OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency
400 7th Street SW, Washington, DC 20219

October 14, 2020

TO: Mark A. Calabria, Director

FROM: Laura S. Wertheimer, Inspector General

SUBJECT: Fiscal Year 2021 Management and Performance Challenges

We are pleased to provide you with this memorandum, issued pursuant to the Reports Consolidation Act of 2000 (P.L. 106-531).

On September 5, 2019, the Department of the Treasury (Treasury) released its Housing Reform Plan (Treasury Plan). The Treasury Plan outlined possible legislative and administrative actions intended to reform the housing finance system, including specific preconditions for ending the conservatorships of Fannie Mae and Freddie Mac (the Enterprises).[1] The Federal Housing Finance Agency (FHFA) has stated that the Treasury Plan is "broadly consistent" with its current top three priorities to: (1) cement FHFA as a world-class regulator that ensures the Enterprises operate in a safe and sound condition; (2) end the conservatorships; and (3) foster competitive, liquid, efficient, and resilient national housing finance markets. FHFA has acknowledged much work must be done before it can end the conservatorships. FHFA also has recognized that the COVID-19 crisis "has provided ample evidence of the critical vulnerabilities in our mortgage system that put taxpayers and our housing market at risk."[2]

In our view, it is critical for FHFA to address the four serious management and performance challenges and one management concern summarized below and identified previously by the FHFA Office of Inspector General (FHFA-OIG) in order to further its mission in these uncertain, challenging times.

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[1] The Treasury Plan was developed in response to a March 27, 2019 Presidential Memorandum directing the Secretary of the Treasury to develop a plan for administrative and legislative reforms to achieve several housing reform goals.

[2] FHFA, *Statement of Dr. Mark A. Calabria Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs* (June 9, 2020).

Overview

FHFA was created in July 2008 by the Housing and Economic Recovery Act of 2008 (HERA) (P.L. 110-289) to serve as regulator of the Enterprises and the Federal Home Loan Banks (FHLBanks). As their regulator, FHFA is charged with overseeing the safety and soundness and statutory missions of these entities. In September 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorships "in response to a substantial deterioration in the housing markets that severely damaged each Enterprise's financial condition and left both of them unable to fulfill their missions without government intervention."[3] For more than a decade, FHFA has served as the Enterprises' conservator and supervisor. More than 12 years in, it is apparent that it was far easier to establish the conservatorships than it will be to end them.

As their conservator, FHFA is ultimately responsible for all the Enterprises' business, policy, and risk decisions. To fulfill its responsibility, the Agency must ensure that both Enterprises are governed effectively and employ sound risk management practices. The stakes are high: with assets of more than $6 trillion as of June 30, 2020, the Enterprises' business and policy decisions both influence and affect the entire mortgage finance industry. This influence and effect are further underscored by a September 2020 statement by the Financial Stability Oversight Council (FSOC),[4] of which FHFA is a member, from an "activities-based" review of secondary mortgage market activities:

> The 2008 financial crisis demonstrated that financial stress at the Enterprises could limit their ability to provide reliable liquidity to the secondary market or perform their guarantee and other obligations on their [mortgage-backed securities (MBS)] and other liabilities, with significant implications for the national housing finance markets, financial stability, and the broader economy. The Enterprises continue to play a central role in the national housing finance markets—acquiring nearly 50% of newly originated mortgages in both single-family and multifamily markets—and are two of the largest U.S. financial institutions. The Enterprises' provision of secondary market liquidity generates significant interconnectedness among the Enterprises, banks, non-bank financial institutions, and other counterparties. Moreover, given their similar business models, risks at the Enterprises are highly correlated; if one Enterprise experiences financial distress, the other may as well. If the Enterprises were unable to provide liquidity to the secondary market, other market participants may be unable in the near- or medium-term to provide liquidity at the scale and pricing needed to ensure smooth market functioning and financial intermediation. As a result, any distress at the Enterprises that affected their secondary mortgage market activities, including their

[3] FHFA, *History of Fannie Mae and Freddie Mac Conservatorships*.

[4] FSOC was established under the Dodd-Frank Wall Street Reform and Consumer Protection Act to provide comprehensive monitoring of the stability of our nation's financial system. FSOC is charged with identifying risks to the financial stability of the United States; promoting market discipline; and responding to emerging risks to the stability of the United States' financial system. FSOC consists of 10 voting members and 5 nonvoting members.

ability to perform their guarantee and other obligations on their MBS and other liabilities, could pose a risk to financial stability, if risks are not properly mitigated.[5]

FHFA is also the supervisor for the Enterprises and for the FHLBanks, the latter of which collectively reported approximately $1 trillion in assets as of June 30, 2020. Under HERA, FHFA is responsible for conducting examinations of the Enterprises and the FHLBanks to ensure they operate safely and soundly and thereby serve as a reliable source of liquidity and funding for housing finance and community investment.

FHFA's new Strategic Plan and 2020 Scorecard "emphasize the need for the Enterprises and FHFA to prepare for a responsible exit from the conservatorships, following a roadmap with clear and appropriate milestones."[6] FHFA recognizes that it must implement a strong and well-executed supervision (examination) program prior to ending the conservatorships. To that end, it must perform "consistently rigorous, timely, and effective" examination work, and allocate "additional resources [] efficiently . . . to meet the needs of critical areas such as risk modeling and information technology." FHFA also recognizes that fixing the corporate cultures at Fannie Mae and Freddie Mac is "a fundamental prerequisite" to the Enterprises exiting conservatorship and acknowledged that the Agency has "a lot of work to do on that front."[7]

Based on our body of work, we have identified four serious management and performance challenges and a management concern, all of which carry over from prior years, that FHFA must address in order to advance its three mission priorities. We provide this report on these challenges and the management concern to assist the Agency in its effort to accomplish its mission. In our view, these management and performance challenges and management concern, if left unaddressed, could adversely affect FHFA's accomplishment of its mission.

The body of work upon which this report is premised is comprised of 176 reports issued by FHFA-OIG since October 2014. In them, we assessed FHFA's progress in addressing elements of each of these challenges. Where we have identified shortcomings and/or weaknesses, we proposed a total of 215 recommendations to address them. FHFA fully agreed to 182 of the 215, or 84.7%. For those recommendations FHFA has accepted, it has either implemented corrective actions or is in the process of doing so.

FHFA-OIG tracks FHFA's implementation of the recommendations to which it has agreed. FHFA-OIG regularly issues a Compendium of Open Recommendations that identifies both

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[5] FSOC, Financial Stability Oversight Council Statement on Activities-Based Review of Secondary Mortgage Market Activities (Sept. 25, 2020).

[6] FHFA, *The 2019 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* at 3 (Oct. 2019); *see also* FHFA, *2020 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions* at 6 (Oct. 2019).

[7] *See* U.S. House Committee on Financial Services, *Prioritizing Fannie's and Freddie's Capital over America's Homeowners and Renters? A Review of the Federal Housing Finance Agency's Response to the COVID-19 Pandemic* (Sept. 16, 2020) (FHFA Director's response to a question from Congressman Barry Loudermilk) (https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=406867, at approximately 3:03 hours).

unimplemented open and rejected recommendations, organized by the risks presented by the serious management and performance challenges identified in this Memorandum. Our Semi Semiannual Reports to the Congress (SARs), for the periods ending March 31 and September 30, 2020, also set forth our unimplemented open recommendations, and those recommendations that FHFA has rejected.

Below are the four significant challenges and the management concern identified by FHFA-OIG, along with our assessments of FHFA's progress in addressing each.

Challenge: Improve Oversight of Matters Delegated to the Enterprises and Strengthen Internal Review Processes for Non-Delegated Matters

The Enterprises are large, complex financial institutions that dominate the secondary mortgage market and the mortgage securitization sector of the U.S. housing finance industry. Given the taxpayers' enormous investment in the Enterprises, the unspecified timeline to end the conservatorships, the Enterprises' critical role in the secondary mortgage market, and their uncertain ability to sustain future profitability, FHFA's administration of the conservatorships remains a major risk.

As the Enterprises' conservator, FHFA is vested by HERA with express authority to operate the Enterprises and conduct their business activities. Although FHFA has retained authority to make certain significant decisions for the Enterprises, it has delegated back to them authority for many matters, both large and small. As conservator, FHFA can revoke delegated authority at any time, retains authority for certain significant decisions, and is ultimately responsible for actions taken by the Enterprises pursuant to their delegated authority.

As demonstrated by our body of work, FHFA has limited its oversight of delegated matters largely to attending (as an observer) Enterprise internal management and board meetings, and to engaging in discussions with Enterprise managers and directors. Read together, the findings in these reports demonstrate that, for the most part, FHFA, as conservator, has not assessed the reasonableness of actions taken by the Enterprises pursuant to delegated authority. For example, our work has found that FHFA has not assessed the reasonableness of the Enterprises' implementation of FHFA's conservatorship directives. Nor has FHFA assessed the adequacy of the oversight exercised by the Enterprises' boards of directors over the actions of management.

FHFA has not clearly defined its expectations of the Enterprises for delegated matters, nor has it established the accountability standard that it expects the Enterprises to meet for such matters. Our body of work has established the ineffectiveness of the Enterprises' internal control systems: directors were not provided with accurate and timely information sufficient to enable them to perform their oversight duties. Likewise, we established that some Enterprise directors did not diligently seek information from management about the matters for which they were responsible. We also identified instances in which corporate governance decisions generally reserved to a board of directors were delegated improperly to management.

As we reported in our Fiscal Year (FY) 2020 work, our independent testing revealed continued challenges to Enterprise compliance with FHFA directives and Enterprise Board committees' execution of their responsibilities.

Our findings over the last six years about the weaknesses in Enterprises' execution of their delegated responsibilities were echoed by Director Calabria in his recent congressional testimony:

> Fannie and Freddie have what I would consider some of the worst corporate cultures I've ever seen in corporate America. Fixing that is a prerequisite to getting out of conservatorship.[8]

For the Enterprises to be governed effectively, their boards of directors and committees thereof must fulfill their delegated responsibilities.

Over the past six years, FHFA-OIG has found that FHFA has retained authority (or has revoked previously delegated authority) to resolve issues of significant monetary and/or reputational value. It is important that FHFA fulfill its conservatorship obligations with appropriately robust review and approval processes for non-delegated matters, which will enable FHFA to track, analyze, and resolve such matters, and provide decision-makers with all relevant information in a prompt and timely manner.

In summary, FHFA, as the Enterprises' conservator, is ultimately responsible for actions taken by the Enterprises, pursuant to authority it has delegated to them. FHFA's challenge, therefore, is to improve the quality of its oversight of matters it has delegated to the Enterprises for the duration of the conservatorships and ensure that its established processes are followed for non-delegated matters to promote reasoned decision-making.

Select FHFA-OIG Report Issued During FY 2020 on Delegated Matters:

- *Freddie Mac Management Failed to Adopt and Implement Conflicts of Interest Policies Which Aligned Fully with FHFA's Directive on Senior Executive Officers' Conflicts of Interest, and With the Charter for the Freddie Mac Board's Nominating and Governance Committee* (COM-2020-006, August 26, 2020).
- *Compliance Review of Fannie Mae's Conflicts of Interest Policies and Procedures Regarding its Senior Executive Officers* (COM-2020-005, August 26, 2020).

Select FHFA-OIG Reports Issued During FY 2020 on Non-Delegated Matters:

- *Compliance Review of FHFA's Process for Reviewing the Enterprises' Proposed FY 2019 and FY 2020 Annual Operating Budgets* (COM-2020-003, March 13, 2020).

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[8] See U.S. House Committee on Financial Services, *Prioritizing Fannie's and Freddie's Capital over America's Homeowners and Renters? A Review of the Federal Housing Finance Agency's Response to the COVID-19 Pandemic* (Sept. 16, 2020) (FHFA Director's response to a question from Congressman Barry Loudermilk) (https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=406867, at approximately 3:03 hours).

Challenge: Upgrade Supervision of the Enterprises and Continue Supervision Efforts of the FHLBanks

As supervisor of the Enterprises and the FHLBanks, FHFA is tasked by HERA to ensure that these entities operate safely and soundly so they serve as a reliable source of liquidity and funding for housing finance and community investment. Examinations of its regulated entities are fundamental to FHFA's supervisory mission. Within FHFA, the Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises and the Division of Federal Home Loan Bank Regulation (DBR) is responsible for supervision of the FHLBanks.

In its most recent annual Performance and Accountability Reports, FHFA cited its supervisory authority as its basis for ensuring the safe and sound operation of the Enterprises:

> FHFA promotes safe and sound operations of the regulated entities through the Agency's **supervisory program**. FHFA conducts supervision using a risk-based approach that prioritizes examination activities based on the risk that a given practice poses to a regulated entity's safe and sound operation or its compliance with applicable laws and regulations. (Emphasis added.)[9]

FHFA has advised that effective safety and soundness supervision "is essential to preparing the Agency and the Enterprises to responsibly exit and operate safely outside of conservatorship."[10]

Prior to the start of the COVID-19 pandemic, FHFA announced that the Enterprises may emerge from conservatorship as early as 2021, and that FHFA has a roadmap by which to end those conservatorships. In January 2020, FHFA announced a realignment of its structure, which, in part, was designed to enhance its capacity to supervise the Enterprises. In March 2020, we reviewed the more than 40 reports we issued since October 2014 on FHFA's supervision program for the Enterprises. Thirty-four of these reports, read together, detailed chronic and pervasive deficiencies in the program itself, as well as in its execution. We identified deficiencies in these areas: (1) examination guidance and execution; (2) the size of the examiner workforce, and the training and qualifications of its members; (3) the communication of supervisory findings; and (4) quality control.

Consequently, we cautioned that the challenge now facing FHFA is formidable. To remediate the deficiencies identified by us (and by FHFA) before the Enterprises are released from conservatorship, FHFA must accomplish a great deal in a relatively short period. Success will require a sustained, disciplined, and robust effort on the part of FHFA, led by an accountable

[9] FHFA, *FY 2019 Performance and Accountability Report* at 13 (Nov. 19, 2019); *see also* FHFA, *FY 2018 Performance and Accountability Report* at 10 (Nov. 15, 2018); FHFA, *FY 2017 Performance and Accountability Report* at 9 (Nov. 15, 2017), FHFA, *FY 2016 Performance and Accountability Report* at 10 (Nov. 15, 2016), and FHFA, *FY 2015 Performance and Accountability Report* at 55 (Nov. 16, 2015).
[10] FHFA, *Statement of Dr. Mark A. Calabria Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs* (June 9, 2020).

senior executive. It will demand disciplined project management, including the establishment of clear roles and responsibilities, work product deliverables, milestones, and specific timelines.

FHFA has taken preliminary steps toward the goal of upgrading and strengthening its supervision program. The Agency informed OIG on June 30, 2020, that it has engaged a contractor to prepare an "organizational optimization Blueprint" to ensure that FHFA "has the optimal workforce, infrastructure, and organization to carry out its supervisory mission in a post-conservatorship environment." More recently, on September 22, 2020, FHFA announced a new strategic plan for the Agency (the plan covers FYs 2021-24). Among other things, the new strategic plan establishes an objective for the Agency to "develop and maintain a world-class supervision program."[11] The means and strategies to achieve this objective include, for example, "[a]dvance supervision practices, processes, systems, and tools to improve the efficiency and efficacy of the supervision programs…"

Six months have passed since our March 30, 2020, report in which we summarized the chronic and pervasive shortcomings in FHFA's supervision program, and we are unaware of any key substantive decisions about the future of FHFA's supervision program made by Agency's leadership; establishment of critical milestones or project deadlines; or the execution of any plans in furtherance of the Agency' stated intention to implement a strong and well-executed supervision (examination) program prior to ending the conservatorships.

The magnitude of the risk posed by the Enterprises is significantly greater than the magnitude of the risk posed by the FHLBanks together because the asset size of the latter is a fraction of the asset size of the former. For that reason, most of FHFA-OIG's work on supervision issues has focused on FHFA's supervision of the Enterprises. However, we also looked at elements of FHFA's supervision program for the FHLBanks. While our reports of that work identified some shortcomings, they did not identify significant weaknesses. Like any other federal financial regulator, FHFA faces challenges in appropriately tailoring and keeping current its supervisory approach to the FHLBanks.

Select FHFA-OIG Reports Issued During FY 2020 on Supervision Matters:

- *Weaknesses in FHFA's Monitoring of the Enterprises' 97% LTV Mortgage Programs May Hinder FHFA's Ability to Timely Identify, Analyze, and Respond to Risks Related to Achieving the Programs' Objectives* (AUD-2020-014, September 29, 2020).
- *DBR's Examinations during the 2017 through 2019 Examination Cycles Generally Complied with its Guidelines, but Some Exceptions to those Guidelines Were Not Documented and/or Approved, and DBR's Quality Control Branch Failed to Identify these Shortcomings* (AUD-2020-010, September 3, 2020).

[11] FHFA, *Strategic Plan: Fiscal Years 2021-2024* (Sept. 16, 2020).

- *FHFA Examiners' Lack of Assessment and Escalation of Shortcomings Identified by an Enterprise in Its Servicer Fraud Risk Management Framework Limited the Agency's Supervisory Oversight* (EVL-2020-002, August 27, 2020).
- *FHFA Faces a Formidable Challenge: Remediating the Chronic and Pervasive Deficiencies in its Supervision Program Prior to Ending the Conservatorships of Fannie Mae and Freddie Mac* (OIG-2020-002, March 30, 2020).
- *Despite FHFA's Recognition of Significant Risks Associated with Fannie Mae's and Freddie Mac's High-Risk Models, its Examination of Those Models Over a Six Year Period Has Been Neither Rigorous nor Timely* (EVL-2020-001, March 25, 2020).
- *Despite Prior Commitments, FHFA Has Not Implemented a Systematic Workforce Planning Process to Determine Whether Enough Qualified Examiners are Available to Assess the Safety and Soundness of Fannie Mae and Freddie Mac* (AUD-2020-004, February 25, 2020).

Challenge: Enhance Oversight of Cybersecurity at the Regulated Entities and Ensure an Effective Information Security Program at FHFA

Cybersecurity is a pressing issue for the regulated entities. In December 2019, FSOC reported:

> The increasing reliance of the financial sector on information technology across a broadening array of interconnected platforms increases the risk that a cybersecurity event will have severe consequences for financial institutions. . . . Sustained senior-level commitment to mitigate cybersecurity risks and their potential systemic implications is necessary at both member agencies and private firms.[12]

FHFA's regulated entities are central components of the U.S. financial system and are interconnected with other large financial institutions. As part of their processes to guarantee or purchase mortgage loans, the Enterprises receive, store, and transmit significant information about borrowers, including financial data and personally identifiable information. Both the Enterprises and the FHLBanks have been the targets of cyber attacks.

FHFA recognizes that its regulated entities face significant operational risk from information security and cybersecurity threats. The Agency has cited this as an area of critical importance due to the Enterprises' concentration of borrower information and their market importance. Further, FHFA has acknowledged that several FHLBanks have issues with vulnerability management, cloud computing, and other information technology (IT) matters.

As cyberthreats and attacks at financial institutions increase in number and sophistication, FHFA faces challenges in designing and implementing appropriate examination activities for the cybersecurity protections for the financial institutions it supervises. These examination activities

[12] FSOC, *2019 Annual Report* at 9.

may be made increasingly difficult by FHFA's continuing need to attract and retain highly qualified technical personnel, with expertise and experience sufficient to handle rapid developments in technology.

Cybersecurity is also a pressing concern for the federal government, as reflected by President Trump's May 2017 executive order regarding strengthening the cybersecurity of federal networks and critical infrastructure. FHFA has computer networks that are part of the nation's critical financial infrastructure, and FHFA is required to design information security programs to protect them. Computer networks maintained by federal government agencies have been proven to be a tempting target for disgruntled employees, hackers, and other intruders. Over the past few years, cyber attacks against federal agencies have increased in frequency and severity. As cyber attacks continue to evolve and become more sophisticated and harder to detect, they pose an ongoing challenge for virtually every federal agency to fortify and safeguard its internal systems and operations.

Our annual audits performed pursuant to the Federal Information Security Modernization Act of 2014 (FISMA) are intended to ensure FHFA's compliance with information security program standards and assist FHFA in strengthening protections over its network operations against those who would seek to attack its network. For FY 2019, an independent public accounting firm under contract with FHFA-OIG determined that FHFA implemented an effective information security program and practices and complied with FISMA, Office of Management and Budget guidance, and sampled security controls selected from NIST Special Publication 800-53, Revision 4, *Security and Privacy Controls for Federal Information Systems and Organizations*. The firm also made multiple recommendations to assist FHFA in strengthening its information security program.

In support of the annual FISMA audit, we perform audits of select Agency information security controls. During FY 2020, these audits identified deficiencies. One audit found that FHFA lacked adequate controls over electronic media approved for destruction and did not follow its electronic media sanitization procedures. In another audit, we determined that FHFA conducted its annual disaster recovery exercise in accordance with its plan and procedures for recovering certain critical network services, but we identified gaps and outdated information in FHFA's plan, which creates the risk that an effective and timely recovery following a service disruption or real disaster may not occur. A third audit to determine whether FHFA followed its policies for cloud-based IT services found that the Agency failed to validate the implementation of the minimum security requirements for certain cloud-based tools and did not include required IT security provisions in some cloud service contracts.

FHFA, like other federal agencies, faces challenges in enhancing its information security programs, ensuring that its internal and external online collaborative environments are restricted to those with a need to know, and confirming that its third-party providers meet information security program requirements.

Select FHFA-OIG Reports Issued During FY 2020 on Cybersecurity and FHFA's Internal Controls Over Information Technology:

- *FHFA Failed to Follow its Cloud-Based Computing Requirements when it Did Not Validate the Implementation of Minimum Security Requirements for Cloud-Based Tools and Did Not Include Required IT Security Provisions in Some of its Cloud Service Contracts* (AUD-2020-013, September 17, 2020).
- *FHFA Cannot Assure that All Electronic Media Approved for Destruction in October 2018 Was Destroyed, and it Continues to Lack Adequate Controls over Electronic Media Targeted for Disposal* (AUD-2020-009, March 30, 2020).
- *FHFA's 2019 Disaster Recovery Exercise of its General Support System Was Conducted as Planned, But its Disaster Recovery Procedures Were Missing Certain Required Elements and Included Outdated Information* (AUD-2020-005, March 23, 2020).
- *Audit of the Federal Housing Finance Agency's Information Security Program, Fiscal Year 2019* (AUD-2020-001, October 25, 2019).

Challenge: Enhance Oversight of the Enterprises' Relationships with Counterparties and Third Parties

The Enterprises rely heavily on counterparties and third parties to properly originate and service the mortgages the Enterprises purchase and to provide operational support for a wide array of professional services. As the Enterprises and FHFA recognize, that reliance exposes the Enterprises to a number of risks, including risks related to information security, business continuity, and other safety and soundness issues. As FSOC has cautioned:

> Financial institutions have become increasingly reliant on third-party service providers to perform important business functions. . . . While outsourcing can have advantages, reliance on third-party service providers also has risks. . . . While cloud providers may offer superior cost or technological solutions, there have also been recent instances of unauthorized access to client data at cloud providers. The reliance of many institutions on a single vendor to provide a critical service creates concentration risk. A service interruption or cyber event at a critical vendor with a large number of clients could result in widespread disruption in access to financial data and could impair the flow of financial transactions.[13]

There also is risk that a counterparty may not meet its contractual obligations. FSOC has noted, "Nonbanks have a particularly important role as providers of mortgage credit and servicing to low-income and riskier borrowers. However, most nonbank mortgage companies have fewer resources to absorb adverse shocks and are more dependent on short-term funding than banks."[14]

[13] FSOC, *2019 Annual Report* at 97.
[14] *Id.* at 6.

In March 2020, FHFA expressed concern that nonbank servicers might be at risk of failing during the coronavirus pandemic as a consequence of the forbearance relief made available to homeowners under the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act).[15]

Another risk is that a counterparty may engage in fraudulent conduct. Our publicly reportable criminal investigations include inquiries into alleged fraud by a variety of counterparties, including real estate brokers and agents, builders and developers, loan officers and mortgage brokers, and title and escrow companies. These illustrate that the risk of fraudulent conduct by counterparties and third parties is both real and multifaceted.

FHFA has delegated to the Enterprises the management of their relationships with counterparties and third parties, and it reviews their management largely through its supervisory activities. We have noted above our significant concerns with the strength and rigor of those supervisory activities. In light of the financial, governance, and reputational risks arising from the Enterprises' relationships with counterparties and third parties, FHFA is challenged to effectively oversee the Enterprises' management of these risks.

Select FHFA-OIG Reports Issued During FY 2020 on FHFA's Oversight of the Enterprises' Relationships with Counterparties and Third Parties:

- *FHFA Examiners' Lack of Assessment and Escalation of Shortcomings Identified by an Enterprise in Its Servicer Fraud Risk Management Framework Limited the Agency's Supervisory Oversight* (EVL-2020-002, August 27, 2020).
- *Oversight by Fannie Mae and Freddie Mac of Compliance with Forbearance Requirements Under the CARES Act and Implementing Guidance by Mortgage Servicers* (OIG-2020-004, July 27, 2020).
- *Compliance Review of FHFA's Enterprise Non-Performing Loan Sales Program* (COM-2020-002, February 26, 2020).

Management Concern: Sustain and Strengthen Internal Controls Over Agency Operations, Including Workforce Planning

FHFA's programs and operations are subject to legal and policy requirements common to federal agencies. Satisfying such requirements necessitates the development and implementation of, and compliance with, effective internal controls within the Agency.

Workforce planning is a process for identifying and addressing gaps between an organization's current staff and its future workforce needs. According to the Office of Personnel Management (OPM), workforce planning serves as the foundation for managing an organization's human

[15] The CARES Act is a $2.2 trillion economic stimulus bill that was signed into law on March 27, 2020, in response to the economic fallout of the COVID-19 pandemic in the United States. *See* P. Law 116-136, § 4022, Foreclosure moratorium and consumer right to request forbearance.

capital.[16] Similarly, the Government Accountability Office recognizes, in its *Standards for Internal Control in the Federal Government* (the Green Book), that "effective management of an entity's workforce, its human capital, is essential to achieving results and an important part of internal control. Only when the right personnel for the job are on board and are provided the right training, tools, structure, incentives, and responsibilities is operational success possible."

In February 2020, we reported that FHFA had not engaged in a systematic workforce planning process for DER for a seven-year period, notwithstanding its prior commitments to do so. In response, FHFA has described actions taken in conjunction with the realignment of the Agency's structure announced in January 2020. As discussed previously, FHFA engaged a contractor in May 2020 to prepare "an organizational optimization Blueprint, including a human capital management plan, to cement FHFA's position as a world-class regulatory agency and to ensure the agency has the optimal organizational framework to carry out its supervisory mission in a post-conservatorship environment." From a control standpoint, it is critical for FHFA to address FHFA-wide organizational issues to ensure that the directions of the Green Book are met.

Our work also demonstrates that FHFA is challenged to ensure that its existing controls, including its written administrative policies and procedures, are sufficiently robust, and its personnel are adequately trained on these internal controls and comply fully with them.

During the last year, we determined that in FY 2019 FHFA paid an IT contractor $80,985 more than it owed under the contract because the contractor did not provide the required staffing levels for more than three months. Another recent audit found that FHFA's controls over its reimbursements and stipends program during FY 2019 were not fully effective: we found non-systemic exceptions related to non-authorized reimbursements. Another audit reviewed a sample of procurement awards and found that FHFA made those awards in accordance with most of its policies and procedures. However, we found that required internal peer reviews were not performed for five contracts in our sample.

In my letter last year, we noted that both the Agency and the Enterprises had undergone significant leadership changes. Since then, in January 2020, FHFA announced a realignment of its structure, and FHFA has announced the hiring of several senior executives during FY 2020. As discussed above, our work has identified shortcomings in the Agency's internal control over its resources; none of the shortcomings were indicative of significant, systemic deficiencies. However, changes in leadership carry the risk that internal controls may deteriorate as new initiatives are undertaken.

[16] OPM has issued guidance and best practices that provide a framework for effective workforce planning. The OPM framework involves analyzing the mission, vision, and strategic plan for an organization; evaluating the current staff of the organization, including identification of current skills and competencies of the workforce (supply analysis); and forecasting the optimal headcount and competencies needed to meet the needs of the organization in the future (demand analysis). Any gap between supply and demand is evaluated to identify headcount or competency gaps.

Select FHFA-OIG Reports Issued During FY 2020 on FHFA's Internal Controls over Agency Operations:

- *For Fiscal Year 2019, FHFA Did Not Always Follow its Policy for Employee Reimbursements and Stipends; FHFA's Practice for Calculating Employee Travel Stipends Was Not Stated in its Policy Nor Consistently Followed* (AUD-2020-007, March 26, 2020).
- *FHFA's Procurement Awards during the Period January 2017 to September 2019 Followed Most of its Acquisition Policies and Procedures but Some Required Internal Peer Reviews Were Not Performed* (AUD-2020-006, March 24, 2020).
- *Management Advisory: FHFA Failed to Enforce a Provision of an IT Services Contract, Resulting in More than $80,000 in Questioned Costs* (OIG-2020-001, March 3, 2020).
- *Despite Prior Commitments, FHFA Has Not Implemented a Systematic Workforce Planning Process to Determine Whether Enough Qualified Examiners are Available to Assess the Safety and Soundness of Fannie Mae and Freddie Mac* (AUD-2020-004, February 25, 2020).

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For the coming year, our audits, evaluations, compliance reviews, and other work will focus on the challenges highlighted in this memorandum. Included in these efforts will be verification testing on closed recommendations to independently determine whether FHFA has implemented in full the corrective actions it represented to us that it intended to take and following up on open recommendations.

cc: Christopher Bosland, Senior Advisor for Regulation
Kate Fulton, Chief Operating Officer
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