, we reviewed relevant Fannie Mae policies, procedures, and codes; Board materials and minutes; and CMS logs and documents related to potential conflicts of interest involving SEOs. We also relied on interviews with Fannie Mae employees and Board members conducted for related OIG matters.

Our analysis of potential conflicts of interest involving SEOs was based on the documents provided to us by Fannie Mae in response to document requests. In December 2016, we requested all Conflict of Interest Review and Approval Forms—the form employees are required by the COI Procedure to submit when requesting review of a potential conflict—for all SEOs submitted between January 1, 2012, and December 2016. In response, Fannie Mae notified us that that form is not used for SEOs, who generally disclose potential conflicts to FM Ethics orally, or in response to annual ethics questionnaires. In lieu of the forms, Fannie Mae provided to us folders from CMS that recorded potential conflicts involving SEOs that arose within the Review Period.

The folders each contained a log documenting events and actions taken by FM Ethics in relation to potential conflict of interest matters, along with other documents relevant to the matters discussed in the log. In some folders, we found no potential SEO conflicts—for example, a folder contained an annual ethics questionnaire with no disclosures, or the potential conflicts involved an employee that did not qualify as an SEO. In other instances, we found that a folder contained multiple potential conflicts—for example, a folder contained an annual ethics questionnaire on which an SEO disclosed multiple potential conflicts. Based on our review of the CMS documents and NGC meeting materials and minutes, we identified a total of 57 potential conflicts involving SEOs that arose during the Review Period. Using minutes of NGC meetings related to these matters and CMS entries, we mapped how each potential conflict was ultimately resolved.

This evaluation was conducted under the authority of the Inspector General Act and in accordance with the Council of the Inspectors General on Integrity and Efficiency’s *Quality Standards for Inspection and Evaluations* (January 2012). These standards require us to plan and perform an evaluation based on evidence sufficient to provide a reasonable basis to support its findings and recommendations. We believe that the findings and recommendations discussed in this report meet those standards.

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



# Federal Housing Finance Agency

## MEMORANDUM

TO: Kyle D. Roberts, Deputy Inspector General for Evaluations

FROM: Bob Ryan, Acting Deputy Director, Division of Conservatorship *BR*  
Nina A. Nichols, Deputy Director, Division of Enterprise Regulation *NAN*

SUBJECT: Draft Evaluation Report: *Corporate Governance: Review and Resolution of Conflicts Involving Fannie Mae's Senior Executive Officers Highlight the Need for Closer Attention to Governance Issues by FHFA*

DATE: January 26, 2018

This Memorandum transmits the management response of the Federal Housing Finance Agency (FHFA) to the FHFA Office of Inspector General (FHFA OIG) draft evaluation report referenced above (Report). FHFA reviewed the draft Report and also shared a copy with Fannie Mae for review.

Differences in FHFA's interpretations and FHFA OIG's interpretations of the relevant COI documents as discussed in the draft Report lead FHFA to disagree with several of the findings and conclusions in the draft Report. However, the draft Report does correctly identify several inconsistencies and provisions subject to inconsistent interpretations in Fannie Mae's corporate governance documents applicable to the review and resolution of senior executive officer (SEO) conflicts of interest (COI) matters. Consequently, FHFA agrees that the appropriate roles of the Board and of management regarding the review and resolution of potential COIs by SEOs need to be clarified. Therefore, FHFA agrees with the recommendations of the draft Report and responds to the specific recommendations as follows:

**Recommendation 1:** *Provide guidance to Fannie Mae on FHFA governance expectations regarding authority to review and resolve actual, potential, and apparent conflicts of interest involving SEO positions.*

**Recommendation 2:** *Direct Fannie Mae to conduct a comprehensive internal review of its governance documents (both board and management generated) for consistency and clarity, with specific emphasis on the assignment of authority to review and resolve conflict of interest matters involving SEO positions, by seniority and rank, and the process to be used to review and resolve such conflicts.*

**Recommendation 3:** *Direct the Fannie Mae Board of Directors to review the results of the comprehensive internal review and determine whether authority to review and resolve conflict of interest matters involving specific SEO positions, by seniority and rank, should be vested in a Board committee or delegated to Fannie Mae management, and determine the process to be used to review and resolve such conflicts. Should the Board determine to delegate to management authority to review and resolve all potential, actual, or apparent conflicts of interest involving the CEO and the CEO's direct reports, counsel the Board on the process that should be put into place to require management to report its resolution of all such conflicts to a Board committee for its review.*

**Recommendation 4:** *To the extent that the Fannie Mae Board of Directors determines to delegate authority to the CCO and FM Ethics to review and resolve certain conflicts of interest involving SEOs, counsel the Board to amend the relevant governance documents and establish a reporting relationship between the NGC, FM Ethics, and the CCO.*

**Management Response to Recommendations 1-4:** FHFA agrees with recommendations 1 through 4. Using its conservatorship governance process, FHFA will issue a directive to Fannie Mae that communicates FHFA's governance expectations regarding the authority to review and resolve actual, potential, and apparent conflicts of interest involving SEO positions by April 30, 2018. The directive will include a requirement that Fannie Mae review its governance documents for consistency and clarity; determine the Board and management authorities and roles consistent with FHFA's expectations; amend the governance documents as needed; and establish reporting relationships between the NGC, FM Ethics, and the CCO as needed. FHFA will expect Fannie Mae to complete these actions by October 31, 2018.

**Recommendation 5:** *Direct FHFA employees to monitor the review and resolution of SEO disclosures of potential, actual, or apparent conflicts of interest to ensure that revised Board committee charter(s) and management policies and procedures are being followed.*

**Management Response:** FHFA agrees with the recommendation. By April 30, 2018, FHFA will direct Fannie Mae to provide FHFA with regular reports on the Enterprise's adherence to internal procedures regarding conflicts of interest of SEOs. In the 2019 examination cycle, DER



will conduct and document examination work to review the reports and assess whether FNM has implemented and consistently followed procedures on conflicts of interest of CEOs.

**Recommendation 6:** *Direct the NGC to use its authority to retain, as appropriate, independent outside corporate governance experts to assist it in fulfilling its obligations under the NGC Charter.*

**Management Response:** FHFA agrees with the recommendation. As the NGC currently has authority to use independent outside corporate governance experts to assist it in fulfilling its obligations under the NGC Charter, FHFA will communicate to the Chair of the NGC by April 30, 2018, its expectation that the Committee retain independent outside governance experts as a resource, as needed and appropriate.

**Recommendation 7:** *Direct the Fannie Mae Board of Directors to assess the skills and professional experiences of current board members and, as vacancies occur, prioritize candidates with demonstrable expertise in corporate governance.*

**Management Response:** In furtherance of steps already taken to advance this objective, FHFA will communicate its expectation that the Fannie Mae Board of Directors assess the skills and professional experiences of current board members and, as vacancies occur, consider demonstrable expertise in corporate governance as an important criterion in the selection process. FHFA will communicate its expectations in writing to the Chair of the Fannie Mae Board by April 30, 2018.

**Recommendation 8:** *Require the NGC to fully document, in meeting minutes, its discussions, deliberations, and actions at each meeting to ensure an effective flow of information between the NGC and other directors and to provide FHFA with sufficient information to enable it to assess whether the NGC is meeting the responsibilities and obligations set forth in its Charter.*

**Management Response:** FHFA agrees with the recommendation and by April 30, 2018, will communicate in writing to the Chair of the NGC its expectation to fully document in meeting minutes its discussions, deliberations, and actions.

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

## ADDITIONAL INFORMATION AND COPIES.....

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