Federal Housing Finance Agency
Office of Inspector General

FHFA's Reporting of Federal Home Loan Bank Director Expenses

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OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

March 20, 2014

TO: Fred Graham, Deputy Director, Division of Federal Home Loan Bank Regulation
Nina Nichols, Deputy Director, Division of Supervision Policy and Support

FROM: Richard Parker, Deputy Inspector General for Evaluations

SUBJECT: FHFA's Reporting of Federal Home Loan Bank Director Expenses (EVL-2014-005)

Summary

The Federal Home Loan Bank (FHLBank) System is comprised of 12 regional FHLBanks and their Office of Finance. The purpose of the FHLBank System is to support housing finance. To this end, the FHLBanks make secured loans, called advances, to their member financial institutions, such as banks and thrifts.[1] Each FHLBank has a board of directors that guides its programs and operations. The directors are elected by the FHLBank's member institutions.[2]

In this evaluation, we assessed the Federal Housing Finance Agency's (FHFA or Agency) reporting of expenses incurred by the members of the boards of directors of the FHLBanks. Our objectives were to: (1) determine whether FHFA included information about FHLBank director expenses in its annual reports to Congress, as required by the Housing and Economic Recovery Act of 2008 (HERA); and (2) illustrate the need for reliable data.

We determined that, since 2010, the FHLBanks have submitted director expense data to FHFA, which is required by the Agency's regulations. Director expenses for the 12 FHLBanks and the Office of Finance from 2010 through 2012 totaled approximately $3 million each year, according to these submissions. To date, however, FHFA has not included information about FHLBank

[1] The Office of Finance issues debt to finance the FHLBanks' operations. For a description of the operations of the FHLBank System, *see* OIG, *An Overview of the FHLBank System's Structure, Operations, and Challenges* (online at http://www.fhfaoig.gov/Content/Files/FHLBankSystemOverview.pdf) (accessed Feb. 6, 2014).

[2] The majority of board members are directors or officers of member institutions, and the remaining directors (at least 40%) are independent. The boards can range in size from 13 to 18 directors.

director expenses in its annual reports to Congress, as required by HERA. An FHFA official told us that, in the course of this evaluation, the Agency realized that it should have been reporting this information all along, and that it would begin doing so with its 2013 annual report, which will be published in 2014.

Although we acknowledge FHFA's commitment to begin reporting FHLBank director expense information as required by law, our review of the data submitted to FHFA by the FHLBanks and other information revealed that the data contain inconsistencies and limitations that diminish their usefulness. We believe that FHFA should address potential data limitations to ensure the reliability of the director expense information that it has stated it will report to Congress in 2014 and subsequently.

Accordingly, we recommend that FHFA: (1) review the 2013 director expense data submitted by the FHLBanks to identify and correct any inconsistencies and inaccuracies prior to the publication of the 2013 annual report, to the extent feasible, and disclose in the report any remaining data limitations; and (2) issue guidance designed to ensure the consistency and utility of the director expense data submitted to the Agency. FHFA essentially agreed with these recommendations.

Background

HERA Required FHFA to Report FHLBank Director Compensation and Expenses to Congress, and the Agency Issued Implementing Regulations

From 2000 to 2008, the amount of compensation that the FHLBanks could pay to members of their boards of directors was limited by law.[3] However, the FHLBanks could reimburse their directors for expenses they incurred in connection with their board service.

When HERA was enacted in 2008, it removed the caps on FHLBank director compensation but left in place the requirement that such compensation be "reasonable." HERA also left in place a provision under which the FHLBanks are permitted to pay their directors "necessary expenses [incurred] in the performance of their duties."[4] Further, HERA added a new provision under which FHFA must include in its annual reports to Congress "information regarding the compensation and expenses paid" by the FHLBanks to their directors.

On April 5, 2010, FHFA issued regulations to implement the new provisions concerning FHLBank director compensation and expenses.[5] Under the regulations, each FHLBank must submit to FHFA each year the:

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[3] The caps began as a maximum of $25,000 per year for the board chair, $20,000 for the vice chair, and $15,000 for other directors, and they increased each year with the Consumer Price Index.

[4] 12 U.S.C. § 1427(i).

[5] Federal Home Loan Bank Directors' Eligibility, Elections, Compensation, and Expenses, 12 C.F.R. § 1261 (2010) (online at: http://www.gpo.gov/fdsys/pkg/CFR-2011-title12-vol7/xml/CFR-2011-title12-vol7-part1261.xml).

- Total compensation paid to each director (and the total for all directors);
- Total expenses paid to each director (and the total for all directors); and
- Total of all expenses incurred at group functions that are not reimbursed to individual directors, such as the cost of group meals in connection with board meetings.

As a result, FHFA receives data that it could use to meet the requirement to report information about FHLBank director compensation and expenses to Congress.

FHFA Has Reported on FHLBank Director Compensation in its Annual Reports and Reviewed FHLBank Director Compensation Practices

To date, each of FHFA's annual reports to Congress has included information about the compensation paid to FHLBank directors, as well as the directors serving on the board of the Office of Finance. In its first annual report, for 2008, FHFA devoted a page to this topic, including a chart depicting the minimum, maximum, and average compensation for directors for each FHLBank.[6] Similar information was included in each annual report through 2012.[7]

In March 2013, FHFA's Division of Federal Home Loan Bank Regulation (DBR) completed a horizontal review of the FHLBanks' and Office of Finance's compliance with the Agency's 2010 FHLBank director regulations.[8] The review covered FHLBank policies related to director compensation, but not director expenses.

Additionally, the regulations required each FHLBank to adopt a written policy annually to provide for the payment of reasonable compensation and expenses to its directors. If FHFA reviews such a policy or related materials and determines that the compensation or expenses to be paid are unreasonable, then it may order the FHLBank to stop incurring payments under the policy. We reviewed the FHLBanks' most recent policies and determined that one of them does not cover director expenses.

[6] FHFA, *Report to Congress 2008*, at 74 (May 18, 2009) (online at http://www.fhfa.gov/webfiles/2335/FHFA_ReportToCongress2008508rev.pdf). The chart did not depict the compensation paid to the chair and vice chair.

[7] FHFA, *Report to Congress 2009*, at 93-94 (May 25, 2010) (online at http://www.fhfa.gov/webfiles/15784/FHFAReportToCongress52510.pdf); FHFA, *Report to Congress 2010*, at 84-86 (June 13, 2011) (online at http://www.fhfa.gov/webfiles/21572/FHFA2010_RepToCongress6__28_11--508_file.pdf); FHFA, *2011 Report to Congress*, at 48-49 (June 13, 2012) (online at http://www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_14_508.pdf); and FHFA, *Report to Congress 2012*, at 50-52 (June 13, 2013) (online at http://www.fhfa.gov/webfiles/25320/FHFA2012_AnnualReport-508.pdf).

For 2008 and 2009, the Office of Finance had only one independent director, the board chair, whose compensation was listed in the text of the annual report. The two other directors were FHLBank presidents who received no additional compensation for their service with the Office of Finance. In 2010, FHFA increased the membership of the Office of Finance board to include the presidents of all 12 FHLBanks and 5 independent directors. FHFA included Office of Finance director compensation in the chart in its annual reports for 2011 and 2012.

[8] Within FHFA, DBR is responsible for overseeing the FHLBanks. In a horizontal review, DBR assesses risk management or compliance in a particular area across the FHLBanks. In October 2013, FHFA reassigned oversight of FHLBank director compensation from DBR to its Division of Supervision Policy and Support

As a result of its review, DBR found that in 2012 only two FHLBanks were in full compliance with these regulations. Some FHLBanks had policies that did not require director compensation to be reduced for failing to attend meetings, for example. Some FHLBanks had policies that did not explain the methodology by which director compensation was set. FHFA required these and other deficiencies identified by its review to be corrected. According to DBR, the FHLBanks and Office of Finance have resolved these matters and, where they have not, corrective actions are underway.[9]

Findings

1. FHFA Has Not Included FHLBank and Office of Finance Director Expenses in its Annual Reports to Congress

In accordance with FHFA's regulations, the FHLBanks have submitted annual director expense data to the Agency. Director expenses for the FHLBanks and Office of Finance totaled approximately $3 million each year from 2010 through 2012, including expenses reimbursed to individual directors and group expenses. To date, however, FHFA has not complied with HERA's provision requiring information about FHLBank director expenses to be included in its annual reports to Congress. An FHFA official told us that, during the course of this evaluation, the Agency realized that it should have included FHLBank director expense information in its annual reports to Congress. He also said that FHFA would begin doing so with the publication of its 2013 annual report in 2014.[10] By reporting information about FHLBank director expenses, along with meeting its statutory requirement, FHFA will increase transparency and may deter questionable expenditures.[11]

2. FHLBanks' Director Expenses Were Submitted Inconsistently, Diminishing the Utility of the Data

Although we acknowledge FHFA's recent commitment to begin reporting FHLBank director expense information as required by law, our review raised questions about the quality of the data that the Agency has collected to date. We reviewed the data submitted to FHFA by the FHLBanks and Office of Finance for 2010 through 2012. As set forth below, the submissions contained instances of inconsistent reporting and other limitations that decrease its usefulness.

(DSPS). FHFA officials explained that DSPS already oversaw compensation for the executives of Fannie Mae, Freddie Mac, and the FHLBanks.

[9] We note that FHFA conducted oversight of FHLBank director compensation, but an assessment of that oversight was beyond the scope of this evaluation.

[10] HERA did not specify the extent of the information to be reported. We believe that FHFA's reporting of director expenses should be informed by its reporting of director compensation, considering that Congress addressed them together in the statute.

[11] In addition to reviewing the director expense data submitted to FHFA, we requested further information from each FHLBank and the Office of Finance about expenses reimbursed for a small sample of directors for recent years and group expenses for 2012. Although our review was limited, it turned up expenses the circumstances surrounding which FHFA might want to consider, such as several thousand dollars for golf outings and baseball games in 2011 and a band and several outdoor activities in 2012 for one FHLBank.

These data limitations appear to be caused by a lack of clarity in FHFA's instructions to the FHLBanks. We determined that FHFA did not review the data submissions and, therefore, did not identify inconsistencies among them. Consequently, the Agency did not clarify its instructions so as to avoid further inconsistent data reporting.[12]

FHLBanks Used Differing Approaches to Submit Individual Director Expenses

FHFA provided the FHLBanks with a template for submitting their directors' individual expenses, such as official travel and meals. The template contains columns for "Director Spouse/Guest Travel Expenses" and "Other Reimbursed Director Expenses, if any" (see Attachment A for the template). We found that two FHLBanks listed all of their director, spouse, and guest expenses in the "Director Spouse/Guest" column. However, other FHLBanks listed most of their director expenses in the "Other Reimbursed Director Expenses" column, possibly listing only spouse and guest expenses in the first column.[13]

The lack of clarity in FHFA's template likely explains the inconsistencies noted above. Specifically, FHFA did not define the terms it used in the template, such as "Director Spouse/Guest Travel Expenses," leaving each FHLBank to define the terms for itself. FHFA can help ensure that FHLBanks report director expense information consistently by defining its terms and otherwise providing the FHLBanks with clear instructions by which to list information in the template.[14]

FHLBanks Used Differing Approaches to Submit Group Director Expenses

FHFA also requires the FHLBanks to submit a total amount for aggregated expenses incurred at group functions, such as "the cost of group meals in connection with board and committee meetings" that are not reimbursed to directors (see Attachment A, box for reporting aggregated expenses). We obtained additional information from each FHLBank about its group expenses for 2012. Our review found that one FHLBank included more than $130,000 for management consulting fees as a group expense, although those fees did not appear to be related to a board group function.[15] Other FHLBanks did not list consulting expenses as group expenses, although

[12] FHFA officials told us that they did not review the FHLBank director expense data for a variety of reasons. They noted that the total annual expenditures were only about $3 million. Instead, the Agency focused on director compensation expenditures, which had grown considerably since HERA removed the caps on such compensation in 2008. Regardless of the reasons, FHFA has an annual statutory obligation to provide Congress with accurate information concerning the compensation and reimbursed expenses of the FHLBanks' directors.

[13] In addition, one FHLBank used only the "Director Spouse/Guest" column in 2010; and it recorded the majority of its director expenses in the "Other Reimbursed Director Expenses" column for 2011 and 2012.

[14] For example, FHFA might consider requiring spouse expenses to be submitted separately. One FHLBank's internal audit division reviewed a sample of expense reports submitted by individual directors. In two cases, directors sought reimbursement for spouse expenses without specifying a clear business reason for them, as required by the FHLBank's policy. In addition, some director expenses were reimbursed even though the FHLBank official who approved them lacked the authority to do so. We were informed by the FHLBank that it is taking steps to prevent this from recurring.

[15] The approximately $130,000 in consulting costs represented more than one-third of the FHLBank's approximately $360,000 in group expenses submitted for 2012.

they may have incurred them. As in the case of individual director expenses, this sort of inconsistency among the FHLBanks renders the data less useful.

We also compared the data the FHLBanks submitted to FHFA about 2012 director expenses with the information they reported to the U.S. Securities and Exchange Commission (SEC) in their public disclosures.[16] In two cases in which we found differences, we requested clarification from those FHLBanks.

One FHLBank told us that the data it had submitted to FHFA were incorrect.[17] The other FHLBank reported approximately $49,000 more in group director expenses to the SEC than it submitted to FHFA. An official of the second FHLBank told us that the FHLBank had excluded certain items in the submission to FHFA based on the definition of group expenses contained in FHFA's regulations.[18] Accordingly, the FHLBank excluded from its report $8,706 in "entertainment" expenses, as well as certain other items.[19] These examples suggest there may be confusion among some FHLBanks as to what constitutes director group expenses. FHFA may have intended the entertainment and other expenses discussed above to be reported as group expenses, but it did not provide the FHLBanks with sufficiently clear instructions in this regard.

Conclusion

FHFA is required by law to report FHLBank director expense information to Congress each year. To date, FHFA has not done so, although the Agency plans to begin reporting such information in its 2013 annual report and subsequent reports. Doing so will enable FHFA to ensure transparency with respect to these expenses and their reimbursement by the FHLBanks.

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[16] Specifically, we reviewed the relevant section of the FHLBanks' Annual Reports on Form 10-K for 2012. Some FHLBanks included only general information about director expenses in their 10-Ks. Perhaps, as an FHFA official conjectured, these FHLBanks did not consider the amounts to be material to investors. Of the FHLBanks that included director expense numbers in their 10-Ks, some FHLBanks matched what they reported to FHFA, and others did not.

[17] The FHLBank explained that a subaccount for in-town meeting expenses had been omitted from its submission to the Agency. Correcting the error increased the FHLBank's aggregate expenses by approximately $30,000. An official of the FHLBank said that the submission to FHFA had been revised and additional action had been taken to prevent such errors from recurring.

Another FHLBank told us that it recently corrected its aggregate expenses, which had been underreported by approximately $33,000. The underreporting was identified by the FHLBank's internal audit division and attributed primarily to employees incurring board-related expenses without providing proper notification of their actions within the FHLBank. An official of the FHLBank said that the submission to FHFA had been revised and steps had been taken to improve the accuracy of future data submissions.

[18] FHFA's 2010 regulations define expenses as "necessary and reasonable travel, subsistence and other related expenses incurred in connection with the performance of official duties as are payable to senior officers of the Bank under the Bank's travel policy, except gift or entertainment expenses."

[19] The FHLBank also excluded from its submission more than $6,000 in audio/video equipment rental fees. Another FHLBank allocated such fees to individual directors and reported them under the "Director Spouse/Guest Travel Expenses" column of FHFA's template. Still a third FHLBank included these fees in its aggregated expenses.

Our analysis of the data submitted to FHFA by the FHLBanks and Office of Finance for 2010 through 2012 reveals inconsistencies in the manner in which the data were submitted and, therefore, raises questions about the overall usefulness of the information. FHFA's instructions to the FHLBanks concerning the submission of such information did not change during 2013. Consequently, we believe that there is a risk that similar inconsistencies exist in the expense data that the FHLBanks and Office of Finance have submitted to FHFA for inclusion in its 2013 annual report to Congress. FHFA told us that it is reviewing the director expense information submitted for 2013. We believe it is incumbent upon the Agency to take steps to ensure the consistency and reliability of the director expense data it collects and reports to Congress.

Recommendations

We recommend that FHFA:

1. Review the 2013 director expense data submitted by the FHLBanks to identify and correct any inconsistencies and inaccuracies prior to the publication of the 2013 annual report, to the extent feasible, and disclose in the report any remaining data limitations; and

2. Issue guidance designed to ensure the consistency and utility of the director expense data submitted to the Agency.

FHFA essentially agreed with these recommendations. The Agency's comments are included in Attachment B.

Objective, Scope, and Methodology

The objectives of this evaluation were to: (1) determine whether FHFA included information about FHLBank director expenses in its annual reports to Congress, as required by HERA; and (2) illustrate the need for reliable data.

To address these objectives, we reviewed applicable federal laws, including HERA, as well as FHFA's regulations. We interviewed FHFA officials from DBR and DSPS, and a Deputy General Counsel.

We also reviewed documents provided by FHFA including director expense and compensation data reported to FHFA by each FHLBank and the Office of Finance for 2010, 2011, and 2012. We then requested that each FHLBank and the Office of Finance provide us with more detailed information about aggregated director expenses for 2012 and, for a sample of directors, about reimbursed expenses. The sample generally included, for each institution, one or more directors with the highest reimbursed expenses in 2010, 2011, or 2012, and two additional directors. The sample was not designed to be a statistical sample. As a result, we do not project the results onto the population of directors.

In addition, we compared the information each FHLBank reported to FHFA regarding director expenses with information it reported to the SEC in its 10-K. In two of the cases where we found differences, we requested and reviewed additional information from the FHLBanks.

We reviewed the FHLBanks' policies on director compensation and expenses. We also reviewed FHFA's Reports of Examination of the FHLBanks and Office of Finance for 2011 and 2012, and its March 2013 Report on FHLBank Compliance with FHFA's Director Regulation. We compared FHFA's oversight and reporting of FHLBank director compensation to its oversight and reporting of FHLBank director expenses, but we did not assess the quality of FHFA's oversight of director compensation.

We did not independently test the reliability of FHFA's or the FHLBanks' data systems.

This evaluation was conducted under the authority of the Inspector General Act and is 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 us to plan and perform an evaluation that obtains evidence sufficient to provide reasonable bases to support its findings and recommendations. We believe that the findings and recommendations discussed in this report meet these standards.

The performance period for this evaluation was October 2013 to January 2014.

We appreciate the cooperation of all those who contributed to this evaluation, which was led by Beth Preiss, Program Analyst, assisted by Adrienne Freeman, Investigative Counsel, and Angela Choy, Director of Fraud Prevention and Program Management. This evaluation report has been distributed to Congress, the Office of Management and Budget, and others, and will be posted on OIG's website, www.fhfaoig.gov.

Attachments: Attachment A: FHFA's Template for FHLBank and Office of Finance Data Submission
Attachment B: FHFA's Comments on OIG's Finding and Recommendations

Attachment A

FHFA's Template for FHLBank and Office of Finance Data Submission

Federal Home Loan Bank of ____ or Office of Finance
Director Compensation and Expenses (in dollars) for 2012

No.	Name of the Director	Director Compensation Paid in Cash	Director Deferred Compensation	Total Director Compensation Earned	Director Spouse/ Guest Travel Expenses	Other Reimbursed Director Expenses, if any	Total Director Compensation and Reimbursed Expenses
	(1)	(2)	(3)	(4) = (2) + (3)	(5)	(6)	(7) = (4) + (5) + (6)
1				$0.00			$0.00
2				$0.00			$0.00
3				$0.00			$0.00
4				$0.00			$0.00
5				$0.00			$0.00
6				$0.00			$0.00
7				$0.00			$0.00
8				$0.00			$0.00
9				$0.00			$0.00
10				$0.00			$0.00
11				$0.00			$0.00
12				$0.00			$0.00
13				$0.00			$0.00
14				$0.00			$0.00
15				$0.00			$0.00
16				$0.00			$0.00
17				$0.00			$0.00
18				$0.00			$0.00
19				$0.00			$0.00
20				$0.00			$0.00
	Total (all directors)	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**

Aggregated expenses not captured above, such as group function expenses that are not reimbursed to directors:
(for example, the cost of group meals in connection with board and committee meetings)

Attachment B

FHFA's Comments on OIG's Findings and Recommendations

Federal Housing Finance Agency

MEMORANDUM

TO: Richard B. Parker, Deputy Inspector General for Evaluations

FROM: Nina Nichols, Deputy Director, Division of Supervision Policy and Support

SUBJECT: Evaluation Report: *FHFA's Reporting of Federal Home Loan Bank Director Expenses* (OIG Survey-2014-01)

DATE: March 7, 2014

This memorandum transmits the Federal Housing Finance Agency's (FHFA) management response to the recommendations in the report prepared by FHFA-OIG, *FHFA's Reporting of Federal Home Loan Bank Director Expenses (EVL-2014-XX).* We appreciate the opportunity to provide feedback on this draft report and the FHFA-OIG findings.

FHFA agrees that it must report Federal Home Loan Bank director expenses in the FHFA Annual Report to Congress and agrees that the Federal Home Loan Banks should report to FHFA their director expense data on a consistent basis.

The report makes two recommendations. This memorandum sets forth management's response to the recommendations and the actions that FHFA will take to address the recommendations.

FHFA-OIG Recommendations

1. Review the 2013 director expense data submitted by the FHLBanks to identify and correct any inconsistencies and inaccuracies prior to the publication of the 2013 annual report, to the extent feasible, and disclose in the report any remaining data limitations.

   Management Response: FHFA agrees that expense data should be presented accurately and consistently in FHFA's Annual Reports to Congress. FHFA will represent 2013 Federal Home Loan Bank director expenses as consistently as possible among the Federal Home Loan Banks given the format in which the expense data has been received and the timeframe for review prior to the Annual Report's publication date.

2. Issue guidance designed to ensure the consistency and utility of the director expense data submitted to the Agency.

   Management Response: FHFA agrees. FHFA will update and enhance expense filing directions relating to the Federal Home Loan Bank directors and the Office of Finance directors. The updated and enhanced instructions will be designed to ensure that information submitted to FHFA by the Federal Home Loan Banks and the Office of Finance is consistently completed and that the reporting entities provide informative data. Final instructions will be issued by October 31, 2014.

cc: Fred Graham, Deputy Director, Division of Bank Regulation
Denise Dunckel, Senior Associate Director for Congressional Affairs & Communications
Neil Crowley, Deputy General Counsel
John Major, Manager, Internal Controls and Audit Follow-up

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