

Federal Housing Finance Agency
Office of Inspector General



**Freddie Mac Management Failed to
Adopt and Implement Conflicts of
Interest Policies Which Aligned Fully
with FHFA's Directive on Senior
Executive Officers' Conflicts of
Interest, and With the Charter for the
Freddie Mac Board's Nominating and
Governance Committee**



COM-2020-006

August 26, 2020

Executive Summary

In September 2008, FHFA placed Freddie Mac and Fannie Mae (the Enterprises) into conservatorships after it determined that their financial condition threatened their ability to operate in a safe and sound manner. By order issued in November 2008, FHFA established the Nominating and Governance Committee (NGC) as one of four standing committees for the board of directors of each Enterprise. In June 2016, Freddie Mac's Board of Directors (Board) determined to vest responsibility in its NGC to "review and address any conflicts of interest (COI) involving directors or executive officers." The Board amended the NGC Charter, effective July 2016, to charge the NGC with this expanded responsibility.

In June 2017, the Board clarified the NGC Charter to specify that the term "conflicts of interest" includes any "actual or potential" COI, including those involving family members of Freddie Mac executive officers and directors or entities in which they have an interest. The NGC Charter does not delegate the NGC's responsibilities to any Freddie Mac employee, including the Chief Compliance Officer (CCO) or employees in the Ethics and Business Practices Department (Ethics Office).

In a September 2017 Management Alert to FHFA, we found no evidence that Freddie Mac had updated its COI policies and procedures to track to the revised NGC Charter. For example, we found that none of these COI policies and procedures expressly recognized that the NGC has been charged with the responsibility to resolve executive officer COI. As a result, we determined that Freddie Mac's COI policies and procedures involving executive officers were not aligned with the NGC's responsibilities, and the divergence created a significant risk that the NGC would not be able to meet its obligations under its revised Charter.

We recommended in our Management Alert that FHFA, as conservator, direct:

- the Board to clarify the scope of the NGC's responsibilities under its Charter that relate to COI involving executive officers; and
- Freddie Mac to revise its policies and procedures to align with the responsibilities assigned to the NGC and facilitate the NGC's execution of its responsibilities.

On April 23, 2018, FHFA issued a conservator directive (Directive) that established the Agency's expectations concerning both Enterprises' internal processes for the disclosure, review, approval, and resolution of actual, potential, or apparent COI involving individuals meeting the defined term for



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senior executive officers (SEOs). It did not issue separate guidance for each Enterprise. FHFA stated that it expected each Enterprise to review existing governance documents for consistency with the Directive, to determine the Board and management authorities consistent with the Directive, and to amend these documents as needed by October 31, 2018.

We initiated this compliance review to determine Freddie Mac's compliance from November 1, 2018 through January 31, 2020 (review period) in implementing three key components of the process to disclose and resolve actual and potential COIs involving SEOs. These three components are:

- (1) Submission by SEOs of annual completed COI questionnaires to the Ethics Office, review of those annual completed questionnaires by the Ethics Office for potential COI issues, and summary memoranda issued by the Ethics Office to the NGC proposing resolution of potential COI issues identified from the annual questionnaires;
- (2) Review by the Ethics Office of the proactive disclosures made by the CEO/director of potential and actual COIs (apart from the mandatory annual questionnaires), its written recommendation to the NGC for resolution of any such COIs, and determination(s) by the NGC;
- (3) Review by the Ethics Office of the proactive disclosures made by any other SEOs of potential and actual COIs (apart from the mandatory annual questionnaires), its determination whether an actual or potential COI existed and written recommendation to the NGC for resolution of it, and its reporting to the NGC of matters involving SEOs where it determined that no COI existed.

For the first component, our independent testing found that SEOs completed and submitted annual COI questionnaires for 2018 and 2019 and that the Ethics Office reviewed the completed questionnaires for potential COI issues and did not identify any COI issues for calendar year 2018. However, FHFA's Directive set forth the expectation that the Ethics Office will provide a summary memorandum to the NGC, including whether no COI issues are identified in its review of the SEO annual disclosures, and the Ethics Office has no discretion whether to provide such a memorandum. The Ethics Office failed to comply with this requirement for calendar year 2018. Freddie Mac has agreed, going forward, to clearly state the results of its review of the completed questionnaires in its first quarterly report to the NGC after completion of its review each year.



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For the second component, our independent testing found that the Ethics Office failed to follow FHFA’s Directive and the NGC Charter by resolving a COI request made by the CEO/Freddie Mac director, even though the Ethics Office lacked authority to resolve that request, and it failed to report this COI “inquiry” or its resolution of it to the NGC. FHFA’s Directive is unambiguous: only the Board’s NGC has the authority to resolve COI issues implicating the CEO/Freddie Mac director. The NGC’s Charter vests sole authority in the NGC to resolve all potential COIs involving the CEO, regardless of how the CEO or the Ethics Office characterizes disclosure of the potential COI. No management-adopted policy or procedure, or interpretation of such a policy or procedure, can authorize the subordinate employees in the Ethics Office to resolve COI issues implicating the CEO/director. Because Freddie Mac’s amended COI policy and procedure, as implemented by the Ethics Office, fails to carry out the agreed-upon recommendation and fails to follow the NGC Charter and the expectation in FHFA’s Directive, we are re-opening the second recommendation.

For the third component, our independent testing found that the Ethics Office again failed to perform its obligation, imposed by FHFA’s Directive, to disclose all COI reports involving SEOs to the NGC “whether or not the Ethics Office determined there was a COI issue.” Categorizing a potential COI reported by a SEO as an “inquiry,” not a “disclosure,” does not void the requirement imposed on the Ethics Office to notify the NGC of all COI matters involving SEOs. Freddie Mac’s amended COI policy and procedure, as implemented by the Ethics Office, fails to carry out the agreed-upon recommendation and fails to follow the NGC Charter and the expectation in FHFA’s Directive. For these additional reasons, we are re-opening the second recommendation. FHFA agrees with the re-opened recommendation, and commits that it will, “by December 31, 2020, issue a directive to Freddie Mac to revise its [COI] policy and procedures and for Freddie Mac to train the Freddie Mac Ethics Office staff on those revisions.”

This report was prepared by Wesley Phillips, Senior Policy 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.fhfa.gov.

/s/

Brian Baker

Acting Deputy Inspector General for Compliance & Special Projects

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ABBREVIATIONS

Board	Board of Directors
CCO	Chief Compliance Officer
CEO	Chief Executive Officer
COI	Conflict of Interest
Directive	FHFA April 23, 2018 Conflict of Interest Directive to the Enterprises
Ethics Office	Freddie Mac’s Ethics and Business Practices Department
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
NGC	Nominating and Governance Committee for Freddie Mac’s Board
OIG	Federal Housing Finance Agency Office of Inspector General
Review Period	November 1, 2018 – January 31, 2020
SEO	Senior Executive Officer. The universe of SEOs at Freddie Mac includes, but is not limited to, the CEO.

BACKGROUND.....

In September 2008, FHFA placed the Enterprises into conservatorships after it determined that their financial condition threatened their ability to operate in a safe and sound manner. As conservator, FHFA succeeded to all rights, titles, powers, and privileges of the company, and of any stockholder, officer, or director of the company with respect to the companies and their assets.

By order issued in November 2008, FHFA established the NGC as one of four standing committees for each Enterprise’s board of directors. In June 2016, Freddie Mac’s Board determined to vest responsibility in its NGC to “review and address any [COIs] involving directors or executive officers.” The Board amended the NGC Charter, effective July 2016, to charge the NGC with this expanded responsibility.

In June 2017, the Board clarified the NGC Charter to specify that the term “conflicts of interest” includes any “actual or potential” COI, including those involving family members of Freddie Mac executive officers and directors or entities in which they have an interest.¹ The NGC Charter does not delegate the NGC’s responsibilities to any Freddie Mac employee, including the CCO or employees in the Ethics Office.

A 2017 OIG Management Alert Found Deficiencies in FHFA’s Oversight of Freddie Mac’s Governance of COI Involving Executives

In a September 2017 Management Alert to FHFA, we found no evidence that Freddie Mac had updated its COI policies and procedures to track to the revised NGC Charter.² For example, Freddie Mac’s COI policy and procedure governing employees’ outside activities directed that under certain circumstances, executive officers’ potential COI involving outside activities would be reviewed and resolved by the CCO or the CEO rather than the NGC. Moreover, none of Freddie Mac’s COI policies and procedures we reviewed established a process to report potential COI involving executive officers to the NGC for it to review and address. We found that none expressly recognized that the NGC has been charged with the responsibility to resolve executive officer COI. As a result, we determined that Freddie Mac’s COI policies and procedures involving executive officers were not aligned with the NGC’s responsibilities, and the

¹ As discussed later in this compliance review report, FHFA introduced the term “senior executive officer” (SEO) in 2018 to define the Enterprises’ executive leadership, and Freddie Mac has revised its Charter to include the term accordingly. NGC Charter, § 10. SEO was the operative term at all times tested.

² *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) (September 27, 2017).

divergence created a significant risk that the NGC would not be able to meet its obligations under its revised Charter.

FHFA asserted in its management response, which was reprinted in its entirety in the Management Alert's Appendix, that Freddie Mac "has consistently interpreted and applied the revised Charter and related documents in a manner that gives effect to" Board-approved reservations and delegations of authority to management. We explained that FHFA's effort to read out of existence the direction in the NGC Charter was unavailing. The Board's resolution delegating authority to management stated that any delegation to management shall be subject to, and in accordance with, Freddie Mac's governing documents, which Freddie Mac defined to include the NGC Charter. Authority to resolve potential or actual conflicts of directors and executive officers was vested by the Board with its NGC.³

For Freddie Mac, we recommended in our Management Alert, that FHFA, as conservator, direct:

- the Board to clarify the scope of the NGC's responsibilities under its Charter that relate to COI involving executive officers; and
- Freddie Mac to revise its policies and procedures to align with the responsibilities assigned to the NGC and facilitate the NGC's execution of its responsibilities.

FHFA agreed with these recommendations.

The 2017 Management Alert Recommendations Were Closed After FHFA Issued a Conservator Directive Setting Forth Its Expectations for the Enterprises

On April 23, 2018, FHFA issued a Directive⁴ that established the Agency's expectations concerning both Enterprises' internal processes for the disclosure, review, approval, and

³ In addition to this Management Alert, we issued three other reports addressing COIs by an Enterprise's CEOs, some of whom were also its directors. In those reports, we explained that, under the Enterprise's existing policies and procedures, only the Enterprise's Board (or its delegated committee) could determine whether a COI existed for an Enterprise Board member and CEOs. See, *Administrative Review of a Potential Conflict of Interest Matter Involving a Senior Executive Officer at an Enterprise* (OIG-2018-001) (July 26, 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) (January 31, 2018); *Administrative Investigation into Anonymous Hotline Complaints Concerning Timeliness and Completeness of Disclosures Regarding a Potential Conflict of Interest by a Senior Executive Officer of an Enterprise* (OIG-2017-003) (March 23, 2017).

⁴ The Directive was accompanied by a conservator policy. See generally *FHFA Directive*, April 2018 (Directive). For presentational purposes, this report refers to the two documents collectively as the Directive.

resolution of actual, potential, or apparent COI⁵ involving individuals meeting the defined term for SEOs.⁶ It did not issue separate guidance for each Enterprise. FHFA stated that it expected each Enterprise to review existing governance documents for consistency with the Directive, to determine the Board⁷ and management authorities consistent with the Directive, and to amend these documents as needed by October 31, 2018.

The following summarizes the Directive’s key expectations critical to this compliance review:

- All Enterprise employees are required to file annual review forms with the Enterprise’s Ethics Office. For forms submitted by the SEOs, the Ethics Office is expected to “provide[s] a summary memorandum regarding the completed disclosure forms and the results of its review for COI issues...” to the NGC.⁸
- Enterprise employees are also required to make timely, proactive disclosures of COI issues on an ongoing basis throughout the year.⁹
 - For proactive COI disclosures by an Enterprise CEO, who is also an Enterprise director, the “CEO must follow both the employee and board COI requirements. If there is a conflict between the employee and board COI requirements, the CEO should follow the more restrictive requirement.” The Ethics Office is expected to “make[] a written recommendation to the Board for resolving all CEO COI issues, including matters where [it] recommends a determination that no COI issue exists, and provides documentation of all relevant facts to the Board. The Board makes the final decisions on all CEO COI matters.”
 - For proactive COI disclosures by Enterprise SEOs other than the CEO, the Ethics Office is expected to determine whether they raise COI issues. Where the Ethics Office determines that such an SEO’s disclosure raises

⁵ The Directive defines COI as “...matters where an employee may have an actual, potential, or apparent interest, financial or otherwise, adverse to the Enterprise, including conduct or actions or failure to act that reasonably could result in reputational risk and associated harm to the Enterprise.” Directive at p.1, Introduction.

⁶ The Directive defines SEOs as the President and CEO, those additional “executive officers” defined by Rule 3b-7 under the Securities and Exchange Act, the Chief Audit Executive, and the CCO. Directive § (1)(a)(i).

⁷ The Directive defines “Board” as the “Board of Directors or the relevant committee thereof.” Directive § (1)(a)(ii)(2).

⁸ For presentational purposes, this section refers to the “NGC” rather than the “Board,” which is the term used in the Directive, since the NGC has been delegated authority from Freddie Mac’s Board of Directors regarding all executive COI matters.

⁹ The Directive states that “[d]isclosure to the [Ethics Office] is [to be] made on a timely basis, *i.e.*, whenever possible, before the involved action or decision occurs.” Directive § (1)(a)(iii)(1).

COI issues, it is expected to provide a written recommendation to the NGC for resolving the issue and provide documentation of all relevant facts. The NGC may approve, deny, or impose further conditions on the Ethics Office's recommendations. When the Ethics Office concludes that such an SEO disclosure does not present a COI, the Ethics Office is expected to notify the NGC with its decision on an informational basis during the next scheduled meeting.

- The Ethics Office is expected to report at least quarterly to the NGC on all COI disclosures by SEOs, including its determinations when a COI did not exist.

Based on the Agency's actions, we closed the two recommendations on July 27, 2018.

Freddie Mac Revised its COI Policies and Procedures for Consistency with the Directive's Expectations

In response to our request, Freddie Mac provided copies of the 13 COI policies and procedures it reported that it had updated to conform to the Directive's expectations as well as documentation of the specific revisions to each policy and procedure. Revisions to the COI policies and procedures relevant to this compliance report are as follows:

- Freddie Mac amended its Annual Conflicts of Interest Questionnaire Process to establish procedures for the Ethics Office to review SEOs' annual disclosure forms for COI determinations, and the amended Outside Activities and Family Member Activities Policy (Amended Policy) under which the results of the SEO annual disclosures are reported to the NGC in the first quarter COI report each year. Neither this Amended Policy nor any of the other amended policies and procedures contain a requirement to mirror the Directive's expectation that the Ethics Office will provide the Board or the NGC (a relevant committee thereof) with a *summary memorandum* regarding the forms and the results of the Ethics Office's review of the annual disclosures for COI.
- For the CEO/director, the Amended Policy provides that the NGC is responsible for resolving whether the CEO's COI proactive disclosures present any COI issues. Upon a written recommendation from the Ethics Office, the NGC shall determine whether a COI exists and, if so, how that conflict shall be resolved. The Amended Policy makes clear that the NGC makes the final decision on all CEO COI issues, including whether a COI exists.
- For other SEO proactive disclosures, Freddie Mac's Amended Policy conforms to the Directive. Where the Ethics Office determines that an actual or potential COI may exist for a SEO other than the CEO, the Amended Policy directs it to escalate the issue

and its recommended resolution of the issue to the NGC. The Amended Policy requires the Ethics Office, on a quarterly basis, to report to the NGC on its review of the SEOs' proactive COI disclosures, including those reviews that determined that no potential or actual COI existed.

Freddie Mac notified FHFA that it had revised its COI policies and procedures prior to the October 31, 2018 deadline established in the Directive.

FINDINGS

We initiated this compliance review to determine Freddie Mac's compliance from November 1, 2018 through January 31, 2020 (review period) in implementing three key components of the process to disclose and resolve actual and potential COIs involving SEOs. These three components are:

1. Submission by SEOs of annual completed COI questionnaires to the Ethics Office, review of those annual completed questionnaires by the Ethics Office for potential COI issues, and summary memoranda to the NGC discussing resolution of potential COI issues identified from the annual questionnaires;
2. Review by the Ethics Office of the proactive disclosures made by the CEO/director of potential and actual COIs (apart from the mandatory annual questionnaires), and its written recommendation to the NGC for resolution of any such COIs, and determination(s) by the NGC;
3. Review by the Ethics Office of the proactive disclosures made by any other SEOs of potential and actual COIs (apart from the mandatory annual questionnaires), its determination whether an actual or potential COI existed and written recommendation to the NGC for resolution of it, and its reporting to the NGC of matters involving SEOs where it determined that no COI existed.

We now discuss our findings for each component.

1. SEOs Filed Annual Completed COI Questionnaires, and These Completed Questionnaires Were Reviewed by the Ethics Office for COI Issues, but the Ethics Office Failed to Specifically Discuss Its Findings from Its Review of the 2018 Annual Disclosures in Its Quarterly Report to the NGC

In response to our request, Freddie Mac provided documentation showing all 11 SEOs completed and submitted the required annual questionnaires to the Ethics Office for calendar years 2018 and 2019. An Ethics Office official reported to us that the Ethics Office reviewed all 11 SEO completed questionnaires for calendar year 2018 and identified no COI issues in them. Freddie Mac also informed us that a similar review of the annual completed questionnaires was undertaken by the Ethics Office for calendar year 2019 but was to be completed after the end of our review period.

The same Ethics Office official advised us that the Ethics Office presented the results of its review of the 2018 COI annual questionnaires by the SEOs in its quarterly COI report to the NGC for the first quarter of 2019, dated May 29, 2019. Our review of this May 29, 2019 quarterly report found no specific reference to the Ethics Office review of the 2018 annual SEO questionnaires. The quarterly report states, “There were no open matters from the first period of reporting,” and it identifies one new proactive disclosure from an SEO that was determined not to raise COI issues.

We recognize that the Ethics Office did not identify any COI issues in the annual disclosures submitted by the SEOs for calendar year 2018. However, the Directive’s expectation is that the Ethics Office will provide a summary memorandum to the NGC, including whether no COI issues are identified in its review of the SEO annual disclosures, and the Ethics Office has no discretion whether to provide such a memorandum. Calendar year 2018 was the first year in which this requirement was in force but the Ethics Office failed to comply with it.

In technical comments to a draft of this compliance review, Freddie Mac agreed, going forward, to clearly explain the results of its review of the completed questionnaires in its first quarterly report to the NGC after completion of its annual review.

2. In Contravention of the Directive and NGC Charter, the Ethics Office Improperly Resolved a COI Issue Raised by the CEO and Failed to Notify the NGC of Its Decision

As explained earlier, the Directive and NGC Charter make clear that only the Board (or NGC) can determine whether the CEO/Board member has a potential or actual conflict, and then resolve it. However, the Ethics Office failed to follow that Directive and the NGC Charter: it made a COI determination, based on an inquiry by the CEO, imposed conditions on his conduct to avoid the appearance of a conflict, and failed to notify the NGC of its ultra vires actions.

In response to our request, Freddie Mac identified one “contact” between the CEO and the Ethics Office.¹⁰ That contact was an email from the CEO, dated November 21, 2019, in which the CEO sought guidance from the Ethics Office under Freddie Mac’s Amended Policy – one of its COI Policies – whether he could accept an honor from a non-profit housing group and participate in fundraising for a October 2020 gala during which the honor would be presented to him. The CEO explained that fundraising for the gala would be from Freddie Mac’s customers and or institutions with whom Freddie Mac actively does business and asked whether his active participation in fundraising from these sources would constitute a violation or perceived violation of policy. Freddie Mac’s Amended Policy expressly prohibits fundraising for outside activities.

The Ethics Office categorized the CEO’s email as a “Conflicts of Interest (non Business Courtesies)” inquiry in its database. It responded to the CEO’s inquiry, by email dated November 26, 2019,¹¹ and advised the CEO that he could accept the honor, provided that he followed the terms it set for his participation in fundraising for the October 2020 gala. Those terms set forth a “list of explicit actions that can and cannot be taken” by the CEO, permitting use of Freddie Mac’s logo in solicitations and publicity (if pre-approved) but not permitting solicitations by the CEO at any time or CEO requests for participation in the gala during business hours. We found no evidence that the Ethics Office reported this COI “inquiry” or its resolution of it, to the NGC.

We asked both Freddie Mac and FHFA, in writing, to provide the basis for the Ethics Office’s authority to resolve this COI inquiry. Freddie Mac, through FHFA, explained in writing that the CEO’s email was an “inquiry” and, accordingly, the Ethics Office was not required to escalate the question to the NGC or inform it of its resolution. FHFA characterized the CEO’s “inquiry” as a “question” rather than a COI disclosure, and asserted that it did not need to be reported to the NGC. As we understood both answers, Freddie Mac and FHFA hold the view that characterizing the CEO’s COI disclosure as an inquiry excludes it from the clear requirements in the Directive and NGC Charter and authorizes the Ethics Office to resolve the COI issue on its own.

In technical comments to a draft of this compliance review, Freddie Mac asserted, for the first time, that it had erred in categorizing the CEO’s inquiry as a COI issue because his request should have been treated as a business courtesy issue. It maintained that the CEO’s request to

¹⁰ The Ethics Office also identified three other contacts for the CEO position involving business courtesies, which were outside the scope of this compliance review.

¹¹ We recognize that, pursuant to Freddie Mac procedures implementing the Amended Policy, an “erroneous” SEO disclosure of a potential or actual COI, such as participation in non-profit professional, civic, or charitable activities (e.g., United Way, Girl Scouts, etc.) or in religious activities does not require review by the Ethics Office. However, the Ethics Office did not treat this inquiry as an “erroneous disclosure,” nor can it do so for the CEO.

accept a proposed award was authorized by its Business Courtesies Policy and that it intended to correct the erroneous record.

Assuming that this error was made in good faith, it is not dispositive. Freddie Mac, in its technical comments and discussions with us, acknowledged that the request from the CEO/director also sought guidance whether he could fundraise on behalf of this non-profit from Freddie Mac customers and that activity implicated its Amended Policy, which forbids such fundraising. Freddie Mac asserted that the Ethics Office was not required to elevate the potential COI implicated by the requested fundraising to the NGC because the Amended Policy clearly prohibits such activity. Because Freddie Mac also maintains that the request by the CEO/director regarding potential fundraising should be characterized as an inquiry, it asserts that its COI Policy and Procedure permit its Ethics Office to resolve COI inquiries involving the CEO/director without elevating them to the NGC (or notifying the NGC of their existence).

Freddie Mac's argument lacks merit. First, the Freddie Mac Ethics Office has no authority to resolve COIs involving directors, and Freddie Mac, in its response, never addresses resolution of potential COIs involving directors. Resolution of a potential COI involving the CEO by Freddie Mac's Ethics Office, and Freddie Mac's subsequent efforts to justify it, are akin to the actions by Fannie Mae's Ethics Office that gave rise to our Management Alert issued in 2018.¹² Such conduct led to FHFA's Directive and conforming changes to the NGC Charters by the Enterprises.

FHFA's Directive is unambiguous: only an Enterprise Board (or its delegatee, here the Board's NGC) has the authority to resolve potential COI issues implicating an Enterprise CEO/Director, regardless of how the CEO or the Ethics Office characterizes such disclosure of a potential COI. The Charter for Freddie Mac's NGC was revised to follow the Directive, which vests sole authority in the NGC to resolve all potential COIs involving directors and the CEO. No management-adopted policy or procedure, or interpretation of either, can authorize Freddie Mac's Ethics Office: 1) to characterize a COI inquiry by the CEO/director to fall outside the exclusive grant of authority to the NGC to resolve such potential COIs; 2) to make COI determinations for the CEO/director on the NGC's behalf, including imposition of conditions; (3) to elect not to present a COI inquiry made by the CEO to the NGC and deprive it of its ability to execute its responsibilities to resolve CEO COI issues; and 4) to fail to notify the NGC that it had made a COI determination for the CEO.

In our view, the Ethics Office, by categorizing the CEO's proactive COI disclosure as an "inquiry" circumvented the clear requirements in FHFA's Directive and the NGC Charter.

¹²See *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) (January 31, 2018).

Neither of these governance documents authorizes the Ethics Office, staffed by employees subordinate to the CEO, to unilaterally review and resolve the CEO’s proactive “inquiries” regarding a potential COI. In addition, nothing in these governance documents permits the Ethics Office to refrain from reporting a proactive COI “inquiry” of a COI to the NGC for its resolution.

3. The Ethics Office Did Not Notify the NGC of an SEO “Inquiry” But Notified the NGC of a Separate SEO “Disclosure” That Was Determined Not to Raise COI issues

In response to our request for proactive COI disclosures by SEOs other than the CEO during the review period, Freddie Mac provided a list of “contacts” between the SEOs and the Ethics Office. We determined that two of these contacts involved SEO disclosures (apart from the CEO disclosure discussed previously) of potential COIs.¹³ The Ethics Office classified one as an “inquiry” and the other as a “disclosure.”

From our review of the materials provided by Freddie Mac, we found that one proactive “inquiry” by an SEO from June 2019 raised two questions: whether a security was on the “prohibited” list and whether the SEO was a “control person” under the securities laws. The Ethics Office did not identify any COI issues and answered both questions. Because the Amended Policy authorizes the Ethics Office to determine whether an inquiry by a SEO raises a conflicts issue, that disposition by the Ethics Office was permitted. However, the Ethics Office did not disclose this proactive inquiry or its resolution in the relevant quarterly COI report to the NGC on an informational basis, in contravention of Freddie Mac’s Amended Policy.¹⁴

In its technical comments to a draft of this compliance review, Freddie Mac asserts that the inquiry by the SEO sought a policy clarification and was not a COI disclosure, and maintains that its Amended Policy only requires the Ethics Office to report COI disclosures to the NGC. According to Freddie Mac, there is an important difference between an inquiry and a disclosure. In its view, inquiries seek clarification from the Ethics Office on a point of policy and how it applies to a specific situation; and disclosures seek a determination whether a COI exists for the SEO. It maintains that the affected SEO made a policy inquiry for which it provided a factual

¹³ Freddie Mac provided us a list of 13 contacts between SEOs (other than the CEO position) and the Ethics Office. We determined that 10 involved “business courtesies,” and were outside the scope of this compliance review. FHFA subsequently reported to us that one of the three remaining contacts was in error and that Freddie Mac would update its records to omit it.

¹⁴ Although FHFA expressed the view that the Ethics Office did not need to disclose its resolution of this SEO COI “inquiry” to the NGC on an informational basis, that view does not align with the expectations set forth in FHFA’s Directive. Pursuant to the Directive, the Ethics Office is to report at least quarterly to the Board (or the NGC, to which the Board delegated relevant authority) regarding all COI disclosures for SEOs and their resolutions “whether or not the Ethics Office determined there was a COI issue.” Directive, § (3). See also Freddie Mac’s Outside Activities Policy, with conforming reporting requirements. Policy § (IV)(f).

response, and no COI determination was made. As we noted in our draft which gave rise to this comment, FHFA expressed the view that the Ethics Office did not need to disclose its resolution of this SEO COI “inquiry” to the NGC on an informational basis.

We explained in that draft and reiterate here that the position articulated by both Freddie Mac and FHFA does not align with the expectations set forth in FHFA’s Directive. Pursuant to the Directive, the Ethics Office is to report at least quarterly to the Board (or the NGC, to which the Board delegated relevant authority) regarding all COI disclosures involving SEOs and their resolutions “whether or not the Ethics Office determined there was a COI issue.” Directive, § (3). See also Freddie Mac’s Amended Policy, with conforming reporting requirements. Policy § (IV)(f). We note that the position advocated by Freddie Mac – that SEOs’ COI communications with the Ethics Office which are styled as or deemed to be inquiries, rather than disclosures, need not be disclosed to the NGC – would keep the NGC in the dark about COI resolutions by the Ethics Office, a result flatly contrary to the Directive and the NGC Charter.

According to documentation from Freddie Mac, the second proactive disclosure was made by a SEO in January 2019 regarding a potential outside investment opportunity. The Ethics Office found that this opportunity did not constitute a COI, provided the SEO followed specific terms and conditions. This COI disclosure and resolution were reported to the NGC in the relevant quarterly report on an informational basis.

CONCLUSIONS

This compliance review tested whether Freddie Mac implemented three key components of the process to disclose and resolve actual and potential COIs involving SEOs to align with the Charter of the NGC and FHFA’s Directive.

For the first component, our independent testing found that SEOs completed and submitted annual COI questionnaires for 2018 and 2019 and that the Ethics Office reviewed the completed questionnaires for potential COI issues and did not identify any COI issues for calendar year 2018. However, FHFA’s Directive set forth the expectation that the Ethics Office will provide a summary memorandum to the NGC, including whether no COI issues are identified in its review of the SEO annual disclosures, and the Ethics Office has no discretion whether to provide such a memorandum. The Ethics Office failed to comply with this requirement for calendar year 2018. Freddie Mac has agreed, going forward, to clearly state the results of its review of the completed questionnaires in its first report to the NGC after completion of its review.

For the second component, our independent testing found that the Ethics Office failed to follow the express direction in FHFA's Directive and the NGC Charter. It resolved a COI request made by the CEO/Freddie Mac director, even though it lacked authority to resolve that request and failed to report this COI "inquiry" or its resolution of it to the NGC. FHFA's Directive is unambiguous: only the Board's NGC has the authority to resolve COI issues implicating the CEO/Freddie Mac director. The NGC's Charter vests sole authority in the NGC to resolve all potential COIs involving the CEO, regardless of how the CEO or the Ethics Office characterizes disclosure of the potential COI. No management-adopted policy or procedure, or interpretation of such a policy or procedure, can authorize the subordinate employees in the Ethics Office to resolve COI issues implicating the CEO/director. Because Freddie Mac's amended COI policy and procedure, as implemented by the Ethics Office, fails to carry out the agreed-upon recommendation (as well as the expectation in FHFA's Directive and instruction in the NGC Charter), we are re-opening the second recommendation. We expect FHFA to direct Freddie Mac to further amend its policy and procedure and to provide training to Freddie Mac's Ethics Office to ensure that potential COIs implicating the CEO/director are resolved only by the NGC.

For the third component, our independent testing found that the Ethics Office again failed to perform its obligation, under FHFA's Directive, to disclose all COI disclosures involving SEOs to the NGC "whether or not the Ethics Office determined there was a COI issue." Categorizing a potential COI reported by a SEO as an "inquiry", not a "disclosure," does not void the requirement imposed on the Ethics Office to notify the NGC of all COI disclosures involving SEOs. Because Freddie Mac's amended COI policy and procedure, as implemented by the Ethics Office, fails to carry out the agreed-upon recommendation and fails to follow the NGC Charter and the expectation in FHFA's Directive, we are re-opening the second recommendation for these additional reasons. We expect FHFA to direct Freddie Mac to further amend its policy and procedure and to provide training to Freddie Mac's Ethics Office to ensure that potential COIs implicating the SEOs are reported to the NGC, regardless of the artful labeling of the request by the Ethics Office.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this compliance review in February 2020 to determine whether Freddie Mac complied with the April 2018 Directive the Agency issued in response to the two recommendations in our 2017 Management Alert report on the Agency’s oversight of Freddie Mac’s governance of conflicts of interest involving SEOs and amended Freddie Mac policies. Specifically, we tested Freddie Mac’s compliance from November 1, 2018 – January 31, 2020 (the review period) with the following expectations in the Directive and Freddie Mac policies: (1) SEOs’ submission of annual COI disclosure forms to the Ethics Office, the Ethics Office’s review of those forms for potential COI, and the Ethics Office’s issuance of summary memoranda to the NGC regarding those forms and the Ethics Office’s review of them; and (2) the Ethics Office’s review of the CEO’s and other SEOs’ proactive disclosures (i.e., voluntary COI disclosures submitted separately from the annual disclosure forms) and the Ethics Office’s subsequent reporting to the NGC.

To accomplish our objective, we obtained annual disclosure forms completed by SEOs for 2018 and 2019. We also reviewed a list of proactive disclosures SEOs had made to the Ethics Office.

To accomplish our objective with respect to reporting, we reviewed the quarterly reports submitted by the Ethics Office to the NGC during our review period.

Our work included interviews with FHFA and Freddie Mac officials.

We conducted our compliance review from February 2020 to July 2020 under the authority of the Inspector General Act of 1978, 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.

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

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Brian Baker, Acting Deputy Inspector General, Office of Compliance & Special Projects

FROM: Robert Fishman, Deputy Director, Division of Resolutions **Fishman, Robert** Digitally signed by Fishman, Robert
Date: 2020.08.20
09:49:09 -04'00'

SUBJECT: Draft Compliance Review: *Freddie Mac Management Failed to Adopt and Implement Conflicts of Interest Policies Which Aligned Fully with FHFA's Directive on Senior Executive Officers' Conflicts of Interest, and With the Charter for the Freddie Mac Board's Nominating and Governance Committee*

DATE: August 20, 2020

Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft compliance review referenced above. As discussed in the compliance review, the Agency, as conservator, issued a directive in April 2018 to Freddie Mac in response to an OIG management alert. The objective of this compliance review was to determine whether Freddie Mac complied with the April 2018 directive.

The OIG concluded that Freddie Mac revised its policies and procedures to be consistent with directive. However, the OIG identified three findings and decided to reopen the recommendation below.

Recommendation: *FHFA, as conservator, direct Freddie Mac to revise its policies and procedures to align with the responsibilities assigned to the NGC and facilitate the NGC's execution of its responsibilities.*

Management Response: FHFA agrees with this recommendation and will, by December 31, 2020, issue a directive to Freddie Mac to revise its Conflict of Interest policy and procedures and for Freddie Mac to train the Freddie Mac Ethics Office staff on those revisions.

If you have any questions related to our response, please do not hesitate to contact me.

cc: Chris Bosland
Kate Fulton
John Major

ADDITIONAL INFORMATION AND COPIES.....

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