

REDACTED

Federal Housing Finance Agency
Office of Inspector General



**FHFA Completed its Planned Procedures
for a 2016 Representation and Warranty
Framework Targeted Examination at
Freddie Mac,
but the Supporting Workpapers
Did Not Sufficiently Document the
Examination Work**

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

Audit Report • AUD-2018-006 • March 13, 2018



AUD-2018-006

March 13, 2018

Executive Summary

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (together, the Enterprises) provide liquidity to the U.S. housing finance system by supporting the secondary mortgage market. The Enterprises purchase residential mortgages from lenders and either hold these mortgages in their portfolios or bundle the purchased mortgages into securities for which they guarantee principal and interest. In guaranteeing the securities, the Enterprises assume the credit risk from possible default of the underlying mortgages. To mitigate this risk, the Enterprises require lenders from whom they purchase residential mortgages to make contractual representations and warranties wherein the lenders represent that the mortgages meet specific underwriting requirements.

Historically, the Enterprises have relied on the lenders' representations and warranties that underwriting requirements were met and conducted limited due diligence at the time the mortgages were purchased. When mortgages defaulted or the borrower missed payments, the Enterprises would then review the loan files for evidence of breach of the representations and warranties and exercise their contractual rights to require lenders to repurchase, or buy back, non-compliant loans. The Enterprises' contractual rights to put back non-compliant loans at any point during the term of the loans enabled the Enterprises to reduce losses caused by underwriting defects.

In September 2012, the Federal Housing Finance Agency (FHFA) announced that the Enterprises would launch a new representation and warranty framework (new framework). The objective of the new framework was to enhance transparency and certainty for lenders by clarifying when a mortgage loan may be subject to repurchase. The new framework, designed by the Enterprises to meet FHFA's stated objective, shifted some risk of non-compliance with representations and warranties from the lenders to the Enterprises (and therefore to taxpayers). The new framework required operational changes at the Enterprises to mitigate the additional risk. FHFA recognized the need to test the adequacy of those operational changes, through its supervisory activities, to ensure that the additional risk had been mitigated.

FHFA is charged by the Housing and Economic Recovery Act of 2008 (HERA) with, among other things, ensuring that the Enterprises and the Federal Home Loan Banks operate in a safe and sound manner. Within FHFA, the Division of Enterprise Regulation (DER) is responsible for the supervision of the Enterprises. We recently issued the results of a completed audit, *FHFA's 2015 and 2016 Supervisory Activities, as Planned, Addressed Identified Risks with Freddie Mac's New Representation and Warranty Framework*, AUD-2017-009, available online at www.fhfaoig.gov/reports/auditsandevaluations.



AUD-2018-006

March 13, 2018

In that audit, we found that for the 2015 examination cycle, DER planned and performed two ongoing monitoring activities to address identified risks with Freddie Mac's implementation of the new framework. For the 2016 examination cycle, DER identified the new framework as a supervisory focus. DER's 2016 Freddie Mac supervisory plan included three new framework-related targeted examinations and one ongoing monitoring activity. During the 2016 examination cycle, we found that DER completed two of the planned targeted examinations, deferred the other to 2017, and completed the ongoing monitoring activity.

This audit follows on that work. In this audit, we sought to determine whether DER performed its planned procedures and sufficiently supported its conclusions for one of the Freddie Mac targeted examinations completed during the 2016 examination cycle, entitled Representation and Warranty Framework. We found that DER performed its planned procedures, and prepared the required examination documents. The conclusions DER presented in the Conclusion Letter were also consistent with those detailed in the targeted examination workpapers. However, the examiner did not prepare the examination workpapers for this targeted examination in a manner that provided a third party with a clear understanding of the examination work performed. Specifically, certain examination work that, upon inquiry, was cited by the Examination Manager to support the conclusion reached for this targeted examination was not referenced in the Analysis Memorandum or documented in the workpapers.

We make one recommendation in this report. In a written management response, FHFA agreed that examiners should document their independent analysis and rationale for how conclusions and findings were reached in examination workpapers. While FHFA disagreed with various statements in the report, it generally agreed with our recommendation. FHFA stated that DER is in the process of rescinding and replacing current examiner guidance for documenting targeted examinations, and will train examination staff on the revised guidance. To the extent the revised guidance addresses the shortcoming with the examination workpapers identified in this report, FHFA's planned corrective actions are responsive to our recommendation.

We are also issuing today the results of our audit of DER's execution of a targeted examination of Fannie Mae's risk management activities related to the new framework. See *FHFA Completed its Planned Procedures for a 2015 Representation and Warranty Framework Targeted Examination at Fannie Mae, but Did Not Document a Change to Planned Testing*, AUD-2018-005, available online at www.fhfa.gov/reports/auditsandevaluations.



AUD-2018-006

March 13, 2018

This report was prepared by James Lisle, Audit Director; April Ellison, Auditor-in-Charge; and Brian Maloney, Auditor; with the assistance of Bob Taylor, Assistant Inspector General for Audits. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of the report.

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

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

TABLE OF CONTENTS

EXECUTIVE SUMMARY2

ABBREVIATIONS6

BACKGROUND7

 DER Supervisory Process.....7

 The New Framework Sought to Provide Greater Certainty to the Lender, Shifting
 Some Risk to the Enterprises.....8

 Prior OIG Work on the New Framework9

FACTS AND ANALYSIS.....10

 Required Documents Were Prepared and Approved for the 2016 Representations and
 Warranties Framework Targeted Examination of Freddie Mac10

 While We Do Not Take Issue with DER’s Conclusion, the Supporting Workpapers
 Did Not Sufficiently Document the Examination Work11

 [REDACTED] Identified During the Targeted Examination
 Was Referred to Ongoing Monitoring.....12

FINDING13

CONCLUSION.....14

RECOMMENDATION14

FHFA COMMENTS AND OIG RESPONSE.....14

OBJECTIVE, SCOPE, AND METHODOLOGY15

APPENDIX: FHFA MANAGEMENT RESPONSE17

ADDITIONAL INFORMATION AND COPIES19

ABBREVIATIONS

DER	Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac
ERM	Enterprise Risk Management
Fannie Mae	Federal National Mortgage Association
FHFA	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
HERA	Housing and Economic Recovery Act of 2008
LRM	Loan Ranking Model
New framework	Representation and Warranty Framework
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
QC	Quality Control

BACKGROUND.....

DER Supervisory Process

Created by Congress in 2008, FHFA is charged by HERA with, among other things, the supervision of the Enterprises. Its mission as a federal financial regulator includes ensuring the safety and soundness of the Enterprises so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA exercises its supervision of the Enterprises through DER. Like other federal financial regulators, FHFA maintains that it uses a risk-based approach to carry out its supervisory activities.

DER executes supervisory activities, which consist of ongoing monitoring and targeted examinations conducted in accordance with a supervisory plan. The *FHFA Examination Manual* states that:

- The purpose of ongoing monitoring is to analyze real-time information and to use those analyses to identify Enterprise practices and changes in an Enterprise’s risk profile that may warrant supervisory attention. This approach allows staff to monitor and evaluate the Enterprise’s operations and assess risk management.
- Targeted examinations are a critical component of supervision and will be undertaken, as needed, based on risk. The purpose of targeted examinations is to allow for a deep or comprehensive assessment of the area under review.”

According to DER’s Operating Procedures Bulletin (OPB) 2013-DER-OPB-04, *DER Supervisory Activities* (September 19, 2013), targeted examinations are designed to assess a particular area, product, risk, or activity of the Enterprise and by definition are narrow in scope. This OPB directs DER examiners to conduct detailed analysis and testing in order to develop specific conclusions.

The *FHFA Examination Manual* and DER’s OPBs define expectations and approval requirements for examiner workpapers. According to 2013-DER-OPB-04 and 2014-DER-OPB-01, *Guidelines for Preparing Supervisory Products and Examination Workpapers* (January 27, 2014), required documents for targeted examinations are:

- Procedures Document – sets forth the steps performed to achieve the objective of the supervisory activity and provides the official agency record of evidence to support the execution of the targeted examination. The Procedures Document must be approved by the Lead Examiner and Examination Manager.
- Request Letter – announces the objective and scope of the targeted examination to the Enterprise, requests the Enterprise to schedule a kickoff and subsequent meetings with management, and requests timely delivery of documentation to be produced by the

Enterprise. The Request Letter must be approved by the Lead Examiner, Examination Manager, and Examiner-in-Charge (EIC).

- Meeting Notes – document the periodic status meetings with management that are conducted throughout the targeted examination to ensure that management is kept apprised of any preliminary findings or emerging concerns. Meeting Notes must be approved by the Lead Examiner and Examination Manager.
- Analysis Memorandum – constitutes the main work product from the targeted examination that supports the Conclusion Letter, and provides the complete record of the work performed, findings, and conclusions. The Analysis Memorandum should include hyperlinks or references to supporting workpapers and must be approved by the Lead Examiner, Examination Manager, and EIC.
- Conclusion Letter – communicates conclusions from targeted examinations to the Enterprise. Conclusion Letters must be approved by the Lead Examiner, Examination Manager, EIC, and DER Deputy Director.

The *FHFA Examination Manual* directs that examiner workpapers, on which the Analysis Memorandum is based, must be prepared in sufficient detail to provide a clear understanding of the examination work performed. Further, 2014-DER-OPB-01, directs DER examiners to prepare workpapers with sufficient detail and explanation so that they can provide a third party with a clear understanding of the examination work performed, the examination findings, conclusions, and ratings reached, and any implications of the findings, conclusions, and ratings.

The New Framework Sought to Provide Greater Certainty to the Lender, Shifting Some Risk to the Enterprises

Implementation of the new framework shifted some risk of non-compliance with representations and warranties from the lenders to the Enterprises. As a result, the Enterprises' quality control (QC) programs¹ became increasingly important to mitigate origination quality risk and credit risk since, for loans covered by the new framework, the Enterprises would no longer be able to seek repurchase from a lender for the life of the loan as a result of some representation and warranty breaches. For loans acquired under the new framework, both Enterprises represented that they would conduct most QC reviews within 30 to 120 days after delivery of the loan to assess whether specific representations and warranties were satisfied.²

¹ A QC program defines the standards for loan quality, establishes processes designed to achieve those standards, and mitigates risks associated with the origination processes. A QC program includes a documented QC plan that outlines requirements for validating that loans are originated in accordance with the Enterprise's established policies and procedures.

² For example, Freddie Mac QC reviews assess representations and warranties related to the underwriting of the borrower, including the seller's assessment of borrower's loan terms, credit history employment, income, assets, and other information used for qualifying the borrower for the mortgage; the assessment also includes the underwriting of the mortgaged premises, which is the analysis of the description and valuation of the mortgaged premises to determine its adequacy as collateral for the mortgage.

The Enterprises also stated that they would develop and use new technologies and data gathering tools to identify loans that were not originated in accordance with applicable underwriting and eligibility requirements. Freddie Mac developed the Loan Ranking Model (LRM)³ to assist in targeting QC reviews on loans with a greater risk of defect,⁴ and a representation and warranty tracking tool to track loan events that impact relief dates.

Prior OIG Work on the New Framework

A 2014 OIG audit found that FHFA mandated the new framework despite significant unresolved operational risks to the Enterprises. The audit also found that neither Enterprise had implemented the processes, procedures, nor systems needed to operate within the new framework before it went into effect in 2013. The 2014 audit report made two recommendations to FHFA, of which one is relevant to the scope of this audit:

[A]ssess the current state of the Enterprises' critical risk assessment tools, representations and warranties tracking systems, and any other systems, processes, or infrastructure to determine whether the Enterprises are in a position to minimize financial risk that may result from the new framework. The results of this assessment should document any areas of identified risk, planned actions, and corresponding timelines to mitigate each area of identified risk. Further, this assessment should provide an estimate of when each Enterprise will be reasonably equipped to work safely and soundly within the new framework.⁵

In its written response, FHFA partially agreed with this recommendation, stating that:

FHFA examination staff will continue to examine and review the Enterprises' loan purchase operations, including those affected by the representations and warranties framework. DER examination staff will request the Enterprises to provide information about operational changes needed at each Enterprise for safe and sound implementation of the new framework, and DER will take this information into account in developing its examination plans for 2015.

³ LRM uses loan information to rank loans according to their probability of containing a defect to produce a targeted QC sample.

⁴ Freddie Mac defines defect as a loan-level deficiency that breaches a term contained in the purchase documents in effect at the time of mortgage purchase. Freddie Mac categorizes defects depending on their severity (e.g., a "finding" would not require a correction or a remedy from the seller, a "significant defect" would require the repurchase of the mortgage or possibly an offer of a repurchase alternative).

⁵ See OIG, *FHFA's Representation and Warranty Framework* (Sept. 17, 2014) (AUD-2014-016) (online at www.fhfaog.gov/Content/Files/AUD-2014-016.pdf).

More recently, a September 2017 OIG audit assessed (1) whether DER’s planned supervisory activities relating to Freddie Mac’s implementation of the new framework for the 2015 and 2016 examination cycles could be tracked to its risk assessments and supervisory strategies and (2) whether DER executed these planned supervisory activities during the 2015 and 2016 examination cycles.⁶ As detailed in the 2017 audit report, we found that the risks identified by DER with respect to Freddie Mac’s implementation of the new framework for the 2015 examination cycle focused on Freddie Mac’s [REDACTED]. To address the identified risk, DER planned and performed two ongoing monitoring activities related to [REDACTED]. For the 2016 examination cycle, DER identified the new framework as a supervisory focus. DER’s 2016 Freddie Mac supervisory plan included three new framework-related targeted examinations and one ongoing monitoring activity. During the 2016 examination cycle, DER completed two of the planned targeted examinations, deferred the other to 2017, and completed the ongoing monitoring activity. We selected one of the completed 2016 targeted examinations, entitled Representation and Warranty Framework, for this audit because its objective directly correlated with Freddie Mac’s loan purchase operations effected by the new framework.

In this audit, we assessed whether DER completed the procedures as planned and sufficiently supported its conclusions for one completed 2016 targeted examination, entitled Representation and Warranty Framework.

FACTS AND ANALYSIS

Required Documents Were Prepared and Approved for the 2016 Representations and Warranties Framework Targeted Examination of Freddie Mac

As discussed above, DER completed its planned targeted examination of the new framework at Freddie Mac during the 2016 examination cycle. According to the Request Letter to Freddie Mac announcing the targeted examination, the objective was “To examine [REDACTED] Freddie Mac’s [REDACTED] specifically those [REDACTED].”

Required targeted examination documents – the Request Letter, Procedures Document, Analysis Memorandum, and Conclusion Letter – were completed, reviewed, and approved by the appropriate DER official(s) in accordance with the requirements of 2013-DER-OPB-04. The targeted examination’s Meeting Notes were not individually approved; however, a DER official told us that since they were linked to the approved Analysis Memorandum, they are

⁶ See OIG, *FHFA’s 2015 and 2016 Supervisory Activities, as Planned, Addressed Identified Risks with Freddie Mac’s New Representation and Warranty Framework* (Sept. 22, 2017) (AUD-2017-009) (online at www.fhfaig.gov/Content/Files/AUD-2017-009FRERWFExaminationsredacted.pdf).

considered approved. Additionally, our review of the Conclusion Letter found that DER's conclusion – We have [redacted] related to [redacted] that Freddie Mac made to its [redacted] affected by the [redacted] -- was consistent with conclusions detailed in the Analysis Memorandum. DER also performed the required internal quality control review of the targeted examination's workpapers prior to issuance of the Conclusion Letter.

While We Do Not Take Issue with DER's Conclusion, the Supporting Workpapers Did Not Sufficiently Document the Examination Work

The planned targeted examination scope and procedures in the approved Procedures Document called for examiners to [redacted] made at Freddie Mac for the [redacted] [redacted] of the [redacted] meet with management to [redacted] meet with Internal Audit to [redacted] [redacted] Freddie Mac's [redacted] According to the Procedures Document, the targeted examination was to focus on Freddie Mac's [redacted] including, but not limited to, its [redacted] [redacted]

In the targeted examination's Analysis Memorandum, the examiners concluded that:

[redacted] Freddie Mac made [redacted] to the [redacted] to support the [redacted] which included [redacted] Freddie Mac was [redacted] In addition, the [redacted] regarding the [redacted] of certain systems [redacted] such as whether the [redacted] has been [redacted] The Memorandum also [redacted] that found the [redacted]

However, the Analysis Memorandum did not document or reference any examination work that explained how DER concluded on [redacted] [redacted]

As a result, we asked the Examination Manager if he thought he had done enough work to reach the conclusion in the Analysis Memorandum. He reported that he believed the examiners did enough to answer the questions because it was not the first time he or his examiners looked at the [redacted] process. He said that he considered DER's entire body of work in this area, which included (1) the results of a

⁷ Base (random) reviews and targeted reviews make up the Performing Loan QC reviews. Targeted reviews are focused on loans with a higher probability of defect (riskier loans).

concurrent targeted examination on Freddie Mac's [REDACTED] process, which included [REDACTED] of individual [REDACTED], and (2) work being performed on an ongoing monitoring activity, which included the review of [REDACTED] reports. This information, however, was not summarized or otherwise documented in the targeted examination's workpapers or the Analysis Memorandum.

We recognize that examiner reliance on work performed across the spectrum of supervisory activities to formulate conclusions for a specific targeted examination is prudent and promotes the efficiency of the supervisory effort. DER, in 2014-DER-OPB-01, directs that workpapers supporting the examination conclusion(s) be sufficiently detailed and clear to provide a third party with a clear understanding of the examination work performed and conclusions reached. For this targeted examination, the work cited by the Examination Manager to support DER's conclusions—the concurrent targeted examination on [REDACTED] and work performed on an ongoing monitoring activity [REDACTED] reports)—was not referenced in the Analysis Memorandum or documented in the workpapers.

In technical comments provided to this report, DER contended that the examiner's analysis as documented in the Procedures Document and Analysis Memorandum provided sufficient support for the conclusions reached in this targeted examination and satisfies the requirements of 2014-DER-OPB-01. We disagree. Our review of the workpapers supporting this targeted examination identified no description of the examination work performed or other examination work relied upon to enable an examiner to conclude on [REDACTED] of the [REDACTED] made to Freddie Mac's [REDACTED] in response [REDACTED]. As discussed above, the Examination Manager for this targeted examination told us that he considered DER's other body of work in this area and specifically identified his consideration of the work conducted as part of two specific supervisory activities. His verbal explanation provided an essential link in understanding the basis for DER's conclusion, and we do not take issue with its conclusion. Nevertheless, verbal explanations fall short of the DER documentation standard that requires workpapers to provide a third party with a clear understanding of the examination work performed and the conclusions reached.

[REDACTED] Identified During the Targeted Examination Was Referred to Ongoing Monitoring

During our review of the Analysis Memorandum, we found that Freddie Mac management [REDACTED]

[REDACTED] The Analysis Memorandum documented that DER examiners were told by Freddie Mac management, in a September 2016 meeting, that they had [REDACTED]

[REDACTED] The Analysis Memorandum stated that this [REDACTED] Freddie Mac management [REDACTED] The Lead Examiner told us this matter did not rise to the level of an examination finding because Freddie Mac was aware of the issue, raised it with the DER examiners, and developed action items to address it. The Lead Examiner also noted that the issue was outside of the scope of the targeted examination and that more work to support an examination finding would have been needed. Instead, DER decided to discuss the matter in the Analysis Memorandum and follow up on it in a subsequent ongoing monitoring activity.

We found that DER followed up on the [REDACTED] during 2017 as an ongoing monitoring activity. Examiners found that [REDACTED] Freddie Mac [REDACTED] In that same month, [REDACTED] Freddie Mac management [REDACTED] ⁸ In addition, DER's ongoing monitoring meeting notes documented that Freddie Mac had taken steps [REDACTED], including [REDACTED]

[REDACTED] The Lead Examiner responsible for this ongoing monitoring activity told us that his review of reports generated by Freddie Mac found that Freddie Mac has been [REDACTED] He further reported that DER planned a targeted examination during 2018 to assess Freddie Mac's [REDACTED] ⁹

FINDING

DER's 2014-DER-OPB-01 directs that workpapers supporting the examination conclusion(s) be sufficiently detailed and clear to provide a third party with a clear understanding of the examination work performed and conclusions reached. For this targeted examination, we found that DER concluded on [REDACTED] Freddie Mac [REDACTED] [REDACTED] without sufficiently documenting the work it relied on. Upon inquiry, the Examination Manager explained how the examiners reached their conclusion by considering DER's entire body of work in this area. However, the work cited by the Examination Manager to support DER's conclusion was not referenced in the Analysis Memorandum or documented in the workpapers supporting this targeted examination. As a result, the Analysis Memorandum and supporting workpapers for the targeted examination did not provide a third party with a clear understanding of the work performed and did not meet the DER documentation standard.

⁸ DER's Freddie Mac examination team prepares and updates quarterly the results for each ongoing monitoring activity in a Quarterly Risk Assessment.

⁹ This targeted examination is included on DER's 2018 supervisory plan for Freddie Mac.

CONCLUSION.....

We found that DER performed its planned procedures and prepared the required examination documents for the 2016 targeted examination entitled Representation and Warranty Framework. The conclusions DER presented in the Conclusion Letter for this targeted examination were consistent with those detailed in the targeted examination workpapers.

DER recognizes the importance of documenting its examination work in workpapers by requiring that workpapers be prepared in a manner that provides a third party with a clear understanding of the examination work performed. In this audit, we found that the Analysis Memorandum did not document or reference examination work that explained how DER concluded on [REDACTED]

[REDACTED] Other examination work verbally cited by the Examination Manager to support DER’s conclusion was not referenced in the Analysis Memorandum or documented in the workpapers supporting this targeted examination. As a result, the workpapers did not provide a third party with a clear understanding of the examination work performed, which is required by DER’s documentation standard.

RECOMMENDATION.....

We recommend that FHFA reinforce, in examiner training, the need to prepare workpapers for targeted examinations with sufficient detail and clarity to provide a third party with a clear understanding of the examination work performed; the examination findings, conclusions, and ratings reached; and any implications of the findings, conclusions, and ratings.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this audit report. FHFA provided technical comments on the draft report, which we incorporated as appropriate. In its management response, which is included in the Appendix to this report, FHFA agreed that examiners should document their independent analysis and rationale for how conclusions and findings were reached in examination workpapers. While FHFA disagreed with various statements in the report, it generally agreed with our recommendation. FHFA stated that DER is in the process of rescinding and replacing 2014-DER-OPB-01. According to FHFA, the revised guidance will articulate to DER examination staff expectations for documentation of targeted examinations to support findings and conclusions to enable effective quality control and management review. Also, by September 28, 2018, DER will provide training to all

examination staff (including Examiners-in-Charge and examination managers) on the provisions of the revised OPB with regard to requirements that examiners should follow when documenting targeted examination conclusions and findings. To the extent the revised guidance addresses the finding in this report, we consider FHFA’s planned corrective actions responsive to our recommendation.

OBJECTIVE, SCOPE, AND METHODOLOGY

We conducted this audit to assess whether DER completed the procedures as planned and sufficiently supported its conclusions for the 2016 targeted examination entitled Representation and Warranty Framework.

To accomplish our objective, we reviewed the *FHFA Examination Manual* (December 2013) and the related examination modules for Credit Risk Management (July 2013), Enterprise Risk Management (August 2013), and Operational Risk Management (October 2013); as well as guidance issued by FHFA and DER related to conduct of and supervisory products for targeted examinations. In addition, we reviewed Freddie Mac Guide Bulletins and Industry Letters related to the new framework.

Specifically, for Freddie Mac, we:

- Reviewed DER’s documentation for the 2016 Representation and Warranty Framework targeted examination, including the Procedures Document, Request Letter, Meeting Notes, Analysis Memorandum, Conclusion Letter, and supporting workpapers to see that the required documents were completed and approved in accordance with FHFA and DER guidance, and supported the conclusions reached for the targeted examination.
- Interviewed DER personnel to gain an understanding of the supervisory activities planned and performed to supervise Freddie Mac’s implementation of the new framework.
- Reviewed DER’s workpapers for other targeted examinations and ongoing monitoring related to the new framework performed during the 2016 and 2017 examination cycles to determine how matters mentioned in discussions with examiners or in the workpapers for the 2016 Representation and Warranty Framework targeted examination were influenced by or followed up on in those other supervisory activities.

- Reviewed the following Freddie Mac guides and bulletins:
 - 2012-18, *New Representation and Warranty Framework* (September 11, 2012)
 - 2014-8, *Selling Representation and Warranty Framework Updates* (May 12, 2014)
 - 2014-21, *Selling Representation and Warranty Framework Life-of-Loan Exclusions* (November 20, 2014)
 - 2015-17, *Selling Representation and Warranty Framework – Origination Defects and Remedies* (October 7, 2015)
 - 2016-1, *Selling Representation and Warranty Framework – Independent Dispute Resolution* (February 2, 2016)
 - Freddie Mac, *Quality Control Best Practices* (July 2017)
 - Freddie Mac Bulletin 2017-3, *Collateral Representation and Warranty Relief and Appraisal Requirement Updates* (March 22, 2017)

We conducted this performance audit from September 2017 through March 2018 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 A. Freedman, Deputy Inspector General for Audits

FROM: Nina A. Nichols, Deputy Director, Division of Enterprise Regulation (DER)^{NAN}

SUBJECT: Draft OIG Report: *FHFA Completed Its Planned Procedures for a 2016 Representation and Warranty Framework Targeted Examination at Freddie Mac, But the Supporting Workpapers Did Not Sufficiently Document the Examination Work*

DATE: March 5, 2018

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

While we disagree with various statements in the Report and the finding, we agree that examiners should document their independent analysis and rationale for how conclusions and findings were reached in examination workpapers.

FHFA management's response to the recommendation is below.

Recommendation:

OIG recommends that FHFA reinforce, in examiner training, the need to prepare workpapers for targeted examinations with sufficient detail and clarity to provide a third party with a clear understanding of the examination work performed; the examination findings, conclusions, and ratings reached; and any implications of the findings, conclusions, and ratings.

Management Response to Recommendation:

FHFA generally agrees with this recommendation. DER is in the process of rescinding and replacing 2014-DER-OPB-01, *Guidelines For Preparing Supervisory Products and Examination Workpapers* (January 29, 2014). This revised guidance will articulate to DER examination staff expectations for documentation of targeted examinations to support findings and conclusions to enable effective quality control and management review. By September 28, 2018, DER will provide training to all examination staff (including Examiners-in-Charge and examination managers) on the provisions of the revised Operating Procedures Bulletin with regard to requirements that examiners should follow when documenting targeted examination conclusions and findings.

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

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