

REDACTED

Federal Housing Finance Agency
Office of Inspector General



**FHFA Conducted BSA/AML
Program Examinations of
10 of 11 Federal Home Loan Banks
During 2016-2018 in Accordance
with its Guidelines, But Failed to
Support a Conclusion in the Report
of Examination for the Other Bank**

This report contains redactions of information that is privileged or confidential.

Audit Report • AUD-2019-008 • July 10, 2019



AUD-2019-008

July 10, 2019

Executive Summary

Created by Congress in 2008, the Federal Housing Finance Agency (FHFA) is charged by the Housing and Economic Recovery Act of 2008 with oversight of Fannie Mae, Freddie Mac, the 11 Federal Home Loan Banks (FHLBanks) (collectively, the regulated entities), and the FHLBanks' fiscal agent, the Office of Finance. Since 2008, FHFA has also served as conservator of Fannie Mae and Freddie Mac.

The Bank Secrecy Act (BSA) was enacted to safeguard the U.S. financial system: from illicit use such as for terrorist financing; to combat money laundering and other illegal activity; and to require suspicious activity reporting, including fraud reporting. In February 2014, the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury, published a Final Rule amending its regulations to define the regulated entities as financial institutions subject to BSA requirements and to delegate authority to FHFA to examine the regulated entities' compliance with those requirements.

FHFA has delegated to its Division of Federal Home Loan Bank Regulation (DBR) the duty to supervise the FHLBanks and the Office of Finance. As such, DBR conducts annual safety and soundness examinations of each FHLBank and the Office of Finance. As part of these examinations, DBR periodically, in accordance with its minimum frequency guidelines, examines the FHLBanks' BSA/Anti-Money Laundering (AML) programs.

In this audit, we sought to determine whether DBR followed FHFA's guidance for examinations of BSA/AML programs performed at each of the 11 FHLBanks. We reviewed the most recent BSA/AML program examination performed at each FHLBank during the 2016, 2017, or 2018 examination cycles (review period).

We found that, during our review period, examinations of BSA/AML programs were performed at all 11 FHLBanks in accordance with DBR's established minimum frequency guidelines. DBR planned, performed, documented, and reported on each examination in accordance with FHFA guidance for 10 of the FHLBanks. For the remaining FHLBank, DBR's examination workpapers did not support a BSA/AML-related conclusion included in the Report of Examination (ROE) that DBR prepared and transmitted to the FHLBank's board of directors. We found that DBR included in its ROE the conclusion that [REDACTED]

[REDACTED] even though there was not support in the workpapers for that conclusion.



AUD-2019-008

July 10, 2019

The unsupported conclusion in the ROE for this FHLBank caused us to examine whether the BSA/AML program examination workpapers underwent a quality control review. DBR's quality control process is intended to confirm that examination findings and conclusions in the ROE are adequately supported before DBR transmits the ROE to the board of the regulated entity. The unsupported conclusion in the ROE in this instance was not detected by DBR's quality control process because that process did not require the review of examination work performed by the Examiner-in-Charge (EIC). This gap in DBR's quality control process increases the risk that an ROE will assure an FHLBank's board of directors that management is meeting FHFA's supervisory expectations when it is not.

We make two recommendations in this report. In a written management response, FHFA agreed with the recommendations.

This report was prepared by James Lisle, Audit Director; Marco Uribe, Auditor-in-Charge; and Michael Rivera, Auditor; with assistance from Bob Taylor, Senior Advisor. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

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

Marla A. Freedman, Deputy Inspector General for Audits /s/

TABLE OF CONTENTS

EXECUTIVE SUMMARY2

ABBREVIATIONS5

BACKGROUND6

 Federal Home Loan Bank System6

 The Bank Secrecy Act/Anti-Money Laundering Program6

 FHFA’s Division of Federal Home Loan Bank Regulation7

 DBR Examination Guidance8

 FHFA’s BSA/AML Examination Module.....9

FACTS AND ANALYSIS.....10

 DBR Planned and Conducted Most FHLBank BSA/AML Program Examinations in
 Accordance with FHFA and DBR Examination Guidance10

 The BSA/AML Examination Module Has Not Been Finalized Even Though it Has
 Been in Field Test for Four Years12

FINDING13

 A BSA/AML Program Examination Conclusion in the ROE for One FHLBank
 Lacked Workpaper Support.....13

CONCLUSIONS.....13

RECOMMENDATIONS14

FHFA COMMENTS AND OIG RESPONSE.....15

OBJECTIVE, SCOPE, AND METHODOLOGY15

APPENDIX: FHFA MANAGEMENT RESPONSE18

ADDITIONAL INFORMATION AND COPIES20

ABBREVIATIONS

AML	Anti-Money Laundering
BSA	Bank Secrecy Act
DBR	Federal Housing Finance Agency Division of Bank Regulation
EIC	Examiner-in-Charge
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
FinCEN	Financial Crimes Enforcement Network
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
ROE	Report of Examination
SAR	Suspicious Activity Report
SD	Supervision Directive

BACKGROUND

Federal Home Loan Bank System

The FHLBank System consists of the 11 FHLBanks and the Office of Finance. As of March 31, 2019, the FHLBank System had combined total assets of approximately \$1.08 trillion with total consolidated obligations of approximately \$1.01 trillion.

The FHLBanks are organized under the authority of the Federal Home Loan Bank Act of 1932, as amended. Their mission is to provide reliable liquidity to member institutions (generally, federally insured depository institutions, insurance companies, and eligible community development financial institutions) to support housing finance and community investment.

To accomplish their mission, FHLBanks provide financial products and services to their members, which include advances. These advances assist and enhance a member's financing of: (1) housing, including single-family and multi-family housing serving consumers at all income levels; and (2) community lending.

The Bank Secrecy Act/Anti-Money Laundering Program

The Bank Secrecy Act is comprised of a number of separate legislative acts stemming from 1970 to the present, including the USA PATRIOT Act, passed in 2001.¹ BSA was enacted: to safeguard the U.S. financial system from illicit use such as for terrorist financing; to combat money laundering and other illegal activity; and to require suspicious activity reporting, including fraud reporting. BSA was designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in U.S. financial institutions.

On February 25, 2014, FinCEN published a Final Rule amending its regulations to define the regulated entities as financial institutions subject to BSA, to require the regulated entities to

¹ BSA was enacted in 1970. Since then, a number of other laws have enhanced and amended BSA. Those laws include: Money Laundering Control Act (1986), Anti-Drug Abuse Act of 1988, Annunzio-Wylie Anti-Money Laundering Act (1992), Money Laundering Suppression Act (1994), Money Laundering and Financial Crimes Strategy Act (1998), Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act), and Intelligence Reform & Terrorism Prevention Act of 2004. BSA is codified at 12 U.S.C. § 1829b, 12 U.S.C. §§1951-1959, 18 U.S.C. §§ 1956, 1957, 1960, and 31 U.S.C. §§ 5311-5314 and 5316-5332 and notes thereto, with implementing regulations at 31 C.F.R. Chapter X. See 31 C.F.R. 1010.100(e).

establish AML programs and file suspicious activity reports (SAR), and to delegate authority to FHFA to examine the regulated entities' compliance with BSA.²

FinCEN's Final Rule outlines the requirements for the AML program. Each regulated entity is required to develop and implement an AML program that is reasonably designed to prevent it from being used to facilitate money laundering or the financing of terrorist activities, and other financial crimes, including mortgage fraud. At a minimum, the AML program must include the following requirements, generally referred to as the four pillars:

- Internal policies, procedures, and controls based upon the regulated entity's assessment of the money laundering and terrorist financing risks associated with its products and services;
- A designated compliance officer responsible for administering the program;
- Ongoing training of appropriate persons with responsibilities under the program; and
- Independent testing to monitor and maintain an adequate program.

In addition, FinCEN's Final Rule requires the regulated entities to file with FinCEN a report of any suspicious transaction relevant to a possible violation of law or regulation by completing a SAR.

FHFA's Division of Federal Home Loan Bank Regulation

The FHFA Director has delegated to the Deputy Director, DBR, the duty to supervise the FHLBanks and the Office of Finance. DBR has adopted a supervision program that it maintains is risk-based and consists of both on-site annual examinations and off-site monitoring of the FHLBanks and the Office of Finance.

Reporting to the Deputy Director, DBR's Examinations Group conducts annual safety and soundness examinations of each FHLBank and the Office of Finance as well as community investment examinations of each FHLBank. DBR issues an annual ROE for each FHLBank

² FinCEN, *Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Housing Government Sponsored Enterprises*, 79 Fed. Reg. 10365 (Feb. 25, 2014) (Final Rule codified at 31 C.F.R. Parts 1010 and 1030).

and the Office of Finance. The ROEs communicate examination conclusions, findings (if any), and composite and component CAMELSO ratings for the entity.³

DBR Examination Guidance

The *FHFA Examination Manual* provides guidance to DBR teams performing examinations within the FHLBank System. Specifically, Part I of the *FHFA Examination Manual* provides a description of the examination program and sets forth the processes examiners are to follow when conducting examination activities at a regulated entity. It also describes the work products examiners are to produce during those examinations. Part II of the *FHFA Examination Manual* includes a general description of the examination modules and Supplemental Examination Guidance. The modules provide examination instructions and work programs organized by risk category and line of business. DBR also issues Operating Procedures Bulletins (OPBs) that set forth expectations of examiners who conduct examinations within the FHLBank System.

The *FHFA Examination Manual* and the *Federal Home Loan Bank Examination Workpaper Standards* (2016-DBR-OPB-01) establish guidance for examiners to document the performance of an examination. The guidance notes that examination documentation serves as the written record of examination activity; must support examination results, conclusions, findings,⁴ and ratings presented in the ROE; and is DBR's primary examination work product.⁵ Examination documentation facilitates the planning, performance, and supervision of examination activities. In addition, examiners must cross-reference documents provided by a regulated entity or other documents created by FHFA staff in their workpapers when necessary to support examination work and explain observations and logic used to reach conclusions. Put simply, the OPB requires that statements in the ROE be supported by workpapers.

³ CAMELSO is a risk-focused rating system under which each FHLBank and the Office of Finance is assigned a composite rating based on an evaluation of various aspects of its operations. For the FHLBanks, the components evaluated are Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk, and Operational Risk. Due to the nature of its activities, the Office of Finance is only rated on the Management and Operational Risk components.

⁴ FHFA uses three categories of adverse examination findings: (1) Matters Requiring Attention (MRAs), (2) Violations, and (3) Recommendations. MRAs are the most serious supervisory matters.

⁵ Key examination documentation consists of the following: (1) pre-examination analysis, (2) pre-examination scope memoranda, (3) work program, (4) activity memoranda, (5) findings memoranda (if findings were identified), (6) conclusion memoranda, and (7) ROE.

FHFA’s supervisory directive SD 2013-01, *Quality Control Program for Examinations Conducted by the Division of Bank Regulation and the Division of Enterprise Regulation*,⁶ states that, “final examination findings and conclusions are subject to a quality control review before a report of examination or supervisory correspondence is communicated to the regulated entity or Office of Finance.” It further states that quality control reviews will evaluate whether workpapers support examination findings, conclusions, and ratings and directs that “participants in a quality control review must not have participated in the examination activity under review.”

DBR has implemented a two-prong quality control process intended to ensure high quality work products that adhere to FHFA and DBR examination guidance.⁷ The first prong of the quality control process assigns primary responsibility for quality control to the DBR staff, supervisors, and executives directly involved in preparing and reviewing work products. Specifically, the examiner is responsible for ensuring that he or she completes work satisfactorily and with adequate documentation. The EIC is responsible for ensuring that documentation adequately evidences the work performed and agrees with conclusions reached and expressed in the ROE. To meet this responsibility, EICs must review a sufficient number of workpapers to have confidence in their adequacy or otherwise ensure that a combination of their reviews and reviews by others provide that confidence. The second prong of the quality control process entails reviews by a DBR examination specialist who is independent of the examination of selected DBR work products.⁸

FHFA’s BSA/AML Examination Module

After FinCEN issued its Final Rule, FHFA issued for field testing an examination module, *Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Program* (BSA/AML examination module), intended to assist FHFA examiners in evaluating the effectiveness of the regulated

⁶ During our review period, SD 2013-01, *Quality Control Program for Examination Conducted by the Division of Bank Regulation and the Division of Enterprise Regulation* (Mar. 25, 2013) set forth the general requirements for DBR to assess examination findings, conclusions, ratings, supporting workpapers, and related documents for quality control purposes. SD 2013-01 has since been superseded and replaced by SD 2017-01, *Quality Control Program* (Apr. 28, 2017); however, the new guidance does not alter our analysis.

⁷ During our review period, 2014-DBR-OPB-003, *Safety and Soundness Examination Quality Control Program* (Dec. 24, 2014) and 2014-DBR-OPB-004, *Community Investment Examination Quality Control Program* (Dec. 24, 2014), defined the DBR quality control process. These two OPBs have since been superseded and replaced by 2018-DBR-OPB-03, *Quality Control Program* (Dec. 26, 2018); however, the new guidance does not alter our analysis.

⁸ The independent examination specialists complete their QC review in two ways: a “general workpaper review” and a “specific workpaper review.” The general workpaper review assesses the planning, summary results, and reporting of the overall examination by reviewing documents such as the supervisory strategy, examination scope memorandum, scope matrix, findings memorandums, etc. The specific workpaper review assesses supporting documentation for a judgmental sample of specific examination activities, i.e., those typically associated with an individual examination work program.

entities' BSA compliance program and AML policies, procedures, and controls.⁹ The BSA/AML examination module lays out work steps to evaluate the minimum requirements (i.e., "the four pillars") of a BSA/AML compliance program: (1) the development of internal policies, procedures, and controls, (2) the designation of a compliance officer, (3) an ongoing employee training program, and (4) an independent audit function to test programs. It also includes work steps for the examiner review of the regulated entities' compliance with SAR filing requirements.

In *Work Program Minimum Frequency Guidelines* (updated October 2016) (2012-DBR-OPB-03), DBR established minimum frequency guidelines (annual, biennial, and triennial) for each examination module. The minimum frequency guideline for the BSA/AML examination module is [REDACTED]. That is, each FHLBank's BSA/AML program should be examined, at a minimum, [REDACTED].

* * * * *

Our objective for this audit was to determine whether DBR followed FHFA's guidance for examinations of BSA/AML programs at each of the 11 FHLBanks. The scope of this audit was the most recent BSA/AML program examination performed at each of those 11 FHLBanks. The examinations were performed during the 2016, 2017, or 2018 examination cycles.

FACTS AND ANALYSIS

DBR Planned and Conducted Most FHLBank BSA/AML Program Examinations in Accordance with FHFA and DBR Examination Guidance

We found that the examinations of BSA/AML programs at all 11 FHLBanks were conducted in accordance with DBR's established minimum [REDACTED] frequency guideline set forth in 2012-DBR-OPB-03. Our review of examination workpapers also found that DBR's BSA/AML program examinations at 10 of the 11 FHLBanks were planned, performed, documented, and reported in accordance with guidance set forth in the *FHFA Examination*

⁹ FHFA, *Bank Secrecy Act / Anti-Money Laundering (BSA/AML) Program - Supplemental Guidance: Field Test* (June 2015). The "Field Test" designation means that the module is in draft and has been since June 2015. While a module is in Field Test, examiners are solicited for their comments and suggestions to improve application of the module. Modules in Field Test are considered by FHFA to be non-public information and are not posted on FHFA's public website at www.fhfa.gov/SupervisionRegulation/ExaminerResources/Pages/Manual-and-Supplemental-Guidance.aspx. Since its initial issuance, the BSA/AML examination module has been used at least once at each of the FHLBanks.

Manual, BSA/AML examination module, and 2016-DBR-OPB-01. Specifically, for each of the BSA/AML program examinations at 10 FHLBanks:

- DBR prepared a BSA/AML pre-examination analysis memorandum that identified areas of review and defined the examination objectives. DBR included the BSA/AML examination module on the schedule of work in the examination’s scope memorandum.
- DBR’s BSA/AML work program included work steps that addressed the examiner-defined objectives from the pre-examination analysis memorandum. These work steps provided for an evaluation of aspects of the program required by regulation, as well as a review of the regulated entities’ SAR filings.
- Documentation of examiner analysis and information obtained from the FHLBank supported conclusion statements made in the BSA/AML work program, activity memorandum, and, when applicable, findings memorandum.¹⁰
- Summary conclusions regarding the BSA/AML program made in the component rating conclusion memorandum and the ROE were consistent with and supported by the conclusion statements made in the work program, activity memorandum, and, when applicable, findings memorandum.

For the remaining BSA/AML program examination at an FHLBank, we found that DBR planned and executed work steps to evaluate the Bank’s implementation of a BSA/AML program (i.e., that the program met the “four pillars” requirements) and the examination workpapers supported the conclusion presented in the ROE that [REDACTED]

[REDACTED] However, this examination also resulted in a specific conclusion in the ROE that [REDACTED]

[REDACTED] We found that this statement was not supported by examination workpapers. While the BSA/AML examination workpapers documented examiner analysis of certain controls surrounding the Bank’s SAR filing process (e.g., board reporting of SARs, internal audit coverage of the SAR filing process, etc.), the work program did not include a related work step to review the Bank’s SAR filings. The examination workpapers also did not contain evidence that such a review was performed.¹¹

¹⁰ DBR examiners identified BSA/AML-related adverse examination findings at [REDACTED] FHLBanks during the review period.

¹¹ A review of SARs is not a mandatory work step in the BSA/AML examination module; however, a conclusion in the ROE regarding SAR filings would infer that work was done to support that conclusion.

The EIC for the 2016 FHLBank examination in question acknowledged that the examination workpapers did not support the conclusion that [REDACTED]. The EIC stated that he performed the work steps in the BSA/AML work program for the FHLBank himself. He said that there was a possibility that he reviewed the Bank’s SAR filings and simply failed to document the work but could not recall whether that happened with any certainty. He also admitted that there was a possibility that a review of SAR filings was not performed – the 2016 examination of the FHLBank’s BSA/AML program was limited in scope because it was a first-time review of a [REDACTED] risk area, examiner resources were limited, and, as the EIC, he had other bank-wide examination priorities on which to focus.

As stated previously, the FHFA quality control guidance in effect at the time the 2016 FHLBank examination was performed stated that it is “important that final examination findings and conclusions are subject to a quality control review before a report of examination...is communicated to the regulated entity...” and that “participants in a quality control review must not have participated in the examination activity under review.”¹² Typically examination work is performed by an examiner and, under DBR quality control procedures, the EIC is responsible for reviewing examiner workpapers to ensure that they support the conclusions reached and expressed in the ROE. However, because the EIC also served as the examiner who performed FHLBank’s BSA/AML program examination and the examination workpapers were not selected for a quality control review, his BSA/AML program examination workpapers were not reviewed by anyone.

The BSA/AML Examination Module Has Not Been Finalized Even Though it Has Been in Field Test for Four Years

The BSA/AML examination module provides background information and delineates examination procedures to examine the basic requirements of an FHLBank’s BSA/AML program. However, this module has remained in a non-public “Field Test” status for four years, and since its initial issuance it has been used at least once at each of the FHLBanks. The Deputy Director told us that the BSA/AML examination module is undergoing a last review and is expected to be issued in final soon. Once final and made public, the BSA/AML examination module informs the regulated entities of the scope of the examination program.

¹² SD 2013-01, *Quality Control Program for Examinations Conducted by the Division of Bank Regulation and the Division of Enterprise Regulation*, and 2014-DBR-OPB-003, *Safety and Soundness Examination Quality Control Program*, were the quality control guidance in effect when the 2016 FHLB Cincinnati examination was conducted. This guidance has since been superseded by SD 2017-01, *Quality Control Program*, and 2018-DBR-OPB-03, *Quality Control Program*, respectively, which continue to emphasize that workpaper reviews should be completed by someone who did not perform the work.

FINDING

A BSA/AML Program Examination Conclusion in the ROE for One FHLBank Lacked Workpaper Support

There is an increased risk that conclusions communicated to regulated entities in an ROE could be inaccurate if they are not supported by examination workpapers and do not undergo quality control review. Guidance set forth in the *FHFA Examination Manual* and 2016-DBR-OPB-01 notes that examination documentation serves as the written record of examination activity and must support examination results, conclusions, findings, and ratings presented in the ROE. Further, FHFA quality control guidance in effect at the time the examination was performed stated that it is “important that final examination findings and conclusions are subject to a quality control review before a report of examination...is communicated to the regulated entity...” and that “participants in a quality control review must not have participated in the examination activity under review.”

For 1 of the 11 FHLBank BSA/AML program examinations we reviewed, the examination workpapers did not support the conclusion, included in the ROE, that [REDACTED]

[REDACTED] According to 2014-DBR-OPB-003, the EIC is primarily responsible for reviewing sufficient workpapers to ensure that “documentation adequately evidences the work performed and agrees with conclusions reached and expressed in the [ROE].” However, since the EIC performed the FHLBank’s BSA/AML program examination, his work supporting the conclusion in the ROE related to the FHLBank’s SARs was not subject to an EIC review under the OPB. Also, as allowed by DBR’s quality control process, the BSA/AML work program for this examination was not selected for a quality control review by a DBR examination specialist who was independent of the examination, so the supporting workpapers prepared by the EIC were not reviewed by anyone.

CONCLUSIONS

During our review period, examinations of BSA/AML programs at all 11 FHLBanks were conducted in accordance with DBR’s established minimum frequency guidelines. DBR planned, performed, documented, and reported examinations in accordance with FHFA guidance for 10 of the FHLBanks.

During the course of our review, we learned that DBR’s quality control process – which is intended to confirm that examination findings and conclusions are adequately supported

before DBR communicates them to the regulated entity – does not require a review of examination findings and conclusions if that examination work was performed by an EIC. As a result, for the remaining FHLBank, a conclusion in the ROE based on examination work by an EIC that [REDACTED] was not supported by examination workpapers and did not undergo a quality control review. Had the conclusion undergone a quality control review, it is likely that DBR would have detected the workpapers did not support the conclusion. As we have previously noted, gaps that allow conclusions to be communicated without quality control present a risk that an ROE will assure a regulated entity’s board of directors that management is meeting supervisory expectations when it is not.¹³ By requiring quality control review when the work is performed by an EIC, DBR would better assure itself that conclusions are accurate and adequately supported.

We also noted that FHFA’s BSA/AML examination module has remained in Field Test status for four years (since its issuance). All the while, the module has not been made publicly available. The Deputy Director told us that the BSA/AML examination module is undergoing a last review and that final issuance is expected soon. We encourage FHFA to continue its work to issue a BSA/AML examination module in final.

RECOMMENDATIONS.....

We recommend that FHFA:

1. Revise DBR’s quality control procedures to specifically require that all examination workpapers supporting examination findings, conclusions, and ratings directly prepared by the EIC be reviewed by an individual who did not participate in the examination.
2. Take action to either determine whether the unsupported conclusion in 2016 ROE for the FHLBank in question [REDACTED] is accurate or inform the board of the FHLBank not to rely on the unsupported conclusion.

¹³ See OIG, *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) (online at www.fhfaig.gov/Content/Files/EVL-2017-006.pdf).

FHFA COMMENTS AND OIG RESPONSE.....

OIG provided FHFA an opportunity to respond to a draft report of this audit. FHFA provided a management response, which is provided as an Appendix to this report. In its response, FHFA agreed with both recommendations and stated that it would take the following corrective actions.

1. DBR will revise its written procedures by September 30, 2019, to require examination workpapers prepared by the EIC to be reviewed by the EIC's Associate Director, or have that review delegated by the Associate Director to the team's Supervisory Examiner or to another EIC who did not participate on the examination. While both the Associate Director and Supervisory Examiner may participate in examinations, they do not report to the EIC and can conduct independent reviews.
2. DBR will provide an unredacted version of the OIG report to the FHLBank in question by September 30, 2019. When doing so, DBR will refer the recommendation regarding the 2016 ROE. In follow-up discussions regarding this response, a DBR official told us that they will also provide an unredacted version of this OIG report to the chairman of the FHLBank's board of directors.

We consider FHFA's planned corrective actions responsive to our recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY.....

We conducted this audit to determine whether DBR has followed FHFA's guidance for examinations of BSA/AML programs at each of the 11 FHLBanks. The scope of this audit was the most recent BSA/AML examination performed at each of those 11 FHLBanks. These examinations were performed during the 2016, 2017, or 2018 examination cycles.

To accomplish our objective, we:

- Reviewed FinCEN's implementing regulation requiring FHFA-regulated entities to establish anti-money laundering programs and report suspicious activities pursuant to the BSA.
- Reviewed the following FHFA documentation:
 - *FHFA Examination Manual* (December 2013)

- *Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Program Supplemental Guidance: Field Test* (June 2015)
- SD 2013-01, *Quality Control Program for Examinations Conducted by the Division of Bank Regulation and the Division of Enterprise Regulation* (March 25, 2013)
- SD 2017-01, *Quality Control Program* (April 28, 2017)
- 2012-DBR-OPB-03, *Work Program Minimum Frequency Guidelines* (December 19, 2012; updated October 7, 2016)
- 2014-DBR-OPB-003, *Safety and Soundness Examination Quality Control Program* (December 24, 2014)
- 2014-DBR-OPB-004, *Community Investment Examination Quality Control Program* (December 24, 2014)
- 2016-DBR-OPB-01, *Federal Home Loan Bank Examination Workpaper Standards* (July 29, 2016)
- 2018-DBR-OPB-03, *Quality Control Program* (December 26, 2018)
- Interviewed FHFA personnel to gain an understanding of the BSA/AML examination module, the examination approach to the program, the FHLBank SAR reporting process, and FHFA policy and guidance review process. Additionally, we interviewed DBR personnel to identify causes for documentation shortcomings.
- Reviewed examination documentation for the most recent BSA/AML examination performed during the review period at each of the 11 FHLBanks to determine whether:
 - DBR’s BSA/AML examination coverage complied with DBR requirements during the review period.
 - Examination procedures were planned in accordance with the *FHFA Examination Manual*, the BSA/AML examination module, and DBR guidance on workpaper preparation.
 - The examiners executed the planned examination procedures, documented the results, and reached and documented supportable conclusions in accordance with the *FHFA Examination Manual*, the BSA/AML examination module, and DBR guidance on workpaper preparation.

- The conclusions documented in the work program support those documented in the activity memorandum, the finding memorandum, conclusion memorandum, and the ROE.
- Adverse examination findings identified in the examination workpapers were reported in the ROE.

We conducted this performance audit from November 2018 through June 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Marla Freedman, Deputy Inspector General for Audits

FROM: Andre D. Galeano, Deputy Director, Division of FHLBank Regulation

SUBJECT: Management Response to Draft Audit Report: *FHFA Conducted BSA/AML Program Examinations of 10 of 11 Federal Home Loan Banks During 2016 – 2018 in Accordance with its Guidelines, But Failed to Support a Conclusion in the Report of Examination for the Other Bank*

DATE: June 28, 2019

Thank you for the opportunity to respond to the draft audit report. We appreciate OIG's acknowledgment that the Division of FHLBank Regulation (DBR) generally planned and conducted BSA/AML program examinations of the FHLBanks in accordance with FHFA and DBR guidance. The draft report makes two recommendations, with which FHFA agrees.

Recommendation 1: *Revise DBR's quality control procedures to specifically require that all examination workpapers supporting examination findings, conclusions, and ratings directly prepared by the EIC be reviewed by an individual who did not participate in the examination.*

Management Response to Recommendation 1: FHFA agrees with the recommendation. DBR will revise its written procedures to require examination workpapers prepared by the EIC to be reviewed by the EIC's Associate Director, or have that review delegated by the Associate Director to the team's Supervisory Examiner or to another EIC who did not participate on the examination. While both the Associate Director and Supervisory Examiner may participate in examinations, they do not report to the EIC and can conduct independent reviews.

We will modify our written procedure by September 30, 2019.

Recommendation 2: *Take action to either determine whether the unsupported conclusion in 2016 ROE for the FHLBank in question ("The Bank . . .") is accurate or inform the board of the FHLBank not to rely on the unsupported conclusion.*

Management Response to Recommendation 2: FHFA agrees with this recommendation. By September 30, 2019, DBR will provide an unredacted version of the OIG report to the FHLBank in question. When doing so, DBR will point to the recommendation regarding the 2016 ROE and advise the Bank that reports of examination are prepared for supervisory purposes and should not be considered an audit report.

We appreciate the OIG's work and professionalism during this engagement.

Cc: Chris Bosland
Larry Stauffer
John Major
Richard Dalton

ADDITIONAL INFORMATION AND COPIES.....

For additional copies of this report:

- Call: 202-730-0880
- Fax: 202-318-0239
- Visit: www.fhfaoig.gov

To report potential fraud, waste, abuse, mismanagement, or any other kind of criminal or noncriminal misconduct relative to FHFA's programs or operations:

- Call: 1-800-793-7724
- Fax: 202-318-0358
- Visit: www.fhfaoig.gov/ReportFraud
- Write:

FHFA Office of Inspector General
Attn: Office of Investigations – Hotline
400 Seventh Street SW
Washington, DC 20219