

**REDACTED**

Federal Housing Finance Agency  
Office of Inspector General



**DER Followed its Guidance to  
Prepare, Review, and Issue the 2020  
CSS Report of Examination**

This report contains redactions of information that is privileged or otherwise protected from disclosure under applicable law.

Audit Report • AUD-2022-005 • March 23, 2022



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## Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) is charged by the Housing and Economic Recovery Act of 2008 (HERA) with the supervision of Fannie Mae and Freddie Mac (together, the Enterprises), any affiliate of the Enterprises, and the Federal Home Loan Banks (collectively, the regulated entities). FHFA's mission includes ensuring the safety and soundness of its regulated entities so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Since 2008, FHFA has served as conservator of the Enterprises.

In 2012, FHFA directed the Enterprises to build a Common Securitization Platform to replace their separate "back-office" systems and to issue a single mortgage-backed security. In 2013, FHFA directed the Enterprises to establish and fund a joint venture, Common Securitization Solutions, LLC (CSS), to develop and operate the Common Securitization Platform. As an affiliated entity of the Enterprises, CSS is subject to FHFA's supervision. On June 3, 2019, CSS began issuing a single mortgage-backed security for both Enterprises, known as the Uniform Mortgage-Backed Security.

Within FHFA, the Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises and CSS. We conducted this audit to determine whether DER prepared and issued the report of examination (ROE) covering the 2020 examination cycle for CSS in accordance with its guidance. That ROE was issued on March 31, 2021 (2020 CSS ROE).

We found that DER followed its guidance in the preparation, supervisory review, and final issuance of the 2020 CSS ROE. In addition, examination results, conclusions, and ratings reported in the 2020 CSS ROE were consistent with and supported by examination activities that had been subjected to required DER Quality Control (QC) reviews. We make no recommendations in this report.

This report was prepared by James Lisle, Audit Director; Marco Uribe, Auditor-in-Charge; and Christopher Mattocks, Auditor; with assistance from Abdil Salah, Assistant Inspector General of Audits; Marla Freedman, Senior Policy Advisor; and Bob Taylor, Senior Advisor. We appreciate the cooperation of FHFA staff with our audit.

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), and [www.oversight.gov](http://www.oversight.gov).

James Hodge, Deputy Inspector General for Audits /s/

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## ABBREVIATIONS .....

2020 CSS ROE	Report of Examination issued to CSS on March 31, 2021
AB	Advisory Bulletin
CSS	Common Securitization Solutions, LLC
DER	Division of Enterprise Regulation
FHFA or Agency	Federal Housing Finance Agency
MRA	Matter Requiring Attention
OPB	Operating Procedures Bulletin
QC	Quality Control
ROE	Report of Examination
ROE OPB	OPB – Reports of Examination

## BACKGROUND .....

### Common Securitization Solutions, LLC

CSS is a service entity jointly owned and equally funded by the Enterprises pursuant to an agreement between the Enterprises and CSS. According to DER’s 2021 Risk Assessments, CSS has no financial assets, other than cash and cash equivalents, that incur credit risk, i.e., the failure to receive payment from a borrower or a counterparty; its principal asset is capitalized internally developed software; the CSS Operating Agreement limits CSS activities to the design, development, build, testing, operation, support, maintenance, updating, and enhancing of the securitization platform, subject to the provisions of the CSS charter; and it will not incur any losses to meet its financial obligations, as all such funding comes from the Enterprises, and CSS does not issue financial instruments, such as debt.

### Supervision of CSS

The Deputy Director, DER, is responsible for providing management oversight, direction, and support for all examination activity involving the Enterprises and CSS. Examination activity at CSS is led by a designated DER official (DER Point of Contact for CSS) for communication between DER and CSS, and this official is responsible for the planning, execution, and documentation of examination activities for CSS.

FHFA maintains that it uses a risk-based approach to supervisory examinations that involves identifying existing and emerging risks, evaluating the overall integrity and effectiveness of the entities’ risk management systems and controls, and assessing compliance with applicable laws and regulations. According to FHFA, examinations are an essential component of DER’s Enterprise Supervision Program.<sup>1</sup> During the 2020 annual examination cycle, DER conducted eight targeted examinations and four monitoring activities at CSS.<sup>2</sup>

DER determined that its supervisory framework for the Enterprises applies to CSS, including, among other things, adhering to DER’s Operating Procedures Bulletins (OPB), where relevant. In accordance with its guidance, FHFA issued a ROE summarizing the findings and

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<sup>1</sup> Examiners execute DER’s examination plans by conducting targeted examinations and monitoring activities. Targeted examinations typically focus on a discrete business or functional area(s), program(s), product(s), model(s), process(es), and/or control(s). Monitoring activities enable examiners to identify significant matters that may affect CSS’ risk profile or financial condition and to respond in a timely manner.

<sup>2</sup> During our audit, the Deputy Director, DER, told us that beginning with the 2022 supervisory cycle, DER will change its approach to examinations for CSS and perform a comprehensive annual review of CSS as a specific point in the examination cycle rather than performing separate examination activities throughout the examination cycle.

conclusions of FHFA’s 2020 CSS examination work on March 31, 2021. This was the first ROE that FHFA issued on CSS.<sup>3</sup>

## Report of Examination

### ***Content and Format Requirements, and Issuance Procedures***

In August 2018, DER issued an OPB titled Reports of Examination (ROE OPB), which established the format and procedures for the drafting and clearance of the annual ROE. This OPB requires that DER examiners summarize examination results, conclusions, findings,<sup>4</sup> and supervisory concerns from the supervisory activities completed during the annual supervisory cycle in an annual ROE. Further, this OPB sets forth guidance for the content and format of the ROE along with procedures for the preparation, supervisory review, and final issuance of the ROE. Among other things, with respect to CSS, the ROE OPB requires that the ROE includes the following:

- An overview section presenting a summary discussion of examination conclusions and findings regarding CSS controls and risk management.
- A Composite rating and Management and Operational component ratings assigned by DER to CSS in accordance with FHFA Advisory Bulletin (AB) 2012-03, *FHFA Examination Rating System*. The summary of ratings section of the ROE should include brief descriptions of the ratings referencing examination results and other factors noted in AB 2012-03.
- Separate sections for each component rating that describe examination results, supervisory views of CSS’ risk management and controls, significant business or

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<sup>3</sup> For the 2016 to 2019 supervisory cycles, DER communicated the findings of its monitoring activities and targeted examinations at CSS through supervisory letters.

<sup>4</sup> FHFA AB 2017-01, *Classifications of Adverse Examination Findings*, classifies adverse examination findings as Matters Requiring Attention (MRA), Recommendations, and Violations. MRAs are designated as either a critical supervisory matter or a deficiency. MRAs designated as critical supervisory matters mean that the findings pose a substantial risk to the safety and soundness of the regulated entity. MRAs designated as deficiencies mean that DER believes that the findings could escalate and potentially have a negative effect on the condition, financial performance, risk profile, operations, or reputation of the regulated entity. MRAs require corrective actions from the regulated entity. Recommendations are advisory in nature and suggest changes to a policy, procedure, practice, or control that supervision staff believes would improve, or prevent deterioration in, condition, operations, or performance. Implementation is discretionary, although FHFA expects the regulated entity to implement a recommendation. Violations are matters in which an examination discloses noncompliance with laws, regulations, or orders. Violations require corrective actions from the regulated entity to correct, if possible, the past noncompliance with requirements and to change a program or practice to prevent recurrence.

operations developments affecting CSS, and existing and emerging risks relevant to the component rating.

- A table that lists all Matters Requiring Attention (MRA) that were closed during the previous calendar year or that remained open as of year-end presented with management's estimated date for completion of remediation.

The ROE OPB also sets forth requirements for issuing the ROE, including that the ROE be:

- Reviewed by DER Senior Management and DER's QC manager;
- Provided, in draft, to CSS for a factual accuracy review;
- Issued by March 31 of the calendar year following the year covered by the ROE and include a request for a written response from the CSS Board of Managers acknowledging the board's review of the 2020 CSS ROE; and
- Presented by the CSS Point of Contact and DER Deputy Director to the board within a reasonable timeframe following transmission of the ROE.

### ***Composite and Component Ratings***

FHFA AB 2012-03 communicates the examination rating system to be used when examining the entities regulated by FHFA. The FHFA Examination Rating System is a risk-focused rating system under which each regulated entity and the Office of Finance is assigned a composite rating based on an evaluation of various aspects of its operations. Specifically, the composite rating of an Enterprise or Federal Home Loan Bank is based on an evaluation and rating of seven components: **Capital**; **Asset quality**; **Management**; **Earnings**; **Liquidity**; **Sensitivity to market risk**; and **Operational risk (CAMELSO)**. However, due to the nature of the activities conducted by CSS, DER's OPB on Enterprise Supervision Program states that CSS' composite rating is based on an evaluation and rating of two components: **Management** and **Operational Risk**.

### **QC Reviews**

DER issued an OPB in January 2020, Independent Quality Control Process, which provides guidance for implementing DER's independent quality control process. According to the guidance, DER conducts independent QC reviews of certain supervisory written products to provide reasonable assurance that examination work performed by examiners meets applicable DER examination standards and FHFA guidance for document preparation and management.

DER conducts QC reviews of, among other things, (a) supervisory correspondence (with supporting documentation) to CSS that communicates results of targeted examinations, which may or may not include adverse examination findings, and adverse examination findings identified through monitoring activities; and (b) monitoring activities that do not result in adverse examination findings, on a sample basis with reviews generally completed prior to the issuance of the ROE.

### **Prior Audit of DER’s Risk Assessment of CSS for the 2020 Supervisory Cycle**

Our audit completed in March 2021 found that the CSS risk assessment that informed the supervisory planning for the 2020 examination cycle was incomplete because it did not address two required components of operational risk – Financial Crimes and Model – that were applicable to CSS business operations. To address this finding, we recommended that FHFA include all required components when preparing the annual risk assessment for CSS. FHFA agreed with the recommendation.<sup>5</sup> In January 2022, we reviewed the corrective actions taken by FHFA. Based on our review, we found that the 2021 CSS risk assessment addressed the required types of risk and risk areas (i.e., components) and included the established risk rating as set forth in DER’s guidance. We concluded these actions met the intent of the recommendation, and we closed the recommendation.

## **FACTS AND ANALYSIS .....**

### **DER Prepared, Reviewed, and Issued the 2020 CSS ROE in Accordance with its Guidance**

We found that DER:

- Prepared the 2020 CSS ROE in accordance with the content and format requirements delineated in the ROE OPB;
- Documented management’s review of the 2020 CSS ROE as required by the ROE OPB; and
- Issued and presented the 2020 CSS ROE to the CSS Board of Managers as required by the ROE OPB. The CSS Board of Managers provided a written response to the 2020

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<sup>5</sup> See OIG, *FHFA’s Failure to Include the Financial Crimes and Model Components in its CSS Risk Assessment Is Inconsistent with a Risk-Based Approach to Supervision* (Mar. 23, 2021) (AUD-2021-005) (online [here](#)).



CSS ROE along with CSS Board of Managers Resolution 21-19 that affirmed the Board's commitment to remediate the MRAs detailed in the report.

## **Examination Results, Conclusions, and Ratings Reported in the 2020 CSS ROE Were Consistent with and Supported by Examination Activities That Had Been Subjected to Required QC Reviews**

### ***The ROE Presented the Results of Examination Activities***

We found that the composite rating and the management and operational risk component ratings reported in the 2020 CSS ROE aligned with the examination conclusions reached as documented in the examination workpapers. DER justified these ratings based on the component conclusions that (1) the Board of Managers and the senior management team were providing [REDACTED] of CSS; (2) the risk management framework adopted by CSS was considered [REDACTED]; and (3) CSS had a [REDACTED]. Further, these ratings reflected FHFA's overall conclusion that CSS' board and management [REDACTED].<sup>6</sup>

### ***All Examination Activities Were Subjected to Required QC Reviews***

Each of the eight targeted examinations and the supervisory correspondence for one adverse examination finding (a recommendation) identified through one monitoring activity were subjected to QC reviews, as required by DER's OPB on Independent Quality Control Process. QC performed these reviews to provide reasonable assurance that the examination work performed by examiners met applicable DER examination standards and FHFA guidance for document preparation and management. In these reviews, QC personnel identified a limited number of clerical and consistency issues. The DER examination team responded to all concerns identified in the QC review prior to the issuance of the examination activities' conclusion letters.

In addition, QC reviewed the four monitoring activities as part of QC's review of a sample of monitoring activities that did not result in adverse examination findings.<sup>7</sup> In these reviews, QC assessed whether the monitoring activity objective was clear and consistent throughout

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<sup>6</sup> While we do not question FHFA's determinations with respect to this ROE, including CSS' board and management [REDACTED], we do note that CSS is a relatively new entity; accordingly, its track record with addressing supervisory findings is limited.

<sup>7</sup> Although one monitoring activity resulted in an adverse examination finding, QC included the aspects of that monitoring activity that did not result in adverse examination findings as part of its review of a sample of monitoring activities.

the examination cycle, the work performed was documented in the appropriate procedure documents and analysis memoranda, and the procedures and analysis memoranda were approved as required. The reviews identified no significant concerns.

## CONCLUSIONS .....

DER followed its guidance in the preparation, supervisory review, and final issuance of the 2020 CSS ROE. In addition, examination results, conclusions, and ratings reported in the 2020 CSS ROE were consistent with and supported by examination activities that had been subjected to required QC reviews.

## 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 and those comments were considered in finalizing this report. FHFA also provided a management response, which is included as an Appendix to this report. In its response, FHFA acknowledged our conclusions.

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

Our audit objective was to determine whether DER prepared and issued its ROE covering the 2020 examination cycle for CSS in accordance with its guidance. The scope of our audit was the CSS ROE for the 2020 supervisory cycle issued on March 31, 2021.

To accomplish our objective, we:

- Reviewed Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO-14-704G (September 2014), and determined that the control activities and information and communications components of internal control were significant to this objective, focusing specifically on the underlying principles that management should design and implement control activities through policies and use quality information to achieve its objectives.
- Assessed the following FHFA and DER policies, procedures, and guidance and the extent to which these policies, procedures, and guidance were consistent with internal control standards:

- AB 2012-03, *FHFA Examination Rating System* (December 19, 2012)
- AB 2017-01, *Classifications of Adverse Examination Findings* (March 13, 2017)
- DER OPB – Enterprise Supervision Program (February 25, 2020)
- DER OPB – Reports of Examination (August 30, 2018: administratively reissued February 24, 2020)
- DER OPB – Independent Quality Control Process (January 24, 2020; administratively reissued February 24, 2020)
- Reviewed prior OIG reports on DER’s supervision of CSS and related topics:
  - OIG, *FHFA’s Failure to Include the Financial Crimes and Model Components in its CSS Risk Assessment Is Inconsistent with a Risk-Based Approach to Supervision* (March 23, 2021) (AUD-2021-005) (online [here](#))
  - OIG, *FHFA’s Completion of Planned Targeted Examinations of Fannie Mae Improved from 2016 through 2018, But Timeliness Remained an Issue; With the June 2019 Issuance of the Single Security, FHFA Should Reassess its Supervision Framework for CSS* (September 17, 2019) (AUD-2019-012) (online [here](#))
  - OIG, *Compliance Review of the Content and Communication of the Federal Housing Finance Agency’s Reports of Examination to the Enterprises’ Boards of Directors* (January 3, 2019) (COM-2019-001) (online [here](#))
  - OIG, *FHFA Failed to Consistently Deliver Timely Reports of Examination to the Enterprise Boards and Obtain Written Responses from the Boards Regarding Remediation of Supervisory Concerns Identified in those Reports* (July 14, 2016) (EVL-2016-009) (online [here](#))
  - OIG, *FHFA’s Failure to Consistently Identify Specific Deficiencies and Their Root Causes in Its Reports of Examination Constrains the Ability of the Enterprise Boards to Exercise Effective Oversight of Management’s Remediation of Supervisory Concerns* (July 14, 2016) (EVL-2016-008) (online [here](#))
- Interviewed DER personnel to gain an understanding of the reporting of findings, conclusions, and ratings in the 2020 CSS ROE.
- Reviewed and confirmed the population of targeted examination and monitoring activities performed during the 2020 CSS examination cycle.

- Reviewed examination workpapers to determine whether DER prepared, reviewed, and issued the 2020 CSS ROE in accordance with guidance. Specifically, we reviewed documentation to determine whether:
  - The composite ratings section of the ROE included descriptions of the ratings and reference examination results;
  - The separate component rating sections for the required management and operational components within the ROE described examination results, supervisory views of CSS risk management and controls, significant business or operations developments that affect CSS, and existing and emerging risks relevant to the respective component rating in accordance with AB 2012-03;
  - The ROE contained an MRA table that presented all the requisite attributes;
  - The draft ROE was reviewed and approved by all the requisite DER officials;
  - DER provided CSS with an opportunity to conduct a factual accuracy review of the draft ROE prior to issuance;
  - The DER Point of Contact transmitted the ROE by March 31, 2021; met with the Board of Managers to present a summary of the ROE; and requested a written response from the Board; and
  - CSS' Board provided a written response to the ROE affirming its commitment to remediate the MRAs detailed in the report.
- Compared the ROE to the conclusion letters and analysis memoranda for each of the eight targeted examination and the analysis memoranda for each of the four monitoring activities performed during the 2020 examination cycle to determine whether the ROE is consistent with the results of examination activities.
- Reviewed DER QC workpapers of DER examination activities to determine whether requisite QC reviews were performed and whether DER examination teams resolved any significant issues identified during the QC reviews.

We conducted this performance audit from October 2021 to March 2022 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: James Hodge, Deputy Inspector General for Audits, Office of Inspector General

FROM: Andre D. Galeano, Deputy Director, Division of Enterprise Regulation **ANDRE GALEANO**

SUBJECT: Draft Audit Report: *DER Followed its Guidance to Prepare, Review, and Issue the 2020 CSS Report of Examination*

DATE: March 15, 2022

Digitally signed by  
ANDRE GALEANO  
Date: 2022.03.15  
16:13:28 -0400

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Thank you for the opportunity to review the Office of Inspector General’s (OIG) draft report referenced above (Report). The objective of the OIG’s audit was to determine whether DER prepared and issued its Report of Examination (ROE) covering the 2020 examination cycle for Common Securitization Solutions, LLC (CSS) in accordance with its guidance. The scope of the audit was the CSS ROE for the 2020 supervisory cycle issued on March 31, 2021.

We are pleased that the OIG concluded that DER followed its guidance in the preparation, supervisory review, and final issuance of the 2020 CSS ROE. In addition, examination results, conclusions, and ratings reported in the 2020 CSS ROE were consistent with and supported by examination activities that had been subjected to required DER Quality Control reviews. The Report makes no recommendations.

We appreciate the professionalism and courtesy of the OIG staff who conducted this audit. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Diana Stebick  
Eric Wilson  
Edom Aweke  
John Major

## ADDITIONAL INFORMATION AND COPIES.....

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