

REDACTED

Federal Housing Finance Agency
Office of Inspector General



**Compliance Review of FHFA
Assessments of MRA Remediation
Plans Submitted by the Enterprises**

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

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Executive Summary

As the regulator of Fannie Mae and Freddie Mac (collectively, the Enterprises) and of the Federal Home Loan Banks, the Federal Housing Finance Agency (FHFA) is tasked by statute to ensure that these entities operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Examinations of its regulated entities are fundamental to FHFA's supervisory mission.

FHFA has directed its Division of Enterprise Regulation (DER) to conduct supervisory activities for the Enterprises. During its supervisory activities, DER may identify concerns or deficiencies occurring at an Enterprise. A Matter Requiring Attention (MRA) represents the Agency's most serious supervisory concern. According to FHFA, MRAs can be "critical supervisory matters (the highest priority) which pose substantial risk to the safety and soundness of the regulated entity" or "supervisory concerns that FHFA believes could, if not corrected, escalate and potentially negatively affect the condition, financial performance, risk profile, operations, or reputation of the regulated entity."

When DER issues an MRA to an Enterprise, that Enterprise must submit a proposed remediation plan to DER. DER's guidance requires DER examiners to conduct an independent analysis or assessment of each proposed remediation plan to determine whether that plan is sufficient to address the MRA and to document that analysis in DER's supervisory record-keeping system.

In July 2016, we issued an evaluation report in which we found, among other things, that DER examiners did not consistently conduct and document independent assessments of a random sample of 18 Enterprise MRA remediation plans. We also found that DER examiners did not consistently and timely store their independent assessments of proposed remediation plans in DER's supervisory record-keeping system. We made one recommendation to address these shortcomings, which FHFA accepted. In June 2017, DER issued revised guidance to implement the recommendation; we closed the recommendation based upon DER's issuance of this guidance and subsequent written clarification.

We initiated this compliance review to assess DER's compliance with its June 2017 guidance directing examiners to perform and document independent assessments of the Enterprises' MRA remediation plans and to maintain those assessments in DER's supervisory record-keeping system. We reviewed examiner assessments (and workpapers and other documentation) of proposed MRA remediation plans conducted between June 21, 2017, and September 1,



COM-2019-003

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2018 (review period). For 30 of the 35 assessments, we found that DER examiners conducted independent assessments (86%). We identified five instances where the examiner assessment reflected that the examiner simply copied (or summarized) portions of the proposed remediation plan or recited the proposed corrective actions and concluded, without any analysis, that the proposed plan was sufficient. We found that all 35 analysis memoranda (and workpapers and other documentation) were properly maintained in DER's supervisory record-keeping system.

We provided FHFA the opportunity to respond to a draft of this report.

This report was prepared by Karen E. Berry, Senior Investigative Counsel, and Gregg M. Schwind, Attorney Advisor. 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.fhfaoig.gov.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY2

ABBREVIATIONS5

BACKGROUND6

 Issuance of MRAs by DER and Subsequent Remediation by the Enterprises6

 OIG Previously Found that DER Examiners Did Not Consistently Conduct and Document Independent Assessments of MRA Remediation Plans, and FHFA Accepted OIG’s Remedial Recommendation.....7

FACTS AND ANALYSIS.....8

 Elements of an Independent Assessment.....8

 DER Examiners Conducted and Documented Independent Assessments of 30 of the 35 Proposed MRA Remediation Plans During the Review Period, But Failed to Do So for the Remaining 5 Plans9

 DER Properly Maintained Examiners’ Assessments of MRA Remediation Plans10

 DER Recently Issued New Guidance for Examiner Assessments of MRA Remediation Plans10

CONCLUSION.....11

OBJECTIVE, SCOPE, AND METHODOLOGY12

ADDITIONAL INFORMATION AND COPIES13

ABBREVIATIONS

AB	Advisory Bulletin
DER	Division of Enterprise Regulation
EIC	Examiner in Charge
Enterprises	Fannie Mae and Freddie Mac
FHFA or Agency	Federal Housing Finance Agency
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin

BACKGROUND.....

As the regulator of the Enterprises, FHFA is tasked by statute to ensure that these entities operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Supervision activities for the Enterprises are conducted by DER. DER conducts ongoing monitoring and targeted examinations into selected areas of high importance or risk at each Enterprise pursuant to a supervisory plan that is prepared annually.

Issuance of MRAs by DER and Subsequent Remediation by the Enterprises

During their supervisory activities, DER examiners may identify concerns or deficiencies occurring at an Enterprise. An MRA represents the Agency’s most serious supervisory concern.¹ According to FHFA, MRAs can be “critical supervisory matters (the highest priority) which pose substantial risk to the safety and soundness of the regulated entity” or “supervisory concerns that FHFA believes could, if not corrected, escalate and potentially negatively affect the condition, financial performance, risk profile, operations, or reputation of the regulated entity.”

DER’s responsibilities for oversight of an Enterprise’s remediation of an MRA are set forth in FHFA’s *Examination Manual* and its Advisory Bulletins (AB), and DER’s Operating Procedures Bulletins (OPB). DER’s responsibilities can be divided into three phases: independent analysis of the adequacy of each proposed remediation plan; assessment of ongoing remediation activities; and, for those MRAs that an Enterprise claims to have fully remediated, independent analysis of the adequacy of the corrective actions.

With respect to the first phase, DER examiners are required to conduct an independent analysis or assessment of each proposed remediation plan to determine whether that plan is sufficient to address the MRA and document that assessment in DER’s supervisory record-keeping system. On the basis of that independent assessment, DER determines whether to issue a “non-objection” letter to the proposed remediation plan, or to reject the plan in whole or in part.

¹ FHFA classifies examination findings into one of three categories: (1) Matters Requiring Attention (MRAs); (2) recommendations; or (3) violations.

OIG Previously Found that DER Examiners Did Not Consistently Conduct and Document Independent Assessments of MRA Remediation Plans, and FHFA Accepted OIG’s Remedial Recommendation

In July 2016, OIG issued an evaluation report² in which we found, among other things, that DER examiners did not consistently conduct and document independent assessments of a random sample of 18 Enterprise MRA remediation plans, as required by DER guidance. We found that DER examiners failed to conduct an independent assessment of the sufficiency of the Enterprises’ proposed remediation plan for 6 of 18 MRAs we reviewed. We also found that DER examiners did not consistently: (1) document, in an analysis memorandum or other workpaper, their independent assessment of the adequacy of each Enterprise MRA remediation plan and the basis upon which such plan was either accepted or rejected; and (2) maintain that document in DER’s supervisory record-keeping system.

We recommended that FHFA “[r]equire DER to conduct and document, in an Analysis Memorandum or other work paper, an independent assessment of the adequacy of each Enterprise MRA remediation plan and the basis upon which the remediation plan is either accepted or rejected, and to maintain that document in DER’s supervisory record-keeping system.” FHFA agreed with the recommendation and committed “to amend its internal guidance to provide that examiners should assess any remediation plan . . . and should include in the summary memorandum the results of that assessment.” The Agency added that its existing guidance already provided that summary memoranda are to be maintained with examination documentation.

On June 21, 2017, DER issued Operating Procedures Bulletin 2017-DER-OPB-03.2 (OPB-03.2), *Adverse Examination Findings Issuance and Follow-Up*. According to OPB-03.2, “DER staff’s review of the [MRA remediation] plan should be documented in an analysis memo that concludes whether the proposed corrective action(s) is sufficient to address the MRA.”

After FHFA issued the OPB, the Agency represented that it had completed the actions it agreed to take in response to the recommendation. We responded, in writing, that the newly issued OPB did not fully implement the recommendation because it did not require examiners to exercise *independent* judgment in conducting their assessments of Enterprise remediation plans.

DER responded to us with a written clarification in which it stated that DER examiner assessments under the OPB were required to be independent and cited, in support, a provision

² OIG, *FHFA’s Inconsistent Practices in Assessing Enterprise Remediation of Serious Deficiencies and Weaknesses in its Tracking Systems Limit the Effectiveness of FHFA’s Supervision of the Enterprises* (July 14, 2016) (EVL-2016-007).

in FHFA’s *Examination Manual* stating that “[w]orkpapers must be prepared in sufficient detail to provide a clear understanding of the examination work performed.” We closed the recommendation based upon DER’s issuance of the OPB and subsequent clarification.

FACTS AND ANALYSIS

In September 2018, we initiated this review to assess DER’s compliance with the June 2017 OPB requiring examiners to conduct independent assessments of proposed remediation plans and to document and retain those assessments in DER’s supervisory record-keeping system. According to DER, 35 examiner assessments of proposed MRA remediation plans were submitted during the review period.

We reviewed the analysis memoranda, workpapers, and other documentation relating to each of the 35 assessments of the adequacy of each proposed MRA remediation plan, each of which provided the basis on which DER issued a non-objection letter as well as whether these materials were maintained in DER’s supervisory record-keeping system. We also interviewed DER officials.

Elements of an Independent Assessment

Our 2016 recommendation, accepted by FHFA, was that DER “conduct and document an independent assessment of the adequacy of each Enterprise MRA remediation plan and the basis upon which such plan is either accepted or rejected, and to maintain that document in DER’s supervisory record-keeping system.”

According to FHFA and DER, an examiner’s independent assessment of a proposed MRA remediation plan should include:

- The results of the examiner’s independent assessment of the proposed remediation plan for each MRA in sufficient detail to provide a clear understanding to individuals reviewing that assessment;
- More than a recitation of the Enterprise’s proposed remediation to correct the MRA deficiency; and
- More than a bare conclusory statement that the plan is, or appears to be, adequate.

That guidance directs that such assessments should be contained in an analysis memorandum, which shall be maintained in DER’s supervisory record-keeping system. All documents referenced in or linked to the analysis memorandum, such as meeting notes and other workpapers, shall also be maintained in that record-keeping system.

Both Examiners-in-Charge (EICs) for the two Enterprise examination teams explained the importance of an examiner’s independent assessment of a proposed MRA remediation plan: (1) it enables DER to determine whether the proposed corrective actions will remediate the MRA, and (2) it establishes DER’s expectations for the remedial actions. Both EICs confirmed that an assessment which only copied or summarized statements from an Enterprise’s proposed remediation plan, without assessing whether that plan was sufficiently detailed and appropriate to resolve the MRA, would not meet the June 2017 OPB requirements.

DER Examiners Conducted and Documented Independent Assessments of 30 of the 35 Proposed MRA Remediation Plans During the Review Period, But Failed to Do So for the Remaining 5 Plans

We reviewed the examiner assessments of the proposed remediation plans for 35 MRAs conducted during the review period and captured in analysis memoranda or other workpapers. Applying the standards for an independent assessment explained above, we found that 30 of the 35 assessments (86%) met those standards and 5 did not.

Our findings are summarized in the following table:

	Independent Assessment	No Independent Assessment
Enterprise A (██████████)	████ (86%)	████ (14%)
Enterprise B (██████████)	████ (86%)	████ (14%)
Total (35 MRAs)	30 (86%)	5 (14%)

We found that five of the assessments were not independent: DER examiners copied portions of the Enterprise’s proposed remediation plan into their analysis memoranda and concluded, based solely on the proposed plan, that it was adequate.

- In an assessment of an Enterprise’s proposed remediation plan for an MRA re-issued in August 2017, the examiner copied and pasted, verbatim, tables from the Enterprise’s plan and concluded, without any analysis, that the steps in the plan seemed to address DER’s concerns and, if properly executed, appeared adequate. The EIC for the examination team agreed, after review of this assessment, that the examiner’s conclusion did not constitute an independent assessment of the remediation plan.
- In an assessment of an Enterprise’s proposed remediation plan for an MRA issued in January 2018, the examiner copied verbatim, from the Enterprise’s proposed

remediation plan, each element of the proposed remediation and the likely result of each element. After this written recitation of the Enterprise’s plan, the examiner concluded that the actions in the plan, if implemented, would address the concerns in the MRA.

- An assessment of the proposed remediation plan for two companion MRAs issued to an Enterprise in April 2017 consisted of a table with five columns: “Element within MRA,” “Supervisory Letter Requirement,” “[Enterprise] Remediation Plan,” “Due Date,” and “Acceptable?” The first four columns recited information from DER’s conclusion letter and the Enterprise’s proposed remediation plan. The final column simply stated the word “Yes” for each MRA element, with no assessment.
- Last, an assessment of a proposed remediation plan for an MRA issued to an Enterprise in October 2017 contained a section titled “Review of Remediation Plan” that included the remediation actions proposed by the Enterprise. Following that recitation, the examiner concluded, with no analysis, that DER had no objection to the proposed plan. The examiner included a link to minutes from a meeting with the Enterprise to discuss the remediation plan. Our review of these minutes found that they contained a summary of the steps the Enterprise planned to take to remediate the MRA, with no analysis of the adequacy of those actions. The EIC for the examination team agreed, after review of this assessment, that the examiner’s conclusion did not constitute an independent assessment of the adequacy of the proposed remediation plan.

In each of these instances, DER issued a non-objection letter to the Enterprise.

DER Properly Maintained Examiners’ Assessments of MRA Remediation Plans

To determine whether DER maintained examiner assessments of proposed MRA remediation plans in DER’s supervisory record-keeping system, as FHFA agreed to do, we sought and obtained from DER the analysis memoranda, workpapers, and other documents from DER’s supervisory record-keeping system relating to the examiners’ assessments of the proposed remediation plans submitted for the 35 MRAs. We found that the required documents were retained in DER’s supervisory record-keeping system.

DER Recently Issued New Guidance for Examiner Assessments of MRA Remediation Plans

After we had concluded the fieldwork for this compliance review, on October 31, 2018, DER issued Operating Procedures Bulletin 2018-DER-OPB-2.4, *Examination Processes and Documentation: Issuance of Adverse Examination Findings and Assessment of MRA*

Remediation (OPB-2.4). Because OPB-2.4 applies prospectively to DER oversight of Enterprise remediation of MRAs, it had no applicability to this compliance review.

This 2018 OPB supersedes the June 2017 OPB specifically with respect to independent assessments of proposed remediation plans. It expressly requires DER examiners to perform an “independent examiner analysis” of an Enterprise’s proposed MRA remediation plan, and instructs that each independent analysis must include the following elements:

- A comparison of the planned corrective actions to the condition giving rise to the MRA, the root cause of the condition, the criteria used as a basis of the concern, and the risk to the Enterprise of not remediating the MRA;
- A determination whether DER should review any interim milestones and/or the adequacy and timeliness of ongoing Enterprise MRA remediation; and
- A determination whether the Enterprise’s proposed remediation completion date is reasonable and commensurate with the required level of effort needed to implement the plan.

CONCLUSION.....

FHFA issues MRAs for the most serious deficiencies and expects the Enterprises to remediate them without delay. When an MRA is issued, FHFA requires the affected Enterprise to submit a proposed remediation plan to DER. DER’s guidance directs DER examiners to conduct an independent analysis or assessment of each proposed remediation plan to determine whether that plan is sufficiently detailed and appropriate to resolve the MRA and document that analysis in DER’s supervisory record-keeping system.

We initiated this compliance review to assess DER’s compliance with its June 2017 guidance directing examiners to perform and document independent assessments of the Enterprises’ proposed MRA remediation plans and to maintain those assessments in DER’s supervisory record-keeping system. We reviewed 35 examiner assessments (and workpapers and other documentation) of proposed MRA remediation plans conducted during the review period. For 30 of the 35 assessments, we found that DER examiners conducted independent assessments (86%). We identified 5 instances where the examiner assessment of the proposed remediation plan contained no independent analysis. We found that all 35 analysis memoranda (and workpapers and other documentation) were properly maintained in DER’s supervisory record-keeping system.

OBJECTIVE, SCOPE, AND METHODOLOGY

The OIG Office of Compliance and Special Projects undertook this compliance review to assess FHFA’s implementation of the actions to which it committed in response to recommendations in the 2016 evaluation report. Our objectives included an assessment of whether: (1) DER conducted and documented an independent assessment of each MRA remediation plan; and (2) whether DER maintains an analysis memo or other workpaper documenting the assessments in FHFA’s supervisory record-keeping system.

To address our objectives, we requested and analyzed DER workpapers and other documentation related to Enterprise MRA remediation plans submitted during the review period, covering a total of 35 MRAs—■ for one Enterprise and ■ for the other Enterprise. We reviewed FHFA examination guidance and prior DER communications with OIG regarding examination guidance. We also interviewed the EICs for both DER examination teams and DER’s quality control manager.

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

We provided a draft of this report to FHFA for its review and comment.

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