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Federal Housing Finance Agency
Office of Inspector General



**FHFA Examinations of CSS Include
Review of the Board of Managers
but Supervision Has a Key Person
Dependency and Outdated Guidance**

This report contains redactions of information that is privileged or otherwise protected from disclosure under applicable law.

Evaluation Report • EVL-2023-002 • March 20, 2023



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March 20, 2023

Executive Summary

At the direction of the Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac (together, the Enterprises) created both a platform to issue their single-family mortgage-backed securities (MBS) and an entity to run this platform. Common Securitization Solutions, LLC (CSS), a jointly and equally owned affiliate of the Enterprises, developed and officially launched the Common Securitization Platform (CSP) to enable the Enterprises' issuance, sale, and administration of MBS. According to FHFA, CSS is the largest issuing agent and administrator of MBS, holding approximately 75 percent of total market share and processing 30 million loans on the platform in 2021.

CSS operates under the 2021 Limited Liability Company Agreement (LLC Agreement), as amended, which sets forth certain rights, obligations, and understandings with respect to CSS. The LLC Agreement defines the CSS Board of Managers' (the Board) composition, authority, and the duties of the managers appointed to the Board. During the conservatorships of the Enterprises, FHFA, as conservator, has the authority to appoint and remove Board managers and thereby exercise control over the Board. Because of CSS' significance to the Enterprises, we undertook this evaluation of FHFA's methodologies and practices for assessing CSS and the Board's performance.

FHFA's Division of Conservatorship Oversight and Readiness (DCOR) and Division of Enterprise Regulation (DER) share oversight responsibility of CSS and the Board. DCOR has conservatorship functional responsibilities, such as approval of CSS budgets. DER, as supervisor and regulator of the Enterprises, is responsible for examining CSS (an affiliate of the Enterprises) for the purpose of ensuring the Enterprises' financial safety and soundness.

DER has established examination practices that are focused on CSS. DER's supervision and examination activities with respect to CSS are led by an examiner-in-charge (the CSS EIC) who was appointed to this position in early 2022. The CSS EIC is responsible for planning examination activities, preparing or supervising the examiners executing those activities and documenting the results of the annual examination, and preparing the report of examination that is presented to the Board.

Since his appointment, the CSS EIC conducted or supervised the bulk of the examination work, although he received assistance from other examiners who are assigned to CSS matters on a temporary basis. DER told us that there is no backup resource in the event the CSS EIC is unable or unavailable to perform the job. We found that DER's heavy reliance on the CSS EIC without a backup resource creates a key person dependency that could impair



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DER's ability to complete examination activities and required work products in a timely and efficient manner.

To assist its examiners, DER developed an examination module specific to CSS in 2016. The CSS module has not been updated since it was issued, and we found that it is materially inaccurate. For the 2022 examination planning, the CSS EIC did not utilize this examination module, but instead relied on another module that primarily focuses on the Enterprises and makes no mention of CSS specifically. The Deputy Director of DER acknowledged the importance of the examination modules and intends to update them over the next few years.

We make two recommendations in this report to address our findings. In a written management response, FHFA agreed with our recommendations.

This report was prepared by Jacob Kennedy, Senior Investigative Evaluator, and Philip Noyovitz, Investigative Evaluator. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaog.gov, and www.oversight.gov.

/s/

Kyle D. Roberts
Deputy Inspector General for Evaluations

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ABBREVIATIONS

| | |
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| CSP | Common Securitization Platform |
| CSS | Common Securitization Solutions, LLC |
| CSS Board or the Board | CSS Board of Managers |
| DCOR | Division of Conservatorship Oversight and Readiness |
| DER | Division of Enterprise Regulation |
| EIC | Examiner-in-Charge |
| Enterprises | Fannie Mae and Freddie Mac |
| FHFA | Federal Housing Finance Agency |
| LLC Agreement | Limited Liability Company Agreement of CSS, as amended |
| MBS | Single-family Mortgage-backed Securities |
| POC | Point of Contact |

BACKGROUND

The Enterprises Depend on CSS for Securities Issuance and Administration

In 2012, FHFA directed the Enterprises to create both a platform to issue their single-family MBS and an entity to run the platform. In 2013, the Enterprises chartered CSS, a jointly and equally owned affiliate of the Enterprises, to develop, operate, update, and maintain the technology and business activities necessary to enable the Enterprises' issuance, sale, and administration of MBS. CSS officially launched the CSP on June 3, 2019, to issue the Enterprises' MBS for sale to investors and also administer the Enterprises' own portfolio of MBS.¹ In sum, CSS provides critical services that facilitate the Enterprises' role in the secondary mortgage market.²

According to FHFA, CSS is the largest issuing agent and administrator of MBS, holding approximately 75 percent of total market share and processing 30 million loans on the platform in 2021. The magnitude and complexity of the data and technology involved in operating the platform inherently increases CSS' operational risk, which extends to the Enterprises considering their dependency on CSS.

The LLC Agreement Sets Forth the Board's Composition and Responsibilities

The LLC Agreement, as amended, sets forth certain rights, obligations, and understandings with respect to CSS. Specifically, it defines the composition of the Board, its authority, and the duties of the managers appointed to the Board.³ The Board is to consist of at least six managers with voting rights specified by the LLC Agreement – they include: two managers designated by Fannie Mae, two managers designated by Freddie Mac, the CSS CEO, and the Chair of the Board, who shall not be a director, officer, or employee of Fannie Mae or Freddie Mac, or an officer or employee of CSS.

¹ For more information on CSS, see OIG, [An Overview of Common Securitization Solutions, LLC](#) (Feb. 9, 2023) (WPR-2023-001).

² CSS provides these services in accordance with the terms of a customer service agreement. That agreement establishes, among other things, service level performance goals that pertain to issuing and administering the Enterprises' MBS portfolios, including securities set-up and registration, calculation and distribution of payments, and disclosure to vendors and investors.

³ In contrast, the Enterprises' bylaws, and the laws the Enterprises elect to follow for corporate governance purposes pursuant to FHFA regulation 12 C.F.R. § 1239.3(b)(2) define the responsibilities and duties of directors of the Enterprises.

FHFA Has Authority to Appoint Members to and Exercise Control Over the CSS Board

During the conservatorships of the Enterprises, FHFA has the ability to exercise control over the Board through its authority to appoint a majority of the Board managers. The LLC Agreement gives FHFA the authority, as conservator, to appoint up to four Board managers, one of whom must be designated as Board Chair, and to remove any Board manager.

Given the importance of CSS to the Enterprises and the broader mortgage market, we conducted this evaluation of FHFA’s methodologies and practices for annually assessing the performance of the CSS Board. We learned early in our evaluation that this responsibility does not rest with DCOR.⁴ Instead, FHFA relies on its supervision program to assess CSS and the performance of the Board, specifically. Therefore, we broadened our scope to evaluate DER’s methodologies and practices for examining CSS and the Board’s performance.

FACTS & ANALYSIS

DCOR and DER Share Oversight of CSS

DCOR Exercises Non-supervisory Oversight of CSS and the Board

According to the Deputy Director of DCOR, DCOR’s current role with respect to CSS includes conservatorship functional responsibilities as defined in the LLC Agreement, such as approving budgets and strategic plans, and addressing board governance issues. The Deputy Director of DCOR advised us that its resources would address these just-in-time issues as needed.

DER Exercises Supervisory and Examination Authority Over CSS

FHFA, as supervisor and regulator of the Enterprises, is responsible for examining CSS (an affiliate of the Enterprises) to determine the condition of the Enterprises for the purpose of ensuring their financial safety and soundness.⁵ DER’s supervision includes examinations

⁴ DCOR is responsible for developing the annual “conservatorship scorecards” for the Enterprises and CSS that FHFA issues to set high level priorities and performance objectives from the conservator. As noted in footnote 2, the customer service agreement establishes the specific performance goals. Last year, we published a report pertaining to FHFA’s scorecards. See [OIG, *FHFA’s Public Reporting of the Enterprises’ Progress Toward the Objectives FHFA Set in the 2020 Conservatorship Scorecard Lacked the Detail and Transparency of Past Reporting*](#) (Mar. 17, 2022) (EVL-2022-002).

⁵ The requirement for an annual onsite examination of FHFA’s “regulated entities” and the purpose of those examinations is established by 12 U.S.C. § 4517(a). Because CSS is an “affiliate” as defined under 12 U.S.C. § 4502(1), CSS is subject to FHFA’s supervision and examination authority.

related to CSS' management and operational risks.⁶ From January 2020 through December 2021, DER conducted several examination activities focused on the CSS Board.⁷ Those examinations were led by a point of contact (POC) within DER, who was assisted by DER examiners on temporary assignment. Subsequent to the POC's retirement, the Deputy Director of DER in February 2022 appointed a former examiner-in-charge from FHFA's Division of Federal Home Loan Bank Regulation to be the examiner-in-charge responsible for CSS-related examination activities.

At the time the CSS POC left FHFA in early 2022, he had not prepared a draft of the 2021 report of examination on CSS. According to the CSS EIC, the POC did not transfer any institutional knowledge about CSS to him before he left FHFA. Pursuant to DER examination guidance, the report of examination should be completed by no later than March 31 of each year. Consequently, the CSS EIC had to quickly research the risks CSS poses to the Enterprises (due to the Enterprises' reliance on CSS) and understand the status of outstanding adverse examination findings in order to prepare the report of examination.

DER's supervision and examination program places significant responsibilities on the examiner-in-charge. For example, the CSS EIC was responsible for assigning examination ratings and preparing and finalizing the 2021 report of examination on CSS that was presented to the CSS Board (issued in March 2022) without having any involvement in the examination activities prior to his appointment as examiner-in-charge. The CSS EIC informed us that, with limited assistance from other examiners, he also prepared the procedures for the scheduled examination activities identified in the 2022 Examination Plan. He further informed us that, throughout the year, he executed the examination plan with assistance from examiners temporarily assigned to perform CSS-related work. The CSS EIC prepared, or supervised the examiners who prepared, mandatory examination work products, such as supervisory correspondence communicating examination results and conclusions, and the analyses memoranda that form part of the record of the 2022 examination activities. We confirmed that the scope of the 2022 annual safety and soundness examination included the Board and that the CSS EIC considers the Board's performance when assigning the

⁶ Pursuant to Advisory Bulletin 2012-03, FHFA applies the "CAMELSO" rating system to report its supervisory views. This framework includes ratings for: (1) the composite rating that assesses the overall condition of the regulated entity and (2) seven individual component ratings for financial condition and risk management: Capital; Asset Quality; Management; Earnings; Liquidity; Sensitivity to Market Risk; and Operational Risk. See FHFA Advisory Bulletin 2012-03, *FHFA Examination Rating System* (Dec. 19, 2012).

⁷ DER conducted its first examination of CSS in 2016, but its records show that its supervision of CSS increased once CSS launched the CSP in 2019. For the 2021 examination cycle, FHFA rated CSS' Management component [REDACTED]

examination rating. During our interview, the CSS EIC expressed that, given his workload, he would welcome additional resources to complete the assigned examination work.⁸

We discussed the resource issue with the Deputy Director of DER. He informed us that he is cognizant of the demands on the CSS EIC but will continue to take a risk-based approach to supervising CSS. For this reason, he intends to maintain the same staffing arrangement (i.e., the CSS EIC assisted by examiners who are temporarily assigned to assist him) in 2023 and beyond. In his view, the risks associated with CSS are not sufficient to justify the creation of a team of examiners assigned exclusively to CSS.

The Deputy Director of DER also informed us that currently he has not designated an examiner to provide backup to the CSS EIC. In our view, DER's heavy reliance on the CSS EIC results in a key person dependency. The loss of the CSS EIC's services, either in the short term (e.g., annual leave, personal time, etc.) or long term (e.g., reassignment, resignation, or retirement) without a backup examiner prepared to step in and fulfill the CSS EIC's responsibilities, could disrupt the timely and efficient completion of CSS examination activities.

FHFA's Guidance for CSS Examinations Is Outdated and Not Relied On

DER developed the existing CSS Examination Manual Module in October 2016 (the CSS Module), almost three years before CSS launched the CSP in June 2019. The module remains in "field test" status and has not been updated since its issuance in 2016.⁹ As a consequence, the CSS Module inaccurately describes CSS' activities and the terms of the LLC Agreement (because the agreement has been amended and restated three times since 2016, including the provisions pertaining to the Board). According to the CSS EIC, he did not rely on the CSS Module when planning or executing examination activities in 2022, but considered DER's March 2020 Board and Senior Management Module and Board of Directors work program (together, the Board Module), which was developed for Enterprise examinations.

⁸ We also found evidence in the examination record that the CSS EIC requested an extension of the deadline to complete the 2022 risk assessment of CSS that is required by DER policy. His basis for the request was that he was unable to complete the mandatory risk assessment by the designated deadline due to his need to complete competing work products in conjunction with the examination. The CSS EIC's request was approved by the Deputy Director of DER. We take no issue with the CSS EIC's request or the Deputy Director of DER's approval, however, we consider the CSS EIC's request to be evidence that resources were stressed at that time and impaired the timely completion of a mandatory examination work product.

⁹ According to FHFA, its Examination Manual and various examination modules "provide examination instructions and work programs organized by risk category or line of business or activity." In our 2019 evaluation, we found that numerous modules had not been finalized and remained in field test for several years. See [OIG, *Five Years After Issuance, Many Examination Modules Remain in Field Test; FHFA Should Establish Timelines and Processes to Ensure Timely Revision of Examiner Guidance*](#) (Sept. 10, 2019) (EVL-2019-03).

According to FHFA, the Board Module applies to CSS because CSS is an “affiliate” of the Enterprises; however, that module focuses on the Enterprises’ boards and makes no mention of CSS or its Board. The CSS EIC informed us that he selected certain content from the 2020 Board Module that he considered to be appropriate for CSS-related examination activities. We note that the Board Module does not address the LLC Agreement, which in our view limits its utility for CSS examination activities.

The Deputy Director of DER acknowledged that the examination modules are important in conducting supervisory work and are intended to provide examiners with possible work steps needed to conduct their examination work. He stated that DER will update the modules over the next three to five years but did not commit to a deadline for completing the update to the 2016 CSS module, citing the importance of updating other modules first based on his risk priorities.

In their current forms, the 2016 CSS module is outdated and inaccurate and the 2020 Board Module does not address CSS-specific issues or provide examination guidance on assessing the Board of Managers. Thus, these sources of examination guidance provide limited practical value to the CSS EIC or to examiners assigned to CSS examination activities. Additionally, the 2016 CSS module has never been updated, which is at odds with DER’s procedures bulletin on development and issuance of examination guidance. That bulletin states that DER “conducts and documents a formal review of in-force supervisory policy and examination guidance on a three year cycle for potential updates or sooner in the event of factors or events that significantly affect existing policy and guidance....”

FINDINGS

1. DER’s reliance on the CSS EIC to perform the bulk of examination activities regarding CSS without a backup resource gives rise to a key person dependency. Given this dependency, the temporary or long-term loss of the CSS EIC’s services could impair DER’s ability to complete examination activities and required work products in a timely and efficient manner.
2. The CSS EIC, the only DER examiner assigned exclusively to CSS, does not utilize the 2016 CSS examination module. The module has not been updated since it was issued, and it is materially inaccurate.

CONCLUSIONS

CSS provides vital services to the Enterprises and their dependence on CSS for securities issuance and administration creates inherent operational risk. Given the importance of supervisory oversight, DER has established examination practices that are focused on CSS. In early 2022, the Deputy Director of DER appointed the CSS EIC to be responsible for CSS-specific examinations. We confirmed that the scope of the 2022 annual examination included the Board, and the CSS EIC will consider the Board’s activities when assigning the examination rating. However, we observed that DER has a key person dependency because of its level of reliance on the CSS EIC. We also note DER’s outdated examination guidance for CSS-related examinations.

RECOMMENDATIONS

We recommend that FHFA:

1. Designate an examiner who would be prepared to assume the responsibilities of the CSS EIC in the event of the short- or long-term loss of the CSS EIC’s services; and
2. In accordance with DER priorities and policies, update and refine the 2016 CSS Module and other examination modules, as appropriate, in order to provide accurate examination guidance applicable to CSS examination activities.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this evaluation report. FHFA provided technical comments on the draft report, which were considered in finalizing this report. FHFA also provided a management response, which is included in the Appendix to this report. In its management response, FHFA agreed with our recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY

In this evaluation, we sought to determine FHFA’s methodologies and practices for annually assessing the performance of the CSS Board, including assessments related to safety and soundness and objectives set forth in the conservatorship scorecard. The scope period for this evaluation was from January 1, 2020, to December 31, 2022.

To meet this objective, we reviewed applicable FHFA examination guidance and standards in effect during our scope period, prior OIG reports, CSS governing documents, DER examination documents, and workpapers. As part of this evaluation, we conducted interviews of personnel from FHFA’s DER and DCOR.

This evaluation was conducted between October 2022 and January 2023 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* (December 2020). 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 and recommendations discussed in this report meet those standards.

APPENDIX: FHFA MANAGEMENT RESPONSE.....

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Federal Housing Finance Agency

MEMORANDUM

TO: Kyle D. Roberts, Deputy Inspector General for Evaluations, Office of Inspector General

FROM: Andre D. Galeano, Deputy Director, Division of Enterprise Regulation **ANDRE GALEANO**

SUBJECT: Draft Evaluation Report: *FHFA Examinations of CSS Include Review of the Board of Managers but Supervision Has a Key Person Dependency and Outdated Guidance*

DATE: March 10, 2023

Digitally signed by
ANDRE GALEANO
Date: 2023.03.10
16:54:55 -05'00'

Thank you for the opportunity to review the Office of Inspector General's (OIG) draft evaluation report referenced above (Report). The objective of OIG's evaluation was to determine FHFA's methodologies and practices for annually assessing the performance of the Common Securitization Solutions, LLC (CSS) Board of Managers, including assessments related to safety and soundness and objectives set forth in the conservatorship scorecard. The review period for this evaluation was from January 1, 2020, to December 31, 2022. While the Report found that DER has established examination practices that are focused on CSS and DER has a CSS Examiner-in-Charge (EIC) who is responsible for CSS-specific examinations, it noted some areas for improvement, and makes two recommendations, to which we agree.

Recommendation 1: *Designate an examiner who would be prepared to assume the responsibilities of the CSS EIC in the event of the short- or long-term loss of the CSS EIC's services.*

Management Response: FHFA agrees with the OIG's recommendation. DER will designate the Fannie Mae EIC as the backup and the Freddie Mac EIC as the alternate backup to the CSS EIC. By June 30, 2023, DER will formalize the backup of the CSS EIC in writing.

Recommendation 2: *In accordance with DER priorities and policies, update and refine the 2016 CSS Module and other examination modules, as appropriate, in order to provide accurate examination guidance applicable to CSS examination activities.*

Management Response: FHFA agrees with the OIG's recommendation. By September 29, 2023, DER will create a project plan to update the CSS Examination Manual with a target completion date of December 31, 2024.

We appreciate the professionalism and courtesy of the OIG staff who conducted this evaluation. We find the results valuable, and we will continue to make enhancements to our supervision of CSS. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Diana Stebick
Eric Wilson
Edom Aweke
John Major

ADDITIONAL INFORMATION AND COPIES.....

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