FEDERAL HOUSING FINANCE AGENCY
OFFICE OF INSPECTOR GENERAL

Follow-up on Freddie Mac's Loan Repurchase Process

EVALUATION REPORT: EVL-2012-007 DATED: September 13, 2012

FEDERAL HOUSING FINANCE AGENCY
OFFICE OF INSPECTOR GENERAL

AT A GLANCE

Follow-up on Freddie Mac's Loan Repurchase Process

Why FHFA-OIG Did This Evaluation

In January 2011, the Federal Housing Finance Agency (FHFA or Agency) announced a settlement with Bank of America, in which the bank agreed to pay $1.35 billion to the Federal Home Loan Mortgage Corporation (Freddie Mac or Enterprise) to settle current and future loan repurchase claims.

FHFA's Office of Inspector General (FHFA-OIG) undertook an evaluation of FHFA's oversight of the settlement and issued a report on September 27, 2011. The report raised concerns about the method that Freddie Mac used to review non-performing loans for repurchase claims for Bank of America and more generally for other loan sellers. In essence, Freddie Mac followed a practice of examining for repurchase claims those loans that had become non-performing within two years of origination or with payment problems in the first two years. But the FHFA-OIG report found that—for a variety of reasons—Freddie Mac's practice effectively excluded from the repurchase claim review process many loans that the Enterprise had purchased or guaranteed during the housing boom years of 2005 to 2007, even though those loans have been defaulting at high levels. This practice limited Freddie Mac's potential recoveries from repurchase requests. In addition, Freddie Mac's internal auditors questioned the governance, business rationale, and objectives of the historical foreclosed loan review process. The FHFA-OIG report recommended that FHFA promptly act on concerns that had been raised about Freddie Mac's loan review process.

This report evaluates FHFA's and Freddie Mac's progress at reforming the loan review process since the issuance of FHFA-OIG's original report.

What FHFA-OIG Found

FHFA and Freddie Mac have acted on the concerns raised in FHFA-OIG's report by adopting a more expansive loan review process. Specifically, Freddie Mac changed its policies to review for potential repurchase claims significantly larger numbers of loans that defaulted more than two years after origination.

It is estimated that the more expansive loan review process will generate additional recoveries ranging from $0.8 billion to $1.2 billion for loans selected for review in 2012 and $2.2 billion to $3.4 billion overall. Because these recoveries had not been anticipated and accounted for, the added revenue will increase Freddie Mac's profits and hence the amount paid to the U.S Department of the Treasury (Treasury).

What FHFA-OIG Recommends

FHFA and Freddie Mac should continue to carry out the loan review and related reforms they have initiated since FHFA-OIG's original report was issued.

TABLE OF CONTENTS

ABBREVIATIONS

Countrywide	Countrywide Financial Corp.
Fannie Mae	Federal National Mortgage Association
FHFA	Federal Housing Finance Agency
FHFA-OIG	Federal Housing Finance Agency, Office of Inspector General
Freddie Mac or Enterprise	Federal Home Loan Mortgage Corporation
HERA	Housing and Economic Recovery Act of 2008
MBS	Mortgage-Backed Securities
QC	Single-Family Quality Control Department
Treasury	U.S. Department of the Treasury

Federal Housing Finance Agency

Office of Inspector General

Washington, DC

PREFACE

FHFA-OIG was established by the Housing and Economic Recovery Act of 2008 (HERA), which amended the Inspector General Act of 1978. FHFA-OIG is authorized to conduct audits, evaluations, investigations, and other activities of the programs and operations of FHFA; to recommend policies that promote economy and efficiency in the administration of such programs and operations; and to prevent and detect fraud and abuse in them.

This evaluation is one in a series of audits, evaluations, and special reports published as part of FHFA-OIG's oversight responsibilities. It follows a previous evaluation entitled *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America* (EVL-2011-006), issued on September 27, 2011. In that report, FHFA-OIG raised concerns with the method that Freddie Mac used to review non-performing loans to determine whether they should have been repurchased by Bank of America. It also generally highlighted the potential adverse ramifications of Freddie Mac's loan review method for loans originated during the housing boom years of 2005 to 2007. FHFA-OIG recommended that FHFA address these concerns, which had also been identified by FHFA staff and by Freddie Mac internal auditors. This evaluation follows up on FHFA's and Freddie Mac's actions to address concerns regarding Freddie Mac's loan review process.

This evaluation was prepared by Senior Investigative Evaluator Bruce McWilliams, with assistance from David Z. Seide, Director of Special Projects, and Omolola Anderson, Statistician. FHFA-OIG appreciates the assistance of all those who contributed to this report.

George Grob

George Grob
Deputy Inspector General for Evaluations

BACKGROUND

About the Enterprises and FHFA

To fulfill their obligations to provide liquidity to the mortgage finance system, the Federal National Mortgage Association (Fannie Mae) and Freddie Mac (collectively, the Enterprises) support the secondary mortgage market. The Enterprises purchase from loan sellers residential mortgages that meet their underwriting criteria.[1] The loan sellers can then use the sales proceeds to originate additional mortgages. The Enterprises can hold the mortgages in their portfolios or can package them into mortgage-backed securities (MBS) that are, in turn, sold to investors. In exchange for a fee, the Enterprises guarantee that MBS investors will receive timely payment of principal and interest on their investments.

In September 2008, the Enterprises entered conservatorships overseen by FHFA. HERA gives FHFA broad authority as the Enterprises' conservator to conserve and preserve the Enterprises' assets and to control and direct their finances and operations. FHFA has exercised that authority by, among other things, requiring FHFA approval of certain categories of Enterprise business operations such as settlements of claims exceeding $50 million.

The Bank of America/Freddie Mac Settlement of Repurchase Claims

During the housing boom years of 2005 to 2007, Freddie Mac purchased large volumes of non-traditional mortgages from large lenders, including Countrywide Financial Corp. (Countrywide). Countrywide, which was purchased by Bank of America in 2008,[2] was one of the most aggressive sellers of non-traditional mortgages, such as limited- or no-documentation, Alt-A, interest only, and option ARM loans.[3] Large numbers of non-traditional mortgages ultimately defaulted, causing significant credit losses to Freddie Mac.

If a homeowner defaults on any loan that Freddie Mac owns or guarantees, the Enterprise is obligated to absorb or reimburse the unpaid balance of the mortgage. If, however, the seller of the mortgage loan in question violated representations and warranties provided to Freddie Mac at the time of the loan sale, then Freddie Mac has the contractual right to demand that the loan seller buy back or repurchase the mortgage loan. Exercising this contractual right is called

[1] This report focuses on mortgage loans purchased and guaranteed by Freddie Mac.

[2] Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, at 250 (Jan. 2011) (online at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).

[3] Financial Crisis Inquiry Commission, *supra* note 2, at 105.

issuing a repurchase request and is often referred to as a "put-back." For the purpose of determining whether representations and warranties have been violated, Freddie Mac examines some, but not all, mortgages it owns or guarantees once they have become seriously delinquent (i.e., become more than 90 days past due).

The number of repurchase requests issued divided by the number of loans reviewed is called the repurchase rate. As of September 2010, Freddie Mac had made repurchase requests on 59,514—or 24%—of the 250,833 foreclosed loans that it had reviewed between 2005 and July 31, 2010.[4] However, as of September 8, 2010, Freddie Mac had received reimbursement for only 35,569—or 14%—of the foreclosured loans it had reviewed. By the end of 2010, Freddie Mac's outstanding repurchase claims against all loan sellers totaled $3.8 billion.[5]

On January 3, 2011, FHFA publicly announced that Freddie Mac and Fannie Mae had settled a significant number of repurchase claims (current and future) with Bank of America. Bank of America agreed to pay $1.35 billion to Freddie Mac to settle existing and potential future claims on 787,000 loans, many of which had been sold by Countrywide.

FHFA-OIG Evaluation Report

Shortly after the Bank of America settlement announcement, FHFA-OIG began to evaluate the process by which FHFA reviewed and approved the settlement. As part of its evaluation, FHFA-OIG staff had multiple meetings over the course of nine months with senior executives and staff at FHFA and Freddie Mac and reviewed a considerable amount of paper and electronic documents. The evaluation culminated on September 27, 2011, when FHFA-OIG issued its report, *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*.[6]

The report highlighted a potentially significant flaw in Freddie Mac's process for reviewing defaulted loans for repurchase claims and noted that the flaw could be costing Freddie Mac a significant amount of money. In particular, the report found that an FHFA senior examiner had raised significant concerns about Freddie Mac's loan review process for mortgage repurchase claims months prior to the Bank of America settlement, but FHFA did not timely act on or test the ramifications of these concerns. As a result, the loan review process then being used by

[4] Email from Jordan D. Hershman, Bingham McCutchen LLP, to Gary J. Cohen, General Counsel, Financial Crisis Inquiry Commission (Sept. 21, 2010) (online at http://fcic.law.stanford.edu/documents/view/1359) (*see* Tab 3: QC Disposition of Foreclosures by Funding Year and Foreclosure Year).

[5] Freddie Mac, 2010 Annual Report (Form 10-K), at 5 (Feb. 24, 2011).

[6] FHFA-OIG Evaluation Report No. EVL-2011-006, available at http://www.fhfaoig.gov/Content/Files/EVL-2011-006.pdf.

Freddie Mac could cost billions of dollars of losses that could otherwise be avoided if the Enterprise changed its loan review method.

Shortcomings Identified in Freddie Mac's Previous Quality Control Process

Overview of the Loan Review Process

The FHFA-OIG report described how Freddie Mac employs a detailed process for determining which non-performing loans are put back to loan sellers. Essentially, after a loan is selected for review, Freddie Mac's Single-Family Quality Control Department (QC) requests from the seller the loan file for the purpose of reviewing it for violations of representations and warranties. Some of the reasons that QC could deem a loan in violation of representations and warranties and request repurchase by the seller include: fraud or misrepresentation, insufficient income or assets, unsupported property valuation, failure to comply with contract or program terms, inaccurate data, missing documentation, and calculation mistakes. If QC determines the loan is in breach of a representation or warranty, a repurchase request may be issued to the loan seller.

Many Housing Boom Loans in Default Overlooked

The FHFA-OIG report described how a senior FHFA examiner with significant knowledge of Freddie Mac operations had discovered a potential flaw with respect to Freddie Mac's review of loans in default. The process that Freddie Mac was using at the time of the Bank of America settlement called for primarily reviewing for repurchase claims only those loans defaulting within the first two years following origination.[7]

The senior examiner pointed out that the failure to examine most defaulted loans that were older than two years was potentially flawed because of the substantially higher incidence of default among housing boom loans two or more years after origination. The senior examiner believed that the increase in default rates in later years was due to the expiration of low-interest, teaser-rate loan features that led to substantially higher interest rates, coupled with falling home values that prevented the refinancing of loans.

In addition to following a rule of not reviewing most loans defaulting more than two years after origination, prior to mid-2011, former Freddie Mac senior management engaged in a process of "overrides" in which they elected not to put back meaningful numbers of loans that breached

[7] The former process also included review of a relatively small subset of foreclosed loans three to five years after origination. This subset was comprised of loans whose borrowers missed a substantial number of payments within the first two years following origination and were said to have had a bad pay history or if there were signs of appraisal or other collateral fraud. But if a borrower on a three or more year old loan was late on only a few payments, his/her loan was not reviewed for violations of underwriting guidelines.

representation and warranties. These former senior managers explained to FHFA-OIG that such overrides were carried out, among other reasons, to maintain good business relations with loan sellers.

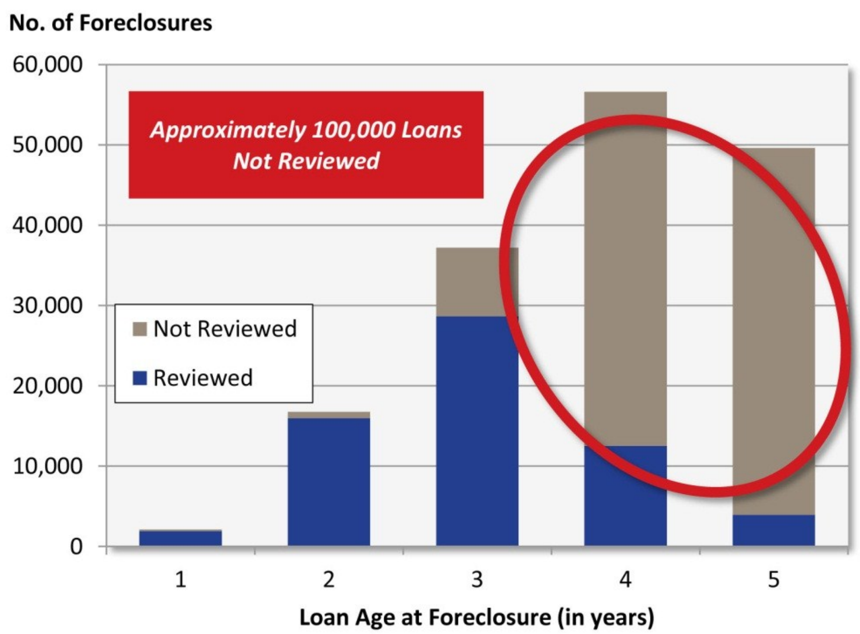
Loan Review Process Controls "Unsatisfactory"

Freddie Mac's Internal Audit Department (Freddie Mac Internal Audit) conducted its own study about how Freddie Mac management chose loans to review. In late June 2011, Freddie Mac Internal Audit concluded that overall controls were "Unsatisfactory" and that Freddie Mac's method for determining which loans to review for possible non-conformance with Freddie Mac's underwriting criteria was flawed.

Magnitude of the Problem

As a result of consistent findings, Freddie Mac Internal Audit and FHFA-OIG observed that Freddie Mac could be missing significant opportunities for putting back loans, thereby sacrificing the recovery of significant amounts of money. In its report, FHFA-OIG prepared the following chart in an effort to estimate the size of potential taxpayer losses. It shows that for loans originated in 2006 *alone*, nearly 100,000 loans were not reviewed for repurchase claims because they did not meet Freddie Mac's criteria for review.

Figure 1: Loans Purchased by Freddie Mac in 2006 that Entered Foreclosure[8]



---

[8] *See* FHFA-OIG, *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*, at 20.

The FHFA-OIG report further estimated that for the four years inclusive of 2004 to 2007, Freddie Mac had not reviewed over 300,000 loans for possible repurchase claims. These loans had an unpaid principal balance of roughly $50 billion. The report noted that although many of these loans are not likely candidates for repurchase, Freddie Mac's portfolio of housing boom loans includes a substantial number of less creditworthy interest only and Alt-A mortgages that have higher foreclosure rates.[9]

FHFA-OIG Recommends Improvements to Freddie Mac's Loan Review Process

Like Freddie Mac Internal Audit, FHFA-OIG recommended in its report improvements to Freddie Mac's loan review process. FHFA-OIG also recommended that FHFA improve its management process. FHFA-OIG's specific recommendations were:

1. **FHFA and its senior management must promptly act on the significant concerns raised about the loan review process.**

   To ensure that Freddie Mac is maximizing its repurchase claim recoveries:

   - FHFA should continue to withhold approval of Freddie Mac repurchase settlements until such time as it is confident that the concerns about the Enterprise's loan review process have been resolved.
   - FHFA senior management should ensure that Freddie Mac management resolves the concerns that prompted their internal auditors to issue an "Unsatisfactory" audit opinion.
   - FHFA senior management should oversee Freddie Mac's "out-of-sample" loan testing and consider independently validating the testing.
   - FHFA should evaluate whether Fannie Mae and Freddie Mac should adopt consistent review practices for repurchase claims.
   - FHFA senior management should initiate an independent assessment of Enterprise repurchase practices in order to ensure that they are maximizing their repurchase claim recoveries.
   - FHFA should issue internal guidance regarding its handling of future repurchase settlements, should they arise.

[9] *See* FHFA-OIG, *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*, at 20.

2. **FHFA must promptly initiate management reforms to ensure more generally that senior management is apprised of and timely acts on significant concerns brought to its attention.**

   FHFA senior management must immediately initiate reforms to avoid the kind of management process shortcomings identified in this evaluation. In particular:

   - Direct supervisors must properly and timely address and act upon significant concerns brought to their attention (i.e., resolve or elevate issues that pose significant potential risks or document decisions not to do so).
   - Senior managers, regardless of their position within FHFA, must timely address and act on significant concerns, particularly when they receive reports that the normal reporting and supervisory process is not working properly.

   FHFA's Acting Director must establish appropriate goals, principles, and procedures at the top of the FHFA organization to guarantee that significant concerns are properly and timely addressed and acted upon.

At the time the report was issued, FHFA stated that it agreed with the first recommendation, but not with each of the specific action steps. At the same time, FHFA had not proposed a specific action plan of its own. Under the circumstances, FHFA-OIG said it would continue to monitor the issues discussed in the report and the actions that FHFA would be taking. With respect to the second recommendation, FHFA has announced that it has taken corrective action. Appendix A contains a table summarizing actions taken or underway on both of the recommendations.

Action Taken Since FHFA-OIG Commenced Its Initial Report on Freddie Mac's Loan Review Process

From January through June 2011, prior to publication of its initial report on Freddie Mac's loan review process, FHFA-OIG repeatedly met with senior staff at both FHFA and Freddie Mac to discuss FHFA-OIG's tentative findings concerning Freddie Mac's existing loan review process. During this period, Freddie Mac's then-senior management defended the existing loan review process in part on the grounds "that past sampling practices are the best guide for future policies," and based on the belief that Freddie Mac would not recover enough from a more expansive loan review process to offset the loss of business from loan sellers.

In late June 2011, shortly after Freddie Mac Internal Audit released its report, FHFA-OIG issued to FHFA a draft of its report. In early August 2011, FHFA provided the draft to Freddie Mac. Meanwhile, Freddie Mac had begun its own examination of its loan review process and had begun a limited test examining an additional 2,000 loans that would otherwise not have been reviewed under its existing loan review rules.

Revised Loan Review Methodology

In early September 2011, Freddie Mac senior management briefed the Enterprise's board of directors on FHFA-OIG's then-draft report and the board discussed its ramifications. In addition, senior management advised the board of directors that management was working on a new, more expansive strategy to review a substantial number of "legacy loans" in default.[10] In other words, management planned to review defaulted loans regardless of whether the defaults occurred within two years of origination. Shortly thereafter, on September 27, 2011, FHFA-OIG issued its final evaluation report.[11] On October 4, 2011, Freddie Mac senior management presented its new loan review strategy to FHFA and proposed to employ it until it was no longer cost effective to do so. FHFA raised no objection to the proposal, and Freddie Mac was permitted to implement the new strategy to review substantially more loans in 2012. In March 2012, Freddie Mac informed its loan seller/servicers that it had begun phasing in an approach for increasing the number of non-performing loans that it would review for repurchase claims.

Thereafter, in June 2012, loan seller/servicers were informed that beginning in August 2012, they would see a further increase in the number of non-performing loans sampled by Freddie Mac because "[b]y further expanding the number of loans we are reviewing, we are able to continue to minimize our losses and the financial risk to taxpayers, related to loans that did not meet contract requirements in place at the time of delivery."

Similarly, in Freddie Mac's SEC Form 10-Q, filed on August 7, 2012, the Enterprise publicly disclosed that:

> During the first half of 2012, we revised our loan sampling methodology. Our new methodology expands the coverage of our loan reviews as compared to our prior sampling methodology and may result in higher levels of repurchase requests. We expect that changes in our loan sampling methodology will additionally increase our repurchase request volumes with our seller/servicers.

This new strategy reflects a consensus that emerged among FHFA-OIG, Freddie Mac Internal Audit, and FHFA's and Freddie Mac's senior managers regarding the need to reform the loan review process. This consensus was built upon the findings made and evidence compiled by

---

[10] "Legacy loans" refers to loans originated before 2009.

[11] The report received widespread publicity, and FHFA's Acting Director was questioned by Members of Congress at public hearings about the report's findings.

FHFA-OIG, Freddie Mac Internal Audit, and Freddie Mac's management team and is reflected in Freddie Mac internal communications such as the following:

> The conclusion from each of these [FHFA-OIG and Internal Audit] reviews was that Freddie Mac's … sample sizes were too small and we were leaving money on the table/not protecting taxpayer dollars. [They] requested that we increase our NPL [non-performing loan] sampling… Freddie Mac received approval to implement an increased NPL [non-performing loan] sample that resulted from FHFA's, OIG's, and Internal Audit's review.[12]

Estimates of Potential Additional Recoveries Based on Revised Sampling Strategy

FHFA-OIG estimates that an additional $2.2 billion to $3.4 billion in repurchase requests will be initiated for the legacy loans originated during the housing boom. For loans selected for review in 2012 alone, Freddie Mac will save somewhere in the range of $0.8 billion to $1.2 billion by making additional repurchase claims. This analysis is premised on, among other things, the review of 350,000 additional legacy loans.

However, the ultimate recoveries will depend on the counterparties involved, the number of loans that will be reviewed, the repurchase rate, resale values, and the amount recovered or saved for each loan put back. Freddie Mac has been carefully monitoring its own activities, modifying its plans, and updating its estimates of results based on its month-to-month experience in reviewing non-performing loans. The final results of Freddie Mac's revised loan sampling strategy will likely not be fully realized at least until 2013 and 2014. Nevertheless, FHFA-OIG finds that Freddie Mac's new strategy is likely to result in substantial recoveries, which otherwise would not occur if the loan review process had not been changed.

Impact on Taxpayers

The money eventually recovered from the loan sellers will reduce Freddie Mac's draw requests from Treasury, thereby saving taxpayer money and reducing the federal deficit. Indeed, pursuant to the August 2012 amendment to Freddie Mac's preferred stock purchase agreement with Treasury,[13] to the extent that the Enterprise's additional recoveries and other revenues general a positive net worth, such net worth will be swept/taken by Treasury in lieu of a set dividend beginning in 2013.

---

[12] Internal email between Freddie Mac employees in response to a question from a seller/servicer (June 12, 2012).

[13] See: http://www.fhfa.gov/webfiles/24203/FINAL_FHFA_PSPA_8172012.pdf.

Major Reforms Planned to Improve Ease-of-Use, Efficiency, and Fairness

In its earlier report, FHFA-OIG also recommended that FHFA evaluate whether Fannie Mae and Freddie Mac should adopt consistent review practices for repurchase claims. On January 19, 2012, FHFA issued a directive to the Enterprises to align their seller/servicer contracts in eight different areas. The entire project is known as "Contract Harmonization" and aims to synchronize the process of determining underwriting violations, the review practices, repurchase rules, and timelines.

FINDINGS

1. **FHFA and Freddie Mac have instituted a more thorough and systematic loan review process than the one previously used.**

The new loan review process includes reviews of potentially defective loans—originated during the housing boom years—in which defaults do not manifest until more than two years after origination.

2. **The new loan review process will likely result in recoveries of between $0.8 billion and $1.2 billion for loans reviewed in 2012 and between $2.2 billion and $3.4 billion in total.**

The actual amount recovered will depend on such factors as the number of loans reviewed, the percent of defects that warrant put-backs, and the recovery per loan.

The revenue obtained from the recoveries will likely lead to higher profits for Freddie Mac that which in turn will either be paid as dividends to Treasury (in the event that the Enterprise's operations are profitable) or reduce the amount of draw requests from Treasury (in the event that operations are unprofitable). In either case, these added recoveries will save taxpayer money. Initial results already show substantial recoveries are being achieved.

CONCLUSION

FHFA and Freddie Mac have initiated significant reforms that are intended to recover losses from inappropriately underwritten loans purchased by the Enterprise and will promote avoidance of such losses in the future. FHFA-OIG will continue to monitor developments in this area.

RECOMMENDATION

FHFA and Freddie Mac should continue to carry out the loan review and related reforms they have initiated since FHFA-OIG's original report was issued.

FHFA agreed with this recommendation. Its detailed comments are found in Appendix B.

SCOPE AND METHODOLOGY

The overall objective of this evaluation is to determine what actions FHFA and Freddie Mac have taken to implement the recommendations that were included in FHFA-OIG's evaluation report entitled *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America* (EVL-2011-006), issued September 27, 2011. It also aims to identify the savings attributable to such actions.

The scope of the review is Freddie Mac's legacy non-performing loans. That is, it examines the actions being taken to require loan sellers to repurchase mortgage loans that were purchased by Freddie Mac before it entered into a conservatorship overseen by FHFA in late 2008, and that went into foreclosure or are likely to do so as a result of not meeting Freddie Mac's underwriting principles. FHFA-OIG used internal Freddie Mac documents to understand the results from their new loan review practices.

This report was prepared 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. These standards require FHFA-OIG to plan and perform evaluations that obtain evidence sufficient to provide reasonable bases for its findings and recommendations. FHFA-OIG believes that the analysis and conclusions contained in this report meet these standards.

FHFA-OIG appreciates the efforts of FHFA and Freddie Mac staff in providing information and access to necessary documents to accomplish this evaluation.

APPENDIX A: STATUS OF FHFA'S RESPONSE TO FHFA-OIG RECOMMENDATIONS

Recommendation	Status
FHFA and its senior management must promptly act on the significant concerns raised about the loan review process.	
• FHFA should continue to withhold approval of Freddie Mac repurchase settlements until such time as it is confident that the concerns about the Enterprise's loan review process have been resolved.	Completed
• FHFA senior management should ensure that Freddie Mac management resolves the concerns that prompted their internal auditors to issue an "Unsatisfactory" audit opinion.	Underway
• FHFA senior management should oversee Freddie Mac's "out-of-sample" loan testing and consider independently validating the testing.	Underway
• FHFA should evaluate whether Fannie Mae and Freddie Mac should adopt consistent review practices for repurchase claims.	Underway
• FHFA senior management should initiate an independent assessment of Enterprise repurchase practices in order to ensure that they are maximizing their repurchase claim recoveries.	Underway
• FHFA should issue internal guidance regarding its handling of future repurchase settlements, should they arise.	Completed
FHFA must promptly initiate management reforms to ensure more generally that senior management is apprised of and timely acts on significant concerns brought to its attention.	
• FHFA senior management must immediately initiate reforms to avoid the kind of management process shortcomings identified in this evaluation. In particular: --Direct supervisors must properly and timely address and act upon significant concerns brought to their attention (i.e., resolve or elevate issues that pose significant potential risks or document decisions not to do so). --Senior managers, regardless of their position within FHFA, must timely address and act on significant concerns, particularly when they recieive reports that the normal reporting and supervisory process is not working properly.	Completed
• FHFA's Acting Director must establish appropriate goals, principles, and procedures at the top of the FHFA organization to guarantee that significant concerns are properly and timely addressed and acted upon.	Completed

APPENDIX B: FHFA'S COMMENTS ON FHFA-OIG'S FINDINGS AND RECOMMENDATION

Federal Housing Finance Agency

MEMORANDUM

TO: George Grob, Deputy Inspector General for Evaluations, FHFA OIG

FROM: Jon Greenlee, Deputy Director, Division of Enterprise Regulation

SUBJECT: FHFA Response to the Follow-up on Freddie Mac's Loan Repurchase Process, (SUR-2012-012)

DATE: September 7, 2012

This memorandum transmits the Federal Housing Finance Agency's (FHFA) management response to the recommendation in the FHFA-OIG's follow-up report to evaluate developments in Freddie Mac's loan review process since the issuance of the 2011 FHFA-OIG report on the Freddie Mac settlement of loan repurchase claims against Bank of America.

As noted in the follow-up report, Freddie Mac has, with direction and approval from FHFA, instituted a number of improvements in its process for review loans, including an increase in the volume of loans subject to review. Both the supervisory and conservatorship functions of FHFA have been involved as appropriate to their respective missions and authorities. As described in the report, Freddie Mac has made and continues to build on improvements in its controls for the repurchase process.

Recommendation: FHFA and Freddie Mac should continue to carry out the loan review and related reforms they have initiated since Freddie Mac's Internal Audit study and the FHFA-OIG report on the Bank of America settlement with Freddie Mac.

Agency Response: FHFA agrees that reforms currently in place or underway will address the weaknesses identified by FHFA-OIG and Freddie Mac Internal Audit. Additional steps are not planned at this time, but as noted in the follow-up report, three measures remain in progress, as described below.

(1) FHFA senior management should ensure that Freddie Mac management resolves the concerns that prompted their internal auditors to issue an "Unsatisfactory" audit opinion.
(2) FHFA senior management should initiate an independent assessment of Enterprise repurchase practices in order to ensure that they are maximizing their repurchase claim recoveries.

Ongoing supervisory work by the Freddie Mac Core Team, under the supervision of the Freddie Mac Examiner-in-Charge, includes review of quality control processes, which Freddie Mac utilizes in its internal review of the treatment of repurchase claims. An effective quality control process is a key element of safe and sound operations. This work is underway for the 2012 examination cycle, and any necessary follow up would be included in the 2013 examination planning.

An "Unsatisfactory" opinion issued by Internal Audit receives supervisory attention, including review of the audit finding and audit workpapers; review of the management response to the audit finding and Board of Directors notification; the action plan established by management to address the deficiencies; execution of the action plan; and validation of results, including any follow up by Internal Audit. This review may extend over multiple examination cycles.

(3) FHFA should evaluate whether Fannie Mae and Freddie Mac should adopt consistent review practices for repurchase claims.

The principal component of FHFA's approach to establishment of review practices that are consistent for Fannie Mae and Freddie Mac is the contract harmonization initiative currently in development under the leadership of the Division of Housing Mission and Goals. The initiative will address the need for consistency and the appropriate parameters of consistency, and is expected to be launched by the end of 2012.

ADDITIONAL INFORMATION AND COPIES

For additional copies of this report:

Call the Office of Inspector General (FHFA-OIG) at: 202-730-0880

Fax your request to: 202-318-0239

Visit the FHFA-OIG website at: www.fhfaoig.gov

To report alleged fraud, waste, abuse, mismanagement, or any other kind of criminal or noncriminal misconduct relative to FHFA's programs or operations:

Call our Hotline at: 1-800-793-7724

Fax your written complaint directly to: 202-318-0358

Email us at: oighotline@fhfaoig.gov

Write to us at: FHFA Office of Inspector General
Attn: Office of Investigation – Hotline
400 Seventh Street, S.W.
Washington, DC 20024