

Federal Housing Finance Agency  
Office of Inspector General



**Compliance Review of FHFA's  
Commitment to Conduct  
Independent Quality Control  
Reviews of DBR's Community  
Investment Examinations**



COM-2021-001

January 6, 2021

## Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) is charged by the Housing and Economic Recovery Act of 2008 (HERA) with oversight of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Bank (FHLBank) System. The FHLBank System consists of 11 FHLBanks and the Office of Finance. Its mission is to provide reliable liquidity to member institutions to support housing finance and community investment.

FHFA's Division of Federal Home Loan Bank Regulation (DBR) supervises the FHLBanks and the Office of Finance using both on-site examinations and off-site monitoring. Our 2018 audit assessed whether DBR had complied with an Agency requirement that personnel who performed quality control (QC) reviews of an examination activity "must not have participated in the examination activity under review." We found that DBR did not comply with this requirement for its community investment examinations: its internal guidance deemed an examination specialist who conducted QC reviews to be independent even if she or he "customarily does not participate in DBR examination fieldwork." In our view, this guidance presented a risk that an examiner who participated in DBR's community investment examinations might be able to conduct a QC review so long as he or she did not "customarily" participate in examination fieldwork, which would violate the Agency's strict independence requirement. We made two recommendations to correct this shortcoming, and FHFA agreed to both of them. In essence, those recommendations asked FHFA to ensure that individuals conducting community investment examinations under DBR's revised independent QC process did not participate in the examination activity under review.

FHFA, through DBR, issued an Operating Procedures Bulletin (OPB), 2018-DBR-OPB-03, on December 26, 2018, setting forth requirements for QC reviews of DBR examinations. This 2018 OPB directs, in relevant part: "QCB specialists who perform a [QC] review *must not* have participated in the activity under review" (emphasis added). We closed the recommendations, based on issuance of 2018-DBR-OPB-03.

In this compliance review, we sought to determine whether DBR complied with 2018-DBR-OPB-03's QC reviewer independence mandate during the period February 1, 2019, through July 30, 2020 (review period), by testing whether any Quality Control Branch (QCB) examination specialists reviewed community investment examinations if they had participated in the examination activity under review. Our testing found no evidence that any QCB examination specialists who performed QC reviews of DBR's



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community investment examinations participated in the underlying examinations.

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

/s/

Brian Baker  
Deputy Chief Counsel

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## ABBREVIATIONS .....

DBR	Division of Federal Home Loan Bank Regulation
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
Freddie Mac	Federal Home Loan Mortgage Corporation
HERA	Housing and Economic Recovery Act of 2008
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
QC	Quality Control
QCB	DBR's Quality Control Branch
Review Period	February 1, 2019 - July 30, 2020
ROE	Report of Examination
SD	Supervision Directive

## BACKGROUND.....

Created in 2008, FHFA is charged by HERA with oversight of Fannie Mae, Freddie Mac, and the FHLBank System. The FHLBank System consists of 11 FHLBanks and the Office of Finance.

The FHLBanks are organized under the authority of the Federal Home Loan Bank Act of 1932, as amended. Their mission is to provide reliable liquidity to member institutions (generally, federally insured depository institutions, insurance companies, and eligible community development financial institutions) to support housing finance and community investment. Although federally chartered, the FHLBanks are cooperatives that are privately and wholly owned by their members and former members. Each FHLBank operates as a separate entity within a defined geographic region of the country, known as its district, with its own board of directors, management, and employees.

To accomplish their mission, FHLBanks provide to their members various financial products and services, including advances. These advances assist and enhance a member’s financing of: (1) housing, including single-family and multi-family housing serving consumers at all income levels; and (2) community lending. The Office of Finance serves as the FHLBanks’ fiscal agent and was established to facilitate the issuance and servicing of FHLBank debt, known as consolidated obligations, and to prepare the FHLBanks’ quarterly and annual combined financial reports.

### Supervision of FHLBanks Through Annual Examinations by DBR

FHFA has delegated to DBR the duty to supervise the FHLBanks and the Office of Finance. DBR has adopted a supervision program that it maintains is risk-based and consists of both on-site annual examinations and off-site monitoring of the FHLBanks and the Office of Finance. Reporting to the DBR Deputy Director, DBR’s Examinations Group conducts annual safety and soundness examinations of each FHLBank and the Office of Finance as well as community investment examinations of each FHLBank. DBR issues an annual report of examination (ROE) for each FHLBank and the Office of Finance. The ROEs communicate examination conclusions, findings (if any), and composite and component CAMELSO ratings for the entity.

FHFA’s *Examination Manual* provides guidance to DBR teams performing examinations within the FHLBank System. The *Examination Manual* is supplemented by FHFA Advisory Bulletins, Supervision Directives (SDs),<sup>1</sup> and Examiner Guidance Bulletins. DBR also issues

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<sup>1</sup> SDs establish guidance for the conduct of FHFA’s supervisory functions.

OPBs that provide specific expectations of examiners who conduct examinations within the FHLBank System.

In March 2013, FHFA issued SD-2013-01, *Quality Control Program for Examinations Conducted by the Division of Bank Regulation and the Division of Enterprise Regulation*, directing DBR and the Division of Enterprise Regulation, which supervises Fannie Mae and Freddie Mac, to “assess examination findings, conclusions, ratings, supporting workpapers, and related documents for quality control purposes.” SD-2013-01 prohibits personnel who conduct an examination activity from subsequently participating in a QC review of that examination activity. To implement the SD for community investment examinations, DBR established a two-step QC process: first, the examination team was required to check its own work; and then a QC review of the examination workpapers was required to be performed by independent examination specialists whose primary duties are to perform such reviews.<sup>2</sup> An independent community investment QC review was to be completed before DBR transmitted the final ROE to the FHLBank. FHFA rescinded and replaced SD-2013-01 with SD-2017-01, *Quality Control Program* (Apr. 28, 2017).

### **Our 2018 Audit Found that DBR Did Not Strictly Forbid Personnel Who Performed Community Investment Examinations from Conducting QC Reviews of Those Examinations**

Our 2018 audit report noted that both of FHFA’s SDs – SD-2013-01 and its successor, SD-2017-01 – required that personnel performing a QC review “*must not have participated* in the examination activity under review” (emphasis added).<sup>3</sup> We observed that DBR, however, considered an examination specialist conducting such QC reviews to be independent even if she or he “*customarily* does not participate in DBR examination fieldwork” (emphasis added).<sup>4</sup> In our view, 2014-DBR-OPB-004 presented a risk that an examiner who participated in DBR’s community investment examination might be able to conduct the QC review so long as he or she did not “customarily” participate in examination fieldwork, a situation that would run afoul of SD 2017-01. Upon assessing 11 QC reviews of FHLBank community investment examinations conducted during the 2017 examination cycle against the independence requirement in SD 2013-01 and SD 2017-01, we found that all failed to meet that requirement. Each of the 11 QC reviews was conducted by an examination

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<sup>2</sup> See 2014-DBR-OPB-004.

<sup>3</sup> FHFA-OIG, *DBR’s Safety and Soundness Quality Control Reviews Were Conducted in Compliance with FHFA’s Standard During the 2017 Examination Cycle but DBR’s Community Investment Quality Control Reviews Were Not*, at 10 (Aug. 17, 2018) (AUD-2018-010).

<sup>4</sup> See 2014-DBR-OPB-004.

specialist who had participated in the fieldwork underlying the examination. To address this shortcoming, we made two recommendations, with which FHFA agreed.

### **We Closed the Recommendations Once DBR Issued Revised Guidance**

On December 26, 2018, DBR rescinded 2014 DER-OPB-004, and replaced it with 2018-DBR-OPB-03. The 2018 OPB – which remains in effect – states that “QCB specialists who perform a [QC] review *must not* have participated in the activity under review.” The 2018 OPB recognizes that staff in DBR’s QCB may be obliged to lend expertise to a particular DBR program office project, and such instances must be approved by the DBR Deputy Director. The 2018 OPB also provides that QCB staff who consult or directly work on examination projects must recuse themselves from any QCB review for the portion of the project in which they were involved. Based on our determination that 2018-DBR-OPB-03 implemented our recommendations, we closed both of them.

## **FINDINGS .....**

We initiated this compliance review in August 2020 to determine whether, during the review period, DBR QCB staff complied with the prohibition in 2018-DBR-OPB-03 precluding QCB examination specialists from conducting QC reviews of community investment examinations if they participated in the underlying examination activity. Our compliance testing found no instance where this prohibition was not followed.

We performed the following testing:

- We obtained from DBR the names of all examination specialists who worked in QCB during the review period;
- We reviewed workpapers for the 14 FHLBank examinations conducted during the review period to identify the DBR personnel who participated in those examinations;<sup>5</sup> and
- We compared the names on the workpapers against the names of the QCB examiners during the review period and found no overlap between the two groups. None of the

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<sup>5</sup> Eleven of the FHLBank exams were initiated and completed during our review period. The other three were initiated in January 2019 (prior to the February 1, 2019, initiation of our review period) but the QC work was conducted during the review period.



QCB examination specialists were mentioned in the workpapers for the 14 examinations as having been participants in those examinations.<sup>6</sup>

We also engaged directly with DBR management and with QCB personnel to verify whether any QCB personnel participated in a community investment examination and then conducted a QC review of that same examination. The DBR Deputy Director reported that he did not authorize any QCB staff to participate in community investment examinations during the review period, and he was confident that no QCB staff had done so without authorization. The head of QCB told us he did not participate in any community investment examinations, nor was he aware of any QCB staff participating in such examinations. We spoke with those QCB staff whom DBR identified as having conducted QC reviews during our review period, and all of them reported that they did not participate in any community investment examinations.<sup>7</sup>

## CONCLUSION.....

Based upon our testing, we found no evidence that any QCB examination specialists reviewing community investment examinations under DBR’s revised independent QC process participated in the underlying examination activity during the review period.

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<sup>6</sup> We acknowledge a limitation of this analysis is that QCB staff would not necessarily state in the community examination workpapers that they participated in creating them or the examination itself.

<sup>7</sup> We did not interview three summer interns whom DBR told us were previously assigned to QCB during our review period.

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

We initiated this compliance review to test whether QCB examination specialists reviewing community investment examinations under DBR’s revised independent QC process participated in the examination activity under review for the period February 1, 2019, through July 30, 2020. To do so, we reviewed DBR’s workpapers for community investment examinations conducted during the review period to determine whether they contained any documentation of QCB staff having participated in the examinations underlying the work product upon which they subsequently performed a QC review. We also interviewed the DBR Deputy Director, the head of QCB, and the four QCB staff whom DBR identified as having conducted QC reviews during the review period.

We conducted our compliance review from August 2020 to October 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 W. Baker, Acting Deputy Inspector General, Office of Compliance and Special Projects

FROM: Andre D. Galeano, Deputy Director, Division of FHLBank Regulation (DBR)

SUBJECT: Draft Compliance Report: *Compliance Review of FHFA's Commitment to Conduct Independent Quality Control Reviews of DBR's Community Investment Examinations*

DATE: January 6, 2021

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Thank you for the opportunity to respond to the draft report titled, *Compliance Review of FHFA's Commitment to Conduct Independent Quality Control Reviews of DBR's Community Investment Examinations*. As a follow-up to a 2018 audit, the Office of Inspector General (OIG) report assessed the independence of our quality control function with respect to community investment examinations. I am pleased OIG did not find breaches to our procedures that ensure quality control staff do not work on community investment examinations that they later assess for quality control purposes.

We appreciate the work and professionalism of the OIG staff who worked with FHFA during this engagement. Please feel free to contact me with any questions or concerns.

cc: Chris Bosland  
Kate Fulton  
John Major  
Richard Dalton

## ADDITIONAL INFORMATION AND COPIES.....

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