

Federal Housing Finance Agency
Office of Inspector General



**FHFA's Division of Enterprise
Regulation Has Made Progress in Its
Quality Control Program but Needs
to Ensure Adequate Reporting and
Feedback Is Provided to
Management**



EVL-2022-001

March 7, 2022

Executive Summary

The Federal Housing Finance Agency’s Division of Enterprise Regulation (DER) is responsible for examining Fannie Mae and Freddie Mac (together, the Enterprises) and does so primarily through targeted examinations and ongoing monitoring activities. Throughout each annual examination cycle, DER communicates examination results and conclusions to Enterprise management, including adverse examination findings and safety and soundness concerns, through supervisory correspondence. DER conducts quality control (QC) reviews prior to transmitting supervisory correspondence in order to provide reasonable assurance that examination work performed by examiners meets applicable DER examination standards and FHFA guidance for document preparation and management.

FHFA began formalizing its QC program in March 2013 through the issuance of Supervision Directive (SD) 2013-01, an internal guidance titled, *Quality Control Program for Examinations Conducted by the Division of Bank Regulation and Division of Enterprise Regulation*. This directive required DER and the Division of Federal Home Loan Bank Regulation (DBR) to establish a QC program to “assess examination findings, conclusions, ratings, supporting workpapers, and related documents.” DER issued an operating procedures bulletin (OPB) in June 2016 as a means to implement SD 2013-01 and establish standards for QC reviews. DER has updated the procedures bulletin several times since 2016 and issued the current OPB on QC in February 2020. The current version states, in pertinent part, that the QC Branch tracks the status of QC reviews, stores completed QC review results reports in QC review files, and “**At least annually, [the QC Branch] provides DER management a report of QC observations**, including gaps or weaknesses in supervisory correspondence and supporting documentation involving [Matter Requiring Attention (MRA)] issuance, review of MRA remediation plans, and MRA closure.” (Emphasis added.)

Our evaluation found that DER’s QC Branch has not produced an annual report of QC observations for DER management in accordance with the governing OPB during our period of review. In the absence of such a report, DER management does not have the benefit of the insights gained from the aggregated QC results in order to improve examiner compliance with the standards. QC results from the review period covered by this evaluation (October 1, 2019, through July 31, 2021) reflect that DER examiners continue to deviate from the examination standards. A December 2021 internal DER presentation based on QC results for the first half of 2021 identified multiple opportunities for improvement, including examination scope, the specificity of the criteria examiners apply, and the adequacy of examination procedures.



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A new Deputy Director of DER was appointed in September 2021. He informed us that, in addition to ensuring that the QC Branch completes an annual report of QC observations, he plans for DER to conduct annual or semi-annual training that highlights the severity and frequency of QC findings to be presented to all DER staff.

The Deputy Director acknowledged the need for a feedback mechanism to communicate QC results within DER and plans to provide multiple channels to do so. Under prior DER leadership, the QC manager also supervised the examination policy development function within DER's Office of Enterprise Supervision Oversight (OESO). The Deputy Director restructured DER to separate the QC function from policy development in order to ensure the QC Branch's independence. However, we found that a formal mechanism was not established to provide feedback from QC reviews to the other responsible DER offices to consider when enhancing and refining examination guidance and standards. According to the QC manager, the QC Branch plans to propose recommendations for improvements to examination guidance and standards to appropriate DER management, who will determine the appropriate course of action.

We make two recommendations in this report to address our findings. In a written management response, FHFA agreed with our recommendations.

This report was prepared by Adrienne Freeman, Investigative Counsel, and Philip Noyovitz, Investigative Evaluator. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaog.gov, and www.oversight.gov.

/s/

Kyle D. Roberts
Deputy Inspector General for Evaluations

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ABBREVIATIONS

DBR	Division of Federal Home Loan Bank Regulation
DER	Division of Enterprise Regulation
Enterprises	Fannie Mae and Freddie Mac
FHFA	Federal Housing Finance Agency
MRA	Matter Requiring Attention
OESO	Office of Enterprise Supervision Oversight
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
QC	Quality Control
SD	Supervision Directive

BACKGROUND.....

DER is responsible for supervising the Enterprises and does so primarily through targeted examinations and ongoing monitoring activities. According to FHFA, targeted examinations typically focus on a discrete business or functional area, program, product, model, process, or internal controls; the purpose of ongoing monitoring is to identify significant matters that may affect an Enterprise’s risk profile or financial condition.

Throughout each annual examination cycle, DER communicates examination results and conclusions, including adverse examination findings and safety and soundness concerns, to the Enterprises through supervisory correspondence.¹ For example, DER operating procedures require issuing a conclusion letter to Enterprise management at the close of each targeted examination, regardless of whether findings are made, and when an ongoing monitoring activity results in adverse examination findings. DER conducts quality control reviews prior to issuing these letters in order to provide reasonable assurance that examination work performed by examiners meets applicable DER examination standards and FHFA guidance for document preparation and management.

DER’s Quality Control Program

FHFA’s effort to formalize a quality control program began in March 2013 with the issuance of SD 2013-01 titled, *Quality Control Program for Examinations Conducted by the Division of Bank Regulation and Division of Enterprise Regulation*. SD 2013-01 required DER and DBR to establish a QC program to “assess examination findings, conclusions, ratings, supporting workpapers, and related documents.” DER subsequently issued an OPB in June 2016 that set forth its standards for QC reviews,² and FHFA replaced SD 2013-01 with SD 2017-01. DER has also made several revisions to that OPB since its issuance, developed QC review templates and job aids, provided training to examiners, and expanded the number of full-time QC employees to four.

DER revised the OPB that implements the QC program three times since June 2016. The current OPB, which DER issued in February 2020 (the QC OPB), describes the purpose and scope of the program and states, in pertinent part, that: “The QC review process is designed to: (i) support consistency in documentation practices across DER branches; (ii) confirm that

¹ FHFA is required by statute to conduct annual onsite examinations of each Enterprise and to include the “results and conclusions” of those examinations in its annual report to Congress. See 12 U.S.C. §§ 4517(a) and 4521(a)(2).

² For a discussion of DER’s difficulties and delays in establishing its QC program, see OIG, [Intermittent Efforts Over Almost Four Years to Develop a Quality Control Review Process Deprived FHFA of Assurance of the Adequacy and Quality of Enterprise Examinations](#) (Sept. 30, 2015) (EVL-2015-007).

applicable DER examination standards and FHFA guidance are followed in preparation and management of examination documentation; and (iii) ensure review by relevant stakeholders is documented.” The QC Branch is responsible for collecting the results of QC reviews, analyzing relevant data to identify gaps and weaknesses, and providing a report of QC observations to “DER management” at least annually. According to the QC OPB:

[The QC Branch] tracks the status of QC reviews, stores completed QC review results reports in QC review files, and as directed, provides periodic summary reports of QC review activity. **At least annually, [the QC Branch] provides DER management a report of QC observations**, including gaps or weaknesses in supervisory correspondence and supporting documentation involving MRA issuance, review of MRA remediation plans, and MRA closure. (Emphasis added.)

New DER Leadership Is Making Changes to the Quality Control Branch

In September 2021, the FHFA Acting Director appointed a new Deputy Director of DER. According to the new Deputy Director, he has established four main goals for the QC Branch: (1) a realigned organizational structure whereby the QC Branch reports directly to the Deputy Director of DER and the examination policy development function is separate from the QC function; (2) an expansion of the scope of QC activities to include QC reviews of other DER offices; (3) refined definitions for key terms commonly used by the QC Branch; and (4) periodic reports, at least annually to the Deputy Director of DER, that contain a full discussion of trends identified from QC reviews. The Deputy Director also curtailed certain examination activities; such as, examiners will no longer be required to provide supervisory responses to remediation plans submitted by the Enterprises that satisfactorily address adverse examination findings and therefore, the QC Branch will no longer review these supervisory correspondences.

DER’s Process for Conducting Quality Control Reviews

The QC review of supervisory correspondence and other work products takes place after an examiner initiates DER’s electronic document review and approval process, known as the “eWorkflow.” The eWorkflow consists of a sequential review of the subject work product by DER officials (including the QC Branch) that culminates in the approval of the supervisory correspondence and issuance to the applicable Enterprise. The eWorkflow creates a record of the review and approval of the work product, including the results of the QC review, and the examiners’ resolution of any QC findings. The detailed results of the QC review are documented in the eWorkflow in the form of QC review reports. Examiners receive the QC results from the QC reviewer and are responsible for correcting deviations from examination

standards identified in the QC report. QC findings should be resolved before the supervisory correspondence under review can be approved and transmitted.

The February 2020 QC OPB states that QC comments “should focus on significant deviations from DER standards and other applicable guidance.” According to DER, QC adopted a “fatal flaw” standard as of August 2021, whereby QC identifies the most significant errors, including problems that impede QC’s ability to perform the QC review (such as broken hyperlinks to supporting documentation) and lists the error in the QC report for the examination team to correct.³ Once the examiners correct the identified error(s), QC notes that QC comments are cleared and its review is complete in DER’s eWorkflow.⁴

Previous OIG Findings and Recommendations Regarding DER’s Quality Control Program

Since September 2015, OIG has issued six reports that focus on DER’s QC program and has made a number of recommendations.⁵ Of particular relevance to this evaluation is the March 2016 report in which we found that DER examiners did not adhere to FHFA requirements and guidance in their supervisory oversight of an Enterprise’s remediation of an MRA.⁶ We recommended that FHFA evaluate the results of QC reviews conducted by DER and DBR, and identify and address gaps and weaknesses pertaining to supervisory oversight of MRA remediation. DER committed to prepare periodic reports on completed QC reviews and results, and we closed our recommendation in April 2017. Approximately two years later, a 2019 OIG compliance review found that DER did not produce reports highlighting gaps and weaknesses identified through the results of its QC reviews and re-opened the

³ It is the EIC’s and examiners’ responsibility to correct any errors not considered a “fatal flaw,” but the correction of those errors would not need QC review before the document is transmitted to the Enterprises.

⁴ QC personnel informed us that the QC reviewer coordinates with the examination team to discuss and resolve QC findings as needed.

⁵ OIG, [Compliance Review of FHFA’s Quality Control Reviews of Enterprise Supervision Activities](#) (Feb. 12, 2021) (COM-2021-003); [Compliance Review of FHFA’s Commitments to Conduct Quality Control Review of Examination Conclusions Prior to Including Them in Reports of Examination](#) (Sept. 15, 2020) (COM-2020-007); [Compliance Review of FHFA’s Commitment to Evaluate its Internal Quality Control Reviews Pertaining to Matters Requiring Attention](#) (Sept. 9, 2019) (COM-2019-007); [The Gap in FHFA’s Quality Control Review Program Increases the Risk of Inaccurate Conclusions in its Reports of Examination of Fannie Mae and Freddie Mac](#) (Aug. 17, 2017) (EVL-2017-006); [FHFA’s Examiners Did Not Meet Requirements and Guidance for Oversight of an Enterprise’s Remediation of Serious Deficiencies](#) (Mar. 29, 2016) (EVL-2016-004); and [Intermittent Efforts Over Almost Four Years to Develop a Quality Control Review Process Deprived FHFA of Assurance of the Adequacy and Quality of Enterprise Examinations](#) (Sept. 30, 2015) (EVL-2015-007).

⁶ See OIG, [FHFA’s Examiners Did Not Meet Requirements and Guidance for Oversight of an Enterprise’s Remediation of Serious Deficiencies](#) (Mar. 29, 2016) (EVL-2016-004).

recommendation.⁷ DER amended its internal guidance in February 2020 and committed to update DER management on QC observations, including gaps and weaknesses in supervisory correspondence and supporting MRA documentation and remediation plans.⁸

FACTS AND ANALYSIS

According to DER Personnel, DER Revised Its Internal Guidance in Order to Clarify Examination Requirements and Establish Minimum Standards

In February 2020, DER issued an OPB for *Examination Processes and Documentation: Targeted Examinations* (February 2020 Targeted Examinations OPB) and replaced the previous version.⁹ According to DER’s QC manager, the new OPB provided additional guidance to examiners for planning, executing, and preparing findings and conclusions of targeted examinations. The QC manager explained that examiners needed more guidance on targeted examinations because the previous guidance was open-ended and vague. According to the QC manager, DER updated the OPB in order to provide more enhanced and detailed guidance, to establish minimum examination standards, and to clarify how examiners should document and perform their work.

The QC manager informed us that DER further enhanced the February 2020 Targeted Examinations OPB in order to address QC findings, such as the finding that examiners were not identifying the specific criteria they were using to assess the Enterprises. DER issued *Division of Enterprise Regulation Operating Procedures Bulletin Targeted Examinations* on December 31, 2020 (December 2020 Targeted Examinations OPB), which rescinded and replaced the February 2020 Targeted Examinations OPB.

DER’s QC manager asserted that the issuance of the February 2020 and the December 2020 Targeted Examinations OPBs provided the examination staff with a better understanding of how their work should be completed. According to the QC manager, there has been significant improvement in examiner work products, and the process will continue to

⁷ See OIG, [Compliance Review of FHFA’s Commitment to Evaluate Its Internal Quality Control Reviews Pertaining to Matters Requiring Attention](#) (Sept. 9, 2019) (COM-2019-007).

⁸ This recommendation was closed after DER revised its QC OPB in February 2020. In 2021, OIG performed a compliance review to assess whether DER documented the results of its QC reviews using the checklists it had designed for that purpose, and confirmed that QC was using the checklists. The review also noted, however, that QC reviews identified shortcomings in 52 of the 59 (88%) examination work products in the sample. See OIG, [Compliance Review of FHFA’s Quality Control Reviews of Enterprise Supervision Activities](#) (Feb. 12, 2021) (COM-2021-003).

⁹ The previous version, DER-OPB-02.2-TE *Examination Processes and Documentation: Targeted Examinations*, had been in place since September 27, 2018.

improve; however, the QC Branch did not provide empirical data to support this claim.¹⁰ Our analysis of DER's QC results during the review period found that DER examiners continue to deviate from DER's examination standards. Similarly, a December 2021 DER internal presentation prepared by the QC Branch reflects that, based on QC results for the first half of 2021, there are opportunities for improvement, including: defining examination scope; the specificity of the criteria examiners apply; and the adequacy of examination procedures. The presentation also reported that the QC Branch expects to make recommendations in the future for continuous improvement based on final QC results and analysis.

The Quality Control Branch Is Required to Produce an Annual Report of Quality Control Observations for DER Management

The February 2020 QC OPB calls for an annual report of QC "observations" to be provided to DER management. It states, in pertinent part, that "[a]t least annually, [the QC Branch] provides DER management a report of QC observations, including gaps or weaknesses in supervisory correspondence and supporting documentation involving MRA issuance, review of MRA remediation plans, and MRA closure." QC has not provided an annual report for 2019 and 2020 in accordance with the OPB.

Quality Control Reporting Is Under Development

According to the QC manager, the QC Branch is currently in the process of developing the reporting template that will be used to produce the annual QC report to the Deputy Director and the measures to be used to present the data. We acknowledge that the QC Branch currently prepares internal reports that are limited in scope; for example, stand-alone reports that summarize the results of QC reviews from a segment of targeted examinations or ongoing monitoring activities. The QC Branch does not distribute those reports to DER management.

The Deputy Director informed us that, in addition to an annual report of QC observations, DER plans to conduct annual or semi-annual training for all DER staff that highlights the severity and frequency of QC findings and identifies categories into which they fall. Eventually, a breakdown by examination team and branch will also be included. He commented that remedial training to DER examiners may be provided depending on QC findings.

¹⁰ It is our understanding that the QC manager based this characterization on the qualitative results of the QC reviews and not on statistical measures derived from a specific dataset.

The Quality Control Branch Expects to Provide the Deputy Director of DER with Recommendations Based on Quality Control Results

The Deputy Director acknowledged the need for a feedback mechanism to communicate QC results and explained that there will be multiple channels for the QC Branch to communicate feedback derived from its QC reviews to other functions within DER. According to the Deputy Director, QC results related to the examination process and procedures will be shared with the Supervision Program and Development Branch within OESO. This branch is responsible for issuing and updating the OPBs that establish examination requirements and standards. The results of QC reviews related to DER’s Enterprise Examination Manual, excluding the section on examination practices, and advisory bulletins (supervisory guidance that communicates FHFA’s supervisory policy) will be shared with the Office of Risk Policy.

Under prior DER leadership, the QC Branch, examination policy development, and examiner training were all within OESO. The QC Branch and examination policy development were led by the same individual (who is now the QC manager). This structure made the need for a formal feedback mechanism unnecessary because the same person who was in charge of the QC Branch also had responsibility for updating the operating procedures bulletins that establish examination standards. The Deputy Director moved the QC Branch out of OESO in order to ensure QC’s independence. However, this change in organizational structure, roles, and responsibilities did not include establishment of a formal mechanism to provide feedback from QC reviews to OESO to consider when enhancing and refining examination guidance and standards and developing training for examiners. The sharing of feedback on QC results is critical to ensure gaps and weaknesses identified during QC reviews are addressed through enhanced examination guidance and training.¹¹ According to the QC manager, the QC Branch expects to propose recommendations for continuous improvement to DER management who will determine the appropriate course of action.

FINDINGS

The Quality Control Branch did not produce an annual report of quality control observations and distribute the report to DER management as required by the governing operating procedures bulletin.

The 2020 QC OPB requires an annual report to DER management of QC observations that includes gaps or weaknesses in supervisory correspondence and supporting documentation

¹¹ For example, our review of the fatal flaw QC reviews for 2020 and 2021 found three examples of QC reviews in which the dialogue between the QC reviewer and the examiner suggests a need for revisions to the operating procedures bulletins.

involving MRA issuance, review of MRA remediation plans, and MRA closure. We found that the QC Branch did not provide DER management with an annual report during the review period. In the absence of such a report, DER management does not have the benefit of the insights gained from the aggregated QC results in order to improve examiner compliance with examination standards.

DER lacks a formal process for communicating quality control feedback to DER management for appropriate action but the Quality Control Branch plans to propose recommendations based on the annual quality control results.

The Deputy Director advised us that he plans to have the results of QC reviews directed to OESO and the Office of Risk Policy; however, at present, there is no formal mechanism in place to communicate gaps and weaknesses identified by the QC Branch to the DER offices responsible for establishing examination standards and training examiners. Under the previous organizational structure, both the QC and examination policy development functions were within OESO, but under the current realignment they are not. The QC Branch expects to propose recommendations for continuous improvement to DER management who will determine the appropriate course of action.

CONCLUSIONS

DER continues to make progress in implementing its QC program, but more remains to be done. Our analysis of DER’s QC results found that examiners continue to deviate from examination standards, and the December 2021 QC presentation also identified areas in need of improvement based on QC review results for the first half of 2021. DER and the QC Branch are in a period of transition as they adjust to the organizational changes in roles and responsibilities instituted by the Deputy Director and develop QC reporting practices. Currently, there is no formal feedback mechanism for communicating aggregate QC results and recommendations to the DER offices responsible for establishing examination standards and training examiners in those standards. The Deputy Director acknowledged the value of a feedback mechanism and plans to have multiple channels for communicating QC results to other functions within DER. DER’s QC program did not provide DER management with an annual report of QC observations as required by DER examination procedures, however, QC personnel are developing a template and prototype report for that purpose. An annual review of observations should provide management with a level of assurance that gaps and weaknesses in the examination program have been identified. This is an opportunity for DER management to develop the QC-related measures that will inform them of whether examiners are conducting their work in a consistent manner and adhering to DER’s examination

standards, and position management to address significant deviations from those standards through revised standards and/or more effective examiner training.

RECOMMENDATIONS.....

We recommend that FHFA:

1. Complete efforts to compile data from all quality control reviews, analyze the data for trends, develop the reporting template, and report the results to DER management at least annually.
2. Establish a formal feedback mechanism to ensure that the DER offices responsible for developing examination standards and training examiners are informed of quality control review results.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this evaluation. FHFA provided technical comments on the draft report, which were considered in finalizing this report. FHFA also provided a management response, which is reprinted in its entirety in the Appendix. FHFA agreed with both of our recommendations. In FHFA’s management response, it committed to develop an annual QC report template, complete the annual report, and provide report results to DER management by May 31, 2022. FHFA also committed to establish interim guidance describing the process for informing the appropriate DER office of QC review results and incorporating the interim guidance into its updated supervision guidance by October 31, 2022.

OBJECTIVE, SCOPE, AND METHODOLOGY

We conducted this evaluation to assess DER’s QC review function to determine what standards the QC Branch uses to evaluate documentation for DER examinations, how aggregated data from the QC reviews is utilized, and if the QC review process resulted in greater consistency across examination offices and improved examiner usage of the appropriate standards. The review period for this evaluation was October 1, 2019, through July 31, 2021 (review period).

To meet this objective, we reviewed applicable FHFA and DER guidance and standards in effect during our review period and prior OIG reports and corresponding workpapers germane to DER’s QC program. We requested and reviewed DER’s QC Review Reports and other spreadsheets completed for the 2020 examination cycle and 2021 examination cycle through July 31, 2021. These reports and spreadsheets were used by the QC review staff to track and report the fatal flaws they found when reviewing DER’s examination workpapers and draft correspondence. We also reviewed periodic QC summary reports that the QC review staff prepared, which aggregated fatal flaws found in the QC reviews.

As part of this evaluation, we conducted interviews of DER’s Deputy Director, the manager of DER’s QC Branch and members of the QC staff who performed the QC reviews, prepared the summary reports, and are involved in the QC program’s development.

This evaluation was conducted between September 2021 and February 2022 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 Evaluation* (December 2020).

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

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

FROM: Andre D. Galeano, Deputy Director, Division of Enterprise Regulation **ANDRE GALEANO** Digitally signed by ANDRE GALEANO
Date: 2022.03.02 17:30:36 -0500

SUBJECT: Draft Evaluation Report: *FHFA's Division of Enterprise Regulation Has Made Progress in Its Quality Control Program but Needs to Ensure Adequate Reporting and Feedback Is Provided to Management*

DATE: March 2, 2022

Thank you for the opportunity to review the Office of Inspector General's (OIG) draft report referenced above (Report). The objective of the OIG's evaluation was to assess DER's Quality Control (QC) review function to determine what standards the QC Branch uses to evaluate documentation for DER examinations, how aggregated data from the QC reviews is utilized, and if the QC review process resulted in greater consistency across examination offices and improved examiner usage of the appropriate standards. The review period for this evaluation was October 1, 2019, through July 31, 2021. While the Report found that DER continues to make progress in implementing its QC program, it noted some areas for improvement, and makes two recommendations, to which we agree.

Recommendation 1: *Complete efforts to compile data from all quality control reviews, analyze the data for trends, develop the reporting template, and report the results to DER management at least annually.*

Management Response: FHFA agrees with the OIG's recommendation. DER's Quality Control Branch is currently in the process of developing the reporting template that will be used to produce the annual QC report, or more frequently if warranted subject to the Deputy Director's discretion. By May 31, 2022, DER will complete this report for the 2021 examination cycle and report the results to DER management.

Recommendation 2: *Establish a formal feedback mechanism to ensure that the DER offices responsible for developing examination standards and training examiners are informed of quality control review results.*

Management Response: FHFA agrees with the OIG’s recommendation. DER will establish interim supervision guidance that describes its process for informing the DER office responsible for developing examination standards and examiner training of quality control review results. This interim supervision guidance will be incorporated into updated supervision guidance on DER’s QC process by October 31, 2022.

We appreciate the professionalism and courtesy of the OIG staff who conducted this evaluation. We find the results valuable, and we will continue to make enhancements to the QC program. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Diana Stebick
Eric Wilson
Edom Aweke
John Major

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