

Federal Housing Finance Agency  
Office of Inspector General



**FHFA's Housing Finance Examiner  
Commissioning Program:  
\$7.7 Million and Four Years into the  
Program, the Agency has Fewer  
Commissioned Examiners**



COM-2018-006

September 6,  
2018

## Executive Summary

In September 2011, we evaluated the capacity of the Federal Housing Finance Agency (FHFA or Agency) to examine Fannie Mae and Freddie Mac (the Enterprises) and the Federal Home Loan Banks (FHLBanks). We found, and the Agency agreed, that the efficiency and effectiveness of its examination program was impeded by an insufficient number of commissioned examiners. Agency officials said then they were in the process of establishing a commissioning program and expected it to be in place by late 2011. FHFA reported to us that as of late 2011, 46 individuals commissioned previously by other financial regulators were “directly involved in examination work” across the Agency. In 2013, FHFA completed development of its own Housing Finance Examiner Commission Program (HFE Program), consisting of classroom courses, on-the-job training (OJT), and a final examination.

The Agency publicly announced the HFE Program to its employees in June 2013 and opened enrollment to them in August 2013. According to FHFA, the goal of the HFE Program is to produce examiners with “broad-based knowledge to conduct successful risk-based examinations” and “the skills and technical knowledge necessary to evaluate the condition and practices of the entities that FHFA supervises” in “approximately four years.” Examiners could also receive HFE commissions based on having been commissioned previously by other financial regulators. During the first half of 2014, FHFA awarded the first HFE commissions to 59 examiners, based on commissions issued from other financial regulators.

In the almost seven years since our 2011 report, FHFA has invested approximately \$7.7 million in developing, implementing, and staffing its HFE Program. We launched this study to assess whether the HFE Program has increased the number of commissioned examiners on the FHFA staff and to determine how FHFA uses its commissioned examiners. This is the fourth report we have published on FHFA’s efforts to increase the size of its corps of commissioned examiners and our third evaluation of the HFE Program. In July 2015 and March 2017, we issued two reports in which we assessed whether the HFE Program was on track to produce commissioned examiners; on both occasions we found it was not. After the publication of our July 2015 report, FHFA identified the reasons that the HFE Program was not on track to produce commissioned examiners within four years and represented to us that it developed and implemented five remedial measures. In our March 2017 special report, we found that FHFA implemented only four of the five remedial measures. (In our fieldwork for this study, we determined that the Agency implemented the fifth remedial measure, but that its compliance with a different corrective action had lapsed.) We observed that FHFA had not, as



COM-2018-006

September 6,  
2018

of March 2017, completed or administered a final examination for the HFE Program, which precluded any enrollee from earning an HFE commission through completion of the program.

*FHFA has not increased the number of commissioned examiners since 2014 and is not on track to do so*

Based on our fieldwork for this study, we found that the Agency has not achieved its goal of increasing the number of commissioned examiners nor is it on track to do so. Since the Agency began awarding HFE commissions in 2014, the total number of its commissioned examiners has decreased from 59 (as of June 2014) to 58 (as of June 2018). Almost seven years after the Agency committed to develop and implement a commissioning program and \$7.7 million later, the Agency's examination program continues to be hindered by an insufficient number of commissioned examiners.

We found the HFE Program suffers from a high non-completion rate. Of the 66 examiners who enrolled in 2013, only 6 completed the HFE Program and passed its final examination. By June 2018 more than half (36) were no longer enrolled in the HFE Program. The remaining 24 continued to be enrolled as of June 1, 2018, almost five years into the approximately four-year program, and one-third (8) had completed less than 75% of the Program's requirements after five years. Since 2014, only 9 individuals have graduated from the HFE Program and passed the final examination.

*None of FHFA's targeted examinations of the Enterprises for the last two supervisory cycles have been led by commissioned examiners; roughly 75% of the examinations of the FHLBanks have been led by commissioned examiners*

This study also sought to assess the Agency's deployment of its commissioned examiners. FHFA acknowledges that "Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime" for the Enterprises and FHLBanks. The Office of the Comptroller of the Currency (OCC), which is responsible for the supervision of all national banks, requires a commissioned examiner to lead examinations, and the Federal Reserve, which is responsible for the supervision of bank holding companies, states that "[a]s a general policy, a commissioned examiner" should lead all "examinations and inspections." While we found no written policy from DBR or DER on the use of HFE commissioned examiners, we recognize that FHFA, in its 2013 *Performance and Accountability Report*, set forth its reasons for its HFE Program: "The main objective of the [HFE] program is to provide examiners with broad-based knowledge" in order "to lead the examination of a major risk area at Fannie Mae, Freddie Mac, and the Federal Home Loan Banks."



COM-2018-006

September 6,  
2018

FHFA's risk-based examinations are conducted by its Division of Federal Home Loan Bank Regulation (DBR), responsible for the supervision of the FHLBanks and the Office of Finance, and its Division of Enterprise Regulation (DER), responsible for the supervision of the Enterprises. Of FHFA's 58 commissioned examiners (as of June 2018), 34 worked in DBR, 18 worked in DER, and 6 worked outside DBR and DER.

Although the Deputy Directors of DBR and DER advised us that they sought to use HFE commissioned examiners to lead examinations, the practice within DBR and DER fell short of that aspiration. DBR's records reflect that, for each of the last three supervisory cycles, commissioned examiners led roughly 75% of annual DBR exams. DER records show that, for the 2016 and 2017 annual supervisory cycles, DER initiated a total of 53 targeted examinations (defined by FHFA as "a deep or comprehensive assessment" of areas of high importance or risk) and none of these 53 targeted exams was led by an HFE commissioned examiner.

*Most of the HFE Program has been suspended or is under internal review*

During our fieldwork for this study, we received a hotline complaint alleging, among other things, that FHFA's December 2017 HFE examination for DER candidates was flawed in numerous ways. After review of documents and interviews, we found that the December 2017 HFE final examination for DER candidates suffered from design and execution problems.

During our investigation of this hotline complaint, the DER Associate Director who oversees the Examiner Development Branch (EDB), which is responsible for administering the HFE Program, reported to us that he launched an initiative to look at the HFE Program "fresh." He explained that this initiative seeks to align internal FHFA classes with FHFA's supervisory program, assess existing OJT requirements, and determine how the content and administration of the final examination should be revised.

According to the DER Associate Director, he hopes that these changes will not cause the HFE Program to be completely redone. It remains to be seen whether the ongoing internal review will produce substantive changes to the HFE Program that will increase its effectiveness and produce HFE commissioned examiners within a four-year window.

We do not doubt that examiners enrolled in the HFE Program have benefited from their HFE Program course work and OJT. We question, however, whether the \$7.7 million in developing, implementing, and staffing the HFE Program has yielded the anticipated results. Based on our prior reports and the fieldwork for this study, we hold the view that the multiple failures in



COM-2018-006

September 6,  
2018

FHFA's administration of its HFE Program have derailed efforts to produce the HFE commissioned examiners that the Agency claimed to need.

We will maintain our recommendation to the Agency as "open" and will monitor the Agency's ongoing efforts to revise the HFE Program.

We provided FHFA with the opportunity to respond to a draft of this Report. Its written Management Response is attached in the Appendix.

This report was prepared by Gregg M. Schwind, Attorney Advisor; Karen E. Berry, Senior Investigative Counsel; Moira Roberts, Special Counsel; and Patrice E. Wilson, Senior Investigative Evaluator. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, [www.fhfaog.gov](http://www.fhfaog.gov).

David Frost  
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**TABLE OF CONTENTS** .....

EXECUTIVE SUMMARY .....2

ABBREVIATIONS .....7

BACKGROUND .....8

FACTS AND ANALYSIS.....10

1. The HFE Program has cost FHFA approximately \$7.7 million to date.....10
2. The net number of commissioned examiners working at FHFA decreased from 59 to 58 in the four years since the Agency began issuing HFE commissions. ....10
3. The HFE Program is still not on track to fulfill FHFA’s acknowledged need for additional commissioned examiners.....11
4. FHFA does not follow the written policies of other federal financial regulators with respect to its use of commissioned examiners.....12
5. Our investigation of a hotline complaint revealed design and execution problems with the December 2017 HFE final examination for DER candidates.....17
6. FHFA Has Launched a Top-to-Bottom Review of the HFE Program.....19

CONCLUSION AND QUESTIONED COSTS .....20

OBJECTIVE, SCOPE, AND METHODOLOGY .....22

APPENDIX: FHFA MANAGEMENT RESPONSE .....23

ADDITIONAL INFORMATION AND COPIES .....25

## ABBREVIATIONS .....

DBR	Division of Federal Home Loan Bank Regulation
DER	Division of Enterprise Regulation
EDB	Examiner Development Branch
Enterprises	Fannie Mae and Freddie Mac
HERA	Housing and Economic Recovery Act of 2008
ICP	Individual Commissioning Plan
FDIC	Federal Deposit Insurance Corporation
FHFA or Agency	Federal Housing Finance Agency
FHLBanks	Federal Home Loan Banks
HFE Program	Housing Finance Examiner Commissioning Program
OCC	Office of the Comptroller of the Currency
OIG	Federal Housing Finance Agency Office of Inspector General
OJT	On-the-Job Training
OPB	Operating Procedures Bulletin
OPM	Office of Personnel Management

## BACKGROUND.....

In September 2011, we issued a report in which we found—and the Agency agreed—that the efficiency and effectiveness of its examination program was impeded by an insufficient number of commissioned examiners. Although FHFA lacked a comprehensive list of commissioned examiners,<sup>1</sup> it provided us with the names of 46 commissioned examiners whom it determined to be “directly involved in examination work” across the Agency during 2011. These commissioned examiners constituted about one-third of FHFA’s corps of examiners.

In our 2011 report, we also found that, unlike other federal financial regulators, FHFA lacked an examiner commissioning program. Agency officials said they were then in the process of establishing such a program and expected it to be in place by late 2011.

According to FHFA, “Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime” for the Enterprises and FHLBanks.<sup>2</sup> In developing its HFE Program, FHFA looked at the commissioning programs in place at the Federal Deposit Insurance Corporation (FDIC), OCC, and Federal Reserve.

In June 2013, FHFA rolled out its HFE Program to its employees, explaining that the purpose of the program was to produce commissioned examiners who meet “a high professional standard of training and experience.” The Agency advised that the HFE Program would require “an approximately four-year commitment” that “may be shortened for participants with prior classroom training and work experience.”<sup>3</sup> FHFA’s acknowledgement of the significant role of commissioned examiners in its supervisory programs is underscored by its requirement that every examiner hired after July 17, 2013, must either have a commission from another financial regulator or graduate from the HFE Program and obtain an HFE commission. Enrollment opened to Agency employees in August 2013.

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<sup>1</sup> At that time, a commissioned examiner was an examiner who had received a commission from another financial regulator before coming to FHFA.

<sup>2</sup> By statute, FHFA must conduct annual examinations of the safety and soundness of the Enterprises and FHLBanks, the FHFA Director has substantially the same authority as the bank regulators, and examiners have the same authority as examiners employed by the Federal Reserve Banks. *See* 12 U.S.C. § 4517(a), (c), (e).

<sup>3</sup> During the fieldwork for our July 2015 compliance review, FHFA officials provided us with several scenarios under which an examiner would complete the HFE Program. Completion times for each scenario varied with the number of OJT and course requirements waived by the Agency. Under all these scenarios, however, the completion time projected by FHFA was less than four years. *See* *OIG, OIG’s Compliance Review of FHFA’s Implementation of Its Housing Finance Examiner Commission Program*, at 9 (July 29, 2015) (COM-2015-001).

In its 2013 *Performance and Accountability Report*, FHFA publicly explained the purpose of its HFE Program:

The main objective of the [HFE] program is to provide examiners with broad-based knowledge to conduct successful risk-based examinations. A Housing Finance Examiner Commission will indicate whether an examiner is qualified to lead the examination of a major risk area at Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The program . . . ensure[s] an examiner has the skills and technical knowledge necessary to evaluate the conditions and practices of the entities that FHFA supervises.

Since its inception, the HFE Program has been administered by the Agency's Examiner Development Branch (EDB). Among other things, EDB coordinates on-the-job training for enrolled examiners, administers courses (e.g., identifies course instructors, reviews course content, and schedules course dates and locations), reviews and approves waiver requests, and maintains records of enrolled examiners' progress in the HFE Program and their completion of it.

FHFA first awarded HFE commissions in 2014. It reported to us that, as of June 2014, it had awarded reciprocal HFE commissions to 59 examiners previously commissioned by other federal financial regulatory agencies.<sup>4</sup>

We conducted a compliance review of the Agency's implementation of the HFE Program with a specific focus on the 19-month period from August 2013 to March 2015 and published the results of our findings in July 2015. We found that the HFE Program was not on track to produce commissioned examiners within the approximately four-year period projected by FHFA, which we attributed to a number of shortfalls in the program that we identified. FHFA committed to take five corrective actions to address these shortfalls.

In March 2017, we issued a special report on FHFA's implementation of the five corrective actions it had committed to take. We found that FHFA had not implemented one of the five corrective actions and observed that FHFA had not, as of March 2017, completed or administered a final examination for the HFE Program, which precluded any enrollee from earning an HFE commission through completion of the program. We held open the recommendation from the July 2015 report.

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<sup>4</sup> In our July 2015 compliance review, cited above, we reported that FHFA advised us that it had awarded HFE commissions to 65 examiners previously commissioned by other financial regulators. In our March 2017 special report, we stated that FHFA had revised that number downward to 59.

## FACTS AND ANALYSIS .....

### 1. The HFE Program has cost FHFA approximately \$7.7 million to date.

Our review of FHFA documents found that, from January 2012 through June 2018, FHFA invested approximately \$7.7 million in its HFE Program.<sup>5</sup> Of this amount, \$7.1 million went to the compensation of approximately 24 employees assigned to EDB over that period, and the balance went to outside contractors, including the Office of Personnel Management (OPM), which provided program development services and assisted in the development of a final examination, and the Mortgage Bankers Association, which provided course materials and training.<sup>6</sup>

### 2. The net number of commissioned examiners working at FHFA decreased from 59 to 58 in the four years since the Agency began issuing HFE commissions.

Notwithstanding FHFA's expenditure of nearly \$8 million on the HFE Program, the net total number of HFE examiners has decreased by one since June 2014, when FHFA began to award HFE commissions.

The Agency reported to us that it opened enrollment in the program to Agency employees in August 2013, and offered the first required course in November of that year. During the first half of 2014, Agency records reflect that it awarded its first HFE commissions to 59 examiners, each of whom held a commission from another financial regulator.

As of June 2018, FHFA records reflect that it employed a total of 58 commissioned examiners—one examiner fewer than the 59 examiners who initially received HFE commissions in 2014. Of those 58 examiners: 49 held or will hold reciprocal commissions, having been commissioned previously by other financial regulators;<sup>7</sup> 2 held commissions

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<sup>5</sup> In its Management Response, FHFA disagrees “that approximately \$7.1 million in compensation over a three-year period represented expenditures on the HFE program.” As the text of this Report (and the draft reviewed by FHFA) makes clear, we calculated, from Agency documents, that FHFA spent \$7.1 million in compensation and benefits for EDB employees tasked with developing, implementing, and administering the HFE Program over a seven-year period. If anything, this calculation is conservative because it does not include compensation of FHFA employees outside EDB who worked in developing and administering the HFE Program. See note 6 below.

<sup>6</sup> This figure excludes salaries of FHFA employees outside of EDB who: assisted in developing the HFE Program, served as instructors, supervised OJT, drafted content for the HFE final examinations, prepared answer keys, and graded the examinations.

<sup>7</sup> Four of the 49 examiners who were granted commissions previously by other federal financial regulators will receive HFE commissions at an FHFA awards ceremony to be held in December 2018. We include them in the total (49) based upon the Agency's certification of their prior commissioning.

based on their completion of the HFE Program, a passing grade on its final examination, and the award of the HFE commission certificate; and 7 completed the HFE Program and passed the final examination, but were awaiting receipt of HFE commission certificates.

### **3. The HFE Program is still not on track to fulfill FHFA's acknowledged need for additional commissioned examiners.**

*The HFE Program has produced few commissioned examiners*

In our July 2015 compliance review, we found that the HFE Program was not on track to produce commissioned examiners qualified to lead major risk sections of examinations of the entities supervised by FHFA. Almost three years later, a total of 9 examiners have completed the HFE Program and passed its final examination, each in approximately four years (or less), the time frame projected by FHFA at the time of the 2013 program roll-out.

FHFA documents continue to show a high rate of non-completion among HFE Program enrollees. Of the 66 examiners enrolled in the HFE Program in 2013, only 6 completed the HFE Program and passed its final examination.<sup>8</sup> More than half (36) were no longer enrolled in the HFE Program by June 2018. Of these 36 enrollees, 16 left the Agency and 20 dropped out of the program. Sixteen of the 20 dropouts remain employed by FHFA as examiners or have been assigned to examination support or examination review. Of the remaining 24 enrollees who continued to be enrolled as of June 1, 2018, almost five years into the approximately four-year program, FHFA records show:

- 16 have completed 75% or more of the program's requirements;
- 3 have completed 50% to 75% of the requirements;
- 5 have not completed 50% of the requirements.<sup>9</sup>

*The Agency is not consistently taking the steps necessary to ensure that examiners progress through the HFE Program*

In our July 2015 compliance review, we reported that the HFE Program was not on track to produce, within approximately four years, commissioned examiners who were qualified to

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<sup>8</sup> The other 3 examiners who have completed the HFE Program and passed its final examination enrolled after August 2013.

<sup>9</sup> In its Management Response, FHFA maintains that we did not acknowledge that the HFE Program currently has 72 enrollees. The purpose of this study is to assess whether the HFE Program, which was launched in 2013, has increased the number of commissioned examiners on the FHFA staff, and to determine how FHFA uses its commissioned examiners. For that reason, the number of current enrollees in the HFE Program, which has been ongoing for five years, lacks relevance.

lead major risk sections of examinations. We recommended that the Agency determine the causes of the weaknesses that we identified in the HFE Program and implement a strategy to ensure the program would fulfill its central objective of producing commissioned examiners who are qualified to lead major risk sections of examinations. In response, FHFA committed to take five corrective actions. In our March 2017 special report, we found that FHFA implemented four of five corrective actions, but failed both to obtain Individual Commissioning Plans (ICPs) from all program enrollees and to include progress in the HFE Program in enrollees' annual performance reviews.

During our fieldwork for this report, we sought to determine whether the Agency had implemented this corrective action and found that it has done so. As of June 2018, the annual performance plan for each enrollee in the HFE Program included, as an objective, the enrollee's progress in meeting the ICP timeline for completion of HFE Program requirements.

However, we also found that the Agency's compliance with a different corrective action had lapsed. Specifically, FHFA committed to notify senior executives in DER and DBR of enrollees' progress in completing program requirements and explained that these regular update reports would enhance executive oversight of HFE Program participants' progress.

We reported, in our March 2017 special report, that FHFA provided an annual update to DBR and DER senior executives in December 2016 summarizing the status of each enrollee's progress in the HFE Program. During our fieldwork, we inquired whether updates were provided for 2017 and learned that FHFA issued no such updates during 2017. After we made this inquiry, FHFA provided updates in April 2018.

#### **4. FHFA does not follow the written policies of other federal financial regulators with respect to its use of commissioned examiners.**

According to FHFA, "Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime" for the Enterprises and FHLBanks.<sup>10</sup> Like the OCC, the Federal Reserve, and the FDIC, FHFA conducts annual examinations of its regulated entities, reports on examination findings in annual reports of examination, and, when necessary, issues findings identifying deficiencies.<sup>11</sup> FHFA's governing statute grants

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<sup>10</sup> By statute, FHFA must conduct annual examinations of the safety and soundness of the Enterprises and FHLBanks, the FHFA Director has substantially the same authority as the bank regulators, and examiners have the same authority as examiners employed by the Federal Reserve Banks. *See* 12 U.S.C. § 4517(a), (c), (e).

<sup>11</sup> The Federal Reserve establishes examination standards, and the Reserve Banks are responsible for supervising bank holding companies, Federal Reserve System member banks, foreign branches of member banks, and other related entities to ensure safe and sound banking practices and compliance with applicable laws and regulations. *See, e.g.*, Federal Reserve Bank of New York, Supervision (online at [www.newyorkfed.org/aboutthefed/org\\_banksup.html](http://www.newyorkfed.org/aboutthefed/org_banksup.html)). The OCC is responsible for ensuring that national

the Director authority to use examiners from the OCC, the Federal Reserve, and the FDIC to conduct examinations, and requires the Director to set compensation levels for FHFA staff that are comparable to other federal financial regulators.<sup>12</sup>

In the Housing and Economic Recovery Act of 2008 (HERA), Congress specifically directed that FHFA examiners “have the same authority and each examiner shall be subject to the same disclosures, prohibitions, obligations, and penalties as are applicable to examiners employed by the Federal Reserve banks.” 12 U.S.C. § 4517(e). According to written guidance issued by the Federal Reserve, examinations shall be led by commissioned examiners, absent “exceptional circumstances.”<sup>13</sup>

Application of HERA suggests that only commissioned examiners should lead examinations by DBR and DER, save for “exceptional circumstances.” We found no written guidance from FHFA, DBR, or DER that sets forth this requirement. As we now show, non-commissioned examiners in DBR and DER have been regularly assigned to lead examinations during the past few supervisory cycles, when no exceptional circumstances exist.

*Assignments of HFE-commissioned examiners in DBR and DER during recent supervisory cycles*

DBR is charged by FHFA with supervision of the FHLBanks and the Office of Finance. At year-end 2017, the 11 FHLBanks collectively reported about \$1.1 trillion in assets. DBR’s supervisory activities for the 11 FHLBanks and the Office of Finance consist of annual examinations of each of these entities as well as periodic visitations, special reviews, and off-site monitoring.

FHFA documents show that, as of June 2018, 110 FHFA employees were assigned to DBR, of which 34 (31%) held HFE commissions, a decrease of 2 HFE commissioned examiners

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banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. See 12 U.S.C. § 1 et seq., 12 U.S.C. § 1461 et seq. See also OCC, What We Do (online at [www.occ.gov/about/what-we-do/mission/index-about.html](http://www.occ.gov/about/what-we-do/mission/index-about.html)). The FDIC examines its supervised financial institutions for safety and soundness and consumer protection. See also FDIC, Mission, Vision, and Values (online at [www.fdic.gov/about/strategic/strategic/mission.html](http://www.fdic.gov/about/strategic/strategic/mission.html)).

<sup>12</sup> See 12 U.S.C. §§ 4515(b), 4517(c). A federal court has observed that Congress granted FHFA the same powers it granted bank regulators and that Congress intended FHFA’s regulatory framework to mirror the banking regulatory framework. See *Fed. Hous. Fin. Agency v. JPMorgan Chase & Co.*, 978 F. Supp. 2d 267 (S.D.N.Y. 2013).

<sup>13</sup> See Federal Reserve Supervisory Letter SR-6 (GEN), at 12 (Jan. 30, 1995). The OCC has issued similar guidance. See Comptroller’s Handbook (Bank Supervision Process), at 5, 7 (Sept. 2012).

since June 2014. According to DBR records, as of June 2018, 33 of the 34 HFE commissioned examiners assigned to DBR participated in examination work.<sup>14</sup>

The Deputy Director of DBR, who assumed that position in August 2017, told us that, absent exigent circumstances, he would prefer annual examinations of the FHLBanks and the Office of Finance to be led by commissioned examiners. His stated preference aligns with the Agency objective for the HFE Program: “to provide examiners with broad knowledge to conduct successful risk-based examinations.”

For each annual supervisory cycle, DBR management appoints 12 line examiners to lead its annual examinations, and these appointed examiners are designated examiners-in-charge (EICs) for the annual examinations they are leading. DBR does not consider its EICs, appointed on a temporary basis, to be senior members of the DBR examination staff.<sup>15</sup>

DBR’s records reflect that, for each of the three most recent supervisory cycles (including the ongoing 2018 cycle), commissioned examiners have not been appointed as EICs for roughly 25% of the 36 examinations. In 2016, examiners with HFE commissions were appointed as EICs to lead 9 of 12 annual examinations, and in 2017, examiners with HFE commissions were appointed to lead 10 of 12 annual examinations. For 2018, the current Deputy Director of DBR determined that only 9 of the 12 annual exams would be led by HFE-commissioned examiners, roughly the same rate as his predecessor.<sup>16</sup> The Deputy Director identified no exigent circumstances that prevented him from appointing HFE commissioned examiners to lead each of the 12 annual examinations during 2018. He explained that he chose examiners

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<sup>14</sup> Within DBR, its Examinations Group is comprised of 54 examiners, 31 of whom (57%) are commissioned. Two of the 3 commissioned DBR examiners outside the Examinations Group participate in examination work: the Deputy Director reviews and approves all DBR’s reports of examination, and one of his advisors participates directly in several annual DBR examinations. The third commissioned employee is assigned to the DBR Office of Risk Modeling where he does not perform any examination work or support or review examinations.

<sup>15</sup> The senior members of DBR’s examination staff are those executive-level employees who either perform examination work or provide management oversight, direction, and support for examination activity. According to DBR, senior leadership of DBR’s examination staff consists of eight positions and all of those positions are currently filled. Those positions are: the DBR Deputy Director, the four associate directors in the Examinations Group, and the three managers in the Examinations Group (supervisory examiners). Individuals in seven of these positions currently hold HFE commissions and the individual in the eighth position has completed the HFE training program and passed the final examination and will receive a commission at an FHFA awards ceremony planned for December 2018.

<sup>16</sup> In its Management Response, FHFA asserts, without evidentiary support that, for this three-year period, “over 80 percent of annual examinations” of the FHLBanks were “overseen by HFE-commissioned EICs and managers.” We calculated both the number of examinations led by HFE-commissioned examiners and the percentage from examination documents produced by DBR and stand by our calculations.

without HFE commissions to lead these three examinations based upon two factors that he values more than an HFE commission: capability and diversity.

We take issue with his claim that non-commissioned examiners have greater capability than HFE commissioned examiners. According to FHFA, the purpose of the HFE Program “ensure[s] an examiner has the skills and technical knowledge necessary to evaluate the condition and practices of the entities that FHFA supervises.” Accordingly, the capability of an HFE-commissioned examiner should be equal to, or exceed, the capability of a non-commissioned examiner.

DER is charged by FHFA with supervision of the Enterprises. At year-end 2017, the Enterprises owned or guaranteed more than \$5 trillion in mortgage assets. DER exercises supervision of the Enterprises through ongoing monitoring and targeted examinations.<sup>17</sup> According to FHFA, the two activities are complementary: targeted examinations enable examiners to conduct “a deep or comprehensive assessment” of the areas found to be of high importance or risk. FHFA documents show that, as of June 2018, 156 FHFA employees were assigned to DER, of which 18 (12%) held HFE commissions—a decrease of 1 since June 2014, when there were 19 HFE-commissioned examiners assigned to DER. DER records establish that, as of June 2018, 15 of these 18 HFE commissioned examiners participated in examination work.<sup>18</sup>

According to the Deputy Director of DER, who has held that position on an acting and then permanent basis since 2014, she would prefer that HFE commissioned examiners lead and conduct targeted examinations. Like the Deputy Director of DBR, her stated preference aligns with FHFA’s objective for the HFE Program: to “provide examiners with broad-based knowledge to conduct successful risk-based examinations” and who are “qualified to lead the examination of a major risk area at Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.” She explained, however, that DER lacked the commissioned examiner resources

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<sup>17</sup> DER currently has 21 positions on its senior examination staff. These positions include: the DER Deputy Director; the Fannie Mae Examiner-in-Charge and the managers of the four branches of the Fannie Mae Examination team; the Freddie Mac Examiner-in-Charge and the managers of the four branches of the Freddie Mac Examination team; the Associate Director of the Office of Risk and Policy and the managers of the four branches of the Office of Risk and Policy; the Chief Accountant and the managers of the four branches of the Office of the Chief Accountant. All of these 21 positions are currently filled. Of the 21 individuals in these positions, only 7 (33%) hold HFE commissions. The Deputy Director of DER is not commissioned, nor are 4 of the 8 (50%) exam team managers. The EICs of the Fannie Mae and Freddie Mac exam teams hold HFE commissions.

<sup>18</sup> Within DER, the Fannie Mae and Freddie Mac examination teams are comprised of 64 examiners, 10 of whom (16%) are commissioned. The 8 remaining commissioned examiners in DER are assigned as follows: 5 work in offices within the Office of Risk and Policy and the Office of Chief Accountant where they perform examination-related work, and 3 are assigned to the Office of Enterprise Supervision Operations where they do not perform examination work or support or review examinations.

necessary to assign HFE-commissioned examiners to conduct or lead its targeted examinations.

Her explanation rings hollow to us for two reasons. First, DER's records show that HFE-commissioned examiners were not assigned to lead any of the targeted examinations initiated during the 2016 and 2017 annual supervisory cycles. DER's supervisory plans for those two cycles showed a total of 53 targeted examinations of the Enterprises. DER's practice is to assign a team of examiners to each targeted examination, with each team headed by a lead examiner. In view of the stated preference by the Deputy Director of DER, we expected to find that HFE-commissioned examiners were assigned to lead some of these 53 targeted examinations. Our review of DER workpapers for these examinations, all of which identified the lead examiner and members of the examination team, found that none were led by examiners holding HFE commissions and no HFE commissioned examiners were members of the exam teams.<sup>19</sup>

Second, DER's recent hiring practices suggest that it has not sought to increase the number of commissioned examiners. DER records show that the Fannie Mae and Freddie Mac examination teams experienced a high rate of examiner turnover since early 2015.<sup>20</sup> Our review of DER organizational charts from February 2015 to June 2018 found that DER hired or assigned at least 32 examiners onto the Fannie Mae and Freddie Mac examination teams during this 40-month period, but only 3 (of these 32) held commissions from other financial regulators when hired. Had the current Deputy Director of DER, in that position since 2014, sought to assign commissioned examiners to lead and conduct targeted examinations, she

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<sup>19</sup> FHFA's stated purpose in developing and implementing its HFE Program was to produce commissioned examiners who were "qualified to lead the examination of a major risk area at Fannie Mae, Freddie Mac, and the Federal Home Loan Banks." For each targeted examination, Agency documents identify the "lead examiner" (or examiner point of contact) for the examination, and workpapers identify the examiners who carried out the examinations. We reviewed more than 200 records of these 53 targeted examinations and found that none of these 53 targeted examinations were led by an HFE-commissioned examiner and none included an HFE-commissioned examiner on the exam team.

In its Management Response, FHFA attempts to minimize this significant shortcoming by maintaining, without evidentiary support, that "over 80 percent of targeted examinations of the Enterprises" during this period were "overseen by HFE-commissioned EICs and managers." FHFA's records reflect that neither the DER Deputy Director, DER Associate Director nor the EIC for the exam team for one Enterprise held HFE commissions during the period when these 53 targeted examinations were commenced. To the extent that any of these three executives oversaw the targeted examinations, that oversight was not provided by an HFE-commissioned manager. The EIC for one Enterprise during the relevant period held an HFE commission. Because his name did not appear on any workpapers for the targeted examinations for this Enterprise, we found no evidentiary basis to conclude that the examination work was "led" by this EIC.

<sup>20</sup> We observed in a 2017 report that of the 61 examiners on DER's January 2017 organizational chart, only 28 had been in DER for the preceding four-year period. See *OIG, FHFA's Practice for Rotation of its Examiners Is Inconsistent Between its Two Supervisory Divisions* (Mar. 28, 2017) (EVL-2017-004).

would have taken actions necessary to hire or assign far more than 3 commissioned examiners to the Fannie Mae and Freddie Mac examination teams during this 40-month period.

## **5. Our investigation of a hotline complaint revealed design and execution problems with the December 2017 HFE final examination for DER candidates.**

During our field work on this study, we received a hotline complaint alleging, among other things, that FHFA’s December 2017 HFE examination for DER candidates may not have been written by commissioned examiners; was “really vague”; was not capable of being scored; could not have been scored; set people up to fail; and, as a result, was a waste of time and resources. Seven DER candidates took the December 2017 HFE exam; five passed and two did not.<sup>21</sup> After reviewing documents and conducting interviews we found design and execution issues with this examination.

### *Development of the HFE final examinations*

As part of its efforts to develop its HFE Program, FHFA initially determined to follow the course set by the FDIC, Federal Reserve, and the OCC and to offer a final validated examination. According to OPM, a “validated” examination is one that has been determined to test fairly whether an individual has the skills and abilities necessary to perform the tasks associated with the position; it measures the extent to which exam scores are related to current or future job performance.

In September 2014, the Office of Personnel Management (OPM) began work, under contract with FHFA, to develop two validated exams for the HFE Program—one for DER examiners who completed the program and one for DBR examiners who completed the program.

The development of the final examination was delayed by internal disagreements among the FHFA subject matter experts over what the HFE final exam should test, as well as disagreements between FHFA and OPM about the length and content of the examination. EDB, which tracked the development of the exams, issued internal progress reports. In its August 2015 report, which was the last one provided to us, EDB stated that all the case studies developed by FHFA needed further review or revision. However, the DER Associate Director, to whom EDB reports, told us that he understood that subsequent updates had been made. He recalled that no one working on the HFE exams raised any concerns to him that the exam content had not been finalized.

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<sup>21</sup> Five DBR candidates took the December 2017 exam; two passed and three did not. The Deputy Director, DBR, caused the failing examinations of DBR candidates to be reviewed by the DBR Associate Director, who confirmed the original scoring.

The head of EDB recalls that she was instructed by DER officials, during 2016, to administer the HFE final examination by March 31, 2017. However, in EDB's files she found only exam materials marked "draft." She asked OPM for the "best/last version" of the examination in its files, which she then received from OPM. Neither the EDB head nor the Associate Director could say with certainty who prepared the exam materials, and both told us that they assumed the exam materials provided by OPM were final products.

The head of EDB reported that, based on her experience with OPM, OPM would have reported if the exam materials had not been finalized and it did not do so. In view of the time and resources dedicated by the Agency to develop the draft exam materials, we were surprised to learn that no senior DER official conducted a qualitative or quantitative assessment of the exam materials provided by OPM to determine whether they tested for the skills sought in HFE commissioned examiners working in DER.

#### *FHFA's decision not to administer an OPM-validated final examination*

FHFA reported to us that it determined in 2017 that it no longer needed a validated final exam from OPM because it determined that it would not use the HFE commission as the basis for employment decisions. It acknowledged that none of the HFE exams were validated by OPM. The DER Associate Director stated that at some point in early 2017, after several meetings with OPM, he and other senior FHFA officials concluded that FHFA would stop engaging with OPM and that EDB would administer HFE exams in March 2017, for DER and DBR candidates, using the exam materials provided by OPM. Prior to the contract's expiration, FHFA paid OPM \$109,500 for its services in assisting FHFA in developing a validated examination.

#### *The March 2017 final examinations*

The DER Associate Director acknowledged that he and others determined that administration of the first HFE final examinations had to occur in March 2017, or the HFE Program would have "lost all credibility." The head of EDB recalled that she was asked by the DER Associate Director whether EDB had the "materials" for the March 2017 final examinations, and responded that EDB had sufficient materials to offer a two-day exam for DER and for DBR candidates. She did not know whether senior officials in DER and DBR reviewed the March 2017 final examination before it was administered; she was directed by the DER Associate Director to administer that examination. The DER Associate Director reported to us that he understood in early 2017, from discussions with the head of EDB and others, that the exam materials for the March administration of the HFE exams were "okay" because OPM told him it had followed its process, but that the grading rubric remained outstanding. Nonetheless, the examination was administered to four candidates; the two DBR candidates passed and the two DER candidates did not.

### *The December 2017 final examinations*

Another set of HFE examinations was administered in December 2017. The head of EDB recalled that she read the December 2017 examinations before they were administered. She acknowledged to us that the DER case study used a chronology that was difficult to understand, but that was not an area of her expertise; the case study might have been unclear because of badly handled redactions; one of the exam questions referenced a document that was omitted from the case study materials; and another exam question asked about asset quality risk although the case study materials dealt with operational risk. According to the EDB head, she did not raise any of these concerns because she believed that the exam materials from OPM were final products and that it was not her place to question materials received from OPM.

FHFA reported to us that none of the content for the December 2017 HFE exam for DER candidates was reviewed or approved by senior DER officials. Given the time and resources devoted by DER staff to developing the HFE Program, offering the required courses and OJT, and drafting the exam content, we cannot understand why senior DER officials permitted administration of the December 2017 DER final examination when they did not review and approve the content of this exam and subject it to quality control review, or why the head of EDB did not escalate her concerns to the Associate Director. Experienced commissioned examiners, tasked with preparing an answer key for the December 2017 DER exam, also identified issues with the exam and flagged two of the issues on the answer key. According to the head of EDB, she discussed the issues with one of the individuals who prepared the answer key. However, the head of EDB and other EDB staff used the answer key to grade the exam.

The DER Associate Director separately acknowledged that he was informed about problems with the December 2017 DER exam after it was administered, and that he believed the exam could be better. The Associate Director and the head of EDB confirmed that the final examination taken by DER candidates in December 2017 would no longer be used. However, neither reported to us that these problems rendered the December 2017 DER exam invalid.

### **6. FHFA Has Launched a Top-to-Bottom Review of the HFE Program.**

The DER Associate Director reported that he launched a review of the entire HFE Program, after the administration of the December 2017 final examination, to see whether any changes should be made to it. He caused a working group to be convened in April 2018 and the group has prepared a Staff Analysis Memo of the work it planned to undertake.

That Staff Analysis Memo proposed to review the course curriculum to ensure that the courses aligned to FHFA's supervisory guidance and the Agency's CAMELSO rating

system.<sup>22</sup> The DER Associate Director has proposed specific changes to the HFE Program, for review and approval by the Deputy Directors of DER and DBR. For example, he seeks to eliminate course and OJT waivers; redesign courses to tie them more closely to examination rating areas; administer tests at the conclusion of every course; and administer only one HFE exam for the HFE Program, not separate exams for DER and DBR candidates. The working group may have additional proposed changes, which will also require review and approval. All changes that receive such approval will be captured in an Operating Procedures Bulletin (OPB) issued by DER or by a joint supervision directive issued by DER and DBR.

The DER Associate Director expressed the view that such changes would make the HFE Program more effective for examiners and hoped that the changes would not require the HFE Program to be completely redone. He reported to us that FHFA’s internal classes for the HFE Program will not be offered until the review of the classes is completed, the HFE final examination to examine candidates’ understanding of the skills to be taught in the revised HFE Program had been suspended, and the OJT requirements are pending review.<sup>23</sup>

## CONCLUSION AND QUESTIONED COSTS .....

In 2011, FHFA acknowledged that the efficiency and effectiveness of its examination program was impeded by the limited number of commissioned examiners then in its employ, totaling 46. The Agency developed a commissioning program with the stated objectives of providing examiners with “broad-based knowledge to conduct successful risk-based examinations” and qualifying them “to lead the examination of a major risk area at Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.”

After seven years and the expenditure of nearly \$8 million, FHFA’s HFE Program has not produced, and is not on track to produce, a significant increase in the number of commissioned examiners sought by the Agency. During the first half of 2014, FHFA records reflect that it awarded its first HFE commissions to 59 examiners, each of whom held a commission from another financial regulator. As of June 2018, FHFA records reflect a total of 58 commissioned examiners—one fewer than the 59 HFE commissions initially awarded by the Agency in 2014. Candidates’ progress through the HFE Program has been slow, with only 9 examiners completing it in four years or less. The Agency has not consistently implemented corrective actions intended to reverse this trend.

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<sup>22</sup> CAMELSO refers to the components of the ratings framework FHFA uses to examine its regulated entities: Capital, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk, and Operational risk.

<sup>23</sup> The Associate Director reported that he would like to administer a final HFE examination in the fall of 2018 for those DER and DBR candidates who previously completed all the necessary courses and OJT.

This study also sought to assess the Agency’s deployment of its commissioned examiners. FHFA acknowledges that “Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime” for the Enterprises and FHLBanks. The OCC, which is responsible for the supervision of all national banks, requires a commissioned examiner to lead examinations, and the Federal Reserve, which is responsible for the supervision of bank holding companies, states that “[a]s a general policy, a commissioned examiner” should lead all “examinations and inspections.” While we found no written policy from FHFA, DBR, or DER on the use of HFE commissioned examiners, we recognize that FHFA, in its 2013 *Performance and Accountability Report*, explained that the main objective of the HFE Program was to produce commissioned examiners who are “qualified to lead” examinations of major risk areas at the entities supervised by FHFA.

However, that objective has not been fulfilled in practice. DBR workpapers demonstrate that DBR has only achieved that objective roughly 75% of the time over the past three years and DER failed to assign a single HFE commissioned examiner to lead any of the 53 targeted examinations initiated in the 2016 and 2017 supervisory cycles.

We do not doubt that examiners enrolled in the HFE Program have benefited from their course work and OJT. We question, however, whether the \$7.7 million in developing, implementing, and staffing the HFE Program has yielded the anticipated results.<sup>24</sup>

Based on our prior reports and the fieldwork for this report, we hold the view that the multiple failures in FHFA’s administration of its HFE Program have derailed efforts to produce the HFE commissioned examiners that the Agency claimed to need. The DER Associate Director reported to us that he launched an initiative to look at the HFE Program “fresh” and intends to issue an OPB with changes to the HFE Program. He stated that he hopes that these changes will not cause the HFE Program to be completely redone. It remains to be seen whether the ongoing internal review produces substantive changes to the HFE Program that increase its effectiveness and produce HFE commissioned examiners within a four-year window.

We will maintain our recommendation to the Agency as “open” and will monitor the Agency’s ongoing efforts to revise the HFE Program.

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<sup>24</sup> FHFA, in its Management Response, asserts that employee compensation costs to develop and implement the HFE Program do not meet the definition of “questioned costs” as defined by the Inspector General Act. We disagree. As we report, FHFA has not achieved its stated goal of increasing the number of commissioned examiners, and is not on track to do so; its HFE Program has a high non-completion rate and has produced few graduates; and it is not using commissioned examiners to lead examinations of major risk areas at the Enterprises. For those reasons, we conclude that the costs of the HFE Program, including the compensation paid to employees to develop and implement this Program, were either “unnecessary or unreasonable” within the definition of “questioned costs” under section 5(a)(6) of the Inspector General Act.

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

The OIG Office of Compliance and Special Projects initiated this study to assess the status of FHFA’s HFE Program and determine whether to close the recommendation made in the March 2012 OIG report and subsequently reopened in the July 2015 OIG report. Our objectives included an assessment of whether the HFE Program has succeeded in increasing the number of HFE-commissioned examiners within approximately four years and to understand the Agency’s use of commissioned examiners.

To address our objectives, we requested documents related to the status of the HFE Program, including a list of commissioned examiners, a roster of HFE Program enrollees with the progress of each enrollee, information related to the HFE final examination, and program policies/procedures. We also asked for detailed cost data related to the HFE Program such as amounts paid to outside entities (e.g., OPM) and employee compensation (salary/benefits) information.

We reviewed FHFA’s documentation of the DER targeted examinations initiated in 2016 and 2017 to draw conclusions as to DER’s use of commissioned examiners to lead or participate in examinations. We also reviewed documentation of annual FHLBank examinations conducted by DBR in 2016 and 2017, and planned for 2018. We researched and reviewed publicly available examiner and commissioning policies of the Federal Reserve and OCC.

Our work also included identifying HFE Program participants who enrolled in the program in 2013 and tracking their progress to June 2018. Finally, we interviewed the Deputy Directors for DER and DBR, as well as the manager of the Examiner Development Branch, and other FHFA employees involved in the development and implementation of the program since 2011.

We conducted our compliance review during the period January to August 2018 under the authority of The Inspector General Act of 1978, and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

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



### Federal Housing Finance Agency

#### MEMORANDUM

TO: David M. Frost, Acting Deputy Inspector General, Compliance & Special Projects

FROM: Nina A. Nichols, Deputy Director, Division of Enterprise Regulation (DER) <sup>NAN</sup>  
Andre D. Galeano, Deputy Director, Division of Bank Regulation (DBR) 

SUBJECT: Draft OIG Report: *FHFA's Housing Finance Examiner Commissioning Program: \$7.7 Million and Four Years Later, the Agency Has Fewer Commissioned Examiners*

DATE: August 30, 2018

This Memorandum transmits the management response of the Federal Housing Finance Agency (FHFA) to the FHFA OIG (OIG) draft report referenced above (Report).

While the Report contains no new recommendations, the Agency will continue to administer FHFA's Housing Finance Examiner Commissioning Program (HFE Program) to support and strengthen the Agency's supervision function. Since establishment of the HFE Program in 2013, FHFA has awarded a total of 62 HFE commissions, and 72 employees are currently enrolled. FHFA continues to work to ensure that all enrollees receive the support needed to complete the HFE Program successfully.

FHFA disagrees with various statements in the Report, and we identified factual inaccuracies that we shared with the OIG. FHFA does not agree with the statement in the Report that approximately \$7.1 million in compensation over a three-year period represented expenditures on the HFE Program. During that time period, the compensated employees also worked to develop and administer other training events, including agency-wide conferences and non-HFE training courses. Furthermore, FHFA does not agree with the OIG's conclusion that the compensation meets the definition of "questioned costs" as defined by the Inspector General Act, as the Report offers no support for the conclusion that all of the costs of the employees' work were unsupported, unnecessary, or unreasonable.

FHFA believes the Report incorrectly applies examination-related provisions of the Housing and Economic Recovery Act of 2008 (HERA) in suggesting HERA mandates that administrative requirements imposed by another federal financial regulator on its examiners must also apply to FHFA examiners. We do not believe this is a reasonable or supported inference of the statute. Furthermore, the Report states that other federal agency guidance requires financial institution examinations to be led by commissioned examiners. The referenced guidance, however, governs only the duties of the examiner-in-charge (EIC), not non-EIC examiners conducting individual targeted examinations. At FHFA, HFE commissions are held by a substantial majority of EICs, examination managers, and examination associate directors, who are responsible for leadership and oversight of examinations of the regulated entities. During the time period covered by the Report, over 80 percent of targeted examinations of the Enterprises and over 80 percent of annual examinations of the Federal Home Loan Banks were overseen by HFE-commissioned EICs and managers.

FHFA does not believe the Report accurately captures DER management's description of the Agency's internal review of the HFE Program. While certain internal courses are currently under review, others are not, and external courses and on-the-job training assignments continue.

Finally, the Report's conclusion that FHFA did not meet its commitment to provide the supervisors of HFE Program enrollees with annual updates summarizing the remaining HFE Program requirements for each enrollee is inaccurate. FHFA provided such transcripts to each candidate and to each candidate's supervisor in 2015, 2016, and 2017, the periods covered by the Report.

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

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