

Federal Housing Finance Agency  
Office of Inspector General



**Compliance Review of FHFA's  
Commitments to Conduct Quality  
Control Review of Examination  
Conclusions Prior to Including  
Them in Reports of Examination**



COM-2020-007

September 15,  
2020

## Executive Summary

The Housing and Economic Recovery Act of 2008 charges the Federal Housing Finance Agency (FHFA) with supervising the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) (together, the Enterprises), their affiliates, and the Federal Home Loan Banks (collectively, the regulated entities). FHFA's mission as a federal financial regulator includes ensuring the regulated entities' safety and soundness so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA's Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises.

Our 2017 audit assessed whether DER's planned supervisory activities relating to Fannie Mae's implementation of the new representation and warranty framework for the 2015 and 2016 examination cycles could be tracked to its risk assessments and supervisory strategies, whether DER executed these planned supervisory activities during the 2015 and 2016 examination cycles, and whether the annual Reports of Examination (ROEs) reporting on the results of these supervisory activities underwent an independent quality control (QC) review. With respect to this last assessment, DER reported to us that all examination conclusions in the ROEs were subject to QC, rendering unnecessary any QC reviews for the ROEs.

We found that an independent QC review of a targeted examination related to Fannie Mae's implementation of the new representation and warranty framework was not completed when the ROE was issued. Nevertheless, in derogation of DER requirements, the ROE reported on the results of this incomplete supervisory activity. To address this shortcoming, we recommended that "FHFA ... hold DER leadership accountable to ensure that targeted examination conclusions presented in the ROE are based on work that has either (1) undergone [QC] review and been communicated in writing to the Enterprise, or (2) the required [QC] review has been waived by the Deputy Director of DER and documented in writing." FHFA agreed with the recommendation and committed to amend its existing internal guidance.

DER issued Operating Procedures Bulletin (OPB) DER-OPB-02.4, Reports of Examination, on August 30, 2018, which permits an examination conclusion to be included in an ROE "provided that the conclusion has been reviewed by QC." FHFA also committed that it would generally only include examination conclusions in the ROE if they had been communicated in writing to the Enterprise via a conclusion letter that was subjected to QC review. Based on these commitments by FHFA, we closed the recommendation on January 31, 2019.



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We initiated this compliance review to assess whether DER met two commitments during the 2018 and 2019 examination cycles when supervising Fannie Mae:

- To subject all examination conclusions to an independent QC review; and
- To generally include examination conclusions in a ROE only if they had been communicated in writing to the Enterprise in a conclusion letter.

Our compliance review found that DER met these commitments. For the first commitment, DER issued to Fannie Mae a total of 45 pieces of pre-ROE supervisory correspondence, setting forth its findings and conclusions from its targeted examinations and ongoing monitoring activities. Our compliance review found that all 45 pieces were subjected to a completed QC review, prior to dispatch of the correspondence by DER to Fannie Mae.

For the second commitment, our review of transmittal documentation confirmed that all 45 pieces of supervisory correspondence were sent by DER to Fannie Mae prior to issuance of the respective ROEs.

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.fhfaog.gov](http://www.fhfaog.gov).

/s/

Brian Baker

Acting Deputy Inspector General for Compliance and Special Projects

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## ABBREVIATIONS .....

Agency or FHFA	Federal Housing Finance Agency
2018 ROE	2018 Fannie Mae Report of Examination issued March 29, 2019
2019 ROE	2019 Fannie Mae Report of Examination issued March 31, 2020
DER	Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin, issued by DER
QC	Quality Control
ROE	Report of Examination

## BACKGROUND.....

Fannie Mae and Freddie Mac provide liquidity to the U.S. housing finance system by supporting the secondary mortgage market. The Enterprises purchase residential mortgages from lenders and bundle them 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 that sell the residential mortgages to make specific contractual representations and warranties in which they represent that the mortgages meet specific underwriting standards.

FHFA is charged by the Housing and Economic Recovery Act of 2008 with the supervision of the regulated entities. Its mission as a federal financial regulator 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. Within FHFA, DER is responsible for supervision of the Enterprises.

FHFA maintains that it uses a risk-based approach to supervisory examinations, prioritizing examination activities based on the risk a given practice poses to a regulated entity's safe and sound operation or to its compliance with applicable laws and regulations. Supervisory activity at each Enterprise is led by an Examiner-in-Charge (EIC), and conducted by a team of on-site examiners, in coordination with other subject matter experts. The EIC serves as the central point of contact for communication between DER and the Enterprise and is responsible for the planning, execution, and documentation of examination activities.

For the Enterprises, DER examiners summarize, in an annual ROE, examination results, conclusions, findings, and supervisory concerns from the supervisory activities completed during the annual examination cycle. The annual ROE constitutes DER's "primary work product that communicates . . . the cumulative results of [DER's] supervisory activities conducted during the annual examination cycle." During fieldwork for a 2017 evaluation, we learned that DER's independent QC review program—intended to confirm that examination findings and conclusions are adequately supported before DER communicates them to the Enterprises—did not review the content of the annual ROEs.<sup>1</sup> Instead, as a proxy, DER performs a QC review of examination findings and conclusions that it sends to the Enterprises in certain supervisory correspondence throughout the year.<sup>2</sup> As we reported, DER held the view that these QC reviews of supervisory correspondence made it unnecessary to perform

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<sup>1</sup> OIG, *The Gap in FHFA's Quality Control Review Program Increases the Risk of Inaccurate Conclusions in its Reports of Examination of Fannie Mae and Freddie Mac* (Aug. 17, 2017) (EVL 2017-006).

<sup>2</sup> *Id.*

QC reviews of the ROEs because the pertinent information had already been subjected to such reviews.<sup>3</sup>

### **2017 Audit Found that DER Improperly Included in Its 2015 ROE an Incomplete 2015 Targeted Examination of Fannie Mae’s QC Processes Relating to Implementation of the New Representation and Warranty Framework**

In a 2017 audit, we assessed whether DER’s planned supervisory activities relating to Fannie Mae’s implementation of the new representation and warranty framework for the 2015 and 2016 examination cycles could be tracked to its risk assessments and supervisory strategies, whether DER executed these planned supervisory activities during the 2015 and 2016 examination cycles, and whether the ROEs reporting on the results of these supervisory activities underwent an independent QC review.

With respect to this last assessment, DER again reported to us that examination conclusions included in the ROEs were subject to independent QC reviews, rendering unnecessary any QC reviews for the ROEs. We found, however, that one targeted examination related to Fannie Mae’s implementation of the new representation and warranty framework was not completed when the ROE was issued and had not undergone independent QC review. Nevertheless, in derogation of DER requirements, the ROE reported on the results of this incomplete supervisory activity. As we explained, reporting examination findings in an ROE before they are vetted through a QC process creates a risk that DER could provide misinformation to the Enterprise and its board of directors. To address this shortcoming, we recommended that “FHFA ... hold DER leadership accountable to ensure that targeted examination conclusions presented in the ROE are based on work that has either (1) undergone [QC] review and been communicated in writing to the Enterprise, or (2) the required [QC] review has been waived by the Deputy Director of DER and documented in writing.”

FHFA agreed with the recommendation and committed to amend its existing internal guidance to define “examination conclusions” to clarify what language must go through a QC review before inclusion in the ROE by September 1, 2018. The Agency also agreed that it would provide relevant training to all examination staff.

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<sup>3</sup> *Id.*

## FHFA Issued Internal Guidance in 2018 and the Recommendation Was Closed

On August 30, 2018, FHFA issued Operating Procedures Bulletin (OPB) DER-OPB-02.4, Reports of Examination.<sup>4</sup> DER-OPB-02.4 stated:

[An] ROE may include any examination conclusion (i.e., a statement supported by examination results) provided that the conclusion has been reviewed by QC. Apart from examination conclusions, any other narrative in the ROE (e.g., statements of fact, descriptions of Enterprise operations, or general supervisory views on risk) does not need to be reviewed by QC.

The Agency further confirmed that it would generally only include examination conclusions in the ROE if they had been communicated in writing to the Enterprise via a conclusion letter. DER requires examination conclusion letters to be subjected to QC. Based on these commitments by FHFA, we closed the recommendation on January 31, 2019.<sup>5</sup>

## FINDINGS .....

We initiated this compliance review to assess whether DER met the following commitments:

- All examination conclusions would be subject to an independent QC review; and
- All examination conclusions would generally only be included in an ROE if they had been communicated in writing to the Enterprise in a conclusion letter.

We recognize that DER guidance directs that ROE narrative other than examination conclusions (e.g., statements of fact, descriptions of Enterprise operations, or general supervisory views on risk) does not require a QC review.

This compliance review assessed the 2018 ROE for Fannie Mae (issued on March 29, 2019) and the 2019 ROE for Fannie Mae (issued on March 31, 2020).<sup>6</sup> As part of this compliance review, we assessed whether the conclusion letters and supervisory correspondence issued by

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<sup>4</sup> OPB-02.4 was administratively re-issued in 2020 as a new, unnumbered OPB also entitled “Reports of Examination.” This new OPB is substantively identical to the prior version, which was in place at all times relevant to this compliance review.

<sup>5</sup> The Agency also provided documentation reflecting that it had created and administered relevant training to all examination staff regarding required ROE content.

<sup>6</sup> This compliance review did not assess any ROE content regarding the results and findings of examinations of the Enterprises’ diversity and inclusion practices. Such content is provided to DER by FHFA’s Office of Minority and Women Inclusion.



DER for its supervisory activities completed during 2018 and 2019 and included in the 2018 or 2019 ROEs were subject to an independent QC review and whether that correspondence was sent in writing to Fannie Mae. We now discuss our findings.

**1. DER Subjected All Conclusion Letters to QC Before Sending Them to Fannie Mae.**

During the 2018 and 2019 examination cycles, DER issued to Fannie Mae a total of 45 pieces of supervisory correspondence, setting forth the results of its findings and conclusions for targeted examinations and ongoing monitoring activities.

Twenty-four pieces of supervisory correspondence were incorporated into the 2018 ROE for Fannie Mae. We reviewed documentation reflecting the initiation and completion of the QC review for each of the 24 pieces of supervisory correspondence and found that all 24 pieces were subjected to a completed QC review prior to dispatch of the correspondence by DER to Fannie Mae.

Twenty-one pieces of supervisory correspondence were incorporated into the 2019 ROE for Fannie Mae. We reviewed documentation reflecting the initiation and completion of the QC review for each of the 21 pieces of supervisory correspondence and found that all 21 pieces were subjected to a completed QC review prior to dispatch of the correspondence by DER to Fannie Mae.

**2. DER Sent Each Piece of Supervisory Correspondence to Fannie Mae Before Including Its Contents in an ROE.**

We reviewed transmittal documentation relating to DER’s issuance of the supervisory correspondence to Fannie Mae. We found that all 45 pieces of supervisory correspondence were sent by DER to Fannie Mae prior to issuance of the respective ROE.

**CONCLUSION.....**

Based on our review, we conclude that DER subjected all examination conclusion letters to QC before sending them to Fannie Mae and that all such letters were sent to Fannie Mae before their contents were incorporated into an ROE.

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

We initiated this compliance review in March 2020 to assess whether every examination conclusion (as that term is defined by DER-OPB-2.4) included in an ROE was subjected to QC and communicated in writing via conclusion letter to Fannie Mae prior to being included in the ROE. We conducted our compliance review from March 2020 through June 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.

To determine whether all the conclusion letters were subjected to QC prior to being included in the ROE, we obtained all the conclusion letters resulting from targeted examinations or ongoing monitoring with adverse conclusions issued to Fannie Mae during our review period. We also obtained documentation reflecting the initiation and conclusion of the QC review for each conclusion letter.

To determine whether all the conclusion letters were communicated in writing to Fannie Mae prior to being included in the ROE, we obtained the transmittal documentation reflecting the Agency’s issuance of the conclusion letters to Fannie Mae and tested whether the conclusion letters were sent to Fannie Mae before the date the corresponding ROE was issued.

Finally, we also interviewed Agency officials regarding the QC review of the conclusion letters and the preparation of the ROEs.

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 W. Baker, Acting Deputy Inspector General for Compliance & Special Projects  
Office of Inspector General (OIG)

FROM: Paul J. Miller, Deputy Director *PJM*  
Division of Enterprise Regulation (DER)

SUBJECT: Draft OIG Report: *Compliance Review of FHFA's Commitments to Conduct Quality Control Review of Examination Conclusions Prior to Including Them in Reports of Examination*

DATE: September 10, 2020

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Thank you for the opportunity to respond to the draft report referenced above. The objective of the compliance review was to determine whether DER subjected all conclusion letters to a quality control (QC) review before issuance to Fannie Mae, and that all such letters were sent to Fannie Mae before their contents were incorporated into the 2018 and 2019 Reports of Examination (ROEs).

We are pleased that the compliance review found that DER conducted QC reviews of all 45 conclusions letters issued during the 2018 and 2019 examination cycles before issuance to Fannie Mae, and all of these letters were sent by DER to Fannie Mae prior to issuance of the respective ROE. We believe these results reflect our continuing efforts to enhance the efficiency and efficacy of our supervisory program.

We would like to thank the OIG staff that worked with the Agency during this compliance review. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Chris Bosland  
Kate Fulton  
Scott Valentin  
Eric Wilson  
John Major

## ADDITIONAL INFORMATION AND COPIES.....

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