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Federal Housing Finance Agency
Office of Inspector General



**Special Report on the
Common Securitization Platform:
FHFA Lacked Transparency and
Exercised Inadequate Oversight over
a \$2.13 Billion, Seven-Year Project**

This document contains redactions of information that is protected under the Privacy Act of 1974 (Pub.L. 93-579, 88 Stat. 1896, enacted December 31, 1974, 5 U.S.C. § 552a).

Special Report • OIG-2019-005 • March 29, 2019

Background

In 2012, the Federal Housing Finance Agency (FHFA or Agency), the conservator of Fannie Mae and Freddie Mac (the Enterprises), directed them to build a Common Securitization Platform (CSP or Platform) to replace their current separate “back-office” systems and to issue a single mortgage-backed security (single security).¹ FHFA reported to Congress that, in its view, the Enterprises’ back-office systems were “outmoded,” and it assumed that the cost to build the CSP and integrate into it the Enterprises’ legacy financial and information technology (IT) systems would be less than the combined costs for the Enterprises to upgrade their back-office systems.²

As originally envisioned by FHFA, the CSP was intended to facilitate issuance of mortgage-backed securities (MBS) by multiple market participants in a future housing finance system.³ The costs for building the Platform were to be borne entirely by the Enterprises. In 2013, FHFA directed the Enterprises to establish and fund a joint venture, Common Securitization Solutions, LLC (CSS), to develop and ultimately operate the CSP. As we reported in May 2014, the work completed as of March 2014 accounted for more than half of the software development necessary to build the Platform, and, as of December 31, 2013, the Enterprises had spent approximately \$65 million on its development.

In May 2014, the then-FHFA Director announced that FHFA had redefined the scope of the CSP project. He explained that developing the CSP to operate in a future housing finance system that had not yet been defined was “extremely risky and could add needless costs.” FHFA decided to “de-risk” the project and limit its scope to a CSP that works “for the benefit of Fannie Mae and Freddie Mac.” According to the then-FHFA Director, “a successful outcome [would] be a seamless transition from the current in-house systems that issue new securities at each Enterprise to a future joint venture owned by Fannie Mae and Freddie Mac that operates one system with updated technology.” Once the CSP was issuing a single security for the Enterprises, FHFA projected that the Platform would “be adaptable for use

¹ See FHFA, *A Strategic Plan for the Conservatorships: The Next Chapter in a Story that Needs an Ending*, at 13 (Feb. 21, 2012). The security itself will be called the Uniform Mortgage-Backed Security (UMBS); as in previous reports, we refer to the UMBS as the “single security.”

² FHFA, *2012 Report to Congress*, at 13 (pdf 25) (June 13, 2013) (online at www.fhfa.gov/AboutUs/Reports/Pages/FHFA-2012-Annual-Report-to-Congress.aspx).

³ See FHFA, *A Strategic Plan for the Conservatorships: The Next Chapter in a Story that Needs an Ending* (Feb. 21, 2012). The “back-office” systems perform the following five functions: data acceptance, issuance support, disclosures, master servicing operations, and bond administration. For more detail on these functions, see OIG, *Status of the Development of the Common Securitization Platform* (May 21, 2014) (EVL-2014-008) (online at www.fhfa.gov/Content/Files/EVL-2014-008.pdf).

by other secondary market actors” when “the future state [of the housing finance system] is more defined.”⁴

When the then-FHFA Director redefined the scope of the CSP, he committed that FHFA would be transparent in its development efforts and incorporate feedback from stakeholders, including the public, whenever possible.

According to FHFA, the de-risked CSP is to be completed in two phases—Release 1 and Release 2. Release 1, which was rolled out in November 2016, consisted of Freddie Mac’s use of the CSP to issue single-family fixed-rate MBS. Release 2, projected by the end of the second quarter of 2019, will require both Enterprises to use the CSP to issue the new single security.

In December 2016, we issued a report in which we assessed whether FHFA had honored its commitment to transparency by disclosing what it knew about the costs of the CSP, both actual and projected, and the risks. We determined that FHFA collected three sets of data: the actual and projected costs to the Enterprises to develop the CSP, the actual and projected costs for the Enterprises to integrate their IT systems into the CSP, and the risks to the successful implementation of the CSP.

We found that FHFA:

- Issued several public updates from May 2014 through early July 2016 in which it discussed the status of development of the CSP and disclosed only the actual cost of \$146 million incurred to develop and test the CSP through mid-2015;
- Represented to Congress, in a non-public cover letter transmitting its July 7, 2016, public update, that, as of the first quarter of 2016, the actual and projected costs to develop and test the CSP through 2018 totaled \$696 million; and
- Did not disclose to Congress or to the public what it knew about the Enterprises’ actual and projected integration costs in any of these updates.

⁴ The Chairman of the Senate Committee on Banking, Housing, and Urban Affairs recently released an outline for the reform of the housing finance system. Among other things, that outline envisions that the “[t]echnology and infrastructure being developed as part of the Common Securitization Platform may be sold or transferred to Ginnie Mae” for Ginnie Mae to operate. On March 27, 2019, the President issued a memorandum directing the Secretary of the Treasury to develop a plan for administrative and legislative reforms to achieve a number of housing reform goals, including “ending the conservatorships of the [Enterprises] upon the completion of specified reforms.” (Online at <https://www.whitehouse.gov/presidential-actions/memorandum-federal-housing-finance-reform/>).

From internal documents provided to us by FHFA, we calculated that, as of July 2016, the Enterprises' actual and projected integration costs totaled \$778 million.

After FHFA received a draft of our December 2016 report for technical comment and learned that we would disclose these actual and projected integration costs, the Agency received a request from Congress for both actual and projected development and integration cost data. In response, the Agency disclosed all of these costs to Congress—for the first and last time. It disclosed a total projected cost of \$1.54 billion (\$696 million in development costs, and \$845 million in integration costs) for the CSP project.⁵

We also found that FHFA had not publicly disclosed the risks to successful development and implementation of the CSP, in disregard of its commitment to transparency. FHFA's rationale for failing to honor its commitment was that the technical risks identified in its internal monthly reports were being remediated and would not affect the completion date for the CSP. Its decision not to disclose both the total actual and projected costs of the CSP and its assessment of the risks deprived stakeholders of important information about the CSP.

FHFA promised to issue another public update on the status of the CSP during the first quarter of 2017. It announced that this update would “include information about [actual] costs incurred through the end of 2016 and projected costs through 2018.” FHFA issued that public update in March 2017.⁶

Review Objectives and Results

In this review, we sought to determine whether: (1) FHFA honored its commitment to transparency about the CSP by disclosing updated projections for the total cost (development and integration) of the CSP and its internal assessment of the risks of this project after December 2016; and (2) FHFA exercised adequate oversight of the CSP project. We found that: (1) FHFA was not transparent; and (2) its oversight of the CSP project was inadequate.

FHFA's Continued Lack of Transparency: Costs of the CSP

In its March 2017 update, FHFA projected a total of \$1.12 billion in Platform development costs, an increase of \$424 million over its prior 2016 projection of \$696 million. In making this representation, FHFA again fell short of its commitment to transparency even though in

⁵ In its November 10, 2016, letter to Congress, FHFA noted that its projections for development costs in 2017 would “likely be higher than those projected in [its] July 2016 letter.”

⁶ See FHFA, *An Update on Implementation of the Single Security and Common Securitization Platform, March 2017* (online at www.fhfa.gov/AboutUs/Reports/Pages/An-Update-on-Implementation-of-the-Single-Security-and-the-Common-Securitization-Platform-March-2017.aspx).

that same update, the Agency reiterated its commitment to transparency. Furthermore in its management response to this report (see Appendix B), FHFA stated that it “fully supports the goals of transparency” and “has been transparent about the costs to develop the CSP...”

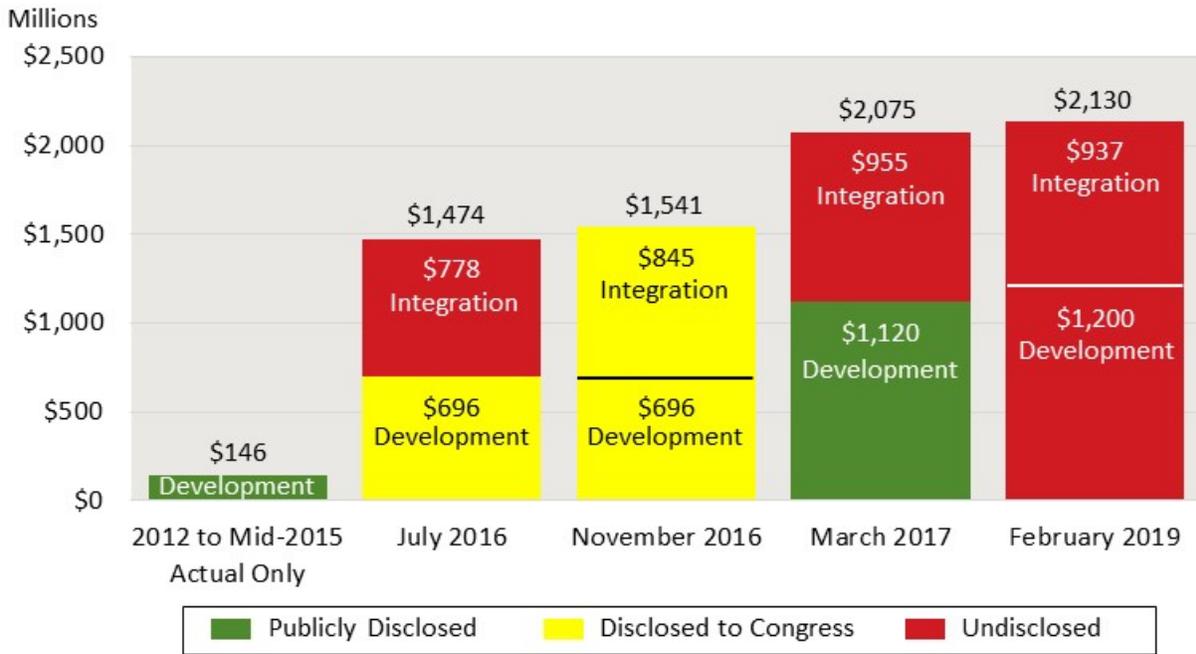
However, as shown below in Figure 1, FHFA did not disclose what it then knew about integration costs:⁷ the Enterprises projected they would spend a total of \$955 million to integrate their IT systems into the CSP.⁸ Adding the disclosed projected development costs of \$1.12 billion to the undisclosed projected integration costs of \$955 million yields a total projected cost of the CSP of nearly \$2.08 billion, an increase of about \$534 million (35%) over FHFA’s November 2016 projection to Congress of \$1.54 billion. FHFA’s decision not to disclose the projected integration costs obfuscated the total projected cost of the CSP to stakeholders.

Since its March 2017 update, FHFA has provided no further cost projections in its public updates. Our review of internal FHFA documents found that, as of February 2019, FHFA projects a total of \$2.13 billion in costs for development of the Platform and integration by the Enterprises by June 30, 2019. See Figure 1 for a summary of the disclosed and undisclosed costs of the CSP.

⁷ In its management response to this report (see Appendix B), FHFA stated, “Disclosure of [integration costs] undermines rather than advances the goals of transparency regarding the CSP project.” FHFA, however, does not explain how the disclosure of such information to stakeholders “undermines” CSP or the goal of transparency.

⁸ In its technical comments to a draft of this report, the Agency asserted that the Enterprises estimate that they would have expended between 10%-35% of these costs, regardless of integration. FHFA provided no evidence to support this assertion; accordingly, we were unable to evaluate FHFA’s claim.

FIGURE 1: DISCLOSED AND UNDISCLOSED COSTS OF THE CSP



The reasonableness of a \$2.13 billion spend on the Platform, which supports only the issuance of a single security by the Enterprises, is beyond the scope of this report.⁹ However, FHFA’s decision not to disclose the total projected cost of the CSP when FHFA possessed such information cannot be reconciled with its repeated commitments to transparency.

We asked a senior official in the Division of Conservatorship (DOC), the division charged with oversight of the CSP, to explain the reasons why FHFA did not disclose the significant increase in the projected total cost of the CSP. The official responded that FHFA’s updates are intended for the housing finance industry at large, and that FHFA did not disclose such detailed information in its updates because it did not “bare [its] chest on everything going on,” notwithstanding its commitment to transparency. However, the official maintained that FHFA’s decision not to disclose the projected total cost of the CSP in the March 2017 update was made by others.

According to the individual who served as Acting Deputy Director, DOC in March 2017, the Enterprises historically provided “crude estimates” of their actual and projected integration costs. He recalled that FHFA, after it reviewed our December 2016 report, directed the Enterprises to provide more accurate information on actual and projected integration costs.

⁹ In its management response to this report (see Appendix B), FHFA asserted that eliminating “the historical difference in liquidity of Fannie Mae’s and Freddie Mac’s” securities would result in savings to “Freddie Mac and taxpayers.” However, FHFA did not provide an estimate of the cost savings nor did it explain how such savings would be achieved. Therefore, we are unable to assess the merits of FHFA’s assertion.

Notwithstanding that explanation, he maintained that FHFA did not include actual and projected integration costs in its March 2017 update because of concerns about the reliability of that information. That justification rings hollow in light of: FHFA’s disclosure to Congress of the Enterprises’ actual and projected integration costs in November 2016, his acknowledgement that the Enterprises provided more accurate information to FHFA about actual and projected integration costs after December 2016, and the caveats that FHFA could have attached to its disclosure of the Enterprises’ actual and projected integration costs.

FHFA’s Continued Lack of Transparency: Risks of the CSP

In its March 2017 update, FHFA represented to stakeholders that several important milestones in the development of the CSP had been met and that Release 1 had been timely implemented. According to FHFA, that implementation “demonstrates that the systems, operations, and controls of CSS and the CSP are functional,” which “should provide greater assurance to market participants and policymakers that Release 2 will be successfully implemented.” FHFA also reported that Release 2 would be delayed until the second quarter of 2019 as a result of lessons learned by CSS and the Enterprises after an extensive review of the project to date. However, FHFA did not disclose the actual reasons for this “extensive review of lessons learned,” of which it was well aware.

Based on our review of FHFA documents and interviews with FHFA officials, we learned that FHFA was aware, in October 2016, from a written report from CSS, that Platform delivery was “off track” and there was a significant risk of untimely completion and additional costs. We found that, in November 2016, the Agency, CSS, and the Enterprises conducted the program review referenced in FHFA’s March 2017 update, called a “Deep Dive,” to assess the significant technical problems with Release 2 and the accuracy of cost projections. We found no evidence that FHFA disclosed the technical and financial forecasting risks identified during the Deep Dive, either publicly or to Congress, which was confirmed by the current Deputy Director, DOC. Again, FHFA did not keep faith with its commitment to transparency.

FHFA’s Oversight of the CSP Project Was Inadequate

Starting in 2012, and every year since, FHFA has emphasized the importance of the CSP in its annual Conservatorship Scorecards, which set forth FHFA’s priorities for the Enterprises and CSS. Developing and implementing the CSP, and related initiatives, accounted for 30% of every Scorecard from 2013 through 2018.

After completion of the Deep Dive, a CSS document identified three root causes for the variances between its 2016 and 2017 projections for development costs:

- “Lack of maturation and focus of the CSS Management Team”

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- “Lack of detailed requirements for phases beyond [Release 1] delivery”
- “Lack of maturation of the IT Hardware/Software Infrastructure”

By November 2016, CSS had been managing the CSP project for three years and this project was its sole responsibility. FHFA, as conservator of the Enterprises, directed the Enterprises to develop and implement the CSP and was charged with oversight of the Enterprises’ execution of their responsibilities to develop and implement the CSP. However, we found that it was not until the Deep Dive that FHFA first recognized the severity of the risks to timely completion of the Platform, after nearly three years and the expenditure of nearly \$1 billion. Its delayed understanding demonstrates the insufficiency of its oversight. That shortcoming mirrors similar findings in more than a dozen reports we have issued since 2015. See Appendix A for a list of those reports.

FHFA’s Response to the Deep Dive

DOC officials reported to us that CSS made a number of commitments to remediate the deficiencies identified by the Deep Dive. These included more comprehensive business and financial planning, and efforts to improve timely decision making. Further, DOC officials told us that CSS concluded that [REDACTED] failure to meet the Scorecard objectives for Release 2. CSS [REDACTED] with FHFA’s input and concurrence.

CSS is both a joint venture and an affiliate of the Enterprises. Accordingly, it is under FHFA oversight as a regulated entity. FHFA, therefore, has the responsibility to assess CSS’s performance against FHFA’s annual conservatorship scorecard. Pursuant to the agreement that established CSS, FHFA also approves the compensation of CSS executive officers.

The CEO of CSS joined CSS in November 2014 and was responsible for the CSS management team, which CSS found to lack “maturation and focus,” one of the root causes of the variance between the 2016 and 2017 financial projections. While a large component of the CEO’s compensation (70%) was fixed, the remainder was “at risk.” FHFA determined half of the “at risk” compensation element, based on its assessment of CSS’s performance against the 2016 Scorecard. (CSS determined the other half, based on its assessment of the CEO’s individual performance against individual goals.) FHFA’s assessment credited CSS with the successful implementation of Release 1 but recognized that CSS failed to accomplish two critical Scorecard objectives during 2016: “Release 2 development;” and “[P]ublication of a timeline for” Release 2. Notwithstanding this finding, FHFA concluded that CSS “had a largely successful year” and assigned it a 90% rating “in light of the overall results

achieved.”¹⁰ FHFA subsequently issued a non-objection to the payment of ██████████ of the at-risk portion of the 2016 compensation award for the CEO of CSS, bringing his total compensation for the year to more than ██████████.¹¹

Conclusion

We found that FHFA was not transparent, because it failed to disclose either its internal projections for the total costs of the CSP or its assessments of the risks to the project. We also found that its oversight of the CSP project was inadequate.

Even if implementation of the Platform occurs on or before June 30, 2019, the Enterprises and CSS will have taken over seven years and spent more than \$2 billion to develop it solely for use by the Enterprises to issue a single security. Although the Agency asserts that the Platform was developed using standard industry technology and interfaces, it acknowledged in technical comments to this report that it has yet to develop plans, establish a timetable, and determine the costs for use of the Platform by any third party.

In its response to this report, FHFA asserts that it “has been transparent about the costs to develop the CSP.” The Agency acknowledges, however, that notwithstanding its commitment to transparency, it chose not to disclose integration costs, amounting to about half the overall costs of the project. The Agency states that it did not disclose these costs, because “disclosure of this information undermines rather than advances goals of transparency regarding the CSP project” and “FHFA has never stated that this non-public information would be disclosed.” FHFA also states that including integration costs as part of the total cost of the CSP would create a “misleading impression.” We cannot comprehend how being transparent about these costs would be “misleading.”

The Agency further states that it has provided “extensive oversight throughout the project.” However, the results of the Deep Dive, conducted three years into CSS’s management of the project, speak for themselves.

FHFA’s management response provides no basis for us to change our conclusions.

¹⁰ According to the former Acting Deputy Director, DOC, FHFA typically concludes that 95% of the objectives in an annual Scorecard have been met, so its finding that CSS only met 90% of its 2016 Scorecard objectives amounted to a “ding[.]”

¹¹ In 2015, Congress imposed a \$600,000 cap on compensation for the CEOs of the Enterprises. FHFA, however, considered the compensation of the CEO of CSS to fall outside of the cap.

Objective, Scope, and Methodology

Our objectives were to provide updated information on the Agency's transparency regarding CSP's risks, development, and costs since our December 2016 report, and the adequacy of its oversight.

To develop the March 2017 and latest projections of the total cost for the CSP, we reviewed publicly available data and FHFA internal documents. Specifically, for the total cost projection as of March 2017, we used FHFA's March 2017 update that included actual and projected development costs through 2019 and data provided by the Enterprises for their projected total integration costs as of March 2017. For the most recent projections, we used the projections for development costs reported by FHFA in its March 2017 update, internal Agency documents on actual spending in 2017 and 2018, information provided by FHFA on CSS's approved budget for 2019, and data provided by the Enterprises to FHFA on projected integration costs that were not reported publicly by the Agency.

We also reviewed other FHFA public reports, documents provided to FHFA by CSS and the Enterprises on the status of the CSP, monthly internal reports prepared by the Agency, and internal analyses from which FHFA's public updates were prepared. We also interviewed Agency officials about FHFA's disclosures of projected costs and risks and its oversight of the CSP project.

We conducted this review from October 2018 to March 2019 under the authority of the Inspector General Act, as amended, 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 A: Reports Finding Issues with FHFA's Oversight of the Enterprises' Execution of Delegated Responsibilities

Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce, OIG-2018-004 (Sept. 6, 2018)

Management Advisory: Freddie Mac's Reimbursement of Certain Employees' Commuting Expenses, OIG-2018-003 (Sept. 6, 2018)

Administrative Review of a Potential Conflict of Interest Matter Involving a Senior Executive Officer at an Enterprise, OIG-2018-001 (July 26, 2018)

Update on FHFA's Implementation of its Revised Procedures for Overseeing the Enterprises' Single-Family Mortgage Underwriting Standards and Variances, COM-2018-003 (Mar. 27, 2018)

Corporate Governance: Review and Resolution of Conflicts of Interest Involving Fannie Mae's Senior Executive Officers Highlight the Need for Closer Attention to Governance Issues by FHFA, EVL-2018-001 (Jan. 31, 2018)

Special Report: Update on FHFA's Oversight of Fannie Mae's Build-Out of its Newly Leased Class A Office Space in Midtown Center, COM-2017-007 (Sept. 28, 2017)

Management Alert: Need for Increased Oversight by FHFA, as Conservator, to Ensure that Freddie Mac's Policies and Procedures for Resolution of Executive Officer Conflicts of Interest Align with the Responsibilities of the Nominating and Governance Committee of the Freddie Mac Board of Directors, OIG-2017-005 (Sept. 27, 2017)

Fannie Mae Dallas Regional Headquarters Project, OIG-2017-002 (Dec. 15, 2016)

Update on the Status of the Development of the Common Securitization Platform, COM-2017-001 (Dec. 9, 2016)

Management Alert: Need for Increased Oversight by FHFA, as Conservator of Fannie Mae, of the Projected Costs Associated with Fannie Mae's Headquarters Consolidation and Relocation Project, COM-2016-004 (June 16, 2016)

FHFA's Oversight of the Enterprises' Implementation of and Compliance with Conservatorship Directives during an 18-Month Period, ESR-2016-002 (Mar. 28, 2016)

Review of FHFA's Tracking and Rating of the 2013 Scorecard Objective for the New Representation and Warranty Framework Reveals Opportunities to Strengthen the Process, AUD-2016-002 (Mar. 28, 2016)

Compliance Review of FHFA's Implementation of Its Procedures for Overseeing the Enterprises' Single-Family Mortgage Underwriting Standards and Variances, COM-2016-001 (Dec. 17, 2015)

FHFA's Oversight of Governance Risks Associated with Fannie Mae's Selection and Appointment of a New Chief Audit Executive, EVL-2015-004 (Mar. 11, 2015)

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Appendix B: Management Response



Federal Housing Finance Agency

MEMORANDUM

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

FROM: Robert Fishman, Deputy Director, Division of Conservatorship *RF for DJF*

SUBJECT: Draft OIG Report: *Special Report on the Common Securitization Platform: FHFA Lacked Transparency and Exercised Inadequate Oversight Over a \$2.13 Billion, Seven-Year Project*

DATE: March 28, 2019

Thank you for the opportunity to respond to the Office of Inspector General (OIG) draft report: *Special Report on the Common Securitization Platform (CSP): FHFA Lacked Transparency and Exercised Inadequate Oversight Over a \$2.13 Billion, Seven-Year Project*. The OIG reviewed FHFA's transparency related to CSP's cost and whether FHFA exercised adequate oversight of the CSP project. The Report contains no recommendations.

FHFA fully supports the goals of transparency, has been transparent about the costs to develop the CSP, and has provided extensive oversight throughout the project. FHFA has ensured that the actual costs of the project are made public through regular disclosures by Fannie Mae and Freddie Mac (the Enterprises) of their contributions of capital to the project via Common Securitizations Solutions, LLC (CSS). The CSS/CSP initiative is part of the broader effort by FHFA to modernize the Enterprises' operations and support the Uniform Mortgage-Backed Security. This effort is designed to create a more efficient, resilient, and liquid secondary mortgage market and to reduce and eliminate the cost to Freddie Mac and taxpayers that has resulted from the historical difference in the liquidity of Fannie Mae's and Freddie Mac's MBS. In this respect alone, the benefits associated with the CSS/CSP initiative will quickly far outweigh the CSP development and integration costs.

As FHFA has previously noted, approximately half of what the OIG report categorized as the total cost of the project is the Enterprises' costs to integrate with CSS, which creates a misleading impression. These integration costs include investments that the Enterprises would have undertaken regardless of the CSS as part of their broader efforts to update and enhance their operations and technology. Disclosure of this information undermines rather than advances the goals of transparency regarding the CSP project. Moreover, FHFA has never stated that this non-public information would be disclosed.

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