

Federal Housing Finance Agency  
Office of Inspector General



# **FHFA's Practice for Rotation of its Examiners Is Inconsistent between its Two Supervisory Divisions**



EVL-2017-004

March 28, 2017

## Executive Summary

Since 2008, FHFA has operated as both regulator and conservator of Fannie Mae and Freddie Mac (collectively, the Enterprises) and regulator of the Federal Home Loan Banks (FHLBanks) to ensure that they operate safely and soundly so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA meets this responsibility, in part, through its supervision program. FHFA's Division of Enterprise Regulation (DER) supervises the Enterprises, conducting ongoing monitoring activities and targeted examinations into strategically selected areas of high importance or risk at each Enterprise. FHFA's Division of Federal Home Loan Bank Regulation (DBR) supervises the FHLBanks. DBR's supervisory activities include annual on-site examinations, periodic visits, special reviews, and off-site monitoring.

According to FHFA, its supervisory authority over its regulated entities "is virtually identical to—and clearly modeled on—Federal bank regulators' supervision of banks." Federal bank regulators recognize that effective supervision of a bank requires examiner independence. One control used by federal financial regulators to achieve examiner independence is mandatory rotation of certain examiners among supervised entities. Federal financial regulators also recognize other benefits from examiner rotation, such as enhancing examiners' professional and leadership skills, and improving their ability to conduct comparisons among institutions and apply regulatory standards consistently.

In the current Audit and Evaluation Plan of FHFA Office of Inspector General (OIG), we identified FHFA's supervision of its regulated entities as a significant risk area. Throughout 2016, we assessed the rigor of numerous elements of DER's supervision of the Enterprises and recommended a number of measures to strengthen each of these elements. In this evaluation, we reviewed the rotation policies and/or practices of the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), and the Federal Deposit Insurance Corporation (FDIC), and compared them to the rotation policies and practices of DBR and DER.

We found that the OCC, the Federal Reserve, and the FDIC have recognized the benefits of examiner rotation and have adopted written policies and/or practices requiring examiner rotation. Former FHFA leadership acknowledged the benefits of examiner rotation but left implementation to DBR and DER.

DBR officials reported to us that, at least since January 2013, DBR has an established practice of rotating all of its examination teams every four years and communicates the reasons for its rotation practice and specific rotation assignments annually. DBR has created and maintained records of examiner



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assignments and reassignments during this period. Our testing of DBR's records found that, from January 2013 through December 2016 (review period), DBR followed its examiner rotation practice. Based on our review of DBR records, we determined that each of the 11 FHLBanks was assigned a different associate director, a different examiner-in-charge (EIC), and different examination team at least every four years.

The Deputy Director of DER acknowledged to DER staff, in an email sent in November 2015 that "[r]egular rotation of on-site examination staff is a best practice of supervisory agencies." In that same email, the Deputy Director announced the rotation of the EICs of the examination teams for the Enterprises and committed that DER intended to adopt "meaningful" examiner rotation.

A senior DER official recalled to us that DER has rotated staff on its examination teams since the fall of 2012. In May 2016, the Deputy Director of DER reported to us that DER has an informal rotation process.

To verify those recollections, we sought documentation from DER to show its efforts to track examiner assignments over time or evidence of an examiner rotation practice, informal or otherwise. DER provided no such materials, apart from the November 2015 email from the Deputy Director, internal organization charts, staffing spreadsheets, and a number of internal and public announcements of organization changes. A DER official reported to us that DER maintained no records of examiner assignments and reassignments, or the period of time examiners have been assigned to a particular Enterprise or specific risk area, and had not created or maintained records to track examiner assignments over time, and no documentation was produced to us by DER showing that it systematically tracked examiner assignments over the review period.

However, DER maintained to us that DER management was aware of its movement of examiners through its review and approval of staffing assignments and reassignments during the review period and that information about examiner assignments could be found in the personnel records for each examiner and in emails. No claim was made by DER that its management reviews the personnel records for each examiner and associated emails when it considers assignments and reassignments, and it did not produce such materials to us in response to our request for materials evidencing examiner rotation. We found no evidence that DER has systematically tracked the length of time each examiner has been assigned to a particular Enterprise or risk area.

Because we were not able to readily verify statements from DER leadership that informal examiner rotation had occurred within DER and in light of DBR's demonstrable practice of rotating its examiners every four years and DER's acknowledgement that regular rotation of examination staff is a "best practice," we



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sought to determine what practice, if any, had been followed within DER to rotate examiners between the two Enterprises and risk areas during the review period from the materials provided to us by DER.

From these materials, we traced examiner assignments to determine how many DER examiners (1) had been assigned to a particular Enterprise or risk area for the entire review period and (2) had been rotated between the Enterprises during the review period. Our review of these DER materials found that 28 employees were assigned to DER throughout the review period, although not all served as examiners throughout the entire period. We also found that 22 of the 28—79%—examined only one Enterprise during the entire review period.

DER's lack of easily accessible and reliable data on examiner assignments over time limits its capacity to make reasoned and effective management decisions about examination resources. Sixteen months after the Deputy Director of DER announced the rotation of EICs and pledged to adopt "meaningful" examiner rotation, we found no evidence, based on our review of DER documents and communications with DER officials, that DER has implemented its pledge of "meaningful" examiner rotation.

We make two recommendations to FHFA to address these shortcomings. FHFA agreed with our recommendations.

This report was prepared by Adrienne Freeman, Investigative Counsel, and Moira Roberts, Special Counsel. 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).

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## ABBREVIATIONS .....

DBR	Division of Federal Home Loan Bank Regulation
DER	Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac, collectively
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FHFA or Agency	Federal Housing Finance Agency
FHLBanks	Federal Home Loan Banks
New York Fed	Federal Reserve Bank of New York
OCC	Office of the Comptroller of the Currency
OIG	Federal Housing Finance Agency Office of Inspector General

## BACKGROUND .....

Since 2008, FHFA has supervised Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System to ensure that these regulated entities operate safely and soundly in order to serve as reliable sources of liquidity and funding for housing finance and community investment. FHFA, like other federal financial regulators, conducts examinations of the financial institutions it supervises.

DBR is responsible for supervision of the 11 FHLBanks. DBR’s supervisory activities include annual on-site safety and soundness examinations typically lasting several weeks, supplemented by periodic visits, special reviews, and off-site monitoring of each FHLBank and the Office of Finance. DER is responsible for supervision of both of the Enterprises. DER has established two core teams of examiners, led by an EIC, each of which is assigned to examine an Enterprise and works on-site at that Enterprise.

According to FHFA, its supervisory authority over its regulated entities “is virtually identical to—and clearly modeled on—Federal bank regulators’ supervision of banks.” Federal bank regulators recognize that effective supervision of a bank requires examiner independence. One control used by regulators of financial institutions to achieve examiner independence is mandatory rotation of certain examiners among supervised entities. As discussed below, federal financial regulators also recognize other benefits that can arise from examiner rotation, such as enhancing examiners’ professional and leadership skills, and improving examiners’ ability to conduct comparisons among institutions and to apply regulatory standards consistently.

### Independence

Examiner independence has been a concern of federal financial regulators, particularly since the financial crisis of 2007 and 2008. Following a crisis stemming from misconduct at one of its supervised banks, and suggestions in the news media that it was too cozy with banks, the Comptroller of the Currency invited a group of regulators from three countries to conduct a peer review of OCC’s supervision of large and midsize financial institutions in 2013. The team of peer reviewers made recommendations across six topic areas that complemented the OCC’s initiatives to change its supervisory approach in response to the financial crisis.

Among other things, the resulting peer review report, issued in December 2013, warned that examiners assigned to the same bank and on-site at that bank for an extended time might “get

stale” and “become too familiar with the mid-management of the institution . . . .”<sup>1</sup> To mitigate this risk, the peer review report recommended that the OCC relocate examiners to OCC premises to “strengthen the external perception of OCC independence” and establish formal rotation for examination staff to enhance consistency in their application of supervisory standards.”<sup>2</sup> In its response to that recommendation, the OCC decided to increase rotation of examiners, which, in turn, “will further strengthen the supervision of national banks and federal savings associations by providing broader, fresh perspectives on a regular basis.” The Comptroller of the Currency also stated that rotating examiners on a regular basis “will enhance the agency’s expert supervision of the nation’s largest and most complex financial institutions . . . [f]acilitat[e] the sharing of information and knowledge among examiners across institutions and . . . provide a fresh and broader perspective to the examination of each large institution.”<sup>3</sup>

Other financial regulators also recognize examiner rotation as a means to foster examiner independence. The president of the Federal Reserve Bank of New York (New York Fed), testifying before a Senate committee in 2014, explained that the New York Fed required examiner rotation every three to five years to allow enough time for an examiner to gain an understanding of a regulated institution without sacrificing examiner independence.

## Examiner Development

According to the OCC and the FDIC, an established policy and/or practice of examiner rotation assists in efforts to retain expertise and impart knowledge to new examiners through on-the-job training that facilitates communication and transfer of knowledge across risk areas. In their view, examiner rotation assists in succession planning.

## Consistent Application of Supervisory Policies and Practices

According to the 2013 OCC peer review report, examiner rotation also promotes the consistent application of regulatory standards across multiple institutions. That report found that periodic rotation of supervisors ensures that “experiences gained supervising one

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<sup>1</sup> OCC, *An International Review of OCC’s Supervision of Large and Midsize Institutions: Recommendations to Improve Supervisory Effectiveness* at 14 (Dec. 4, 2013) (online at [www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184a.pdf](http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184a.pdf)).

<sup>2</sup> *Id.* at 16.

<sup>3</sup> OCC, *OCC Announces Actions to Respond to International Peer Review Recommendations* (2014), (online at <http://occ.treas.gov/news-issuances/news-releases/2014/nr-occ-2014-75.html>) (accessed Aug. 31, 2016).



institution can be applied to another.”<sup>4</sup> It also observed that rotating exam supervisors among regulated institutions and risk areas enhances consistent application of supervisory policies.

Other federal financial regulators have recognized that examiner rotation can enhance their capacity to compare the performance of regulated institutions and improve the overall operations of the supervised institutions.<sup>5</sup> We learned, from the Federal Reserve and from the OCC peer review, that experienced examiners who have examined only one institution for an extended length of time may be more prone to conclude, based solely on their own past experience, that they are fully knowledgeable of that institution’s risks. In their view, examiner rotation among regulated institutions brings in fresh perspectives and new expertise from other examiners with comparative experience, which mitigates assumptions of existing examiners—due to either inexperience or familiarity—about the adequacy of an institution’s internal controls.

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<sup>4</sup> OCC, *An International Review of OCC’s Supervision of Large and Midsize Institutions: Recommendations to Improve Supervisory Effectiveness*, at 15 (Dec. 4, 2013) (online at [www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184a.pdf](http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184a.pdf)).

<sup>5</sup> *Id.*

## FACTS.....

FHFA consistently maintains, based on the language of its authorizing statute,<sup>6</sup> that its supervisory authority over its regulated entities “is virtually identical to—and clearly modeled on—Federal bank regulators’ supervision of banks.” According to FHFA, “Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime” for the Enterprises and FHLBanks.<sup>7</sup> Like the OCC, the Federal Reserve, and the FDIC, FHFA conducts annual examinations of its regulated entities, reports on examination findings in annual reports of examination, and, when necessary, issues findings identifying deficiencies.<sup>8</sup> FHFA’s governing statute grants the Director authority to use examiners from the OCC, the Federal Reserve, or the FDIC to conduct examinations, and requires the Director to set compensation levels for FHFA staff that are comparable with other federal financial regulators.<sup>9</sup> A federal court has observed that Congress granted FHFA the same powers it granted bank regulators and that Congress intended FHFA’s regulatory framework to mirror the banking regulatory framework.<sup>10</sup>

For these reasons, we compared the policies and/or practices of the OCC, the Federal Reserve, and the FDIC on examiner rotation to the policies and practices of FHFA.

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<sup>6</sup> Federal Housing Enterprises Financial Safety and Soundness Act of 1992, 12 U.S.C. § 4501 et seq. and § 4513, as amended by Sections 1101 and 1102 of the Housing and Economic Recovery Act of 2008, and § 4517(c).

<sup>7</sup> By statute, FHFA must conduct annual examinations of the safety and soundness of the Enterprises and FHLBanks; the FHFA Director has substantially the same authority as the bank regulators; and examiners have the same authority as examiners employed by the Federal Reserve Banks. *See* 12 U.S.C. § 4517(a), (c), (e).

<sup>8</sup> The Federal Reserve establishes examination standards, and the Reserve Banks are responsible for supervising bank holding companies, Federal Reserve System member banks, foreign branches of member banks, and other related entities to ensure safe and sound banking practices and compliance with applicable laws and regulations. *See, e.g.*, Federal Reserve Bank of New York, Supervision (online at [www.newyorkfed.org/aboutthefed/org\\_banksup.html](http://www.newyorkfed.org/aboutthefed/org_banksup.html)). The OCC is responsible for ensuring that national banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. *See* 12 U.S.C. § 1 et seq., 12 U.S.C. § 1461 et seq. *See also* OCC, What We Do (online at [www.occ.gov/about/what-we-do/mission/index-about.html](http://www.occ.gov/about/what-we-do/mission/index-about.html)). The FDIC examines its supervised financial institutions for safety and soundness and consumer protection. *See also* FDIC, Mission, Vision, and Values (online at [www.fdic.gov/about/strategic/strategic/mission.html](http://www.fdic.gov/about/strategic/strategic/mission.html)).

<sup>9</sup> *See* 12 U.S.C. §§ 4515(b), 4517(c).

<sup>10</sup> *See Fed. Hous. Fin. Agency v. JPMorgan Chase & Co.*, 978 F. Supp. 2d 267 (S.D.N.Y. 2013).

## Examiner Rotation Policies and Practices of Other Federal Financial Regulators

The OCC, the FDIC, and the Federal Reserve use rotation to foster the supervisory goal of examiner independence. They also recognize that rotation improves their supervisory programs because it enhances the skills of their examiners and it promotes effective comparisons between, and consistent treatment of, the supervised entities.

### ***Office of the Comptroller of the Currency – Formal Policy on Rotation of Large Bank Examiners***

Following the peer review report discussed on page 7, the OCC established in 2015 a formal rotation policy covering examiners for the largest and most complex financial institutions. The policy, which may not be fully implemented, requires all examiners-in-charge and lead experts at mid-size and large banks to rotate at least every five years. In addition, the policy requires other examination positions, including certain large bank examiners and certain Assistant Deputy Comptrollers, to follow a five-year rotation. The OCC uses a tracking tool to monitor compliance with its rotation policy and requires documentation of any exceptions.

### ***Board of Governors of the Federal Reserve System – Policy and Practice on Rotation of Examiners-in-Charge and, at Some Banks, All Examiners***

The Federal Reserve has had a national policy since 2002 that requires the EICs of large bank supervisory teams and central points of contact for large complex banking organizations to rotate every three to five years. The Federal Reserve applies this policy to foster examiner independence and to give examiners more experience. Several Federal Reserve Banks, including the New York Fed, augment the national policy by requiring staff-level examiners to rotate. William C. Dudley, President and CEO of the New York Fed, testified in November 2014 at a Senate hearing that rotation of examiners among supervised institutions mitigates the tendency of examiners to adopt the perspective of a supervised entity. He reported that the New York Fed required examiner rotation after three to five years to promote unbiased analysis and professional objectivity.<sup>11</sup>

### ***Federal Deposit Insurance Corporation – Practice of Rotating All Examiners-in-Charge and Other Senior Examination Staff***

According to public statements from the FDIC, it values examiner skepticism and independence, and has adopted a practice of examiner rotation to prevent examiners from

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<sup>11</sup> Senate Committee on Banking, Housing, and Urban Affairs, Testimony of William Dudley, President of Federal Reserve Bank of New York, *Improving Financial Institution Supervision: Examining and Addressing Regulatory Capture*, at 9 (Nov. 14, 2014) (online at [www.banking.senate.gov/public/?a=Files.Serve&File\\_id=3401D43A-8E5D-4B83-9480-CE2C13389DB4](http://www.banking.senate.gov/public/?a=Files.Serve&File_id=3401D43A-8E5D-4B83-9480-CE2C13389DB4)).

getting too close to supervised institutions. While the FDIC has not adopted a formal written policy on examiner rotation, its unofficial policy is to rotate EICs for community banks at least every three years, for large banks every five years. The FDIC has publicly described its rotation practice for EICs as “providing a healthy outside perspective and better consistency in addressing large bank issues.” In addition, the FDIC rotates other senior examination staff among the banks it regulates to provide consistency and fresh perspectives.

### **Former Leadership of FHFA Acknowledged the Benefits of Examiner Rotation and Left Implementation of an Examiner Rotation Practice to DBR and DER**

In 2011, the former Acting Director of FHFA reported to us that he saw rotation as a tool to avoid examiner staleness and reduce the risk that examiners would become too comfortable with the management perspective of the institution that they were assigned to supervise. FHFA’s *Examination Manual*, adopted in December 2013 during the tenure of the former FHFA Acting Director, contains no requirement or guidance on examiner rotation and FHFA currently has no agency-wide policy or guidance on examiner rotation. We found no evidence that FHFA directed DBR or DER to adopt guidance on examiner rotation or to put examiner rotation into practice. It appears that FHFA leadership left implementation of an examiner rotation practice to DBR and DER.<sup>12</sup>

### **DBR Records Show that DBR Consistently Followed its Announced Practice of Examiner Rotation During the Review Period**

DBR officials reported to us that DBR uses regular examiner rotation to preserve examiner independence. One associate director told us that DBR uses rotation to reduce the risk that its examiners, particularly the EICs, would begin “to see things the way the bank sees things.” According to DBR officials, DBR’s rotation practice ensures fresh eyes are on each bank.

DBR officials also told us that rotation develops staff professional and leadership skills, fosters fresh perspectives, fosters consistency in examination approaches and results, and develops a common knowledge of all banks among the examination staff. According to these officials, shared knowledge of all FHLBanks improves DBR’s ability to address systemic issues and problems at the banks.

Although DBR has not adopted a formal written policy or guidance on examiner rotation, annual emails from DBR management to its examiners explain DBR’s examiner rotation practice, the reasons for that practice, and specific rotation assignments. The rotation email

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<sup>12</sup> Recently, FHFA issued guidance to the Enterprises that recommended the Enterprises consider rotating the internal audit staff in order to maintain objectivity and independence.

for 2016, like the emails for three prior years, also contained a chart showing the rotation assignments under each DBR associate director.

Three associate directors oversee the safety and soundness examinations of the FHLBanks. Each of the three associate directors manages a staff of about 14 examiners and is responsible for a portfolio of approximately four banks. DBR officials reported to us that DBR’s annual rotation chart changes every associate director’s portfolio for that year by adding a new bank and removing another, usually the bank that has been in that associate director’s portfolio for the longest time. Our review of DBR records found that, from January 2013 through December 2017,<sup>13</sup> each FHLBank was assigned a different associate director, a different EIC, and different examination staff at least every four years.<sup>14</sup>

Within DBR’s structured rotation practice, the associate directors have discretion to move staff resources where needed.<sup>15</sup> For example, an associate director may, during the four years that an FHLBank remains in his or her portfolio, rotate the assigned examination staff to different roles, such as to a different risk area, or from an EIC of one bank examination to a staff examiner on another, and to other FHLBanks in the portfolio. The associate directors also have flexibility to borrow resources from each other and to draw on resources outside the examination staff. For example, associate directors have borrowed staff from other offices with specialized financial and modeling expertise to perform bank examination tasks.

### **DER, Like DBR, Recognizes the Benefits of Examiner Rotation and Pledged to Adopt a “Meaningful” Examiner Rotation Approach but its Records Reflect that Examiner Rotation Has Largely Not Occurred During the Review Period**

DER, like DBR, lacks a written examiner rotation policy. In November 2015, the Deputy Director of DER reported to all DER staff that “[r]egular rotation of on-site examination staff is a best practice of supervisory agencies.” In that same email, the Deputy Director of DER announced a new EIC for Fannie Mae, who had formerly been the EIC for Freddie Mac, and a new EIC for Freddie Mac, who had previously been the head of DER’s Office of Modeling and Capital. She further committed that DER would adopt “meaningful” examiner rotation that would “improve coordination among offices.”

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<sup>13</sup> DBR provided OIG its 2017 rotation schedule, which covers the entire examination cycle beginning January 2017.

<sup>14</sup> DBR’s rotation records are contained both in the annual rotation charts attached to emails and in worksheets that trace associate director and EIC assignments among the FHLBanks.

<sup>15</sup> DBR does not track its temporary, ad hoc reassignments between associate directors.

According to one senior DER official, DER has rotated staff on its examination teams since the fall of 2012. In May 2016, the Deputy Director reported to us that DER has an informal rotation process.

As we had done with DBR, we sought to verify those recollections. We sought documentation from DER to show its efforts to track examiner assignments over time or evidence of an examiner rotation practice, informal or otherwise. DER provided no such materials, apart from the November 2015 email from the Deputy Director, internal organization charts, staffing spreadsheets, and a number of internal and public announcements of organization changes. A DER official reported to us that DER maintained no records of examiner assignments and reassignments or the period of time examiners have been assigned to a particular Enterprise or specific risk area and had not created or maintained records to track examiner assignments over time, and no documentation was produced to us by DER showing that it systematically tracked examiner assignments over time.

However, DER maintained to us that DER management was aware of its movement of examiners through its review and approval of staffing assignments and reassignments during the review period and that information about examiner assignments could be found in the personnel records for each examiner and in emails. No claim was made by DER that its management reviews personnel records for each examiner and associated emails when it considered assignments and reassignments, and it did not produce such materials to us in response to our request for materials evidencing examiner rotation. We found no evidence that DER has systematically tracked the length of time each examiner has been assigned to a particular Enterprise or risk area.

Because we were not able to readily verify statements from DER leadership that informal examiner rotation had occurred within DER and in light of DBR's demonstrable practice of rotating its examiners every four years and DER's acknowledgement that regular rotation of examination staff is a "best practice," we sought to determine what practice, if any, had been followed within DER to rotate examiners between the two Enterprises and risk areas during the review period, from the materials provided to us by DER. From these materials, we traced examiner assignments to determine how many DER examiners (1) had been assigned to a particular Enterprise or risk area for the entire review period and (2) had been rotated between the Enterprises during the review period.

We found that DER's organization chart for January 2017 reflected a total of 61 examiners. Of those 61 examiners, DER's organization charts showed that 28 had been in DER for the four-year review period, the time period used by DBR to rotate all its examiners. Of those 28, we found:

- 14 were assigned to examine the same Enterprise and same risk area for the entire review period (50%).<sup>16</sup>
- 8 were assigned to examine the same Enterprise but not the same risk area for the entire review period (29%).
- 4 were assigned to non-examination work for some parts of the review period but otherwise were assigned to examine the same Enterprise during the review period (14%).
- 2 were rotated between the Enterprises as examiners during the review period (7%).

We did not test the accuracy of the information reported in the materials provided to us by DER. We recognize that our tracing efforts were limited by the information available in the documents provided by DER. For example, we learned from two DER examiners that their examination duties remained unchanged, even though the title of the risk area to which they were assigned was changed on the organization charts. Even with those caveats, our tracing effort shows that 22 of the 28 staff who worked at DER during the four-year review period—79%—performed examination work only at one Enterprise throughout the period, and an additional 4—14%—only examined one Enterprise when they performed examination work.

Sixteen months after the Deputy Director of DER reported the reassignments of the Enterprise EICs and pledged to adopt “meaningful” examiner rotation, our review of DER materials found no evidence that DER has adopted any “meaningful” rotation. No DER official with whom we spoke explained: the timeframe for the intended examiner rotation; whether examiners would be rotated across or within Enterprises; or which types of examiners, in addition to the EICs, would be subject to the announced “meaningful” rotation.

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<sup>16</sup> We reviewed other DER documents, including examination work papers and examination plans and schedules, to identify risk area assignments when that information was not available on DER organization charts.

## FINDINGS .....

- The OCC, the Federal Reserve, and the FDIC have recognized the benefits of a formal policy and/or practice of examiner rotation and each of these regulators has implemented a policy or practice (or both) across its supervisory division.
- Former FHFA leadership acknowledged the benefits of established, systematic examiner rotation and left implementation of a rotation practice to DBR and DER.
- Prior to January 2013, DBR adopted a formal practice of rotation of all DBR examiners and maintained records of examiner assignments and reassignments for the period January 2013 through December 2016.
- OIG review of these records confirmed that DBR consistently followed its practice of examiner rotation, at all levels, from January 2013 to December 2016.
- In November 2015, the Deputy Director of DER reported to all DER staff that “[r]egular rotation of on-site examination staff is a best practice of supervisory agencies.” In that same email, the Deputy Director of DER announced new EICs for the Enterprises and committed that DER would adopt “meaningful” examiner rotation practices.
- A senior DER official reported to us that examiner rotation occurred within DER before and after that November 2015 commitment from the Deputy Director of DER. In May 2016, the Deputy Director also told us that DER has an informal examiner rotation process.
- We found no evidence that DER has systematically tracked the length of time each examiner has been assigned to a particular Enterprise or risk area over the review period.
- DER’s lack of easily accessible and reliable data on examiner assignments over time limits its capacity to make reasoned and effective management decisions about examination resources.
- OIG review of the only DER records provided to us relating to examiner rotation, supplemented by Agency documents we obtained during prior audits and evaluations, found only 7% of the examiners working in DER during the review period were rotated between the Enterprises during this period.
- To the extent that DER has relied on occasional examiner reassignments and reorganizations to achieve examiner rotation, that haphazard approach has not been successful, according to our analysis of data contained in DER’s documents.



- OIG found no evidence that DER had developed a plan to implement a practice of “meaningful” examiner rotation over the 16 months since the Deputy Director of DER made that commitment.
- We also found no evidence of any “meaningful” examiner rotation in DER, other than the rotation of EICs announced at that time by the Deputy Director, during these 16 months.

## CONCLUSION.....

According to FHFA, its supervisory authority over its regulated entities “is virtually identical to—and clearly modeled on—Federal bank regulators’ supervision of banks.” Federal bank regulators—the OCC, the Federal Reserve and the FDIC—have recognized the benefits of examiner rotation and have adopted written policies and/or practices requiring examiner rotation.

Former FHFA leadership acknowledged the benefits of examiner rotation and left implementation to DBR and DER. While our testing of DBR records confirms that DBR has an established practice of rotating all of its examination teams every four years, our review of DER materials found that rotation of DER examiners has largely not occurred.

The Deputy Director of DER acknowledged to DER staff in November 2015 that “[r]egular rotation of on-site examination staff is a best practice of supervisory agencies.” In that same email, the Deputy Director announced the rotation of the EICs for the examination teams for the Enterprises and committed that DER intended to adopt “meaningful” examiner rotation.

However, DER provided no documentation to us to show its efforts to track examiner assignments over time, and we found no evidence that DER has systematically tracked the length of time each examiner has been assigned to a particular Enterprise or risk area. DER’s lack of easily accessible and reliable data on examiner assignments over time limits its capacity to make reasoned and effective management decisions about examination resources.

Using DER materials, we found only 7% of the examiners working in DER during the review period were rotated between the Enterprises. To the extent that DER has relied on occasional examiner reassignments and reorganizations to achieve examiner rotation, that haphazard approach has not been successful, according to our analysis of data contained in DER’s documents.

Sixteen months after the Deputy Director of DER announced the rotation of EICs and pledged to adopt “meaningful” examiner rotation, we found no evidence, based on our review of DER documents and communications with DER officials, that DER has implemented its pledge of “meaningful” examiner rotation.

## RECOMMENDATIONS .....

OIG recommends that FHFA:

1. Develop, communicate to DER examination staff, and implement an examiner rotation practice or policy that explains the timeframe for examiner rotation, whether examiners would be rotated across or within Enterprises, and which types of examiners, in addition to the EICs, would be subject to the rotation practice or policy; and
2. Direct DER to implement a mechanism to track and document over time DER examiner assignments by Enterprise and risk area to facilitate implementation of the examiner rotation practice or policy.

OIG provided FHFA an opportunity to respond to a draft report of this evaluation. In its management response, which is reprinted in its entirety in the appendix, FHFA agreed with the recommendations. FHFA also provided technical comments that we incorporated into the report, as appropriate.

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

We conducted this evaluation to identify and evaluate the policies and practices of DBR and DER governing the rotation of examination staff for the Enterprises, the FHLBanks, and the Office of Finance, and to compare those policies and practices with those of other federal financial regulators.

To achieve these objectives, we met with FHFA officials, reviewed examination staff assignments from 2013-2017 using materials provided by DBR and DER (we did not test the accuracy of the information contained in these materials), and met with FHFA personnel knowledgeable about the Agency's rotation practices. We also reviewed policy and guidance regarding examiner rotation issued by the OCC, the Federal Reserve, and the FDIC.

This evaluation was conducted under the authority of the Inspector General Act and in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation* (January 2012). These standards require us to plan and perform an evaluation based upon evidence sufficient to provide a reasonable basis to support its findings and recommendations. We believe that the findings discussed in this report meet those standards.

## APPENDIX: FHFA MANAGEMENT RESPONSE .....



# Federal Housing Finance Agency

## MEMORANDUM

TO: Angela Choy, Assistant Inspector General for Evaluations

FROM: Nina A. Nichols, Deputy Director, Division of Enterprise Regulation (DER) <sup>NAN</sup>  
Fred C. Graham, Deputy Director, Division of Bank Regulation (DBR) *Fred C. Graham*

SUBJECT: Draft OIG Report: *FHFA's Practice for Rotation of its Examiners Is Inconsistent between its Two Supervisory Divisions*

DATE: March 22, 2017

This Memorandum transmits the management response of the Federal Housing Finance Agency (FHFA) to the FHFA OIG draft report referenced above (Report).

FHFA agrees that examiner rotation can provide important benefits to supervision, including knowledge sharing and staff development.

While DER does not currently have a formal examiner rotation policy or practice of tracking examiner assignments, DER has nevertheless achieved rotation benefits in recent years as a result of reassignments, detail and training opportunities, and reorganizations since September 2012. Further, as the Report notes, DER assigned new examiners-in-charge at both Enterprises in late 2015.

FHFA management's response to the recommendations are below.

**Recommendation 1:**

*OIG recommends that FHFA develop, communicate to DER examination staff, and implement an examiner rotation practice or policy that explains the timeframe for examiner rotation, whether examiners would be rotated across or within Enterprises, and which types of examiners, in addition to the EICs, would be subject to the rotation practice or policy.*

**Management Response to Recommendation 1:**

FHFA agrees with this recommendation with respect to examiners-in-charge and examination managers. By March 1, 2018 DER will develop internal guidance regarding rotation that will include target timeframes for rotation among the different offices and branches of DER.

**Recommendation 2:**

*OIG recommends that FHFA direct DER to implement a mechanism to track and document over time DER examiner assignments by Enterprise and risk area to facilitate implementation of the examiner rotation practice or policy.*

**Management Response to Recommendation 2:**

FHFA agrees with this recommendation. By March 1, 2018 DER will establish a mechanism for tracking examiner assignments by Enterprise and risk area.

cc: John Major, Internal Controls and Audit Follow-up Manager  
Larry Stauffer, Acting Chief Operating Officer

## ADDITIONAL INFORMATION AND COPIES.....

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