OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency
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October 5, 2015

TO: Melvin L. Watt, Director

FROM: Laura S. Wertheimer, Inspector General

SUBJECT: Fiscal Year 2016 Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000 (P.L. 106-531), the attached annual statement summarizes and assesses the most serious management and performance challenges facing the Federal Housing Finance Agency (FHFA or Agency).

FHFA serves two distinct roles for Fannie Mae and Freddie Mac (collectively, the Enterprises): currently, it acts as conservator for the Enterprises and as their regulator. It is also the regulator of the Federal Home Loan Banks (FHLBanks). In the attached statement, FHFA Office of Inspector General (OIG) identifies four key challenges the Agency faces in fulfilling these duties: conservatorship operations, supervision, non-bank sellers, and information technology security.

The attached summary and assessment statement is based on ongoing OIG work, OIG reports, other publicly available information, and OIG's general knowledge of FHFA's operations and the external environment.

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The Federal Housing Finance Agency Office of Inspector General's Summary of the Agency's FY 2016 Management and Performance Challenges and Assessment

The Federal Housing Finance Agency (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 Fannie Mae and Freddie Mac (collectively, the Enterprises) and the Federal Home Loan Banks (FHLBanks), overseeing the safety and soundness and statutory missions of these government-sponsored enterprises (GSEs). In September 2008, FHFA exercised its authority under HERA to place Fannie Mae and Freddie Mac into conservatorship. According to FHFA, it placed the Enterprises into conservatorship "in response to a substantial deterioration in the housing markets that severely damaged Fannie Mae and Freddie [Mac's] financial condition and left them unable to fulfill their mission without government intervention."[1] FHFA currently serves in a unique role: it is both conservator of and regulator for the Enterprises; and regulator for the FHLBanks.

Pursuant to the Reports Consolidation Act of 2000 (P.L. 106-531), the FHFA Office of Inspector General (OIG) has identified four significant management and performance challenges facing FHFA, based on ongoing OIG work, OIG published reports, other publicly available information, and OIG's general knowledge of FHFA's operations and the external environment: conservatorship operations; supervision; non-bank sellers; and information technology security. In this statement, OIG explains each of the four significant management and performance challenges and discusses specific aspects of those challenges. Both FHFA and OIG have previously acknowledged the difficulties resulting from the ongoing uncertainty regarding the future role of the Enterprises in the housing finance system. In identifying and assessing these four serious management and performance challenges facing FHFA, OIG remains mindful of this uncertainty and recognizes that such ongoing uncertainty adds additional difficulties for FHFA as it seeks to address these challenges.

Challenge: Conservatorship Operations

HERA, which vested FHFA with the power to place the Enterprises into conservatorship, grants FHFA sweeping authority over the Enterprises while they remain in conservatorship. As conservator, FHFA possesses all rights and powers of any stockholder, officer, or director of the Enterprises; it may operate the Enterprises and conduct all of the Enterprises' business activities; it may take actions necessary to put the Enterprises in a sound and solvent condition; and it may take actions appropriate to carry on the Enterprises' business and preserve and conserve the Enterprises' assets and property.

When then-Secretary of the Treasury Paulson announced the conservatorships in September 2008, he explained that the following period of time was meant to be a "'time out' where we have stabilized the" Enterprises, during which the "new Congress and the next Administration must decide what role government in general, and these entities in particular, should play in the housing market." The current FHFA Director has echoed that view in recognizing that

[1] FHFA, *FHFA as Conservator of Fannie Mae and Freddie Mac* (online at www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx).

conservatorship “cannot and should not be a permanent state” for the Enterprises. However, putting the Enterprises into conservatorships has proven to be far easier than ending them, and the “time out” period for the conservatorships has now entered its eighth year.

Since September 2008, FHFA has administered two conservatorships of unprecedented scope and undeterminable duration over two entities that dominate the secondary mortgage market and the mortgage securitization sector in the United States, and thus affect the entire mortgage finance industry. The lack of consensus in Congress about the nation’s future mortgage finance system and the role, if any, for the Enterprises may mean that the Enterprises will continue to operate under FHFA’s conservatorship for a considerably longer period. Since entering conservatorship, the Enterprises have required $187.5 billion in financial support from the U.S. Department of the Treasury (Treasury) to avert insolvency, and, through September 2015, the Enterprises have paid to Treasury approximately $239 billion in dividends. Although market conditions have improved and the Enterprises have returned to profitability, their ability to sustain profitability in the future cannot be assured for a number of reasons: the winding down of their investment portfolios and reduction in net interest income; the level of guarantee fees they will be able to charge; the future performance of their business segments; the elimination by 2018 of a capital cushion to buffer against losses; and the significant uncertainties involving key market drivers such as mortgage rates, homes prices, and credit standards. (For a detailed discussion of the uncertainty of the Enterprises’ future profitability, see OIG, *The Continued Profitability of Fannie Mae and Freddie Mac Is Not Assured* (Mar. 18, 2015) (WPR-2015-001) (online at www.fhfaoig.gov/Content/Files/WPR-2015-001.pdf).)

As noted above, as conservator, FHFA is vested with express authority under HERA to operate the Enterprises and has expansive authority over trillions of dollars in assets and billions of dollars in revenue. FHFA also makes business and policy decisions that influence the entire mortgage finance industry. For reasons of efficiency, concordant goals with the Enterprises, and operational savings, FHFA has determined to delegate revocable authority for general corporate governance and day-to-day matters to the Enterprises’ boards of directors and executive management. The Enterprises recognize that FHFA, as conservator, has succeeded to—all rights, titles, powers, and privileges of the Enterprises and of any shareholder, officer, or director of the Enterprises, and that the directors of the Enterprises “no longer ha[ve] the power or duty to manage, direct or oversee [the] business and affairs” of the Enterprises.[2]

Given the taxpayers’ enormous investment in the Enterprises, the unknown duration of the conservatorships, the Enterprises’ critical role in the secondary mortgage market, and their unknown ability to sustain future profitability, OIG has determined that FHFA’s administration of the conservatorships continues to be a critical risk. OIG identified this risk in each prior management and performance challenges statement and reiterates here that FHFA is challenged to increase its oversight of the Enterprise conservatorships. In particular, FHFA should strengthen its oversight of delegated matters and continue to strengthen its internal process to decide non-delegated matters.

[2] See Fannie Mae, *Annual Report* (*Form 10-K*), at 25, 162 (Feb. 20, 2015) (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2014/10k_2014.pdf). See also Freddie Mac, *Annual Report* (*Form 10-K*), at 20 (Feb. 19, 2015) (online at www.freddiemac.com/investors/er/pdf/10k_021915.pdf).

Oversight of Delegated Matters

As conservator of the Enterprises, FHFA owes duties to the U.S. taxpayers, the largest shareholders in the Enterprises, and has statutory responsibilities to ensure that the Enterprises achieve their statutory purpose. Pursuant to its powers under HERA to take actions "necessary to put [Fannie Mae and Freddie Mac] in a sound and solvent condition" and "appropriate to carry on the business of [Fannie Mae and Freddie Mac]" and "preserve and conserve" their assets, 12 U.S.C. § 4617(b)(2)(D), FHFA has delegated authority for many matters, both large and small, to the Enterprises and, since 2008, has issued more than 200 conservatorship directives in which it instructs the Enterprises to take certain actions, most of which relate to delegated responsibilities. The Enterprises acknowledge in their public securities filings that their directors serve on behalf of the conservator and exercise their authority as directed by and with the approval, when required, of the conservator.[3] As Fannie Mae states, "Our directors have no fiduciary duties to any person or entity except to the conservator." FHFA, as conservator, can revoke delegated authority at any time (and retains authority for certain significant decisions). As conservator, FHFA is ultimately responsible for all decisions made and actions taken by the Enterprises, pursuant to FHFA's revocable grant of delegated authority.

Historically, FHFA's oversight of delegated matters, in its role as conservator, has largely been limited to attendance at Enterprise internal management and board meetings as observers and discussions with Enterprise managers and directors. For the most part, FHFA, as conservator, has not assessed the reasonableness of Enterprise actions pursuant to delegated authority, including actions taken by the Enterprises to implement conservatorship directives. FHFA has not clearly defined the Agency's expectations of the Enterprises for delegated matters and has not established the accountability standard that it expects the Enterprises to meet for such matters.

FHFA should clearly define the Agency's expectations of the Enterprises for delegated matters; should define the standard it intends to apply when it assesses the actions of Enterprise directors, pursuant to the authority delegated to them by FHFA; and should strengthen its oversight of the Enterprises for matters delegated to them by the conservator. In a recent report, OIG assessed FHFA's conservatorship oversight of Fannie Mae's October 2013 appointment of its Chief Audit Executive—who heads Internal Audit, which is a critical element of Fannie Mae's risk management controls—and found that it was ineffective. Among other things, OIG found that FHFA had delegated to Fannie Mae's Board of Directors' Audit Committee the responsibility to hire a Chief Audit Executive and that Committee did not develop a plan to assess the appointee's conflicts or develop comprehensive controls to address them. As a consequence, Fannie Mae hired a candidate who was burdened by conflicts without controls in place to mitigate them. Even after FHFA, acting in its capacity as regulator, directed the Audit Committee to assess the candidate's conflicts and put compensating controls in place, the Committee declined to complete the requested assessment and adopt controls in a timely manner. For more than a year after the conflicted Chief Audit Executive began work, Fannie Mae's Internal Audit was not in

[3] See, e.g., Fannie Mae, *Annual Report (Form 10-K)*, at 25, 162 (Feb. 20, 2015) and Freddie Mac, *Annual Report (Form 10-K)*, at 20 (Feb. 19, 2015).

full conformance with governing standards, but FHFA failed to impose any consequences on either the individual Committee directors or on Fannie Mae. FHFA agreed with our remedial recommendations and, among other things, committed to instruct Fannie Mae to retain an independent third party to conduct a comprehensive evaluation of the Audit Committee's effectiveness, communicate to Fannie Mae its expectations for enhanced Audit Committee processes, and examine in 2016 the processes and criteria used by Fannie Mae to select and rotate members of board committees.

While FHFA employees attend Enterprise internal management and board meetings as observers, review materials provided by the Enterprises, and participate in discussions with Enterprise managers and directors, the Agency has lacked a structured process to share the information obtained by different FHFA employees with senior FHFA officials regarding matters delegated to the Enterprises. Lack of information sharing impedes the Agency's ability to oversee the Enterprises in carrying out their delegated responsibilities. For example, in our evaluation of Fannie Mae's hiring of a Chief Audit Executive, an FHFA employee told us that he raised concerns regarding the candidate's conflicts of interest to his superiors, but nothing in the record suggested that these concerns were raised with FHFA's then-Acting Director. Had those issues been socialized within senior FHFA management, FHFA senior officials would have been able to direct Fannie Mae to assess the candidate's conflicts and put controls in place to mitigate them before he was hired. FHFA committed to enhance its internal processes for information sharing.

Non-Delegated Matters

As noted, FHFA has retained authority to decide specific issues and can, at any time, revoke previously delegated authority. The Agency also should strengthen its processes for review and approval of non-delegated items. While FHFA has reported to OIG that it has made a number of enhancements to existing internal processes to improve the information flow to the FHFA Director, it has acknowledged, in response to a recent report from OIG, that additional improvements are warranted and have been put into place. (OIG, *FHFA's Exercise of Its Conservatorship Powers to Review and Approve the Enterprises' Annual Operating Budgets Has Not Achieved FHFA's Stated Purpose* (Sept. 30, 2015) (EVL-2015-006) (online at www.fhfaoig.gov/Content/Files/EVL-2015-006.pdf).)

In that evaluation, we assessed the effectiveness of FHFA's existing budget review and approval process for the Enterprises' annual operating budgets, which had increased approximately 31% between 2012 and 2015. We found budget submissions by the Enterprises after the fiscal year had begun, combined with cursory level analysis by FHFA's Division of Conservatorship and inadequate resources within that Division to assess the reasonableness of the proposed budgets, prevented FHFA from exercising effective control over Enterprise spending, both in amount and direction, and FHFA's approval of the budgets created the risk that it endorsed Enterprise spending that was not well understood by FHFA. OIG recommended, and FHFA agreed, to require the Enterprises to submit Board-approved proposed annual operating budgets before the end of a fiscal year so that the Agency has sufficient time to analyze them; to staff the internal FHFA review process with employees who have the skills and experience necessary to critically assess whether the proposed budgets align with the Agency's strategic direction and safety and soundness priorities; and to set a date certain early in the fiscal year by which the Agency will act on the proposed budgets.

Selected FHFA Actions Taken

We now summarize a number of recent actions taken by FHFA relating to its conservatorship responsibilities, in addition to the actions discussed above that it has committed to take relating to our remedial recommendations. OIG has not assessed the impact of these actions on FHFA's responsibilities as conservator. In January 2015, FHFA issued its 2015 conservatorship scorecard outlining the measures the Agency will use to assess the Enterprises' performance for the year. During the first six months of 2015, FHFA issued 17 conservatorship directives to the Enterprises providing instruction on a broad range of delegated responsibilities. FHFA continues to work on development of a single mortgage-backed security to be issued by Fannie Mae or Freddie Mac and development of a common securitization platform.

Challenge: Supervision

As noted earlier, FHFA plays a unique role, as both conservator and as regulator for the Enterprises, and as regulator for the FHLBanks. As FHFA recognizes, effective supervision of the entities it regulates is fundamental to ensuring their safety and soundness. Within FHFA, the Division of Federal Home Loan Bank Regulation (DBR) is responsible for supervision of the FHLBanks. Section 20 of the Federal Home Loan Bank Act (12 U.S.C. 1440) requires each FHLBank to be examined at least annually. The exam function for the FHLBanks descends from the old Federal Home Loan Bank Board, through the Federal Housing Finance Board, to FHFA. As a result, there is a long history of examination practice and examination standards for DBR to draw upon.

FHFA's Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises. FHFA's annual examination program assesses Fannie Mae's and Freddie Mac's financial safety and soundness and overall risk management practices through ongoing monitoring, targeted examinations, and risk assessments. Prior to the creation of FHFA, the Enterprises were regulated by the Office of Federal Housing Enterprise Oversight (OFHEO), and OFHEO's first examination took place in 1994. In its Fiscal Year 2014 Performance and Accountability Report to Congress, FHFA stated, "To ensure that the regulated entities are operating safely and soundly, FHFA identifies risks to the regulated entities and takes timely supervisory actions to address risks and improve their condition." OIG agrees that effective supervision of the FHLBanks and the Enterprises is critical to ensuring their safety and soundness. OIG has determined that FHFA's administration of its supervision responsibilities continues to be a critical risk. OIG identified this risk in prior management and performance challenges statements and reiterates here that FHFA is challenged to increase the robustness of its supervision over the entities it regulates.

Quantity and Quality of Examiners

OIG has previously reported that both DBR and DER lacked a sufficient number of examiners and that the Agency lacked an adequate number of commissioned examiners, both of which placed the efficiency and effectiveness of FHFA's examination program at risk.[4] In response to our reports, FHFA committed to add examiners and has added examiners.

As regulator for the Enterprises and the FHLBanks, FHFA has long recognized that its examiners require certain skills and technical knowledge necessary to evaluate the condition and practices specific to them. In its 2011 report, *Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs* (Sept. 23, 2011) (EVL-2011-005), OIG found, among other things, that two-thirds of FHFA examiners were not commissioned: they had not completed a structured program of classroom and on-the-job training designed to provide technical competencies and practical examination experience. The Agency acknowledged that commissioned examiners were critical to strengthening the efficiency and effectiveness of its supervision of the regulated entities and that it lacked a sufficient number of commissioned examiners, and it agreed to monitor the development and implementation of an examiner commission program. In 2013, the Agency inaugurated its Housing Finance Examiner commission program that was designed to produce, in the next four years, a corps of commissioned examiners for its supervision of the Enterprises and of the FHLBanks. Our compliance review this year found that the commissioning program was not on track to graduate commissioned examiners with the knowledge, skills, and technical expertise necessary to conduct successful, risk-based examinations in the projected timeframe. OIG recommended, and FHFA agreed, to take steps to address shortfalls in the program.

<u>Accurate, Complete, and High-Quality Examinations</u>

In 2011, FHFA's Office of Quality Assurance (OQA), which is tasked with conducting internal reviews of DER and DBR examinations to enhance the effectiveness of FHFA's supervision, recommended that DER develop and implement a comprehensive quality control process. DER agreed to that recommendation in September 2012. In March 2013, FHFA issued a supervision directive in which it required formal internal quality control reviews to be conducted for all examinations conducted by DER and DBR.

DBR put into place formal internal quality control reviews. Notwithstanding DER's commitment in September 2012 to establish and implement formal quality control reviews for its examinations of the Enterprises and FHFA's March 2013 directive that such reviews be conducted for examinations, DER did not establish and implement a comprehensive internal quality control review process for its targeted examinations of the Enterprises. Only after OIG commenced an evaluation of this issue and completed its fieldwork did DER advise OIG that on July 28, 2015, a comprehensive internal quality control process had been launched. Without a comprehensive internal quality control review of DER examinations, FHFA lacked assurance that DER's targeted examinations were accurate, complete, and of uniform high quality, which put at risk the quality of its examination program for the Enterprises.

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[4] OIG, *Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs*, at 23, 31 (Sept. 23, 2011) (EVL-2011-005), online at www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf; *Update on FHFA's Efforts to Strengthen its Capacity to Examine the Enterprises* (Dec. 19, 2013) (EVL-2014-002), online at www.fhfaoig.gov/Content/Files/EVL-2014-002.pdf.

Consistency of DER Examination Work

Observations made by OIG during its ongoing evaluation work of other DER programs has led us to question whether all DER examiners regularly follow the examination requirements set forth in FHFA's Examination Manual and DER's Operating Procedures Bulletins, which supplement the Examination Manual.

Records Management System

In 2014, OIG found that DER's recordkeeping practices impeded the efficient retrieval of workpapers by FHFA personnel and oversight organizations, including OIG. (OIG, *Evaluation of the Division of Enterprise Regulation's 2013 Examination Records: Successes and Opportunities* (Oct. 6, 2014) (EVL-2015-001) (online at www.fhfaoig.gov/Content/Files/EVL-2015-001.pdf).)

In that evaluation, OIG found that DER maintained no index or directory for the universe of workpapers, examination teams within DER used different document naming conventions, and electronic folders did not adhere to a cohesive, common structure. To strengthen records management, DER advised OIG that it would institute a practice in 2015 to align folder names with each team's examination plan. In addition, DER advised that it would use standardized workpaper folders in 2015 and would consider a permanent change. OIG's observations, from fieldwork conducted in 2015, are that little improvement has been made in DER's records management system.

Selected FHFA Actions Taken

We now summarize a number of recent actions taken by FHFA relating to its supervision responsibilities, in addition to the actions discussed above that it has committed to take relating to our remedial recommendations. OIG has not assessed the impact of these actions on FHFA's supervision responsibilities. For the first nine months of 2015, FHFA issued seven Advisory Bulletins addressing fraud risk management, information technology investment management, the rescission of guidance documents issued by OFHEO, Enterprise fraud reporting, FHLBank fraud reporting, FHLBank unsecured credit exposure reporting, and FHLBank core mission achievement. It approved the merger of the FHLBanks of Des Moines and Seattle in December 2014, which was finalized in May 2015. At the beginning of the fiscal year the Agency also reorganized personnel within its supervisory divisions, bringing the Agency's examination standards and examination execution groups together under one executive.

Challenge: Non-Bank Sellers

The Enterprises rely heavily on counterparties for a wide array of services, including mortgage origination and servicing. That reliance exposes the Enterprises to counterparty risk—that the counterparty will not meet its contractual obligations. Generally, FHFA has delegated to the Enterprises the management of their relationships with counterparties and reviews that management largely through its regulatory responsibilities.

There are numerous counterparty relationships with the Enterprises and each carries risk. One critical counterparty risk is the risk posed by loan originators that are not depository institutions (also called non-banks). In recent years, the share of Enterprise single-family loan purchases from depository institutions has fallen while the share of purchases from non-banks has risen. Based on OIG analysis of Enterprise data, from 2010 to 2014, Fannie Mae's share of purchases of single-family loans from non-depository institutions increased from 17% to 49% ($187 billion), while Freddie Mac's share increased from 10% to 38% ($97 billion).

Non-bank sellers are not regulated by federal financial regulatory agencies and may not have the same financial strength, liquidity, or operational capacity needed to meet their obligations to the Enterprises as depository institutions. As a result, there is a risk that a non-bank seller that failed to honor its contractual obligations, such as by selling loans to an Enterprise that did not comply with the Enterprise's lending requirements, would not have sufficient capital or liquidity to honor repurchase demands by the Enterprises for non-compliant loans. FHFA and other financial market participants must address the implications of a changing marketplace, including the attendant risks from non-banks.

Selected FHFA Actions Taken

We now summarize a number of recent actions taken by FHFA relating to its supervision of the Enterprises in connection with non-bank sellers. OIG has not assessed the impact of these actions on FHFA's responsibilities. In December 2014, FHFA issued an Advisory Bulletin in which it articulated its supervisory expectation that the Enterprises will effectively manage counterparty risks and directed the Enterprises to implement a board-approved risk management framework that includes risk-based oversight of single-family seller/servicers. In May 2015, FHFA announced that the Enterprises were issuing new capital and liquidity requirements for non-depository sellers and servicers of single-family mortgages, effective December 31, 2015.

Challenge: Information Technology Security

In 2012, then-FBI Director Robert Mueller warned that "there are only two types of companies: those that have been hacked and those that will be. And even they are converging into one category: companies that have been hacked and will be hacked again." Recent cyber security incidents affecting the federal workforce illustrate the scope of potential attacks. The Office of Personnel Management (OPM), which provides personnel services to federal government agencies, said in one incident 4.2 million current and former federal employees had personnel data stolen. In a separate incident, OPM said that 21.5 million people had their Social Security numbers and other sensitive information stolen from databases containing background investigation information.

Cyber attacks from outside an organization come in numerous forms and include attack vehicles such as malicious software aimed at gaining control of a system or efforts compromising the availability of a system or network by overloading the network. Broadly speaking, external cyber attackers can be grouped into three categories: "hacktivists," who use digital tools to promote a political or social agenda; nation states; and criminals who may directly attack an organization's system, or they may attack indirectly through a third party such as a vendor, contractor, or counterparty.

Information technology vulnerabilities also can come from inside an organization. Employees and contractors, current or former, with authorized access to an organization's network or data can exceed or misuse access and compromise the confidentiality, integrity, or availability of the organization's information or information systems. Even when an organization builds high barriers to protect its electronic assets from outsiders, it may have few protections against insiders. Insider threats can be particularly potent because insiders typically have greater access to sensitive information, a better understanding of internal processes, and an understanding of potential weaknesses in controls.

Larry Zelvin, the former Director of the National Cybersecurity and Communications Integration Center at the Department of Homeland Security, opined at a cyber security roundtable that, of the 16 critical infrastructure sectors in this country, "finance probably wins the cyber security threat award." He called the industry "a massive target" because it is "where the money is." The Enterprises own or guarantee $5 trillion in mortgage assets supporting the U.S. mortgage market. As part of their processes to guarantee or purchase loans, the Enterprises receive a substantial amount of information about mortgage borrowers, including financial data and personally identifiable information. Fannie Mae[5] and Freddie Mac[6] have been the subject of cyber attacks, although none caused significant harm. Similarly, the FHLBanks and their Office of Finance have not experienced material losses related to cyber attacks or other breaches.[7] All of the entities regulated by FHFA acknowledge that the substantial precautions put into place to protect their information systems may be vulnerable to penetration. In this regard, the cyber threat to these entities is no different from the threat to other major financial institutions.

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[5] As disclosed by Fannie Mae in its 2014 Annual Report (*Form 10-K*): "From time to time we have been, and likely will continue to be, the target of attempted cyber attacks, computer viruses, malicious code, phishing attacks and other information security breaches. To date, we have not experienced any material losses relating to cyber attacks or other information security breaches, but we could suffer such losses in the future."

[6] As disclosed by Freddie Mac in its 2014 Annual Report (*Form 10-K*): "Like many corporations and government entities, from time to time we have been, and likely will continue to be, the target of attempted cyber attacks. Although we devote significant resources to protecting our various systems and processes, there is no assurance that our security measures will provide fully effective security."

[7] As disclosed by the FHLBank Office of Finance in the 2014 Annual Report (*FHLBanks Combined Financial Report for the Year Ended December 31, 2014*) (online at www.fhlb-of.com/ofweb_userWeb/resources/2014Q4Document-web.pdf): "To date, the FHLBanks and the Office of Finance have not experienced any material effect or losses related to cyber attacks or other breaches. . . . Although each of the FHLBanks and the Office of Finance takes measures to protect the security of its information systems, these actions may not be able to prevent or mitigate the negative effects of certain failures or breaches. As such, a failure or breach of information systems could disrupt and adversely affect an FHLBank's or the Office of Finance's ability to conduct and manage its business effectively and could also result in significant losses, reputational damage, or other harm."

As conservator, FHFA has delegated to the Enterprises the responsibility to manage the security of their computer systems, software, and networks to best protect them from cyber attacks, breaches, unauthorized access, misuse, computer viruses or other malicious codes, or other attempts. The FHLBanks and their Office of Finance are responsible for such security management. In light of the significant financial, governance, and reputational risks that could flow from a cyber attack on either of the Enterprises, any of the FHLBanks, and/or their Office of Finance, FHFA must ensure adequate supervision of the information technology security controls put into place at each of the entities it regulates.

Selected FHFA Actions Taken

We now summarize recent actions taken by FHFA relating to its supervision of the Enterprises and the FHLBanks in connection with cyber security. OIG has not assessed the impact of these actions on FHFA's responsibilities. In 2014, FHFA issued an Advisory Bulletin to provide guidance to the entities it regulates for a risk-based approach to cyber security management. The Advisory Bulletin requires each entity to select a cyber security standard it will follow and then sets forth, in broad terms, characteristics of a cyber risk management program that FHFA believes should enable the entities to safeguard their cyber environments.[8] FHFA also incorporated assessment of the adequacy of cyber security controls into its 2015 examination program.

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To best leverage OIG's resources, we determined to focus our work on programs and operations that pose the greatest financial, governance, operational, and reputational risks to FHFA, the Enterprises, and the FHLBanks. Accordingly, our Audit and Evaluation Plan aligns to the challenges outlined above. OIG remains focused on assessing the adequacy of the controls put into place by FHFA and at the entities regulated by FHFA to mitigate those risks.

[8] The characteristics are: proportionality; cyber risk management; risk assessments; monitoring and response; system, patch, and vulnerability management; third-party management; and privacy and data protection.