Federal Housing Finance Agency
Office of Inspector General

Semiannual Report to the Congress

April 1, 2013, through September 30, 2013

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OIG's Mission

The mission of the Federal Housing Finance Agency Office of Inspector General (OIG) is to: promote the economy, efficiency, and effectiveness of the programs and operations of the Federal Housing Finance Agency (FHFA or agency); prevent and detect fraud, waste, and abuse in FHFA's programs and operations; review and, if appropriate, comment on pending legislation and regulations; and seek administrative sanctions, civil recoveries, and criminal prosecutions of those responsible for fraud, waste, or abuse in connection with the programs and operations of FHFA.

In carrying out this mission, OIG conducts independent and objective audits, evaluations, investigations, surveys, and risk assessments of FHFA's programs and operations; keeps the head of FHFA, Congress, and the American people fully and currently informed of problems and deficiencies relating to such programs and operations; and works collaboratively with FHFA staff and program participants to ensure the effectiveness, efficiency, and integrity of FHFA's programs and operations.

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OIG's Accomplishments from 2010 to Present

- **27** Audits
- **23** Evaluations
- **4** Evaluation Surveys
- **5** White Papers
- **311** Investigations
- **4** Systemic Implication Reports (SIRs)

Work

63
Reports

149
Recommendations

311
Investigations

132
Subpoenas

157
Indictments/Charges

86
Convictions/Pleas

4
Civil Cases

27
Regulatory Activities

6
Additional Actions

Reports by Subject Area

Conservatorship and Enterprise Oversight

Conservatorship
8 Evaluations
3 Evaluation Surveys
3 White Papers

Credit Risk
5 Audits
3 Evaluations

Interest Rate Risk
1 Evaluation
1 White Paper

Operational Risk
2 Audits
3 Evaluations
1 SIR

Real Estate Owned
2 Audits
1 White Paper
1 SIR

Housing Mission and Goals
2 Evaluations

Mortgage Servicing
5 Audits
2 Evaluations
1 SIR

FHLBank System Oversight

Conservatorship
1 Evaluation

Credit Risk
2 Audits
2 Evaluations
1 SIR

Housing Mission and Goals
1 Evaluation

FHFA Internal Operations

Conservatorship
1 Audit

Operational Risk
10 Audits
1 Evaluation Survey

Results

$3.6 billion
Restitutions

$2.8 billion
Recoveries

$6.5 million
Financial Settlements

$20.9 million
Other*

*Other is comprised of funds put to better use, questioned costs, unsupported costs, and fines.

A Message from the Acting Inspector General

I am pleased to present OIG's sixth Semiannual Report to the Congress, which covers our activities and operations from April 1, 2013, to September 30, 2013.

During this semiannual reporting period, OIG continued to reinforce the effectiveness, integrity, and transparency of FHFA's programs and operations. At the same time, OIG experienced a watershed event: our founder departed. Effective September 29, 2013, Steve A. Linick resigned from OIG and was appointed the State Department Inspector General. During his three years with OIG, Mr. Linick established our vision and mission; recruited seasoned professionals with backgrounds in housing, securities, finance, investigations, statistics, and economics; built our infrastructure; and led audit, evaluative, and investigative efforts that resulted in the recovery of billions of dollars and the indictments and convictions of hundreds of individuals. We are grateful for his extraordinary leadership.

Michael P. Stephens
Acting Inspector General of the
Federal Housing Finance Agency

It is now my honor to lead OIG, pending the appointment of a permanent Inspector General. I look forward to the challenge and am gratified by OIG's accomplishments during the reporting period. OIG issued 16 audit, evaluation, and other reports focusing on high-risk mission areas affecting the nation's housing finance system. These reports address a range of topics from concerns relating to the security of information technology owned by Fannie Mae and Freddie Mac (collectively, the enterprises) to a mid-program assessment of the Home Affordable Refinance Program (HARP) to an evaluation of FHFA's efforts to gradually increase the guarantee fees charged by the enterprises to reduce their dominant position in the housing finance system.

Additionally, OIG remains active on the law enforcement front. During this period, OIG's investigative efforts resulted in the indictment of 75 individuals and the conviction of 55 individuals, as well as the award of more than $104 million in criminal fines and restitution orders.

All of OIG's reports and selected law enforcement actions are detailed herein.

This Semiannual Report also describes the current status of the significant players under our purview (i.e., FHFA, the enterprises, and the Federal Home Loan Banks (FHLBanks)). It then includes a detailed discussion of three important factors that bear on housing finance reform—soundness, oversight, and balance—all of which are important for a stable and liquid mortgage market. We present this discussion, which draws from our experience, to provide FHFA, Congress, policymakers, and the public with information that may be useful during the debate on housing finance reform.

I want to thank all of the dedicated employees at OIG for their efforts in making this report possible. This report comes once every six months, but they work continuously throughout the year and the results of their work are long lasting.

Michael P. Stephens
Acting Inspector General
October 31, 2013

Executive Summary

Overview

This Semiannual Report discusses OIG operations and FHFA developments from April 1, 2013, to September 30, 2013.[1]

The changing conditions noted in our last Semiannual Report have continued during this period. The enterprises' dominance of the secondary market for residential mortgages persists in an environment of escalating home prices, improved credit quality, and increasing **guarantee*** fees. Thus, their profitability has steadily improved since the end of 2011. Further, in light of the August 2012 amendments to the **Senior Preferred Stock Purchase Agreements (PSPAs)**, the enterprises' profits are beginning to offset losses that began in 2007.

As the enterprises' profits have increased, their need for government financial assistance has decreased. Accordingly, for the third semiannual reporting period, the Department of the Treasury (Treasury) was not required to increase its investment in the enterprises, which remains at approximately $187.5 billion.

Meanwhile, during the first six months of 2013, advance demand among the **FHLBanks** continued to show signs of stabilizing, and the FHLBanks experienced a marginal increase in profitability.

> ***Terms and phrases in bold are defined in Appendix A, *Glossary and Acronyms*. If you are reading an electronic version of this Semiannual Report, then simply move your cursor to the term or phrase and click for the definition.**

Exploring these and other issues, this report is organized as follows. Section 1, *OIG Description, Accomplishments, and Strategy*, highlights several OIG audits, evaluations, and investigations relating to the programs and operations of FHFA. Section 2, *FHFA and GSE Operations*, provides a closer look at FHFA and **government-sponsored enterprise (GSE)** developments during this reporting period. And, finally, Section 3, *Lessons for Housing Finance Reform: Five Years After the Federal Government's Takeover of Fannie Mae and Freddie Mac*, discusses three important factors that bear on housing finance reform—soundness, oversight, and balance—all of which are important for a stable and liquid mortgage market.

Section 1: OIG Description, Accomplishments, and Strategy

This section provides a brief overview of OIG's organization and describes its oversight activities, including audits, evaluations, and investigations. It also discusses OIG's priorities and goals.

For example, in this section we discuss:

- *FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees* (EVL-2013-005, July 16, 2013), in which we analyzed the agency's initiative to increase the enterprises' guarantee fees to encourage greater private-sector investment in mortgage credit risk and reduce the enterprises' dominant position in housing finance. We also assessed FHFA's communication and interaction with the **Federal Housing Administration (FHA)**, a government agency that insures mortgages against credit losses, which recently announced a cessation of its mortgage premium increases.

- *Home Affordable Refinance Program: A Mid-Program Assessment* (EVL-2013-006, August 1, 2013), in which we analyzed FHFA's administration and oversight of HARP, which is a streamlined refinance program for loans owned or guaranteed by the enterprises. HARP is designed to assist borrowers who are current on their loans but have not been able to refinance because they have little or no **equity** in their homes.
- *FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit* (EVL-2013-008, August 6, 2013), in which we examined the agency's implementation of its 2012 horizontal review of unsecured credit risk management practices and supervisory and enforcement responses to violations identified during the review.
- *FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies* (AUD-2013-010, September 24, 2013), in which we assessed Freddie Mac's deficiency recovery practices for borrowers who possess the ability to pay amounts owed on foreclosed mortgages owned or guaranteed by the enterprise.

We also discuss numerous OIG investigations, which resulted in indictments and convictions of individuals responsible for fraud, waste, or abuse in connection with FHFA's and the regulated entities' programs and operations, and in fines and restitution orders totaling more than $104.6 million.

Further, this section addresses our:

- Audit and Evaluation Plan, which focuses on areas of FHFA operations posing the greatest risks to the agency and to **Fannie Mae**, **Freddie Mac**, and the FHLBanks (collectively, the GSEs);
- Systemic Implication Reports, which identify potential risks and weaknesses in FHFA's management control systems that we discovered during the course of our investigations;
- Regulatory Activities, which include our assessment of proposed legislation, regulations, and policies related to FHFA; and
- Communications and Outreach Efforts, which educate stakeholders—FHFA, Congress, policymakers, and the public—about OIG, FHFA, and GSE developments, as well as broader issues of fraud, waste, and abuse.

Section 2: FHFA and GSE Operations

This section describes the organization and operations of FHFA, the enterprises, and the FHLBanks, as well as notable developments for each during the reporting period.

Among the most notable developments during the semiannual period was the unprecedented size of the dividends the enterprises paid Treasury under the PSPAs for the six months ended June 30, 2013—Fannie Mae and Freddie Mac paid $63.6 billion and $12.8 billion, respectively. Fannie Mae's extraordinary dividend payment resulted from the release of a valuation allowance on deferred tax assets, as well as its improved profitability. Moreover, the $76.4 billion in quarterly dividend payments does not reduce the outstanding balance of Treasury's investment.

Additionally, over the last six months, FHFA and the enterprises made significant progress in their efforts to develop a common securitization infrastructure for residential mortgage-backed securities (RMBS); the agency released reports from the enterprises assessing the viability of their multifamily lending businesses in the absence of a government guarantee; Freddie Mac—in compliance with FHFA's directive to test credit risk sharing transactions—made the first in a series of bond offerings that are not guaranteed by the enterprise; and lawmakers introduced two major bills intended to reform housing finance and the Administration announced core principles that it believes should underlie such reform. These and other developments and OIG's efforts in relation to them are summarized in Section 2.

Section 3: Lessons for Housing Finance Reform: Five Years After the Federal Government's Takeover of Fannie Mae and Freddie Mac

It is no longer a question of if the nation's housing finance system will be reformed, but how. Will the government continue to play a role, or will it exit the secondary mortgage market entirely? How will the government reduce its huge footprint in a multi-trillion-dollar industry? As policymakers debate these and other issues, we offer, in Section 3, a discussion of three factors that are important to a safe, stable, and liquid mortgage market—whatever its ultimate structure.

First, soundness. The recent housing crisis has shown that, at minimum, the secondary mortgage market needs quality underwriting, robust risk assessment, and market-aligned servicing. Second, oversight. Our work demonstrates that effective housing finance oversight requires well-equipped regulators to verify decision making and enforce compliance. Third, balance. Whatever the future mortgage market's structure, participants will have to balance between interrelated laws, roles, and practices.

Section 3 draws on our experience and is not intended to take sides. Rather it is intended to provide our stakeholders with information that will be useful during the debate on housing finance reform.

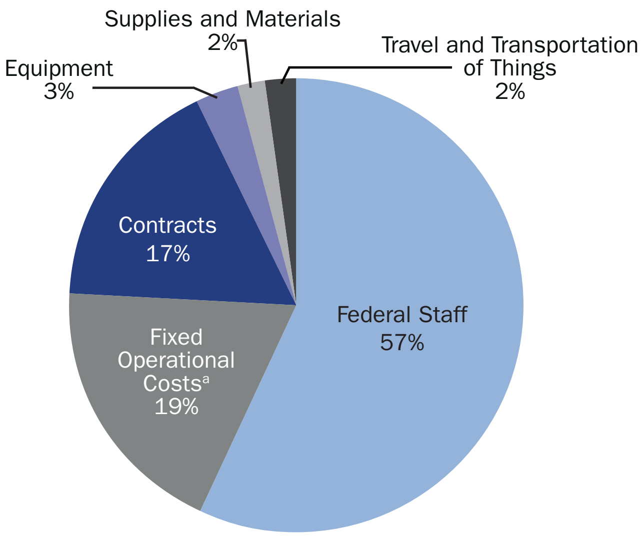
Section 1: OIG Description, Accomplishments, and Strategy

Description

OIG began operations on October 12, 2010. It was established by the **Housing and Economic Recovery Act (HERA)**, which amended the **Inspector General Act**. OIG conducts audits, evaluations, investigations, and other law enforcement activities relating to FHFA's programs and operations.

OIG's operations are funded by annual assessments that FHFA levies on the enterprises and the FHLBanks pursuant to 12 U.S.C. § 4516. For fiscal year 2013, OIG's operating budget (see Figure 1, below) was $48 million, with 150 full-time-equivalent staff.

Figure 1. OIG's Operating Budget for Fiscal Year 2013



[a] Fixed operational costs include items such as space rent and shared service agreements.

Leadership and Organization

On April 12, 2010, President Barack Obama nominated FHFA's first Inspector General, Steve A. Linick, who was sworn into office on October 12, 2010. Mr. Linick resigned on September 29, 2013, and his Principal Deputy Inspector General, Michael P. Stephens, commenced acting in the capacity of Inspector General pursuant to 5 U.S.C. § 3345(a)(1).

Mr. Stephens was appointed as Principal Deputy Inspector General in September 2011. Prior to his joining OIG, Mr. Stephens served as Acting Inspector General and Deputy Inspector General for the Department of Housing and Urban Development (HUD). Earlier, he was the Deputy Assistant Inspector General for Investigations for the Department of Veterans Affairs and a senior criminal investigator for the Office of Inspector General for the Resolution Trust Corporation. Each of these appointments followed a distinguished 20-year career with the Secret Service, during which he held the distinction of being assigned to the Presidential Protection Division at the White House, along with various supervisory positions within the agency.

OIG consists of the Acting Inspector General, his senior staff, and OIG offices, principally: the Office of Audits (OA), the Office of Evaluations (OE), and the Office of Investigations (OI). Additionally, OIG's Executive Office and the Office of Administration provide organization-wide supervision and support. (See Appendix E for OIG's organizational chart and Appendix F for a detailed description of OIG's offices and strategic goals.)

Accomplishments and Strategy

From April 1, 2013, to September 30, 2013, OIG's significant accomplishments included: (1) issuing 16 audit, evaluation, and other reports; (2) participating in a number of criminal and civil investigations; and (3) reviewing and commenting on FHFA rules.

Audits and Evaluations

During this semiannual period, OIG released 14 audit and evaluation reports, which are summarized below.

Audits

FHFA Can Strengthen Controls over Its Office of Quality Assurance (AUD-2013-013, September 30, 2013)

FHFA's Office of Quality Assurance (OQA) is a crucial internal control for the agency's examinations of the GSEs. **Internal controls**, when effective, give FHFA management greater assurance that the agency can achieve its mission, operate effectively and efficiently, report reliably, and comply with applicable laws and regulations.

Per its charter, OQA conducts internal reviews of FHFA's divisions that carry out the agency's examination and examination support functions. The agency uses OQA reviews to enhance the effectiveness of FHFA's supervision of the housing GSEs, helping to ensure that they operate in a safe and sound manner and provide liquidity for the housing market.

OIG conducted this performance audit to assess controls related to the (1) effectiveness of OQA's review of FHFA's examination and examination support functions and (2) extent of OQA's coverage of other FHFA functions that may pose significant risks.

OIG found that OQA generally conducted effective, risked-based reviews of FHFA's examination and examination support functions. Further, OIG validated that in four of OQA's reports the conclusions, findings, and recommendations were supported by adequate evidence.

However, most of OQA's 22 recommendations have not been fully or promptly resolved (see Figure 2, below), primarily because OQA did not (1) require FHFA to respond formally in writing and commit to specific timelines for completing corrective actions and (2) follow up on corrective actions. As of March 31, 2013:

- 8 recommendations remained open, 6 of them for 520 or more days; and
- 14 recommendations were reported as "closed," but OQA had not validated 7 of them to ensure that the proposed corrective actions had been implemented or adequately addressed the recommendations.

Figure 2. Status of OQA Recommendations

Issuance Date	2011	2012	Total
Open	6	2	8
Closed	5	9	14
Total	**11**	**11**	**22**
Percent Open	55%	18%	36%

Addressing OQA recommendations in a complete and timely manner can help FHFA ensure the quality of its examinations and maximize the value of its investment in OQA.

In addition, OQA's risk-based reviews do not cover all of FHFA's offices. The present focus of OQA on examination and related support functions excludes key agency operations, such as the Office of Conservatorship Operations, which approves management decisions affecting the enterprises.

OIG recommended that FHFA should strengthen controls over OQA reporting and follow-up; evaluate the roles and responsibilities of OQA across the agency and revise OQA's charter accordingly; assess the risks across all agency operations for the purposes of planning OQA review coverage; and direct performance reviews of those areas that pose the most significant risks to FHFA.

FHFA provided comments agreeing with the recommendations in the report.

Additional FHFA Oversight Can Improve the Real Estate Owned Pilot Program (AUD-2013-012, September 27, 2013)

Typically, when borrowers **default** on enterprise-owned or -guaranteed mortgages and efforts to cure the defaults are unsuccessful, the mortgages are foreclosed on. Through **foreclosure**, properties that secure the defaulted mortgages can be acquired by the enterprises as **real estate owned (REO)** properties.

The enterprises' REO inventory levels increased dramatically in the years following the financial crisis. In accordance with its broad **conservatorship** objective to minimize costs and maximize the net present value of REO, FHFA initiated a pilot program in 2012 to assist with REO disposition efforts. The REO Pilot Program was the first, and to date only, transaction to be conducted under a broader FHFA initiative to develop and implement an improved REO disposition program. For the pilot transaction, about 2,500 single-family Fannie Mae REO properties, many with tenants, were consolidated into pools in eight geographic areas and offered to prequalified investors for sale.

OIG audited FHFA's oversight of Fannie Mae's policies, procedures, and practices with respect to the selection and administration of investors participating in the REO Pilot Program. OIG found that FHFA established a sound process for reviewing, scoring, and recommending investors to qualify as bidders under the pilot program. However, Fannie Mae's bidder qualification contractor did not fully comply with important provisions of the established process. Specifically, the contractor did not properly score the risk attributes for 12 of 47 potential investors, 6 of whom were determined to be eligible to bid even though they did not meet prescribed bidder qualification scoring criteria. Figure 3 (see page 9) provides a summary of the results of OIG's analysis of the scoring of investor applications. Moreover, certain areas of the application and scoring criteria require clarification if used for similar programs in the future.

Additionally, Fannie Mae did not always follow its contractor's scores and recommendations. For example, the enterprise, with FHFA's concurrence, permitted two potential investors to bid on mortgage pools even though both were scored by the contractor as high risk and not recommended to bid. Further, FHFA did not independently verify the work performed by Fannie Mae's bidder qualification contractor, and thus, the instances of noncompliance were not discovered by the agency.

In addition, FHFA had not clarified several goals that are applicable to the REO Pilot Program. Specifically, FHFA had not clarified how the goals and objectives of the pilot program will be achieved or how the agency intends to monitor and assess the performance of the pilot or any other future initiatives under the overall REO disposition program.

OIG recommended that FHFA: (1) establish verification controls to ensure enterprise contractors are performing in accordance with agreed-upon criteria and that any proposed waivers to the criteria are documented and submitted for FHFA review and approval; (2) clarify guidance regarding bidder submission of financial statements and explanation of adverse financial events as part of the bidder

Figure 3. Scoring of Investor Qualification Applications

Bidder Score Given by Fannie Mae Contractor	No. of Applications	Correctly Scored	Incorrectly Scored
Low	9	8	1
Medium	31	23	8
High	7	4	3
Total Applications Scored	**47**	**35**	**12**

Bidder Score Given by Fannie Mae Contractor	No. of Bidders with Incorrect Score that Resulted in an Unchanged Risk Score	No. of Bidders with Incorrect Score that Resulted in a Changed Risk Score
Low	0	1
Medium	2	6
High	3	0
Total Applications Scored	**5**	**7**

Bidder Score Given by Fannie Mae Contractor	Resultant Risk Score	
	Medium	High
Low	1	0
Medium	0	6
High	N/A	N/A
Total Applications Scored	**1**	**6**

qualification process; and (3) issue formal guidance for the REO disposition program, including the REO Pilot Program, requiring a program plan with clearly defined goals and objectives, a program monitoring and oversight mechanism, criteria to measure and evaluate program success, and the means to assess alternative REO disposition strategies.

FHFA generally agreed with OIG's recommendations and will implement corrective action if transactions beyond the initial REO Pilot Program are pursued.

FHFA Can Improve Its Oversight of Fannie Mae's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies (AUD-2013-011, September 24, 2013)

FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies (AUD-2013-010, September 24, 2013)

If either a foreclosure sale's proceeds or the value at which an enterprise records a property in its REO portfolio is less than the borrower's mortgage loan balance, the shortfall (or deficiency) represents a loss to the enterprise. Losses of this type can be reduced if the enterprises recover deficiencies from borrowers who possess the ability to repay. Enhanced deficiency management practices can also serve as a deterrent to those who would choose to strategically default on their mortgage obligations.

In October 2012, OIG issued a report that assessed the agency's oversight of the deficiency management efforts of the enterprises. In that audit, OIG found that FHFA had an unfulfilled opportunity to provide the enterprises with guidance about effectively pursuing and collecting deficiencies from borrowers who may possess the ability to repay. In these follow-up audits, OIG focused in more detail on the enterprises' deficiency recovery practices for borrowers who possess the ability to pay amounts owed on foreclosed mortgages owned or guaranteed by the enterprises.

Enhanced deficiency management practices can deter those who would choose to strategically default on their mortgage obligations.

OIG concluded that FHFA can improve its oversight of the enterprises' deficiency recovery processes. First, OIG found that Freddie Mac did not refer nearly 58,000 foreclosures with estimated deficiencies of approximately $4.6 billion to its deficiency collection vendors to evaluate the borrowers' ability to repay those deficiencies. Most of these foreclosed mortgages were associated with properties in states where Freddie Mac did not pursue deficiencies but where Fannie Mae did, with some success. The remainder were foreclosure sales to third parties rather than the enterprise; these third-party sales can result in deficiencies, but as a practice, Freddie Mac—unlike Fannie Mae—did not pursue deficiencies arising from third-party sales.

Second, delays in the deficiency collection vendors' evaluation process limited Freddie Mac's opportunity to pursue deficiencies related to more than 6,000 foreclosed mortgages for which state statutes of limitations had expired. The delays were caused by challenges associated with coordinating among Freddie Mac's various foreclosure/deficiency collection counterparties—**servicers**, attorneys, and vendors. Specifically, the vendors did not timely receive from the servicers and attorneys the information needed to calculate deficiency balances and pursue collection.

OIG also found that Fannie Mae's deficiency collection vendors generally did not pursue deficiencies on foreclosure sales when, in their view, applicable statutes of limitation for filing deficiency claims against borrowers provided insufficient time to obtain the necessary information from servicers and foreclosure attorneys to evaluate if deficiency balances existed.

OIG recommended that FHFA: (1) evaluate periodically the efficiency and effectiveness of Freddie Mac's deficiency recovery strategies for pursuit of borrowers with the ability to repay; (2) review Freddie Mac's monitoring controls over its servicers, foreclosure attorneys, and collection vendors involved in deficiency recovery activities to ensure that oversight across these counterparties is maintained; (3) direct Freddie Mac to establish and implement controls for its counterparties to deliver timely documents to deficiency collection vendors and provide for financial consequences to those counterparties that fail to meet delivery deadlines; and (4) direct the enterprises to implement a control to consider time frames in state statutes of limitations in prioritizing, coordinating, and monitoring deficiency collection activity for borrowers with the ability to repay.

FHFA provided comments agreeing with the recommendations in these reports.

Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs (AUD-2013-009, August 30, 2013)

Recent reports have emphasized the growing threat of cyber attacks against government and private-sector computers and networks. These attacks pose a significant risk to the safety and soundness of financial organizations, including the enterprises, which store personal protected information (PPI) for 28 million active borrowers, as well as other sensitive financial information. If that PPI is compromised, the enterprises, FHFA, and Treasury could be exposed to significant financial risk; trust in the enterprises would also suffer greatly. The objective of this audit was to assess the effectiveness of FHFA's oversight of enterprise information security and privacy programs.

Key aspects of FHFA's oversight of these programs were ineffective during our January 2010 to November 2012 audit period. The agency did not issue formal information security and privacy guidance to the enterprises, complete a risk assessment for information security and privacy necessary to support the annual examination plan, conduct ongoing monitoring of some key IT security issues, or address some previously identified findings regarding information security.

Further, FHFA did not have an adequate process to support its reliance on the work of the enterprises' internal audit divisions related to information security. Although guidance states that FHFA examiners review outstanding issues and assess staff levels and skills of internal auditors, these activities alone are insufficient for establishing reliance. FHFA's reliance on enterprise internal audit work—without properly establishing and documenting grounds for such reliance—increases the risk that examination analysis and results could be based on inaccurate or unsubstantiated work.

To strengthen FHFA's oversight of enterprise information security and privacy programs, we recommended that the agency: (1) establish formal program requirements, (2) implement a workforce plan for IT examination staffing, (3) complete required risk assessments, (4) consistently deploy tools for monitoring IT security activities, and (5) establish and document a process for relying on enterprise internal audit activities.

FHFA agreed with these recommendations and stated that it has adopted a new approach to supervision activities.

Evaluations

Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses (EVL-2013-012, September 18, 2013)

This report evaluates Fannie Mae's servicer reimbursement operations for delinquency expenses. Fannie Mae relies on servicers to make various payments on behalf of delinquent borrowers. Generally, these payments are for property preservation expenses, insurance, taxes, and foreclosure costs and expenses. Figure 4 (see page 12) provides examples of the line items covered by these payments. Fannie Mae uses a contractor to administer major aspects of the servicer reimbursement function, including manually processing claims.

OIG assessed FHFA's oversight of Fannie Mae's servicer reimbursement operations.

Figure 4. Examples of Reimbursement Categories and Line Items

Category	Line Item
Property Preservation Expenses	• Landscaping • Trash Removal • Locksmith
Insurance	• Hazard Premium • Mortgage Insurance Premium • Title Insurance
Taxes	• State Taxes • Property Taxes
Foreclosure Costs and Expenses	• Eviction Costs • Sheriff's Fees and Costs

We concluded that Fannie Mae's oversight of its contractor's manual claim processing focuses on measuring contractual performance rather than minimizing overpayments to servicers. Currently, FHFA is not aware of the impact of this approach; neither FHFA nor Fannie Mae aggregates the amount of overpayments to servicers that result from its contractor's processing errors. OIG estimates that the enterprise's contractor incorrectly approved 3.1% of servicer reimbursements in 2012. These processing errors prompted Fannie Mae to pay servicers $89 million in overpayments.

Fannie Mae's oversight of its contractor's processing of servicers' claims for reimbursement focuses on measuring the contractor's performance rather than minimizing overpayments to servicers.

We recommended that FHFA: (1) ensure Fannie Mae takes the actions necessary to reduce processing errors, including utilizing its process accuracy data in a more effective manner and implementing a red flag system; (2) require Fannie Mae to quantify and aggregate its overpayments to servicers regularly and implement a plan to reduce these overpayments by identifying their root causes, creating reduction targets, holding managers accountable, and reporting its findings and progress to FHFA periodically; and (3) publish Fannie Mae's reduction targets and overpayment findings.

FHFA agreed with the first and second recommendations.

Reducing Risk and Preventing Fraud in the New Securitization Infrastructure (EVL-2013-010, August 22, 2013)

The objective of this evaluation was to assess risks and fraud threats in the securitization infrastructure that FHFA and the enterprises are developing, and to address such risks by recommending countermeasures for the emerging policies, procedures, internal controls, and organizational structures as they are designed. Because information in this report could be used to exploit vulnerabilities and circumvent recommended countermeasures, it was not released publicly.

FHFA's Oversight of Fannie Mae's 2013 Settlement with Bank of America (EVL-2013-009, August 22, 2013)

In January 2013, FHFA approved an $11.6 billion settlement with Bank of America (see Figure 5, page 13) that resolved issues involving repurchase claims and servicing penalties. In addition, FHFA allowed the transfer of

Figure 5. Agreements Between Fannie Mae and Bank of America ($ billions)

Agreement	Settlement Cash Proceeds
Representation and Warranty Settlement	
Cash "Make-Whole" Payment	$3.6
Repurchases	6.7
Total Representation and Warranty Settlement	**10.3**
Compensatory Fees for Failure to Meet Delinquency Timelines	1.3
Transfer of Mortgage Servicing Rights	No funds to or from Fannie Mae
Total	**$11.6**

servicing rights on about 1.1 million mortgages from Bank of America to other servicers.

When approving the settlement, FHFA employed a new policy governing the review of repurchase claim settlements that it developed in part as a response to an earlier OIG evaluation and recommendation.[2] Because FHFA's policy applied to one, but not all, portions of the settlement, the 2013 settlement enabled OIG to evaluate FHFA's oversight under its settlement policy in the context of its oversight of matters that fell outside of that policy.

OIG found that FHFA adhered to its new policy when reviewing the settlement of repurchase claims between Fannie Mae and Bank of America. This policy did not apply, however, to the resolution of claims related to servicing penalties or the transfer of mortgage servicing rights (MSR). Consequently, FHFA's consideration of these aspects of the settlement did not benefit from an established review process.

OIG recommended that FHFA establish a formal review process for claims related to servicing deficiencies and significant MSR transfers. FHFA agreed with this recommendation and committed to establish guidelines by January 31, 2014.

Fannie Mae's Compliance with FHFA Email Retention Requirements (EVL-2013-011, August 16, 2013)

In November 2011, while conducting an investigation, OIG special agents learned that although Fannie Mae permanently retained the email of most employees in sensitive positions, it automatically deleted the unsaved email of other employees after 60 days. In October 2012, FHFA directed Fannie Mae to immediately begin saving all employee email records and establish and implement a corporate five-year email retention policy.

OIG reviewed Fannie Mae's compliance with the email retention directive and confirmed that the enterprise is now in compliance.

OIG will continue to monitor FHFA's oversight of the enterprises' email retention practices and records management policies to ensure that they fulfill their intended purposes.

FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit (EVL-2013-008, August 6, 2013)

In addition to making secured loans, known as advances, to member financial institutions, the FHLBanks extend short-term, unsecured credit to domestic and foreign-owned financial institutions. In June 2012, we reported that some FHLBanks followed potentially risky unsecured credit management practices, including undertaking large exposures to counterparties located in the financially troubled Eurozone.[3] Furthermore, we found that some FHLBanks violated FHFA's regulatory limits on unsecured credit extensions. We recommended that FHFA: (1) assess the extent of such violations in its 2012 horizontal review of unsecured credit risk

Figure 6. FHFA's Supervisory Actions Taken in Response to Unsecured Credit Violations

FHLBank	Violations	Supervisory Action	Remediation Date
FHLBank A	474	MRA	3/31/2013
FHLBank B	201 Primary, 201 Secondary	MRA	12/31/2012
FHLBank C	33[a]	MRA	3/31/2013
FHLBank D	9	MRA	10/31/2012
FHLBank E	6	MRA	3/31/2013
FHLBank F	1 Primary, 1 Secondary	MRA	12/31/2012
FHLBank G	1	Violation	9/30/2012

[a] FHFA determined that FHLBank C's aggregate term extensions of credit to two counterparties exceeded the regulatory limits for a combined total of 33 months, 15 months of which are attributable to one counterparty and 18 months of which are attributable to the other. The number of individual transactions in excess of the regulation is likely higher.

management practices and (2) consider revising its regulations to mitigate associated risks.

In this follow-up evaluation, we assessed FHFA's (1) implementation of the 2012 horizontal review and (2) supervisory and enforcement responses to identified violations.

We found that FHFA conducted a proactive and thorough review that identified over 900 unsecured credit violations at seven FHLBanks and risk management deficiencies at the other five.

We also found that FHFA's responses to the violations at the seven FHLBanks were consistent with its policy. The agency issued matters requiring attention (MRAs), among other actions, requiring the banks to remediate deficiencies within specified time periods. See Figure 6 (above) for a list of FHFA's supervisory actions in response to FHLBank unsecured credit violations.

As FHFA began to monitor compliance with MRAs, however, it found that one FHLBank had difficulty implementing the required remedies. Although FHFA had not yet decided on a supervisory strategy for the FHLBank, the case shows the importance of continued, diligent monitoring and enforcement of compliance with MRAs and other requirements.

We recommended that FHFA assess the FHLBanks' compliance with its unsecured credit supervisory requirements during the 2013 and 2014 examination cycles, and take enforcement actions as required to ensure that corrective and remedial actions are implemented over time. FHFA agreed with these recommendations.

FHFA's Oversight of Capital Markets Human Capital (ESR-2013-007, August 2, 2013)

The enterprises' combined capital markets businesses, which include their funding, **hedging**, and investment activities, manage portfolios of more than $1.1 trillion of mortgage-related assets. Although generally profitable, certain elements of these businesses have incurred tens of billions of dollars in losses since September 2008, the start of FHFA's conservatorships. For this reason, we initiated a series of evaluations relating to FHFA's supervision of the enterprises' capital markets businesses. This evaluation began after the enterprises disclosed concerns about voluntary attrition among employees with specialized skills in their 2011 annual filings.

Since the start of the conservatorships, voluntary attrition of staff with specialized skills has risen markedly. However, as of late 2012, human capital risk posed by such attrition, while still a concern, appears to have dissipated. Specifically, the Fannie Mae group that manages the enterprise's investment activity saw a rise in its rate of voluntary attrition from January 2010 to September 2012, but the group grew over the same period, suggesting that the human capital risks posed by the increase in attrition rate were mitigated. The attrition rate for Freddie Mac's investment management group also rose from

2010 to 2012, but the attrition rate appears to be stabilizing, as its 2012 rate was lower than its 2011 rate.

We concluded that human capital risks associated with voluntary attrition rates within the enterprises' capital market businesses had been adequately managed and that no additional study on this topic was needed. However, voluntary attrition rates are not static, and an improving economy puts additional pressure on the enterprises' attrition rates as attractive opportunities become available to their employees. Therefore, we will continue to monitor FHFA's oversight of the enterprises' human capital resources and planning associated with human capital risk, and we will initiate additional work on this topic as warranted.

Home Affordable Refinance Program: A Mid-Program Assessment (EVL-2013-006, August 1, 2013)

FHFA, in coordination with Treasury, announced HARP in March 2009. HARP is a streamlined refinance program for loans owned or guaranteed by Fannie Mae or Freddie Mac. It is designed to assist borrowers who are current on their loans but have not been able to refinance because they have little or no equity in their homes. We conducted this program evaluation to assess FHFA's administration and oversight of HARP.

When HARP was announced, Treasury estimated that 4 to 5 million borrowers would have the opportunity to refinance under the program. As of September 2011, however, fewer than 1 million of those borrowers had refinanced. Based on consultations with lenders and feedback from borrowers, FHFA directed the enterprises to modify the program; this resulted in HARP 2.0, which is scheduled to expire on December 31, 2015.

As a result of the initial HARP 2.0 program modifications and subsequent changes made throughout 2012 and 2013, HARP refinance volume has substantially increased (see Figure 7, page 16). As of March 2013, 2.4 million HARP refinances had been completed. It is difficult, however, to project how many HARP-eligible loans will ultimately be refinanced. Several unknown variables, including interest rates, lender participation, and borrowers' willingness to refinance, make any estimate uncertain.

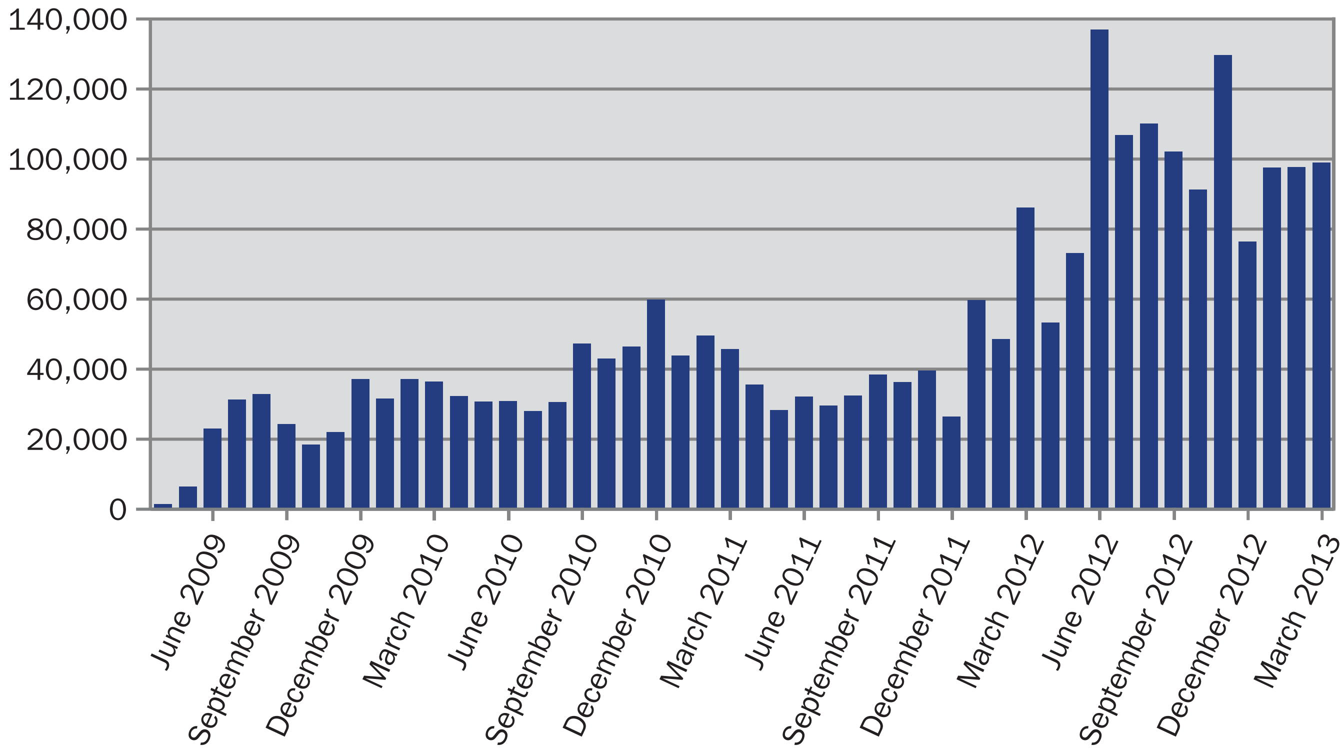
Additionally, challenges to the program's success remain. These challenges include educating borrowers and encouraging their participation in the program. FHFA is planning to address the challenges by implementing a nationwide public education campaign.

FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees (EVL-2013-005, July 16, 2013)

FHFA has argued that federal financial support for the enterprises over the years has permitted them to set their guarantee fees—charged to protect investors' **mortgage-backed securities (MBS)** against potential credit losses—at artificially low levels. At such levels, the fees priced competitors out of the **conforming loan** market and increased the enterprises' risks. The agency has directed the enterprises to increase guarantee fees to encourage greater private-sector investment in mortgage credit risk, reduce the enterprises' dominant position in housing finance, and limit potential taxpayer losses.

We conducted this evaluation to: (1) analyze FHFA's initiative and (2) assess FHFA's communication and interaction with FHA, a government agency that insures mortgages against credit losses, which recently announced a cessation of its mortgage premium increases.

Figure 7. Total HARP Refinances for April 2009 Through March 2013



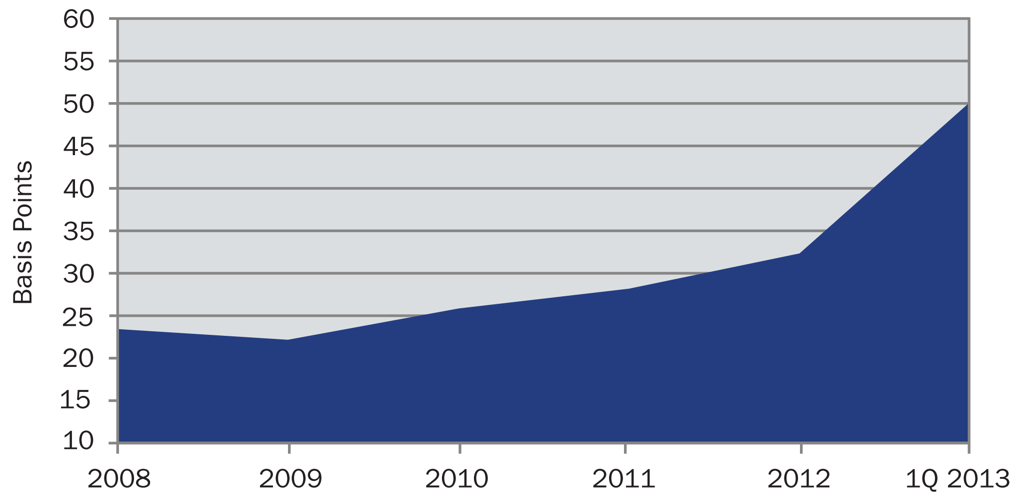
We found that although the enterprises' average combined guarantee fees have nearly doubled since 2011 (see Figure 8, page 17), FHFA has not determined how high the enterprises must increase guarantee fees to achieve FHFA's objectives. The agency also has not yet defined or developed measures for increasing private-sector investment in mortgage credit risk. In addition, the agency must confront related challenges: too-high increases could dampen consumer demand for mortgages and certain federal initiatives—designed to combat abusive lending—could limit private-sector investment.

Although the enterprises' average combined guarantee fees have nearly doubled since 2011, FHFA has not determined how high guarantee fees must increase to achieve its objectives.

Further, we found that FHFA may realize additional benefits by seeking to establish a more formal working relationship with FHA and jointly assessing the key issues that may affect their pricing initiatives. For example, coordination may help to avoid a pricing disparity between guarantee fees and insurance premiums that could shift a portion of the enterprises' mortgage business and associated risks to FHA's market without an overall increase in private-sector investment in mortgage credit risk.

We recommended that FHFA establish definitions and performance measures for its initiative to raise enterprise

Figure 8. Estimated Enterprise Aggregated Annual Single-Family Guarantee Fee Pricing 2008 Through March 31, 2013



guarantee fees and assess the feasibility of establishing a formal working arrangement with FHA. FHFA did not agree with our recommendations. We will continue to monitor these issues.

FHFA's Oversight of the Federal Home Loan Banks' Affordable Housing Programs (EVL-2013-04, April 30, 2013)

Funded by the FHLBanks, the Affordable Housing Program (AHP) is the largest private source of grant funds for affordable housing in the United States. Since 1990, the FHLBanks have awarded over $4 billion to subsidize low-income rental or owner-occupied housing.

Although AHP projects must meet specific regulatory requirements and eligibility criteria, the FHLBanks have some leeway in how they weigh scoring criteria. FHFA is responsible for ensuring that the FHLBank System fulfills its affordable housing objectives.

We initiated this evaluation to examine FHFA's oversight of the FHLBanks' administration and management of their AHPs.

We found that FHFA conducts annual examinations and collects data regarding each FHLBank's AHP, but it generally relies on the FHLBanks, their member institutions, and various private and public entities to monitor projects. The FHLBanks' oversight of AHP projects is also primarily paper based. Further, the FHLBanks have varying practices regarding whether and when they conduct site visits of projects. For example, although some FHLBanks visit projects during construction, others only visit projects that receive a certain level of funding or are placed on watch lists.

As the regulator of the FHLBank System, FHFA is well positioned to provide cross-cutting feedback and analyses to the FHLBanks to improve oversight of their programs, but it typically has not published such data. In addition, agency officials noted that they had limited resources and staffing levels. Though the FHLBanks work together to share best practices, unbiased analyses from FHFA could better inform policy and administrative decisions regarding these programs.

We recommended that FHFA: (1) develop a policy for FHLBank site visits of AHP projects that includes guidance on their frequency, scope, and administration; (2) conduct and report cross-cutting analyses of common issues and themes across the

FHLBanks, using analytically rigorous methods; and (3) analyze staffing levels needed to perform additional cross-cutting analyses and oversee housing project site visits by the FHLBanks, and take appropriate actions to meet those staffing targets.

FHFA agreed with our recommendations and noted specific steps it will undertake to address them.

Recommendations

A complete list of OIG's audit and evaluation recommendations is provided in Appendix B.

Other Reports

In addition to its audits and evaluations, OIG issued two management alerts.

Management Alert: Delay Implementing Advisory Bulletin No. 2012-02 (August 5, 2013)

In a memo to the FHFA Acting Director, OIG raised concerns about the delay, authorized by FHFA, in the enterprises' compliance with Advisory Bulletin No. 2012-02. The bulletin directed the enterprises to change their current practices and classify any single-family loan that is delinquent for 180 or more days as a loss. The bulletin initially called for compliance in April 2012, although FHFA agreed to extensions until January 1, 2015.

Given this lengthy delay and because the advisory bulletin involves matters central to sound risk management and accounting practices at the enterprises, OIG recommended that FHFA require the enterprises to report the estimated impact on their financial statements as if the bulletin were in effect. The agency agreed with the recommendation.

Public Company Accounting Oversight Board Criticisms of Public Accounting Firms that Do Business with the GSEs (May 3, 2013)

The Public Company Accounting Oversight Board inspects selected audit work of public accounting firms to assess compliance with requirements established by the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission (SEC), and professional standards. The board found that two firms, which conduct annual financial statement audits for the GSEs, had failed to satisfy concerns it had identified in previous inspections. While those concerns were unrelated to the firms' work for the GSEs, we recommended that FHFA request that the GSEs confirm that their audit committees and management provide elevated attention to the work conducted by the two firms.

Civil Fraud Initiative

OA launched its Civil Fraud Initiative in June 2013. OA, with support from OI and the Office of Counsel (OC), conducts civil fraud reviews (also known as nonaudit services) to identify fraud and make referrals for civil actions and administrative sanctions against entities and individuals who commit fraud against FHFA, Fannie Mae, Freddie Mac, or the FHLBanks.

Currently, OA is working with various assistant U.S. Attorneys on reviews of lenders' loan origination practices to determine their compliance with enterprise requirements. Lenders are considered for review through the use of data-mining techniques and requests from government agencies.

Audit and Evaluation Plan

OIG maintains an Audit and Evaluation Plan that focuses strategically on the areas of FHFA's operations that pose the greatest risks to the agency and the GSEs. The plan responds to current events and feedback from FHFA officials, members of Congress, and others. The plan is available for inspection at www.fhfaoig.gov/Content/Files/audit%26evaluation%20plan_0.pdf.

Figure 9. Criminal and Civil Recoveries from April 1, 2013, Through September 30, 2013

	Criminal/Civil Recoveries
Fines	$20,451,359
Restitutions	$84,175,968
Total	**$104,627,327**

Investigations

OIG investigators have participated in numerous criminal, civil, and administrative investigations, which during the semiannual period resulted in the indictment of 75 individuals and the conviction of 55 individuals. In many of these investigations, we worked with other law enforcement agencies, such as the Department of Justice (DOJ), the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), the FBI, HUD Office of Inspector General (HUD-OIG), the Secret Service, and state and local entities nationwide. Further, in several investigations, OIG investigative counsels were appointed as Special Assistant U.S. Attorneys and supported prosecutions. Figure 9 (see above) summarizes the criminal and civil recoveries from our investigations during the reporting period. Although most of these investigations remain confidential, details about several of them have been publicly disclosed and are summarized below.

During this period, OIG's investigative efforts resulted in the indictment of 75 individuals and the conviction of 55 individuals, as well as the award of more than $104 million in criminal fines and restitution orders.

Fraud Committed Against the Enterprises, FHLBanks, or FHLBank Member Institutions

Investigations in this category involved multiple schemes that targeted the enterprises, the FHLBanks, or FHLBank members.

Mortgage Company Diverts Loan Sales Proceeds, Mesa, Arizona

On June 28, 2013, Scott Powers and David McMaster were sentenced to serve 96 and 188 months of incarceration, respectively, in the U.S. District Court for the District of North Dakota. In addition to their prison terms, Powers and McMaster were ordered to pay a money judgment (jointly and severally) of $28.5 million to BNC National Bank (BNC), which is a member of the FHLBank of Des Moines. On May 6, 2013, Lauretta Horton and David Kaufman were sentenced in the same court to two years of supervised release.

From 2006 to 2010, all four worked for American Mortgage Specialists, which was a mortgage company headquartered in Mesa, Arizona. American Mortgage Specialists used money provided by BNC to originate residential mortgage loans that were then sold to commercial investors, such as the enterprises. American Mortgage Specialists was supposed to repay BNC with the sales proceeds, but the money was diverted to the company's payroll and operating expenses. Money from earlier mortgage sales was used to pay back BNC for funding current originations, causing the defendants to falsely represent their company's financial health. When the fraud was discovered, the company shut down, owing BNC $28.5 million.

This was a joint investigation with SIGTARP and DOJ's Criminal Division Fraud Section with support from the Financial Crimes Enforcement Network (FinCEN).

Fannie Mae Contractor Sells Customer Information, Atlanta, Georgia

On April 29, 2013, Alex Dantzler was sentenced in the U.S. District Court for the Northern District of Georgia to 15 months of incarceration and 24 months of supervised release. Dantzler previously pled guilty to conspiracy to commit bank fraud.

From June 2011 to July 2012, Dantzler, then a Fannie Mae contract employee assigned to the National Underwriting Center in Dallas, Texas, used his access to Fannie Mae's Quality Assurance System database to obtain PPI about numerous Fannie Mae borrowers. Dantzler then sold the information to an individual in Atlanta, Georgia, who used it to conduct various identity theft schemes involving additional conspirators. A total of four individuals, including Dantzler, were convicted for their participation in this conspiracy.

This was a joint investigation with the FBI.

Bank Vice President Defrauds Employer, Atlanta, Georgia

On April 5, 2013, former Appalachian Community Bank Vice President, Adam Teague, was sentenced in the U.S. District Court for the Northern District of Georgia to 5 years and 10 months of incarceration for conspiring to defraud Appalachian. He was further ordered to serve 5 years of supervised release and pay restitution of $5.8 million. Teague had previously pled guilty to conspiracy to commit bank fraud.

Bank vice president sentenced to 5 years and 10 months incarceration and $5.8 million in restitution.

Teague engaged in illegal schemes to unjustly enrich himself at the expense of Appalachian and prevented the Federal Deposit Insurance Corporation (FDIC) from discovering certain past due loans on Appalachian's books. Specifically, Teague and an unindicted co-conspirator arranged a number of sham real estate transactions and caused Appalachian to issue approximately $7 million in fraudulent loans to another unindicted co-conspirator, making it appear that the loan proceeds were used to purchase certain properties from Appalachian's foreclosure inventory and that regular monthly payments on the new mortgages were being made.

Appalachian was a member of the FHLBank of Atlanta. As such, it received advances from the FHLBank of Atlanta and pledged portfolios of its loans as **collateral** for those advances. Due to its poor financial condition, Appalachian was closed on March 19, 2010, and FDIC was appointed as receiver. At that time, Appalachian owed the FHLBank of Atlanta approximately $67 million.

This was a joint investigation with the FBI, FDIC Office of Inspector General (FDIC-OIG), and SIGTARP.

Property Management Scheme

The wave of foreclosures following the housing crisis left the GSEs holding a large inventory of REO. To minimize losses associated with REO, the GSEs rely heavily on contractors to secure, maintain and repair, price, and ultimately sell their properties. In a property management scheme, contractors overbill for work performed or bill for work not performed.

Mortgage Servicer Falsifies Property Inspections, Tampa, Florida

On July 18, 2013, in the U.S. District Court for the Middle District of Florida, Tammy Roaderick pled guilty to conspiracy to commit wire fraud.

From about March 2007 to December 2009, Roaderick, Vice President of American Mortgage Field Services, ordered and oversaw the submission to Bank of America of fraudulent property inspection reports for inspections of foreclosed properties for which American Mortgage Field Services was paid but never performed. The enterprises reimbursed Bank of America, as their servicer, for the fake inspections. As part of her plea deal, Roaderick also agreed to forfeit $2.4 million to Bank of America and the enterprises. The overall loss for the conspiracy, involving company president, Dean Counce, and other employees, was estimated at $12.8 million.

This was a joint investigation with HUD-OIG and the Secret Service.

Condo Conversion and Builder Bailout Schemes

These schemes begin with sellers or developers seeking out investors with good credit who want low-risk investment opportunities. Investors are offered deals on properties with no money down and other lucrative incentives, such as cash back and guaranteed and immediate rent collection. To fund these incentives, sellers use complicit appraisers to inflate the sales price. The incentives are not disclosed to lenders, who are defrauded into making loans far exceeding property values. When the properties go into foreclosure, lenders suffer large losses.

Condo Conversion, West Palm Beach, Florida

On September 26, 2013, in the U.S. District Court for the Southern District of Florida, an information was filed, charging Jose Aller and Ernesto Rodriguez with conspiracy to commit bank fraud.

The information alleges that between February and December 2008, Aller and Rodriguez, former co-owners of JAER Guaranteed Investments, conspired with others to provide buyers of condominiums at Kensington of Royal Palm Beach with incentives that were not disclosed on the HUD-1 statements that were submitted as part of the loan application and approval process. The allegedly fraudulently induced mortgages were sold to Freddie Mac by the originating lenders.

This was a joint investigation with the FBI.

Escrow Agent Pleads Guilty After Defrauding the Enterprises, Los Angeles, California

On June 13, 2013, Jacqueline Burchell pled guilty to conspiracy to commit bank and wire fraud in the U.S. District Court for the Central District of California.

From 2008 to 2011, Burchell, an escrow agent, conspired with other individuals who negotiated with the builders of new condo developments in Arizona, California, and Florida to sell units on their behalf in exchange for large commissions that were not disclosed to the lenders. The defendants recruited **straw buyers** and prepared loan applications with false information to sell more than 100 units. The enterprises have lost approximately $2.4 million because they purchased some of the fraudulently originated loans.

This was a joint investigation with the FBI and IRS-Criminal Investigation (IRS-CI).

A $39 Million Florida Condo Conspiracy, Ft. Lauderdale, Florida

On April 9, 2013, Dayanara Montero was sentenced to 22 months of incarceration, 3 years of supervised release, and $1,746,567 in restitution. On April 24, 2013, Quelyory Rigal was found guilty of wire fraud, mail fraud, and conspiracy to commit wire and mail fraud. On April 29, 2013, Sandra Campo was sentenced to 70 months of incarceration, 5 years of supervised release, and $3,575,981 in restitution. On May 3, 2013, Osbelia Lazardi was sentenced to 25 months of incarceration, 3 years of supervised release, and $912,575 in restitution. On July 11, 2013, Marisa Perez was sentenced to 5 years of supervised release, 9 months of home confinement with electronic monitoring, 300 hours of community service, and $278,878 in restitution. On September 20, 2013, Marina Superlano was sentenced to one year and one day of incarceration, three years of supervised release, and $278,878 in restitution. The sentences and verdict were all rendered by the U.S. District Court for the Southern District of Florida.

Mortgage broker sentenced to 70 months incarceration and $3.6 million in restitution.

Montero, Rigal, Campo, Lazardi, Perez, Superlano, and others participated in condo conversion schemes in the Florida cities of Ft. Lauderdale, Orlando, and Tampa. Of the 165 transactions involved in their schemes, 131 have been foreclosed and another 26 are in foreclosure. The targeted lenders have lost $34 million of the $39 million loaned, Freddie Mac's exposure is $8.5 million, and Fannie Mae has reported losses of $4.2 million.

Loan Origination Schemes

Loan or mortgage origination schemes are the most common type of mortgage fraud, as the volume of cases below attests. These schemes typically involve misrepresentations of buyers' income, assets, employment, and credit profile to make them more attractive to lenders. Bogus Social Security numbers and fake or altered documents, such as W-2 forms and bank statements, are often used. These schemes are designed to defraud lenders into making loans they would not otherwise make. Perpetrators pocket origination fees or inflate home prices and divert proceeds into personal accounts.

Unlicensed Broker Alleged to Have Originated Fraudulent Mortgages, San Diego, California

On July 31, 2013, Shellie Lockard pled guilty to conspiracy to commit wire and bank fraud in the U.S. District Court for the Southern District of California. In addition, on August 8, 2013, Donald V. Totten was indicted for conspiracy to commit wire fraud and wire fraud involving a financial institution in the same court.

From approximately 2002 until 2007, Totten was a loan officer who acted as an unlicensed mortgage broker (operating under broker licenses held by others). During this time, Totten owned or operated Integrated Home Loans, Integrated Lending, Money World, and other entities and generated business by advertising on television and other media. In 2006, Totten allegedly obtained $2.2 million in mortgage loans on behalf of a single straw buyer by allegedly using false information on the straw buyer's loan applications and then collected kickbacks and commissions on the sales. Lockard, a loan processor, worked for Totten from January 2006 through June 2007, during which time she processed these and other fraudulent loans. Lockard created and processed fraudulent loan applications and fraudulent supporting documents, such as false Certified Public Accountant letters, false bank statements, and false verification of deposit forms. She submitted them to mortgage lenders including FHLBank members. Many of the loans subsequently defaulted, causing the mortgage lenders and secondary purchasers, including the enterprises, to suffer significant losses as a result of the conspiracy.

This was a joint investigation with the FBI, IRS-CI, and U.S. Attorney's Office for the Southern District of California.

Loan Officer Sentenced, Annandale, Virginia

On July 30, 2013, in the U.S. District Court for the Eastern District of Virginia, Rina Delgado was sentenced to 12 months of incarceration and 3 years of supervised release. She was also ordered to pay $1,160,611 in restitution. She previously pled guilty to conspiracy to commit wire fraud.

From September 2006 until August 2007, Delgado worked as a loan officer with SunTrust Mortgage in Annandale, Virginia. In this capacity, she placed false information in loan applications and used false documents, such as W-2 forms, to qualify otherwise unqualified applicants for loans. The enterprises suffered losses exceeding $800,000 as a result of Delgado's conduct.

This was a joint investigation with the FBI and was prosecuted with assistance from an OIG investigative counsel.

Servicer Allegedly Diverted Over $18 Million Owed to the Enterprises, Ft. Lauderdale, Florida

On July 11, 2013, in the U.S. District Court for the Southern District of Florida, a criminal information was filed against Patrick Mansell, alleging conspiracy to commit wire fraud. Mansell pled guilty on August 5, 2013.

Starting in April 2007, Mansell used his position as vice president, secretary, and director of Coastal States Mortgage Corporation to defraud the enterprises. Through February 2012, Coastal States withheld mortgage loan payoffs due to the enterprises for extended periods. Coastal States would use these funds for its own business purposes and to make monthly mortgage payments on paid-off loans, misrepresenting them as performing loans. Payoffs fraudulently retained by Coastal States were also used to remit funds due to the enterprises for previously withheld payoffs. Daily and monthly servicing reports were supplied to the enterprises containing false information and altered loan-identifying numbers, which enabled the scheme to go undetected. The enterprises lost more than $18 million as a result.

The Florida Office of Financial Regulation provided assistance to OIG during the initial stages of the investigation.

Inflated Sales Prices and Multiple Sales of Single Properties, Dallas, Texas

On July 10, 2013, Herbert Williams was indicted for conspiracy to commit bank fraud and aggravated identity theft in the U.S. District Court for the Eastern District of Texas.

Williams and a conspirator allegedly inflated the sales prices of a home that was sold in two fraudulent transactions. Williams was also involved in similar schemes with five other properties. The combined schemes caused a loss of $1.2 million to the involved financial institutions, including a loss of $900,000 to the enterprises, which bought mortgages on the properties.

This was a joint investigation with the Secret Service.

Mortgage Fraud Conspiracy Charges, Oxnard, California

On June 26, 2013, Jose Garcia, Lucy Garcia, Jose Fernando Murguia, Sesilia Garcia, Lili Ayala Hernandez, Gregg Quinn, Lidubina Perez, and Cesar Rodriquez Azamar were indicted in the U.S. District Court for the Central District of California for conspiracy to commit wire and bank fraud. On September 27, 2013, Quinn pled guilty to conspiracy to commit bank and wire fraud.

According to the indictment, the conspirators allegedly generated dozens of mortgage loans for unqualified borrowers. For these unqualified borrowers, the conspirators allegedly prepared mortgage applications that contained false information about borrowers' income, employment, and assets. The defendants in these cases generated huge commissions and fees through the mortgage application process—typically at least $10,000 per mortgage.

This was a joint investigation with the FBI, HUD-OIG, and the Secret Service.

Former Broker Sentenced, Morristown, New Jersey

On June 21, 2013, Joshua Van Orden was sentenced in the Superior Court of New Jersey, County of Morris, to five years of incarceration.

Between September 2009 and February 2010, Van Orden, while a mortgage broker at Superior Mortgage Corporation, knew that loan applications for three borrowers that he presented to his employer contained false information and omissions of material facts. Additionally, with respect to one of the three transactions, Van Orden facilitated a **short sale** from Fannie Mae to a straw buyer that resulted in a loss to Fannie Mae of approximately $150,000. A judgment was ordered for $107,000 in favor of Fannie Mae.

Mortgage broker sentenced to five years incarceration.

This was a joint investigation with the New Jersey Attorney General and the New Jersey Division of Criminal Justice.

Indictments in a $3.5 Million Mortgage Fraud Scheme, Baltimore, Maryland

On June 10, 2013, Edgar Tibakweitira, Flavia Makundi, Annika Boas, Makorya Wambura, Carmen Johnson, and Cane Mwihava were indicted in the U.S. District Court for the District of Maryland for wire fraud, conspiracy to commit wire fraud, aggravated identity theft, and aiding and abetting.

The defendants allegedly diverted funds from $3.5 million in fraudulently obtained loans, which resulted in losses of over $1 million to lenders, FHA, and the enterprises.

This was a joint investigation with HUD-OIG, the Secret Service, IRS-CI, Treasury Office of the Inspector General, and Immigration and Customs Enforcement-Homeland Security Investigations.

Inflated Loans and Kickbacks, Dallas, Texas

On May 30, 2013, in the U.S. District Court for the Eastern District of Texas, Ronzell Mitchell pled guilty to mail fraud. On June 4, 2013, and June 12, 2013, respectively, Christi Wyatt pled guilty to conspiracy to commit mail fraud and Lacie Devine was indicted for conspiracy to commit mail fraud in the same court.

From about March 2008 through February 2010, Mitchell and Wyatt conspired with others to recruit buyers to purchase properties from sellers at inflated sales prices, to help the buyers obtain mortgage loans based on these inflated sales prices, to cause the sellers to kickback portions of the loan proceeds, to pay portions of the loan proceeds to the buyers, and to cause the escrow officer not to disclose these payments to the lender. Mitchell was involved with fraudulent transactions on seven homes and Wyatt on eight homes. Devine, an escrow officer, is alleged to have been involved in several of these transactions. The enterprises bought a number of the loans, and the scheme caused losses of $1.6 million to Fannie Mae and $240,000 to Freddie Mac.

This was a joint investigation with the FBI, HUD-OIG, and the Texas Department of Insurance Fraud Unit.

Real Estate Company Uses Straw Buyers to Flip Properties, Chicago, Illinois

On May 30, 2013, Steven Bartlett, owner of SSB Real Estate Solutions; Robert Lattas, an attorney; and Nicholas Burge, a loan originator, were indicted in the U.S. District Court for the Northern District of Illinois for mail and wire fraud.

From January 2008 to January 2009, Bartlett, Lattas, and Burge allegedly used straw buyers to obtain $1.5 million in loans. The properties subject to the loans were then sold at inflated prices in a loan origination and property flipping scheme. The enterprises purchased several of the loans and suffered losses of $890,000.

This was a joint investigation with HUD-OIG and the Postal Inspection Service (USPIS).

Indictments and Guilty Pleas in a $2 Million Diversion, Denver, Colorado

On May 16, 2013, Michael Martinez, Katherine Norman, and Benjamin Velasquez were indicted for theft and forgery in the City and County of Denver District Court, Colorado. On June 3, 2013, Norman pled guilty to theft, and she was sentenced to five years of supervised release on July 15, 2013. Martinez pled guilty to theft on July 15, 2013.

From 2010 to 2011, Martinez, operator of Martinez Investments, and Norman, his bookkeeper, devised a scheme to divert funds designated for specific real estate transactions. The scheme resulted in over $2 million in losses by Quantum Title, one of Martinez Investments' holdings. Martinez, Norman, and Velasquez, a straw buyer, also allegedly committed loan origination fraud on three enterprise-owned properties by acting as straw buyers and providing false employment, income, and residency documents to lenders. As a result, Freddie Mac lost $178,000.

This was a joint investigation with the Colorado State Attorney General's Office.

Company Owners Plead Guilty to Conspiracy to Commit Mortgage Fraud, New Haven, Connecticut

On May 14, 2013, in the U.S. District Court for the District of Connecticut, Kwame Nkrumah (also known as Roger Woodson) pled guilty to conspiracy to commit mail, wire, and bank fraud. As a result of his plea, Nkrumah was sentenced to 48 months of incarceration, 5 years of supervised release, $2,940 in restitution to Fannie Mae, and a $113,080 forfeiture. On June 14, 2013, in the same court, Charmaine Davis pled guilty to making a false statement for the purpose of influencing the action of a financial institution. As a result of her plea, Davis was sentenced to 24 months of incarceration, 5 years of supervised release, a $6,000 fine, and a $39,434 forfeiture.

Nkrumah and others fraudulently obtained more than $1 million in loans, submitted fake documents for more than $10 million in mortgages in a short sale scheme involving enterprise loans, and attempted to fraudulently purchase dozens of multifamily properties.

This was a joint investigation with the FBI, USPIS, and HUD-OIG.

Guilty Plea in a $1 Million Fraud Conspiracy, Dallas, Texas

On May 8, 2013, Michael Burnham was indicted for conspiracy to commit bank fraud in the U.S. District Court for the Eastern District of Texas. He pled guilty on July 3, 2013.

From March to August 2010, Burnham conspired to sell seven properties at inflated prices to straw buyers in exchange for kickbacks. The scheme caused losses of $948,000 for the enterprises.

This was a joint investigation with HUD-OIG.

Former Banker Flips Properties, Washington, DC

On May 2, 2013, Lonnie Johnson pled guilty to conspiracy to commit bank fraud in the U.S. District Court for the District of Columbia. On August 30, 2013, in the same court, an information was filed against Cheryl Morrison, alleging conspiracy to commit mail fraud. On September 25, 2013, Morrison pled guilty to the charge.

Johnson, a former personal banker; Morrison, a former owner of CEM Title, Inc.; and other individuals engaged in a scheme to defraud financial institutions and mortgage lenders by producing fraudulent documents to support untruthful loan applications. Fannie Mae purchased a number of these fraudulently originated mortgages and faces exposure to a potential loss exceeding $1 million.

This was a joint investigation with the Department of State Bureau of Diplomatic Security, the Central Intelligence Agency Office of Inspector General, DOJ Office of Inspector General, the Department of Homeland Security Office of Inspector General, the Secret Service, the FBI, and HUD-OIG.

Mortgage Company Falsifies Documents for 50 Loans, Philadelphia, Pennsylvania

On May 1, 2013, an indictment was unsealed in the U.S. District Court for the Eastern District of Pennsylvania, charging six former employees of the now defunct Madison Funding of Allentown—Joel Tillett, Jason Boggs, Claribel Gonzalez, Florentina Peralta, Ghovanna Gonzalez, and Angela Diaz—with conspiracy, bank fraud, false statements, and aiding and abetting. On August 14, 2013, Tillett was sentenced to four years of incarceration and ordered to pay restitution of $979,562, after pleading guilty to conspiracy and to uttering and publishing false documents to obtain a loan insured by FHA. On August 16, 2013, a seventh former employee of Madison Funding of Allentown, Denise Peralta, was sentenced to 4 years of supervised release, 60 hours of community service, and a fine of $500.

From October 2006 until at least June 2008, the defendants allegedly conspired to defraud mortgage lenders by submitting loan applications supported by falsified, forged, and altered documents. Many of the fraudulently originated loans were sold to Fannie Mae, which lost approximately $1.3 million from defaults associated with the loans.

This was a joint investigation with HUD-OIG and FDIC-OIG.

A $20 Million Mortgage Fraud Scheme, San Diego, California

On April 25, 2013, Mary Armstrong pled guilty to wire fraud, money laundering, and conspiracy. As a result of her plea, Armstrong was sentenced to 100 months of incarceration and 36 months of supervised release. On May 6, 2013, William Fountain pled guilty to conspiracy to commit wire fraud and money laundering. As a result of his plea, Fountain was sentenced to 42 months of incarceration, 36 months of supervised release, and $532,687 in restitution. On June 17, 2013, John Allen pled guilty to conspiracy to commit wire fraud and money laundering. As a result of his plea, Allen was sentenced to 1 year and 1 day of incarceration and 36 months of supervised release. All pleas and sentences occurred in the U.S. District Court for the Southern District of California.

Mortgage broker sentenced to 100 months incarceration.

With the help of her co-conspirators, Armstrong, an unlicensed mortgage broker, operated a nationwide loan origination fraud and kickback scheme, defrauding lenders through the sale of $100 million of real estate at inflated prices. She siphoned overpayments to bank accounts she controlled and collected up to $14.5 million in kickbacks. Purchasers of her fraudulently originated loans, including the enterprises, suffered losses of up to $20 million.

This was a joint investigation with the FBI.

Suspended Real Estate Agent and Six Conspirators Indicted, Kansas City, Kansas

On April 23, 2013, in the U.S. District Court for the District of Kansas, Manjur Alam was indicted for conspiracy, wire fraud, bank fraud, and money laundering; Janice Young, Bruce Dykes, Christopher Ginyard, Henry Pearson Sr., and Steven Pelz were indicted for conspiracy and wire fraud; and Henry Pearson Jr. was indicted for conspiracy. On September 3, 2013, Pearson Sr., Ginyard, and Young pled guilty to wire fraud, and Pearson Jr. pled guilty to bank fraud. Dykes pled guilty to wire fraud on September 5, 2013.

From 2006 to the present, Alam and his conspirators allegedly schemed to sell properties using bogus sellers, buyers, and documentation. Several loans involved in their scheme were purchased by the enterprises.

This was a joint investigation with IRS-CI and HUD-OIG.

Recruiter, Escrow Officer, Builders, and Loan Officers Charged, Dallas, Texas

On April 11, 2013, in the U.S. District Court for the Eastern District of Texas, Lawrence Day was indicted for conspiracy to commit wire and mail fraud, wire fraud, aggravated identity theft, and aiding and abetting; Donna Cobb, Bryan Scott, and Donald Mattox were indicted for conspiracy to commit wire and mail fraud; and Michael Edwards and Scott Sherman were indicted for wire fraud and conspiracy to commit wire and mail fraud.

From September 2005 through July 2008, the defendants allegedly conspired to defraud lending institutions by using material misrepresentations and omissions of material fact in loan documents to induce lenders to fund mortgage loans. Day allegedly recruited buyers and helped loan officers, builders, and escrow officers to perpetrate the fraud for at least 28 properties. Financial institutions have lost $13.2 million in the scheme. Fannie Mae's and Freddie Mac's estimated losses total $968,000 and $130,000, respectively.

This was a joint investigation with the FBI.

Realtor Launders Money Through Real Estate Transactions, Dallas, Texas

On April 10, 2013, realtor Stephen King and loan officer Euneisha Hearns were indicted for conspiracy to commit money laundering in the U.S. District Court for the Eastern District of Texas. On July 11, 2013, King pled guilty to conspiracy to commit money laundering.

During April 2008, King, Hearns, and others allegedly conspired to launder proceeds from fraudulent real estate transactions. The fraudulent real estate transactions scheme caused a loss of $686,000 to the involved financial institutions, including the enterprises, which purchased mortgages that funded the fraudulent transactions.

This was a joint investigation with IRS-CI.

Real Estate Investor Falsifies Loan Documents, St. Louis, Missouri

On April 4, 2013, in the U.S. District Court for the Eastern District of Missouri, Jerrick Hawkins was sentenced to 37 months of incarceration, 60 months of supervised release, and $2,392,237 in restitution, including $144,917 in restitution to Fannie Mae. Hawkins previously pled guilty to bank fraud and false statements.

As a real estate investor, Hawkins supported loan applications with fraudulent documents and received substantial payments for directing buyers into loans that tended to default. The scheme involved over 14 enterprise loans and 21 FHA loans.

This was a joint investigation with HUD-OIG and USPIS.

Appraiser and Borrower Sentenced, Baltimore, Maryland

Appraiser sentenced to 15 months incarceration and $2.4 million in restitution.

On April 3, 2013, Kenneth Koehler was sentenced to 18 months of incarceration, 2 years of supervised release, and $1 million in restitution, after pleading guilty to conspiracy to commit wire fraud. On April 19, 2013, David C. Christian was sentenced to 15 months of incarceration, 3 years of supervised release, and $2.4 million in restitution, after pleading guilty to conspiracy to commit wire fraud. Both were sentenced in the U.S. District Court for the District of Maryland.

Christian prepared at least 17 fraudulent appraisals for $4.3 million in loan originations. Koehler obtained fraudulent loans on six properties. The enterprises purchased many of the loans involved in the scheme and suffered losses of $3.5 million.

This was a joint investigation with the FBI and USPIS. It was prosecuted by the U.S. Attorney's Office for the District of Maryland with assistance from an OIG investigative counsel.

Short Sale Schemes

A short sale occurs when a lender allows a borrower who is "**underwater**" on his/her loan—that is, the borrower owes more than the property is worth—to sell his/her property for less than the debt owed. Short sale fraud usually involves a borrower intentionally misrepresenting or not disclosing material facts to induce a lender to agree to a short sale to which they would not otherwise agree.

Las Vegas Realtors Use Straw Buyer to Commit Short Sale Fraud, Las Vegas, Nevada

On June 12, 2013, Robert and Cynthia Hosbrook were indicted in the U.S. District Court for the District of Nevada for bank fraud and conspiracy.

On June 7, 2010, a short sale was approved for the Hosbrook's personal residence allegedly based on fraudulent representations that the short sale was due to personal hardships, the transaction was arms-length (i.e., the sellers and buyers were not family members), and the seller would not remain in the property subsequent to the sale. In contrast, the Hosbrooks, real estate professionals, allegedly made a cash sale of their personal residence to a relative acting as a straw buyer and remained in their home after the sale. Freddie Mac suffered a loss of $174,000 as a consequence of the short sale.

This was a joint investigation with the Nevada Attorney General's Office.

Homeowner Commits Short Sale Fraud, Sacramento, California

On May 14, 2013, Agustin Simon pled guilty to conspiracy to commit bank fraud in the U.S. District Court for the Eastern District of California.

From March through October 2010, Simon conspired with others, including a real estate broker and a straw buyer, to defraud his financial institution and Freddie Mac by making false statements about the short sale of his home. Simon knowingly failed to disclose an agreement that would ultimately allow him to regain ownership of his home following the short sale. The transaction caused a loss of $107,000 to Freddie Mac and a loss of $247,000 to Tri Counties Bank, a federally insured financial institution.

This was a joint investigation with the FBI, IRS-CI, and Stanislaus County District Attorney's Office.

Loan Modification and Property Disposition Schemes

Many companies claim to be able to secure loan modifications for desperate homeowners. Some even claim affiliation with the government. Unfortunately, the offers usually come with upfront fees and little action, leaving homeowners even worse off. Additionally, various fraud schemes can impact sales of enterprise REO.

Former Loan Officer Defrauds Real Estate Investors, Saint Louis, Missouri

On September 26, 2013, in the U.S. District Court for the Eastern District of Missouri, Daniela Spiridon pled guilty to wire fraud.

Spiridon, operating under various business names including Proficio Mortgage, defrauded individuals by misrepresenting that she had contracts with Fannie Mae and banking institutions allowing her to sell packages of REO properties, as well as individual foreclosed properties, on their behalf. Spiridon required individuals to wire earnest money for foreclosed properties and told them that if they put more money down it was more likely that Fannie Mae would select them as the buyer. Spiridon obtained large down payments (hundreds of thousands of dollars) from investors/victims who thought they were paying for packages of bundled foreclosed properties. Spiridon failed to deliver the properties to the investors and admitted she had no connection with the properties. Since 2011, Spiridon received over $4 million from her scheme and caused losses of over $2.4 million.

This was a joint investigation with the FBI and USPIS.

Distressed Homeowners Targeted, Alameda County, California

On September 24, 2013, in Alameda County Superior Court, California, Karl Robinson, Michael Bachmeier, Thomas Powell, Yamen Elasadi, and Jahi Kokayi were charged with conspiracy to offer a false or forged instrument.

The complaint alleges that between 2008 and 2010, the conspirators received over $5 million from victims who were promised delayed foreclosures and evictions in exchange for upfront cash payments and monthly fees. The conspirators accomplished the delays by recording backdated and forged deeds of trust, filing false bankruptcies, and forging clients' signatures on deeds of trust.

This was a joint investigation with the Alameda County District Attorney's Office, U.S. Office of Trustees, Riverside County Sheriff's Department, Orange County Sheriff's Department, Newport Beach Police Department, Los Angeles County Sheriff's Department, U.S. Attorney's Office, and the FBI.

Four Employees of Mortgage Modification Mill Plead Guilty, Sacramento, California

On June 24, 2013, Jesse Wheeler and Brent Medearis pled guilty to **bankruptcy** fraud. On July 8, 2013, Jewel Hinkles (also known as Cydney Sanchez) pled guilty to bankruptcy fraud. On July 15, 2013, Cynthia Corn pled guilty to misprision of a felony. The pleas occurred in the U.S. District Court for the Eastern District of California.

Wheeler, Medearis, Hinkles, and Corn, employees of Horizon Property Holdings, conspired to defraud distressed homeowners out of fees to accomplish mortgage modifications. From 2008 through at least February 2010, Horizon received some $5 million in fees from more than 1,000 homeowners who were facing foreclosure in exchange for false promises that it would help them modify their mortgages. The conspirators told homeowners that for a substantial upfront payment and a monthly fee they would save the homeowners' residences from foreclosure. However, the conspirators failed to arrange the modifications.

This was a joint investigation with USPIS, the FBI, and the Stanislaus County District Attorney's Office.

Lease Back Fraud Scheme, St. Louis, Missouri

On April 18, 2013, Jay Dunlap was convicted of wire, bank, and mail fraud in the U.S. District Court for the Eastern District of Missouri. On July 31, 2013, he was sentenced to 60 months of incarceration, $346,000 in restitution, and 5 years of supervised release.

Dunlap defrauded homeowners by operating a mortgage rescue scheme in 2006. The scheme—which used a Dunlap employee as a straw buyer—involved buying and financing a property owned by homeowners who were delinquent on their mortgage. The homeowners then rented the property back for a year, with the option to purchase it thereafter. After the year had ended, Dunlap conducted a fake closing to cause the homeowners to believe that they had purchased the property. Dunlap made mortgage payments during the first year, but the payments stopped following the fraudulent closing. Fannie Mae owned or guaranteed the mortgage.

This was a joint investigation with USPIS and the Secret Service.

Fraudulent Loan Modification Scheme Lures Clients with Infomercials and Fake Attorneys, Sacramento, California

On April 11, 2013, in Sacramento County Superior Court, California, Cynthia Flahive pled no contest to taking advance fees associated with a loan modification scheme and then not performing the legal services as represented in violation of a California statute. As a result of her plea, Flahive was sentenced to 3 years of supervised release, 240 hours of community service, and $9,000 in restitution payable to six specific clients. On August 2, 2013, Gregory Flahive pled guilty to grand theft in Sacramento County Superior Court for his role in the mortgage modification scheme. As a result of his plea, Flahive was sentenced to one year of incarceration, three years of supervised release, and $30,609 in restitution.

Attorney sentenced to one year incarceration.

From January 2009 to December 2010, the Flahives and conspirators at Flahive Law Corporation marketed a fraudulent mortgage modification scheme using radio ads and infomercials. Clients purportedly spoke with attorneys in an intake department but were actually speaking with unlicensed office workers. Clients paid mortgage modification fees in advance, but in most cases, no modifications were actually obtained. Included in the group of mortgages for which modifications were to be requested were mortgages owned by the enterprises.

This was a joint investigation with the State of California Attorney General's Office and SIGTARP.

Home Equity Conversion Mortgage Scheme

FHA's Home Equity Conversion Mortgage program offers federally insured reverse mortgages for seniors to convert equity to cash by borrowing against the value of their home. The program is intended to provide otherwise inaccessible cash to seniors, who often have limited income. However, fraudsters have devised a number of ways to rob seniors of the equity they have built over their lives. For example, a loan officer may convince a senior to purchase unnecessary yet costly insurance using their loan proceeds. In other cases, a family member or caretaker may divert loan proceeds to their personal accounts. Fannie Mae has actively purchased Home Equity Conversion Mortgage loans.

Conviction for Defrauding Elderly Homeowner, St. Louis, Missouri

On May 30, 2013, Larry Bradshaw pled guilty to theft of public funds and wire fraud in the U.S. District Court for the Eastern District of Missouri. As a result of his plea, Bradshaw was sentenced to 18 months of incarceration, 3 years of supervised release, and $89,245.73 in restitution.

In 2008, Bradshaw, a former tenant of an elderly victim, devised a scheme to defraud the victim by using a power of attorney to obtain a reverse mortgage on her residence and diverting over $54,000 in loan proceeds to himself. Eventually, Fannie Mae foreclosed on the home when the victim failed to make payments on an insurance policy she never knew she had. To date, the enterprise has not taken action to force the victim out of her home.

Civil Cases

During the reporting period, OIG continued to actively participate in the RMBS Working Group, which was established by the President in 2012 to investigate those responsible for misconduct contributing to the financial crisis through the pooling and sale of RMBS. The working group is a collaborative effort of dozens of federal and state law enforcement agencies.

OIG's participation has included acting as a source of information about the secondary finance market, providing strategic litigation advice, supporting witness interviews, and obtaining and reviewing documents and other evidence. To date, OIG has played a significant role in four cases brought by members of the working group:

- The New York Attorney General instituted two civil proceedings against Bear Stearns—and its successor, JP Morgan Chase—and Credit Suisse, alleging fraud in connection with the sale of RMBS.
- The U.S. Attorney for the Western District of North Carolina instituted a civil proceeding against Bank of America alleging violations of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).
- The U.S. Attorney for the Southern District of New York instituted a civil proceeding against Bank of America and its predecessors, Countrywide Financial Corporation and Countrywide Home Loans, Inc., alleging that they engaged in a scheme to defraud the enterprises in connection with sales of mortgage loans. The complaint seeks damages and civil penalties under the False Claims Act and FIRREA.

Systemic Implication Reports

Systemic Implication Reports identify possible risks and exploitable weaknesses in FHFA's management control systems that OIG discovers during the course of our investigations. We communicate these to the agency promptly so it can strengthen both its systems and those of the entities it supervises and regulates.

Servicer Mortgage Payment Remittance (SIR-2013-5, June 17, 2013)

A mortgage servicer did not follow the Home Affordable Modification Program (HAMP) directives pertaining to processing payments for GSE-held mortgages, resulting in financial losses to Fannie Mae and potentially leading the enterprise to foreclose on properties inappropriately. Rather than apply borrowers' payments to their mortgages while it determined their eligibility for loan modification—a process that could take the servicer up to two years due to backlogs—a servicer held those funds in suspense accounts. This made it appear to Fannie Mae as though borrowers were delinquent—a precursor for foreclosure proceedings. Further, if the servicer found borrowers to be ineligible for HAMP, it returned the held funds to the borrowers rather than to Fannie Mae, as required. The enterprise did not detect the issues due to oversight weaknesses.

We recommended that FHFA consider reviewing Fannie Mae's oversight of servicers to ensure compliance with these HAMP directives.

Federal Home Loan Bank Collateral Verification Reviews (SIR-2013-4, June 17, 2013)

To support $67 million in outstanding advances, Appalachian Community Bank pledged fraudulent and overvalued collateral to the FHLBank of Atlanta. The problematic collateral pledges derived from various schemes. In one scheme, senior managers at Appalachian concealed past due loans from bank regulators by using Appalachian funds to purchase the related properties through a shell company. In another scheme, the senior managers used shell companies to buy condos in Florida, which they then refinanced through Appalachian at inflated values for their personal enrichment. The FHLBank failed to recognize obvious fraud indicators associated with the pledged collateral.

We recommended that FHFA assess FHLBank reviews of assets pledged as collateral and that FHLBank credit and collateralization departments be notified when fraud indicators are found.

Investigations Strategy

OIG has developed and intends to further develop close working relationships with other law enforcement agencies, including DOJ and the U.S. Attorneys' Offices; state attorneys general; mortgage fraud working groups; the Secret Service; the FBI; HUD-OIG; FDIC-OIG; IRS-CI; SIGTARP; FinCEN; and other federal, state, and local agencies.

During this reporting period, OI provided 48 Fraud Awareness Briefings to various audiences.

Regulatory Activities

Consistent with the Inspector General Act, OIG considers whether proposed legislation, regulations, and policies related to FHFA are efficient, economical, legal, and susceptible to fraud and abuse. During the semiannual period, OIG made substantive remarks on a final rule and a proposed rule. Additionally, two rules that OIG previously commented on were finalized and published.[4]

1. **FHFA Final Rule: Stress Testing of Regulated Entities (RIN 2590-AA47, OIG Comments Submitted on July 15, 2013)**

   FHFA forwarded to OIG a draft of a final rule adopted to implement section 165(i)(2) of the **Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)**. This section requires primary financial regulators for certain nonbank financial institutions to conduct annual stress tests under at least three different sets of conditions, including baseline, adverse, and severely adverse, and to publish a summary of the results of the required tests. See 12 U.S.C. § 5365(i)(2)(C)(ii) and 5365(i)(2)(C)(iv). The statute does not vest regulators with the authority to allow institutions to publish a summary of some, but not all, of the required stress tests. To the contrary, the statute makes clear that the summary shall include the results of all the tests.

   Notwithstanding the statute's plain language, FHFA's draft final rule proposed to require the GSEs to publish summaries of the results of stress tests only under severely adverse conditions. OIG recommended that FHFA conform the final rule to the plain language of Dodd-Frank.

   FHFA published the final rule on September 26, 2013, see 78 Fed. Reg. 58,219, which requires the GSEs to publish summaries of the results of stress tests only under severely adverse conditions.

2. **FHFA Proposed Rule: Removal of References to Credit Ratings in Certain FHLBank Regulations (RIN 2590-AA40, OIG Comments Submitted on April 5, 2013)**

   FHFA has adopted a proposed rule to implement section 939A of Dodd-Frank, which requires federal agencies to review regulations that require the use of an assessment of the creditworthiness of a security or money market instrument, to remove any references or requirements regarding credit ratings in them, and to adopt appropriate alternative standards for determining creditworthiness. Although OIG neither concurred nor nonconcurred with the draft proposed rule, it noted that the rule lacked sufficient discussion about what factors the FHLBanks should consider (and how) when assessing investment quality. OIG urged FHFA to address how the FHLBanks are expected to assess investment quality and to emphasize the importance of independence. FHFA did not address these concerns or implement OIG's suggestions in the published version of the proposed rule.

3. **FHFA Interim Final Rule: Executive Compensation (RIN 2590-AA12, OIG Comments Submitted on February 28, 2011)**

FHFA drafted a proposed final rule to implement its responsibility to prohibit and withhold unreasonable and incomparable compensation for executives of the GSEs pursuant to HERA. The draft final rule was based upon a proposed rule, which was published more than a year prior to the commencement of OIG's operations. See 74 Fed. Reg. 26,989 (June 5, 2009).

OIG made three comments on the proposed final rule. First, the draft final rule erred by discarding the previously published proposed rule's provision authorizing enforcement actions against noncompliant entities. FHFA published an interim final rule on May 15, 2013, see 78 Fed. Reg. 28,442, and FHFA neither reinstated the enforcement provision of the proposed rule nor included any comparable regulatory language that allows FHFA to take supervisory action. Instead, FHFA modified the preamble to explain that there is statutory enforcement authority that allows FHFA to obtain restitution or reimbursement from entity-affiliated parties who have been unjustly enriched.

Second, the draft final rule could lead to a violation of the Administrative Procedures Act (APA). The earlier proposed rule set specific requirements for the entities when submitting to FHFA executive compensation information (e.g., concrete time frames for submission). The draft final rule, however, excised these requirements in exchange for issuing informal guidance later. In OIG's view, these information submission requirements qualify as a "legislative rule" for APA purposes and, therefore, notice-and-comment rulemaking is required for their adoption. See 5 U.S.C. § 553(a). Thus, issuing requirements later as informal guidance without notice-and-comment threatens to violate APA. Instead of reinstating the proposed rule's information submission requirements, FHFA modified the language in the interim final rule to indicate that the GSEs are not required to submit particular information.

Third, the draft final rule should be revised to clarify how FHFA will review compensation arrangements put into place many years before the enactment of HERA. Because HERA does not appear to prohibit FHFA from evaluating pre-HERA compensation arrangements, OIG believes that FHFA should specify the criteria that it will apply to such reviews to ensure that they are conducted in a consistent, equitable, and auditable manner. FHFA made no revisions to the interim final rule in this regard.

4. **FHFA Proposed Rule: Golden Parachute and Indemnification Payments (RIN 2590-AA08, OIG Comments Submitted on February 28, 2011)**

During this reporting cycle, FHFA published a proposed rule concerning golden parachute and indemnification payments that OIG previously commented on. See 78 Fed. Reg. 28,452 (May 14, 2013).

OIG made two comments concerning the rule. OIG's first comment critiqued the efficiency of FHFA's proposed two-stage approval process. FHFA plans initially to review and approve any golden parachute agreement into which a GSE seeks to enter and then to review and approve the actual payments made pursuant to such an agreement if the GSE is subject to a specified "triggering event." Such events include a GSE being insolvent, subject to control by a conservator or receiver, in a troubled condition, or suffering from a poor composite rating. OIG contended that this two-stage approval requirement will render the first approval meaningless and, thus, will create a perverse disincentive for FHFA staff to scrupulously analyze golden parachute agreements because oversight mistakes theoretically can be fixed at the payment stage, assuming a triggering event occurs. OIG also noted that the two-stage process could hinder the GSEs' ability to recruit and retain well-qualified employees, who may not work for them if compensation agreements are subject to later revision (i.e., years later at the payment stage).

OIG's second comment pertained to the procedures applicable to FHFA's payment approval process (i.e., the "second approval"). The draft rule provided that when deciding whether to approve payments, FHFA might consider negative factors, such as any fraudulent act or omission; breach of fiduciary duty; violation of law, rule, regulation, order, or written agreement; and the level of willful misconduct and malfeasance on the part of the party who would benefit from the payments. Further, the draft rule stated that such factors may create a presumption against approval, but it did not specify how FHFA will evaluate such factors or what showing would rebut the presumption. OIG recommended that FHFA should articulate the criteria that it will apply when weighing negative factors and define the showing required to rebut the presumption against approval. These revisions would avoid future claims alleging arbitrary and capricious action by FHFA and would facilitate development of an accurate, transparent audit trail, allowing OIG and other interested parties to review FHFA's decision making.

FHFA did not revise the proposed rule to address OIG's comments.

Communications and Outreach

A key component of OIG's mission is to communicate clearly with the GSEs, industry groups, other federal agencies, Congress, and the public. OIG facilitates clear communications through its targeted outreach efforts, hotline, coordination with other oversight organizations, and congressional statements and testimony.

Outreach

During the reporting period, OIG staff made over 50 presentations to law enforcement officials, real estate and banking industry professionals, and homeowners. The presentations to law enforcement officials were made to multiple mortgage fraud working groups across the country and individual federal agencies responsible for investigating mortgage fraud, such as the FBI, HUD-OIG, and the Secret Service. In addition, OI developed its partnership with the National Association of District Attorneys to train local and state law enforcement officials and prosecutors throughout the country, putting on 11 presentations in 11 cities: Ft. Myers, Florida; Boston, Massachusetts; Princeton, New Jersey; Portland, Oregon; Atlanta, Georgia; San Juan, Puerto Rico; New York, New York; Chicago, Illinois; Las Vegas, Nevada; Seattle, Washington; and Denver, Colorado.

With respect to presentations to housing professionals, OIG staff made presentations to professional organizations, such as the Mortgage Bankers Association and the Association of Appraisal Regulatory Officials. The presentations focused on fraud trends in the mortgage industry.

Hotline

OI operates a hotline that allows concerned parties to report directly and in confidence information regarding possible fraud, waste, or abuse related to FHFA or the GSEs. We honor all applicable whistleblower protections. As part of our effort to raise awareness of fraud and how to combat it, OIG promotes the hotline through our website, posters, emails targeted to FHFA and GSE employees, and our semiannual reports.

During the reporting period, the hotline received over 250 tips.

Report fraud, waste, or abuse related to FHFA's programs and operations by visiting www.fhfaoig.gov/ReportFraud or calling (800) 793-7724.

Coordinating with Other Oversight Organizations

OIG shares oversight of federal housing program administration with several other federal agencies, including HUD, the Department of Veterans Affairs, the Department of Agriculture, and Treasury's Office of Financial Stability (which manages the Troubled Asset Relief Program); their inspectors general; and other law enforcement organizations. To further the oversight mission, we coordinate with these entities to exchange best practices, case information, and professional expertise. During the semiannual period ended September 30, 2013, we participated in the following cooperative activities:

- ***RMBS Working Group.*** OIG continued to actively participate in the RMBS Working Group, as discussed in "Civil Cases" (see page 32).
- ***Joint Report on Federally Owned or Overseen Real Estate Owned Properties.*** We partnered with HUD-OIG to report on our efforts to shrink the inventory of REO properties held by the GSEs and HUD.[5] As of September 30, 2012, the GSEs held 158,138 REO properties, while HUD held 37,445. In addition, the GSE and HUD "shadow inventory"—residential loans at least 90 days delinquent but not yet owned by the GSEs or HUD—totaled 1,708,033 properties. Even a fraction of the shadow inventory falling into foreclosure could considerably swell HUD and GSE REO inventories and result in profoundly negative consequences for communities, financial markets, and taxpayers. The report discusses areas that our offices have examined or plan to evaluate to help ensure that our respective agencies address REO issues effectively and efficiently.
- ***Council of Inspectors General on Financial Oversight.*** The Council of Inspectors General on Financial Oversight (CIGFO) was created by Dodd-Frank to oversee the Financial Stability Oversight Council (FSOC), which is charged with strengthening the nation's financial system. OIG is a permanent member of CIGFO, along with the inspectors general of Treasury, FDIC,

the SEC, and others. In July 2013, CIGFO published its *Audit of the Financial Stability Oversight Council's Designation of Financial Market Utilities.*[6] Among other activities, FSOC designates financial market utilities, which provide infrastructure for processing transactions among financial institutions, as "systemically important" if their failure could create liquidity or credit problems in financial sectors. If designated as such, a utility is subject to enhanced monitoring. The report made several recommendations to FSOC, including that it consider foreign utilities, establish guidelines for monitoring activities, and conduct periodic reviews.

Communicating with Congress

In fulfilling our mission, OIG works in close partnership with Congress and is committed to keeping it fully apprised of our oversight of FHFA. The former Inspector General met regularly with members of Congress, and he and his staff provided frequent briefings to key congressional committees and offices. Briefing topics included recommendations from OIG reports and FHFA's progress in implementing them, themes emerging in OIG's body of work, OIG's organization and strategy, and areas of ongoing work.

Additionally, we endeavor to inform Congress through responses to numerous technical assistance and information requests. During the reporting period, the former Inspector General responded to formal written inquiries from members of Congress on various topics, including high-priority unimplemented recommendations, consumer protection laws, and FHFA progress and remaining challenges in reducing reliance on enterprise decision making.

Further, the former Inspector General testified before the Senate Banking, Housing and Urban Affairs Committee on April 18, 2013, at a hearing entitled *Oversight of Federal Housing Finance Agency: Evaluating FHFA as a Regulator and Conservator.* The hearing covered a variety of topics, including enforcement of agency directives, examination capacity, FHFA's ability to implement and oversee multiple new initiatives, implementation of OIG recommendations, PSPA amendments, and challenges stemming from ongoing uncertainty.

Copies of the Inspector General's written testimony to Congress are available at www.fhfaoig.gov/testimony.

Section 2: FHFA and GSE Operations

Overview

In July 2008, HERA created FHFA to oversee vital components of our nation's secondary mortgage market.[7] FHFA is responsible for the effective supervision, regulation, and housing mission oversight of Fannie Mae, Freddie Mac, the FHLBanks, and the FHLBanks' Office of Finance to promote their safety and soundness and to support housing finance, affordable housing, and a stable and liquid market.[8]

In this section, we provide an overview of FHFA and its relationship with the GSEs; a brief discussion of the GSEs' business models and the primary reasons for their improved financial results; and a summary of selected FHFA and GSE activities.

FHFA and the Enterprises

Under HERA, FHFA was appointed conservator of the enterprises on September 6, 2008, and it serves as their regulator and conservator. As regulator, the agency's mission is to ensure the enterprises operate in a safe and sound manner and that their operations and activities contribute to a liquid, efficient, competitive, and resilient housing finance market.[9] As conservator, the agency seeks to conserve and preserve enterprise assets.

FHFA accomplishes its mission by performing onsite examinations of the enterprises; coordinating congressional, public, and consumer inquiries; assisting the enterprises with foreclosure prevention actions; and developing and implementing a strategic plan for the future of the enterprises' conservatorships.[10]

The enterprises were chartered by Congress to provide stability and liquidity in the secondary market for home mortgages. They fulfill this charter by purchasing residential loans from loan originators that can use the sales proceeds to make additional loans.

Under HERA, the enterprises receive financial support from Treasury to prevent their liabilities from exceeding their assets, subject to a cap.[11]

FHFA and the Enterprises' Role in Housing Finance

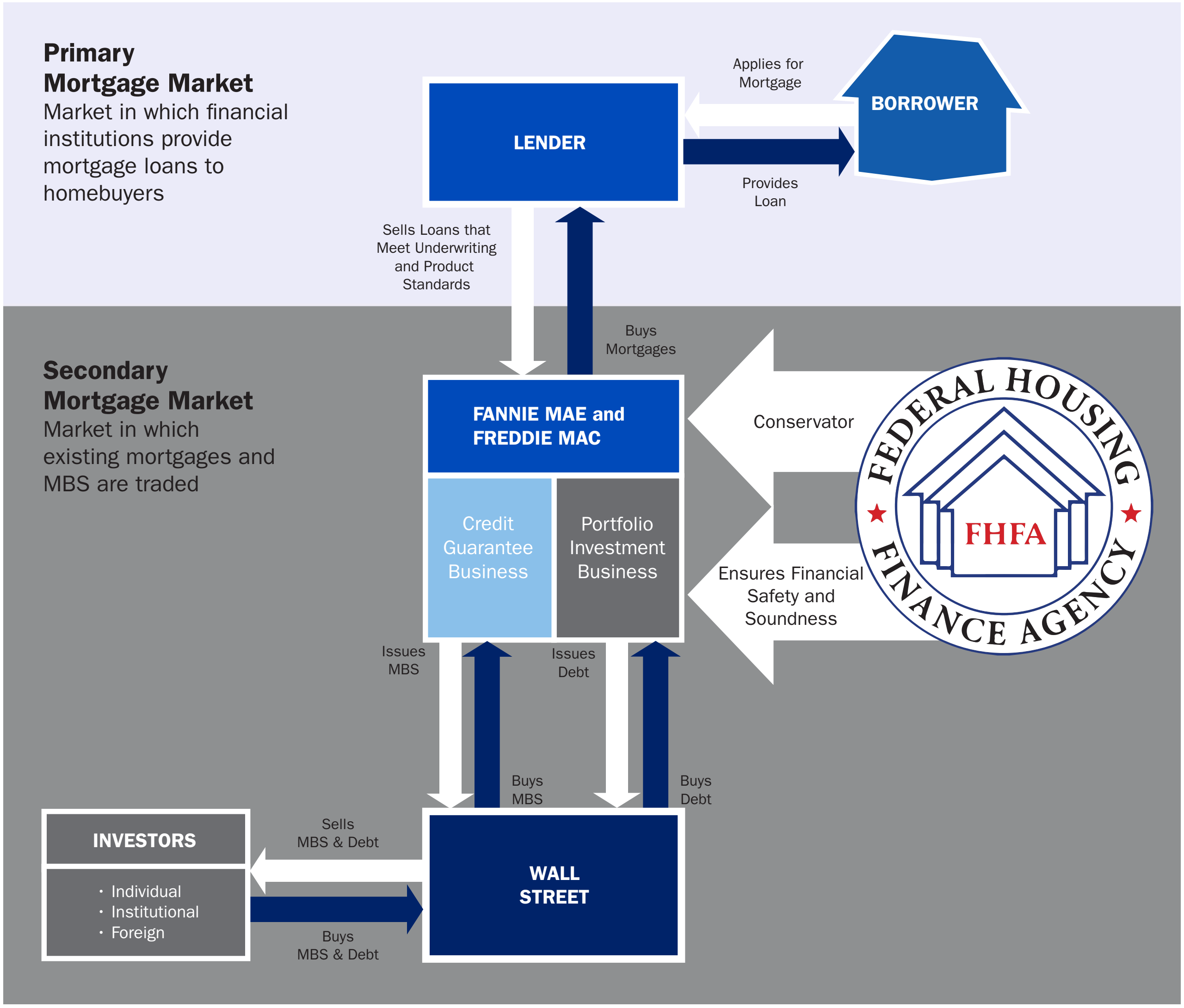
As the regulator of the enterprises, FHFA has a statutory responsibility to ensure that they operate in a safe and sound manner and that their activities support a stable and liquid housing finance market.[12]

As Figure 10 (see page 39) illustrates, the enterprises support the nation's housing finance system by providing liquidity to the secondary mortgage market. Liquidity is created when the enterprises purchase mortgages that lenders—such as banks, **credit unions**, and other retail financial institutions—originated for homeowners.

These mortgages are **securitized** by pooling and packaging them into MBS and are either sold or kept by the enterprises as an investment. As part of this process, the enterprises—for a fee—guarantee payment of principal and interest on the mortgages.

Historically, the enterprises have benefited from an **implied guarantee** that the federal government would prevent default on their financial obligations, and the enterprises assumed dominant positions in the residential housing finance market.[13]

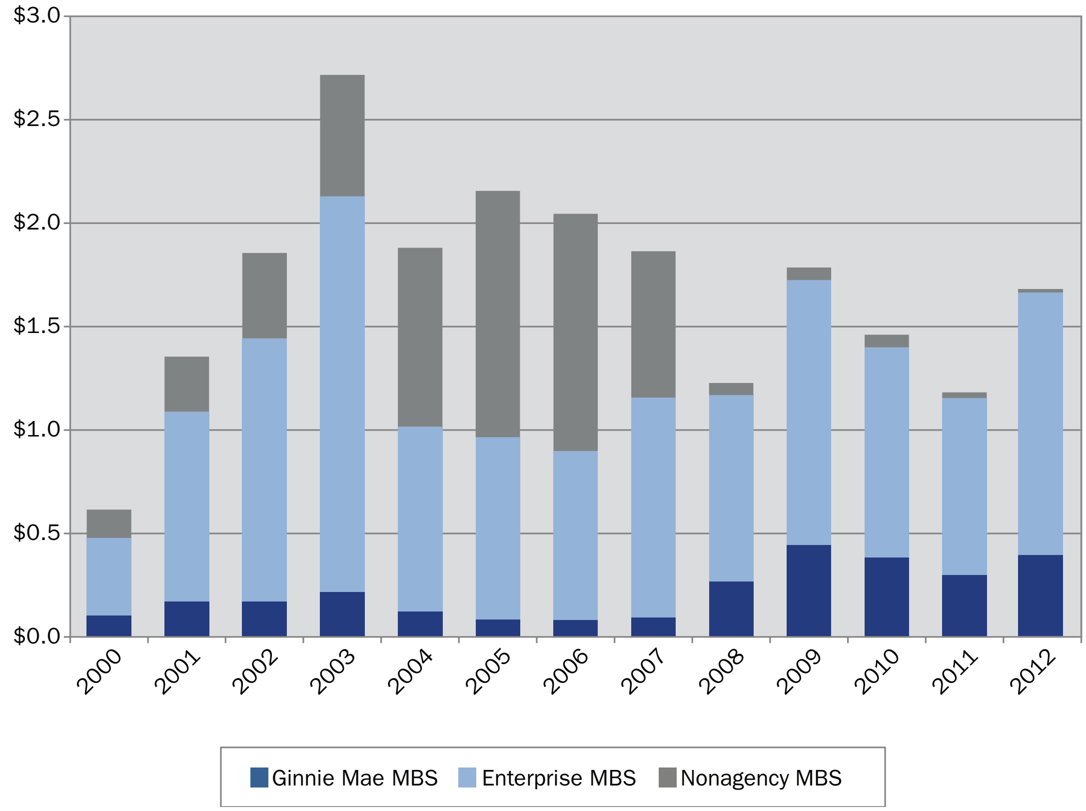
Figure 10. Overview of the Enterprises and FHFA's Role



Enterprises' Market Share of the Secondary Market

As Figure 11 (see page 40) illustrates, after losing market share to nonagency competitors during the housing boom from 2004 through 2007, the enterprises regained dominant positions in the residential housing finance market (with the federal government's financial support) as the financial crisis continued and private-sector financing for the secondary market nearly disappeared.[14]

Figure 11. Primary Sources of MBS Issuances from 2000 to 2012 ($ trillions)



Since entering conservatorships in September 2008, the enterprises have bought and guaranteed approximately three out of every four mortgages originated in the United States.[15] By providing a majority of the liquidity to the housing finance market, the enterprises (and, therefore, the taxpayers) own a majority of the mortgage credit risk.[16]

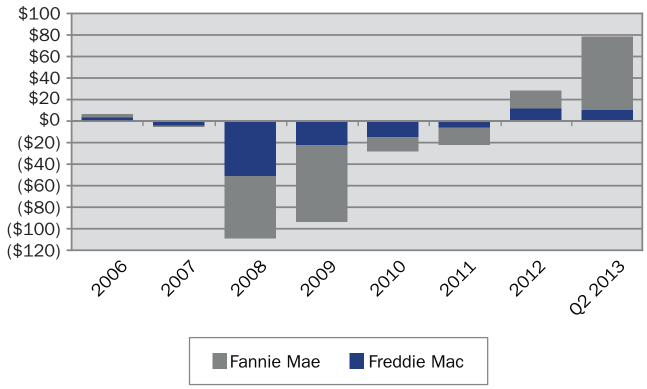
Since entering conservatorships in September 2008, the enterprises have bought and guaranteed approximately three out of every four mortgages originated in the United States.

Enterprises' Financial Performance

For the six months ended June 30, 2013, the enterprises reported record profits. These profits have risen since 2012 and are beginning to offset the losses that started in 2007 (see Figure 12, page 41).[17]

As shown in Figure 13 (see page 41), Fannie Mae reported net income of $68.8 billion for the six months ended June 30, 2013, compared with net

Figure 12. Enterprises' Annual Net Income (Loss) 2006 Through Second Quarter 2013 ($ billions)



income of $7.8 billion for the same period in 2012.[18] Freddie Mac reported net income of $9.5 billion for the six months ended June 30, 2013, compared with net income of $3.6 billion for the same period in 2012.[19]

A key factor in Fannie Mae's net income for this period is the release of a substantial portion of its **valuation allowance** against its **deferred tax assets**. The enterprises are required to maintain a valuation allowance for deferred tax assets that they determine will not be realized. This caused them to establish substantial allowances to balance deferred tax assets during the years that they experienced net losses. As of March 31, 2013, however, Fannie Mae determined that the factors in favor of releasing the allowance outweighed the factors in favor of maintaining it. Therefore, Fannie Mae released a substantial portion of its valuation allowance during the first quarter of 2013, which resulted in the recognition of $50.6 billion as a federal income tax benefit.[20]

The release of the valuation allowance on Fannie Mae's deferred tax assets does not include $491 million of the valuation allowance that pertains to **capital loss carryforwards**. Additionally, Fannie Mae expects that any remaining valuation allowance not related to capital loss carryforwards will be reduced against income before federal income taxes throughout the remaining quarters of 2013 until that amount is reduced to zero by December 31, 2013.[21]

Freddie Mac, on the other hand, continues to evaluate the pros and cons (on a quarterly basis) regarding whether a valuation allowance is necessary for their deferred tax assets. As of June 30, 2013, Freddie Mac determined that the cons continue to outweigh the pros in supporting a release of the valuation allowance; and, therefore, it will not be able to realize deferred tax assets. However, with recent continued improvements in earnings, the evidence for releasing the valuation allowance (i.e., positive evidence) has been improving and additional evidence could become positive as early as the third quarter of 2013.[22]

Other key factors in the enterprises' continued profitability are discussed below. These factors include: (1) continued improvements in the single-family

Figure 13. Enterprises' Summary of Net Income for the Six Months Ended June 30, 2013 and 2012 ($ billions)

	Fannie Mae		Freddie Mac	
	2013	2012	2013	2012
Net Interest Income	$12.0	$10.6	$8.4	$8.9
Credit-related Income (Expenses)	6.9	0.8	1.2	(2.1)
Gain (Loss) on Derivative Agreements	1.8	(2.4)[a]	1.7	(1.9)
Impairment of Securities Considered Other than Temporary	(0.0)	(0.7)	(0.1)	(0.7)
Other Income (Expense)	48.1	(0.5)	(1.7)	(0.6)
Net Income	**$68.8**	**$7.8**	**$9.5**	**$3.6**

[a] Loss on derivatives referenced to Table 8, p. 21, in the Fannie Mae 2013 Second Quarter 10-Q Report.

business segment driven by stronger credit quality, (2) increases in guarantee fee income as a result of FHFA direction, (3) an increase in home prices causing a reduction in defaults, and (4) **derivative gains** due to an increase in swap rates.

Continued Improvement in Credit Quality of New Single-Family Business

Fannie Mae's credit-related income for the six months ended June 30, 2013, was $6.9 billion, compared with $772 million for the same period in 2012.[23] Freddie Mac's credit-related income for the six months ended June 30, 2013, was $1.2 billion, compared with credit-related expenses of $2.1 billion for the same period in 2012.[24] The increase in credit-related income is primarily the result of continued improvements in the credit quality of each enterprise's single-family book of business—as higher credit quality leads to fewer loan delinquencies—and the increase in national home prices.[25]

The enterprises' single-family books of business consist of loans purchased and guaranteed that generate interest and guarantee fee income. The credit quality of the single-family loans acquired by the enterprises beginning in 2009 (excluding HARP and other relief refinance mortgages) is significantly better than that of those loans acquired from 2005 to 2008, as measured by **loan-to-value (LTV)** ratios, FICO scores, and the proportion of loans underwritten with fully documented income.[26]

This improved credit quality is attributed to: (1) more stringent credit policies and **underwriting** standards, (2) tighter mortgage insurers' and lenders' underwriting practices, and (3) fewer purchases of loans with higher-risk attributes (e.g., **Alt-A**, interest-only, credit scores below 620, and LTV ratios above 90%).[27]

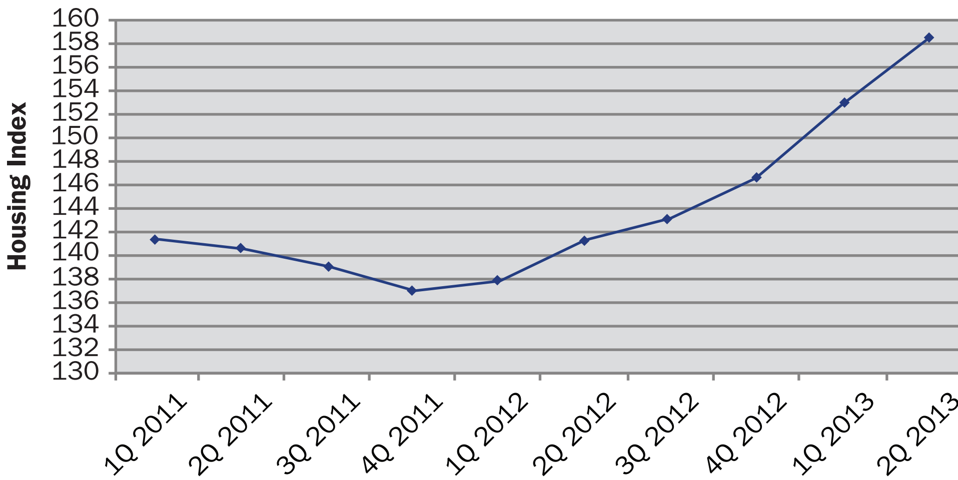
Further, the enterprises are now holding more loans with higher credit quality acquired from 2009 to present in their single-family books of business. As of June 30, 2013, loans acquired after 2008 comprised 72% and 70%, respectively, of Fannie Mae's and Freddie Mac's books of business.[28] Conversely, the legacy housing boom loans acquired from 2005 through 2008, which have a higher probability of credit defects, have declined to 17% of the single-family book of business for Fannie Mae and 19% for Freddie Mac as of June 30, 2013, compared with 26% and 28%, respectively, as of June 30, 2012.[29]

Increase in Guarantee Fee Prices

A significant source of income for the enterprises comes from receiving guarantee fees.[30] MBS investors of both single-family and multifamily loans pay these fees to gain an enterprise guarantee of the principal and interest payment.[31] In 2012, FHFA directed the enterprises to increase their guarantee fees, and FHFA intends to direct further gradual guarantee fee increases to achieve several objectives, such as increasing private-sector investment in mortgage credit risk.[32] As a result, guarantee fee income increased for the six months ended June 30, 2013, with an expectation that future increases will further augment revenue. Additionally, Fannie Mae's increase for the six months ended June 30, 2013, is a result of liquidating loans with lower guarantee fees while adding loans with higher guarantee fees to their multifamily book of business.[33]

Fannie Mae's combined single-family and multifamily guarantee fee income for the six months ended June 30, 2013, was $5.5 billion, compared with $4.4 billion for the same period in 2012—a 26% increase; Freddie Mac's combined single-family and multifamily guarantee fee income for the six months ended June 30, 2013, was $2.6 billion, compared with $2.1 billion for the same period in 2012—a 25% increase.[34]

Figure 14. Home Price Index 2011 Through Second Quarter 2013



Impact of National Home Prices on Credit Losses

Another factor positively influencing credit-related expenses, i.e., credit losses, is national home prices. An increase in home prices can decrease the likelihood that loans will default and reduce the estimated credit losses on the loans that default.[35] As shown in Figure 14 (see above), the S&P/Case-Shiller Home Price Indices for the last 10 quarters ending June 30, 2013, show a steady increase in the housing index since the first quarter of 2012.[36]

Higher Increases in Swap Rates Lead to Derivative Gains

The enterprises use **derivative** instruments to manage the interest rate and prepayment risk associated with their investments in mortgage loans and mortgage-related securities.[37] Derivative instruments include written options, interest rate guarantees, and short-term default guarantee commitments.[38]

Fannie Mae's derivative gains for the six months ended June 30, 2013, were $1.8 billion, compared with a loss of $2.4 billion for the same period in 2012. Freddie Mac's derivative gains for the six months ended June 30, 2013, were $1.7 billion, compared with a loss of $1.9 billion for the same period in 2012.[39]

These overall derivative gains were primarily due to gains in risk management derivatives and mortgage commitment derivatives. The gains in risk management derivatives were a result of increases on swap rates, and the increases in mortgage commitment derivatives were a result of gains on commitments to sell mortgage-related securities, as a consequence of a decrease in prices as interest rates increased during the commitment period.[40]

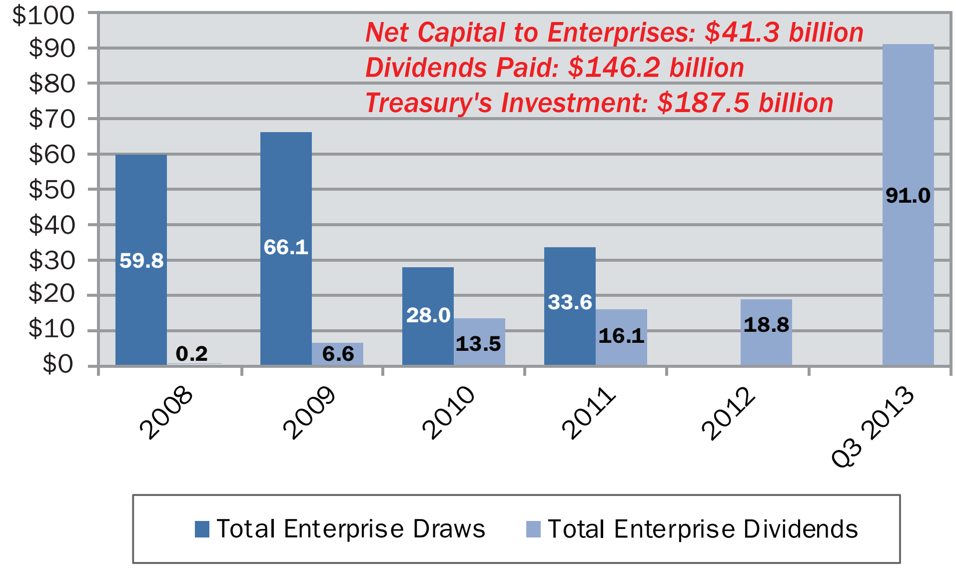
Government Support

Due to the continued profitability of the enterprises, they are no longer requesting draws from Treasury, are paying significant dividends, and do not currently require additional government support.

Treasury Draw Requests and Dividend Payments Due Under the Senior Preferred Stock Purchase Agreements

In August 2012, FHFA and Treasury agreed to a third amendment to the PSPAs that, among other

Figure 15. Enterprises' Treasury Draws and Dividend Payments Due Under PSPAs ($ billions)



things, replaced the fixed dividend rate the enterprises pay as of the first quarter of 2013. This ended the circular practice of the enterprises drawing funds from Treasury in order to pay dividends back to Treasury. The enterprises' net worth (above a specified amount) is now effectively distributed to Treasury; for the six months ended June 30, 2013, approximately $76.4 billion was distributed, with an additional $14.6 billion due in the third quarter of 2013.[41]

Fannie Mae's net worth, including **noncontrolling interests**, as of June 30, 2013, was $13.2 billion, resulting from comprehensive net income of $69.6 billion for the six months ended June 30, 2013, and a beginning equity balance of $7.2 billion—i.e., the enterprise's net worth as of December 31, 2012—less $63.6 billion paid to Treasury in senior **preferred stock** dividends during the first half of 2013. As a result, Fannie Mae did not request a draw from Treasury in the second quarter of 2013 under the PSPA.[42]

Freddie Mac's net worth as of June 30, 2013, was $7.3 billion, resulting from comprehensive net income of $11.3 billion for the six months ended June 30, 2013, and a beginning equity balance of $8.8 billion less $12.8 billion paid to Treasury in senior preferred stock dividends during the first half of 2013. As a result, Freddie Mac did not request a draw from Treasury in the second quarter of 2013 under the PSPA.[43]

As shown in Figure 15 (see above), since the conservatorships began in 2008 through September 30, 2013, the enterprises have drawn a total of $187.5 billion from Treasury and paid $146.2 billion in dividends. As of June 30, 2013, Fannie Mae's total draws from Treasury under the PSPA remain at $116.2 billion and Freddie Mac's remain at $71.3 billion.[44]

For the second quarter of 2013, Fannie Mae and Freddie Mac made dividend payments of $59.4 billion and $7 billion, respectively, to Treasury without any assistance under the PSPAs. For the third quarter of 2013, Fannie Mae and Freddie Mac will make additional payments of $10.2 billion and $4.4 billion, respectively, under the terms of the PSPAs. As of September 30, 2013, Fannie Mae and Freddie Mac will have paid Treasury a total of $105.3 billion and $40.9 billion, respectively, in dividends on the senior preferred stock.[45] These dividend payments do not reduce the principal balance of Treasury's investments in the enterprises.[46]

Additional Government Support

The enterprises also benefited from extraordinary government measures to support the housing market overall. Since September 2008, the Federal Reserve and Treasury have purchased more than $1.3 trillion in enterprise MBS, and the Federal Reserve has purchased an additional $135 billion of **bonds** issued by the enterprises.[47] The Federal Reserve became the predominant purchaser of MBS during its purchase programs, and its purchases helped to prime the nation's housing finance system.[48]

As of the second quarter of 2013, the enterprises currently do not require additional government support. Treasury's last purchase of enterprise MBS, through the **GSE MBS Purchase Facility**, was in December 2009, and the Federal Reserve last purchased MBS and bonds from the enterprises in March 2010.[49]

FHLBank System

The FHLBanks are GSEs, federally chartered but privately **capitalized** and independently managed. The 12 regional FHLBanks together with the Office of Finance, the fiscal agent of the FHLBanks, comprise the FHLBank System. All FHLBanks operate under the supervisory and regulatory framework of FHFA.[50] FHFA's stated mission with respect to the FHLBanks is to provide effective supervision, regulation, and housing mission oversight to promote the FHLBanks' safety and soundness, support housing finance and affordable housing, and facilitate a stable and liquid mortgage market.[51]

The FHLBank System was created in 1932 to improve the availability of funds for home ownership and its mission is to provide local lenders with readily available, low-cost funding to finance housing, jobs, and economic growth.[52] The 12 FHLBanks fulfill this mission by providing liquidity to their members, resulting in an increased availability of credit for residential mortgages, community investments, and other housing and community development services.[53]

The FHLBanks are cooperatives that are owned privately and wholly by their members. Each FHLBank operates as a separate entity within a defined geographic region of the country, known as its district, with its own board of directors, management, and employees. Each member of an FHLBank must purchase and maintain capital stock as a condition of its membership.[54] FHLBank members include financial institutions such as **commercial banks**, **thrifts**, **insurance companies**, and credit unions.[55] Figure 16 (see page 46) provides a map of the districts of the 12 FHLBanks.

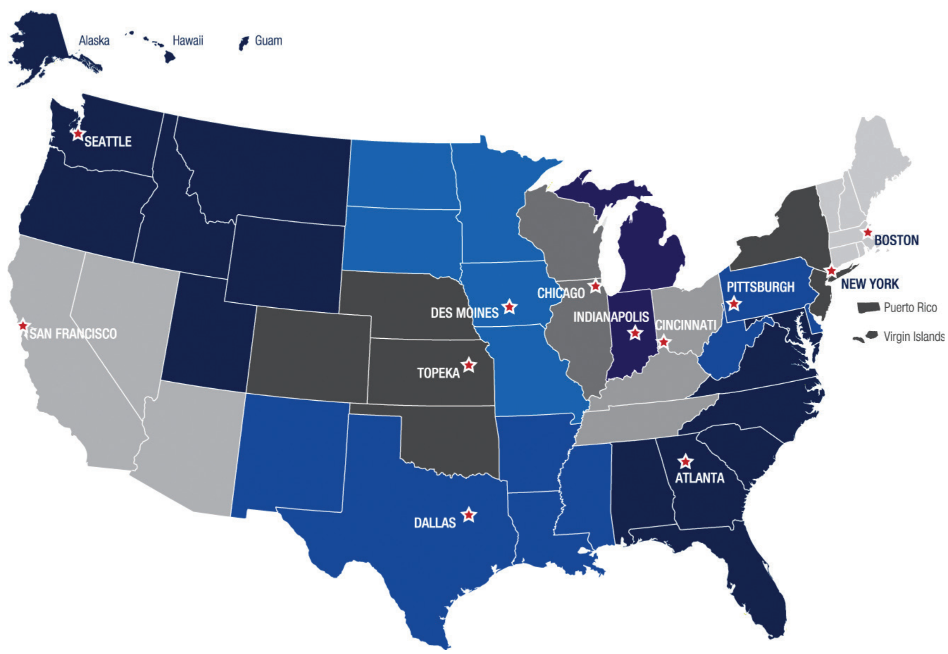
The primary business of the FHLBanks is to raise funds in the capital markets by issuing debt, known as consolidated obligations, through the Office of Finance and to use the consolidated obligations to provide their members with loans, known as advances.[56] The interest earned on advances less the interest owed on consolidated obligations is the FHLBanks' primary source of earnings.[57]

In the event of a default on a consolidated obligation, each FHLBank is **jointly and severally liable** for losses, which means that each individual FHLBank is responsible for the principal and interest on all consolidated obligations issued by the FHLBanks.[58] However, like the enterprises, the FHLBank System has historically enjoyed benefits (e.g., debt costs akin to those associated with Treasury bonds) stemming from an implicit government guarantee of its consolidated obligations.[59]

The FHLBanks' Combined Financial Performance

The regional housing markets affect the FHLBanks' demands for advances from member institutions

Figure 16. Regional FHLBanks



to fund residential mortgage loans. During the six months ended June 30, 2013, FHLBank members' borrowing increased but remained below historical levels due in part to a slow economic recovery combined with higher consumer deposits and weakened lending. Further, during this period, the demand for advances continued to show signs of regional stabilization and certain FHLBank members, particularly large-asset members, increased their use of advances.[60]

The main source of the FHLBanks' income is interest earned on advances, mortgage loans, and investments (i.e., assets).[61] Fluctuations in short-term interest rates affect the FHLBanks' interest income and expense because a considerable portion of the FHLBanks' assets and liabilities are either directly or indirectly tied to short-term interest rates.[62]

For the six months ended June 30, 2013, compared with the same period in 2012, short-term interest rates generally decreased, and the FHLBanks had a modest increase—1.9%—in net income.[63]

As shown in Figure 17 (see page 47), during the six months ended June 30, 2013, the FHLBanks experienced a marginal increase in profitability, compared with the same period in 2012. Their net income was $1.3 billion for the six months ended June 30, 2013, an increase of only $25 million compared with the same period in 2012.[64]

Lower returns on interest-earning assets—the main factor influencing net income—largely

During this period, the demand for advances continued to show signs of regional stabilization and certain FHLBank members increased their use of advances.

Figure 17. FHLBanks' Net Income for the Six Months Ended June 30, 2013 and 2012 ($ millions)

	2013	2012
Net Interest Income	$1,682	$2,048
Reversal of (Provision for) Credit Losses	10	(13)
Other-than-Temporary Impairment Losses[a]	(6)	(86)
Other Income (Loss)	189	(31)
Total Non-interest Expense	(421)	(485)
Total Assessments	(144)	(148)
Net Income	**$1,310**	**$1,285**

[a] Of the other-than-temporary impairment losses, private-label MBS comprised $6 million and $84 million for the six months ended June 30, 2013 and 2012, respectively.

derive from decreases in interest income on advances, **held-to-maturity securities**, prepayment fees, and mortgage loans. Interest income on advances decreased from $1.6 billion to $1.3 billion—i.e., 21%—and interest income on held-to-maturity securities decreased from $1.3 billion to $1.1 billion—a 19% decline—for the six months ended June 30, 2013, compared with the same period in 2012. Also during this period, interest income on prepayment fees was reduced from $158 million to $64 million—or 59%—and interest income on mortgage loans decreased from $1.1 billion to $969 million—a 15% decline, compared with the same period in 2012.[65]

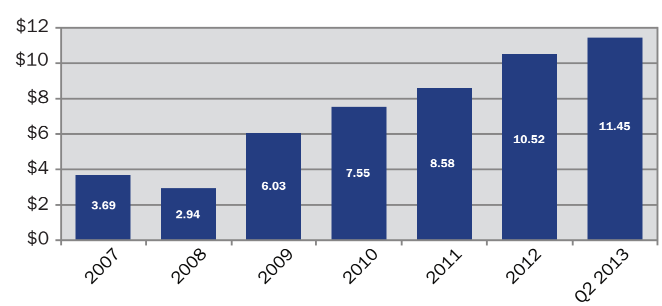
On the other hand, a decrease in interest expense from $3.2 billion to $2.6 billion—i.e., 20%—prevented additional declines in net interest income. The decrease was driven by lower funding costs and reductions in the balances of interest-bearing liabilities. The refinancing of consolidated obligations, which resulted in lower interest payments, was a key contributor to this decline. Due to these lower payments, consolidated obligation expenses decreased from $3.1 billion to $2.4 billion, or 22%, for the six months ended June 30, 2013, compared with the same period in 2012.[66]

The FHLBanks are exposed to interest rate risk primarily from the effect of interest rate changes on their interest-earning assets, as well as the funding sources for these assets. The goal of the FHLBanks is not to eliminate interest rate risk entirely but to manage it within appropriate limits. To achieve this goal, the FHLBanks use derivatives (e.g., **interest rate swaps**, **options**, and **swaptions**), which help reduce funding costs, maintain favorable interest rates, and manage overall assets and liabilities.[67]

Changes in mark-to-market items prevented further declines in overall profitability, adding gains on derivatives and hedging activities. Specifically, the gains accounted for additional non-interest income of $293 million for the six months ended June 30, 2013, compared with a loss of $1 million for the same period in 2012—a substantial increase.[68]

As shown in Figure 18 (see below), the FHLBanks' combined retained earnings have increased every year for the last six years and now approach $12 billion as of June 30, 2013.[69] As long as the FHLBanks are profitable, retained earnings should continue to increase because of the joint capital enhancement plan provisions adopted by the FHLBanks last year. The plan calls for the FHLBanks to set aside 20% of their net income into a separate, restricted retained earnings account.[70] The joint capital enhancements ensure

Figure 18. FHLBanks' Retained Earnings 2007 Through Second Quarter 2013 ($ billions)



members' access to liquidity during times of economic stress; create an additional buffer to absorb FHLBank losses; provide protection on members' capital investments; and ensure that the FHLBanks will meet their consolidated obligations.[71]

Selected FHFA and GSE Activities

Over the last six months, there were several significant FHFA and GSE developments related to: developing a common securitization infrastructure; creating exemptions to appraisal requirements for higher-priced mortgages; assessing the viability of the enterprises' multifamily lending businesses in the absence of a government guarantee; sharing credit risk with private investors; proposing legislation designed to replace the activities of the enterprises with a system more reliant on private capital; and recovering enterprise losses stemming from alleged violations of securities laws in the sale of **private-label MBS**. These developments and OIG's efforts in relation to them are summarized below.

Mortgage Industry Standards

Common Securitization Infrastructure

In April 2013, FHFA issued a progress report on the development of a common securitization infrastructure for RMBS. Earlier, in an October 2012 white paper, FHFA called for a two-pronged approach involving the creation of a new **securitization platform** and a model contractual and disclosure framework. The proposal was designed to contract the dominant presence of the enterprises in the secondary mortgage market while simplifying and shrinking their operations. FHFA received public responses to the white paper from a broad cross-section of industry participants and other stakeholders in the securitization process.[72]

Based on this feedback, the update noted progress on the design, scope, and building of a securitization platform to perform functions related to data validation, issuance, disclosures, master servicing, and bond administration. Additionally, it reported that efforts to align enterprise contracts and standards for agency MBS are continuing. The update also noted that the development of uniform contracts and standards for credit risk transfer activities is proceeding according to plan.[73]

On August 22, 2013, OIG issued to FHFA a report assessing risks and fraud threats in the securitization infrastructure under development and recommending countermeasures for potential threats. Because information in this report could be used to exploit vulnerabilities and circumvent recommended countermeasures, it has not been released publicly.

Appraisal Requirements for Higher-Priced Mortgages

In July 2013, six federal financial regulatory agencies issued a proposed rule creating three exemptions to appraisal requirements for higher-priced mortgage loans. In January, the agencies had issued a rule requiring creditors making higher-priced mortgage loans to use a licensed or certified appraiser to prepare a written appraisal report based on a physical visit to the interior of the property. Loans are considered higher priced if they are secured by a consumer's home and have interest rates above a certain threshold. The July 2013 proposed rule exempts from the appraisal requirements loans of $25,000 or less, certain "streamlined" refinancings, and certain loans secured by manufactured housing.[74]

Mortgage Transactions

Multifamily Housing

In May 2013, FHFA released reports from the enterprises assessing the potential viability of their multifamily housing lending businesses without the benefit of a government guarantee. The enterprises had also been asked by FHFA, as part of the *2012 Conservatorship Scorecard*, to analyze the likelihood of the firms operating on a stand-alone basis after attracting private-sector capital and making adjustments for pricing. The reports concluded that without government guarantees, the enterprises' multifamily businesses would have little inherent value and the sale of those businesses would return little value to Treasury or the taxpayers.[75]

Since the conservatorships began, the enterprises have used their government guarantees to provide a secondary market for $30 billion to $50 billion in annual multifamily loan production. Fannie Mae, currently the largest lender in the multifamily market, said that because of the need to capitalize an independent firm's balance sheet, neither Fannie Mae nor Treasury would benefit from the sale of the business. In addition, it said the withdrawal of the government guarantee would have serious negative consequences for independent lenders, borrowers, and the renters they serve.[76]

Risk Reduction Initiative

In July 2013, Freddie Mac offered $500 million of bonds designed to reduce credit exposure and taxpayer risk. The Structured Agency Credit Risk Debt Notes were the first in a planned series of bond offerings that are not guaranteed by Freddie Mac.[77]

Due to investor demand, the size of the bond offering was increased from $400 million to $500 million and attracted 50 diversified investors, including mutual funds, hedge funds, real estate investment trusts, pension funds, banks, insurance companies, and credit unions.[78]

FHFA's Acting Director noted that the transaction was "a key step in the process of attracting private capital back to the U.S. housing finance market."[79] FHFA's *Conservatorship Strategic Plan: Performance Goals for 2013* called on each enterprise to test the viability of multiple types of risk transfer transactions involving single-family mortgages with at least $30 billion of unpaid principal balances in 2013.[80]

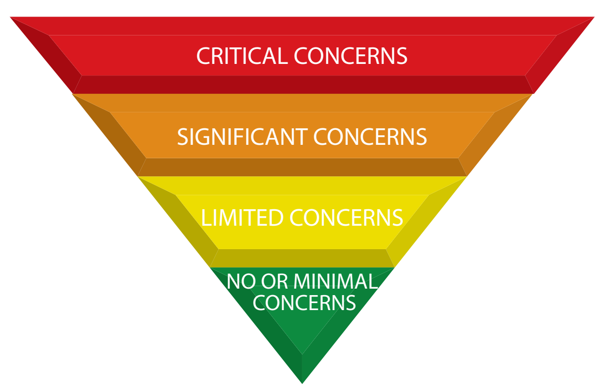
FHFA and GSE Performance and Accountability

On June 13, 2013, FHFA released its *2012 Report to Congress*, which detailed the agency's examinations of the enterprises, the 12 FHLBanks, and the FHLBanks' Office of Finance.[81]

For 2012, FHFA assigned the enterprises composite ratings of critical concerns, which were unchanged from 2011. It said they exhibit critical financial weaknesses stemming from lack of capital, the quality of legacy assets, and uncertainty about the conservatorship status.[82] Figure 19 (see below) depicts FHFA's supervisory ratings.

The report noted that the conservatorships of the enterprises, combined with Treasury's financial support, have stabilized the enterprises but have not restored them to a sound financial condition. It said the enterprises remain exposed to credit, counterparty, and **operational risks**. Because of their large volume of distressed assets and ongoing stress in certain housing markets, the FHFA report noted that credit risk management is a key priority for both enterprises.

Figure 19. FHFA's Supervisory Ratings



In addition, counterparty risk is an area of concern, especially given the changes in the mortgage industry and the greater prominence of new types of seller-servicers. The report also singled out operational risk as an area of concern because of challenges related to legacy systems, recordkeeping, and ongoing concerns about human capital.[83]

FHFA's discussion of the FHLBank System indicated that the FHLBanks of Boston, Chicago, and Pittsburgh presented "limited supervisory concerns," while the FHLBank of Seattle presented "supervisory concerns." The FHLBanks of New York, Atlanta, Cincinnati, Indianapolis, Des Moines, Dallas, San Francisco, and Topeka were described as "satisfactory."[84]

FHFA's summary of the FHLBanks' Office of Finance noted improvements in corporate governance and operational risk management processes. Principal supervisory concerns included weaknesses in the director compensation policy, weaknesses in certain internal controls, incomplete implementation of a vendor management program, and the lack of a formalized process for collecting from the FHLBanks selected data related to dealer eligibility.[85]

Lawmakers introduced two major bills intended to reform housing finance, and the Administration announced core principles that it believes should underlie such reform.

Housing Finance Reform

One of OIG's strategic goals is to contribute to the dialogue on enterprise reform and collaborate with Congress on legislative policy initiatives before they become program requirements. In our fifth Semiannual Report, we featured a discussion of key reformers and reform proposals. Since then, lawmakers introduced two major bills intended to reform housing finance, and the Administration announced core principles that it believes should underlie such reform. These recent developments are summarized below.

In June 2013, the Corker-Warner Housing Finance Reform and Taxpayer Protection Act was introduced in the Senate.[86] The bill calls for the winding down of the enterprises and FHFA within five years of the bill's passage. It would transfer the functions of the entities to the Federal Mortgage Insurance Corporation (FMIC), modeled on FDIC.[87]

Under the bill, the FMIC would collect insurance premiums and maintain a deposit fund on all outstanding obligations. It would provide backstop insurance that will kick in after a substantial amount of private capital is exhausted. The FMIC would capitalize the housing finance system by separating credit risk from interest rate risk and bringing in private capital to take on both. In addition, the FMIC would leave the securitization and insurance functions to private-market participants.[88]

In July 2013, the Protecting American Taxpayers and Homeowners Act was introduced in the House of Representatives.[89] The bill would end the FHFA conservatorships of the enterprises in five years. During the transition period, it would reduce the enterprises' mortgage portfolios by 15% a year.[90]

The bill would replace the enterprises with a nonprofit National Mortgage Market Utility. The utility, which would not be a government entity, would operate the securitization infrastructure platform, currently being developed by FHFA and the enterprises, for eligible private-sector lenders. However, the utility would not originate, service, insure, or guarantee any residential mortgage or financial instrument associated with residential mortgages.[91]

In August 2013, President Obama announced the Administration's plans for reforming the enterprises. "I believe that our housing system should operate where there's a limited government role and private lending should be the backbone of the housing market," Obama said. "We can't leave taxpayers on the hook for irresponsibility or bad decisions by some of these lenders or Fannie Mae or Freddie Mac. We've got to encourage the pursuit of profit, but the era of expecting a bailout after you pursue your profit and you don't manage your risk well—well, that puts the whole country at risk. And we're ending those days."[92]

The Administration's plan includes four core principles:

- Put private capital at the center of the housing finance system;
- Wind down the enterprises;
- Ensure widespread access to safe, responsible financing, like the 30-year fixed-rate mortgage; and
- Support affordability and access for renters and homeownership for first-time buyers.[93]

When announcing the Administration's plan, President Obama indicated that he supports the Senate bill.[94]

Section 3 of this Semiannual Report provides a discussion of the roles of soundness, oversight, and balance in a reformed mortgage market.

Lawsuits/Settlements

On July 25, 2013, FHFA announced that it had reached an $885 million settlement with UBS Americas Inc. covering claims for alleged violations of federal and state securities laws in connection with private-label MBS purchased by the enterprises. Under the terms of the agreement, UBS Americas Inc. will pay approximately $415 million to Fannie Mae and $470 million to Freddie Mac to resolve claims related to securities sold to the companies between 2004 and 2007.[95]

FHFA alleged that the company failed to perform proper due diligence during the underwriting process and that disclosure documents contained misstatements and omissions about the mortgage loans underlying the private-label MBS, including false or inadequate characterizations of the mortgage borrowers' creditworthiness, the quality of the origination process, and the practices used to evaluate and approve the loans.[96]

The case was 1 of 18 filed by FHFA against financial services firms involving private-label MBS; it is the third case that has been reported as settled.[97]

Section 3: Lessons for Housing Finance Reform: Five Years After the Federal Government's Takeover of Fannie Mae and Freddie Mac

Introduction

Five years have passed since the enterprises entered conservatorships in September 2008, where they still remain. In the meantime, Congress continues to consider the future of the secondary mortgage market and what, if any, role the government should play in it.[98] As policymakers deliberate, we offer this discussion, which draws on our experience, of three factors that are important to a safe, stable, and liquid mortgage market—whatever its ultimate structure.[99]

- First, *soundness*. The recent housing crisis has shown that, at minimum, the secondary mortgage market needs quality underwriting, robust risk assessment, and market-aligned servicing.
- Second, *oversight*. Our work demonstrates that effective housing finance oversight requires well-equipped regulators to verify decision making and to enforce compliance.
- Third, *balance*. Whatever the future mortgage market's structure, participants will have to find a balance among interrelated laws, roles, and practices.

Below, we discuss how these factors bear on housing finance. Our goal is not to take sides but to provide our stakeholders—FHFA, Congress, policymakers, and the public—with information that will be useful during the debate on housing finance reform.

Context: Reforms and Reformers

Historically, the enterprises have facilitated the flow of mortgage credit by purchasing mortgages from lenders, who, in turn, are freed up to make more mortgage loans.[100] When the housing bubble burst, though, the enterprises became insolvent, which ultimately resulted in their entering conservatorships under FHFA's supervision. Since then, the agency has worked to conserve and preserve their assets and to ensure that they follow prudent business practices.

Initially, FHFA understood the conservatorships to be temporary while, in the Acting Director's words, "Congress and the Administration could figure out how best to address future reforms."[101] As the conservatorships became more long term, the agency advised that it would continue to guide the enterprises to accomplish generally agreed-upon objectives—restoring their financial fitness and reducing their market footprint—while not precluding any of the major enterprise reform proposals, which range from privatization to elimination.

In July 2010, Congress responded to the nation's recession with Dodd-Frank. This law contains several housing finance reforms that are intended to address practices that contributed to the housing boom, including reducing the risk of borrowers defaulting.[102] It also requires MBS issuers to retain credit risk in the assets they securitize, that is, to keep some skin in the game.[103] Although this law addressed some important problems that led to the housing crisis—lenders with little to lose loaning to borrowers with little to repay—it did not resolve other fundamental concerns, such as the appropriate role for the government in housing finance.

In February 2011, the Administration published its vision of the government's role in *Reforming America's Housing Finance Market*. In general, the Administration argues for replacing the enterprises with the private market as the primary source of mortgage credit. For its part, the government would explicitly provide robust oversight, protect consumers and investors, assist low- and moderate-income homeowners and renters, help stabilize the market, and respond to crises.[104]

In August 2013, President Obama clarified the Administration's plan for reforming the enterprises. The Administration's plan includes four core principles:

- Put private capital at the center of the housing finance system;
- Wind down the enterprises;
- Ensure widespread access to safe, responsible financing, like the 30-year fixed-rate mortgage; and
- Support affordability and access for renters and homeownership for first-time buyers.[105]

Individual members of Congress have also made proposals. For example, on June 25, 2013, eight members of the Senate Banking, Housing and Urban Affairs Committee introduced a bill, the Housing Finance Reform and Taxpayer Protection Act of 2013.[106] The bill calls for greater private-sector participation in the secondary mortgage market, winding down the enterprises over five years, and creating a new government insurance entity.[107] On July 22, 2013, five members of the House Financial Services Committee introduced housing finance reform legislation, entitled the Protecting American Taxpayers and Homeowners Act of 2013.[108] The bill winds down the enterprises over a five-year transition period and reduces the government's role in the housing finance market.[109]

Academics, industry experts, and interest groups also have made housing finance reform proposals. However, in spite of the diversity of sources, essentially there are only three categories of proposals:[110]

- Private—the private sector takes over the secondary mortgage market;[111]
- Public—the government takes over the enterprises' current role;[112] or
- Private/Public—the government provides some safety for private participants.[113]

The private model relies upon private companies to buy and securitize mortgages and to guarantee payment of principal and interest on the resulting securities. Under this model, the government does not guarantee the companies or the securities. The key to most of the private model options is to wind down the enterprises over a defined period of years.[114] In theory, this will provide an incentive for private-sector participation as guarantee fees increase to what the market will bear.

In the public model, a government corporation replaces the enterprises, and it buys, securitizes, and sells residential mortgages. Approved lenders pay guarantee fees to the corporation in order to ensure timely payment of interest and principal on the resulting securities.[115] This type of proposal requires the federal government to back all of the corporation's obligations, or at least to guarantee MBS' principal and interest payments.

Many envision a private and public hybrid model for the secondary mortgage market. In the broadest context, the hybrid model calls for private participants to buy and securitize mortgages from approved lenders with some form of government guarantee.[116] Such proposals tend to vary according to the level of government support, with many models also proposing government intervention during economic crises.[117]

Figure 20 (see page 55) highlights the major reforms and reformers.

These proposals can be expected to grow more detailed as they progress since specific issues, such as establishing underwriting standards and managing risk, will need to be resolved. The following is intended to serve as a backdrop to deliberations about these more granular issues.

Soundness: Lessons from the Past

Our work has corroborated several lessons learned from the housing crisis: a sound housing finance market should include quality underwriting, robust risk management, and servicers who have incentives to align their interests with those of other market participants. Below, we review the historical basis for recognizing these lessons when reforming housing finance and then discuss some of our work that supports their importance.

U.S. property values spiked from 2001 to 2006—an average of 12% each year.[118] As the boom proceeded, underwriting standards loosened and lenders increasingly approved higher mortgages for higher-risk borrowers who had little to no down payments, unverified incomes, and high debt. Associated credit risks spread throughout the financial system as these mortgages were bundled into publicly traded enterprise and private-label MBS.[119]

The dominant players in the secondary mortgage market before the boom, Fannie Mae and Freddie Mac took steps to maintain their market share during it. In 2001, the enterprises began buying—for their own investment portfolios—private-label MBS, many of which were collateralized by subprime mortgages.[120] According to the Government Accountability Office (GAO), the enterprises' holdings of private-label MBS increased rapidly from 2003 to 2006.[121] This helped Fannie Mae's assets and guaranteed mortgages grow from $1.3 trillion in 2000 to $3.1 trillion in 2008, while Freddie Mac's increased from $1 trillion to $2.2 trillion during the same period.[122]

As mortgage volume grew, the enterprises agreed to buy and guarantee higher-risk loans.[123]

Traditionally, the enterprises confined their businesses to lower-risk, prime loans.[124] But, during the housing boom, Fannie Mae, for instance, issued large numbers of variances, or exceptions, from its underwriting guidelines that permitted it to buy higher-risk products, such as zero down payment mortgages made to buyers with low credit scores and unverified income.[125]

In 2006, home prices leveled off, and the housing boom turned into a bust.[126] In 2007 and 2008, the enterprises began losing billions of dollars on their multi-trillion-dollar MBS guarantees and investments.[127]

In the aftermath, many serious questions have arisen regarding the origination and securitization process.[128] Notably, during the summer of 2011, FHFA filed lawsuits against 18 large financial institutions, alleging violations of federal and state securities laws in connection with sales of private-label MBS to the enterprises. FHFA is pursuing fraud and other claims, alleging misleading disclosures about the quality of the mortgages that were used to securitize the MBS. FHFA's complaints allege that the mortgage collateral securing the private-label MBS had materially different and higher-risk characteristics than described.[129]

Although there are different perspectives on which factors were most to blame for the housing crisis, it is generally agreed that contributing causes

Figure 20. Reform Models and Reformers and Their Proposals

Reform Models

Private Model

- Private companies purchase and securitize mortgages and guarantee the principal and interest payment
- No explicit guarantee by the federal government
- Key to most options is the wind down of the enterprises over 10 or 15 years
- One proposal suggests a temporary governmental agency to guarantee the principal and interest payment

Hybrid Model

- Blended—private entity or entities purchase and securitize mortgages with some government guarantee
- Some models advocate full replacement of the enterprises
- Governmental intervention mechanisms in times of economic hardship
- Private sector to absorb losses before the federal guarantee is tapped

Government Model

- Government-owned corporation replaces the enterprises
- Federal government backs all obligations or at least guarantees the principal and interest payments
- Approved mortgage originators pay a guarantee fee to the corporation to secure payment of interest and principal

Reformers and their Proposals

The Administration

- Make the private market the primary source of mortgage credit
- Phase out the enterprises
- Government should provide oversight, protection, targeted assistance, and support for market stability and crisis response

Legislative Proposals

- Modify the enterprises or create a new private or government-owned company to replace them
- Focus on improving accountability, lowering the government's costs, and reducing the enterprises' competitive advantage

Academics, Industry Experts, and Interest Groups

- Generally envision a private mortgage market backed by some type of governmental guarantee
- Argue for less volatility in housing credit and more protection in times of financial crisis by having a buyer "of last resort" providing additional liquidity
- Suggest splitting the enterprises into entities that respectively hold their collective good and bad assets

included loosened underwriting standards, poor risk management, and servicers with little incentive to prevent foreclosures.

Loosened Underwriting Standards

Single-Family

As discussed in one of our reports, Fannie Mae's basic underwriting standards for mortgage loans secured by single-family homes have not changed much. On the other hand, the enterprise has granted variances that have had the effect of modifying its underwriting standards over time. Essentially, variances allow lenders to deviate from underwriting standards for mortgage loans they sell to the enterprises; for instance, the enterprises may allow no down payment instead of the minimum 5% they typically require.[130]

As shown in Figure 21 (see above), Fannie Mae's basic underwriting standards did not change significantly before 2006 or after 2011.

However, as shown in Figure 22 (see below), the number of variances that Fannie Mae allowed declined substantially from 2006 to 2011. For example, in 2005 when standards were loosened, Fannie Mae authorized over 11,000 variances. Thereafter, Fannie Mae began rescinding variances, which tightened underwriting standards. Some of these canceled variances related to risky features, such as loans made with unverified income.[131]

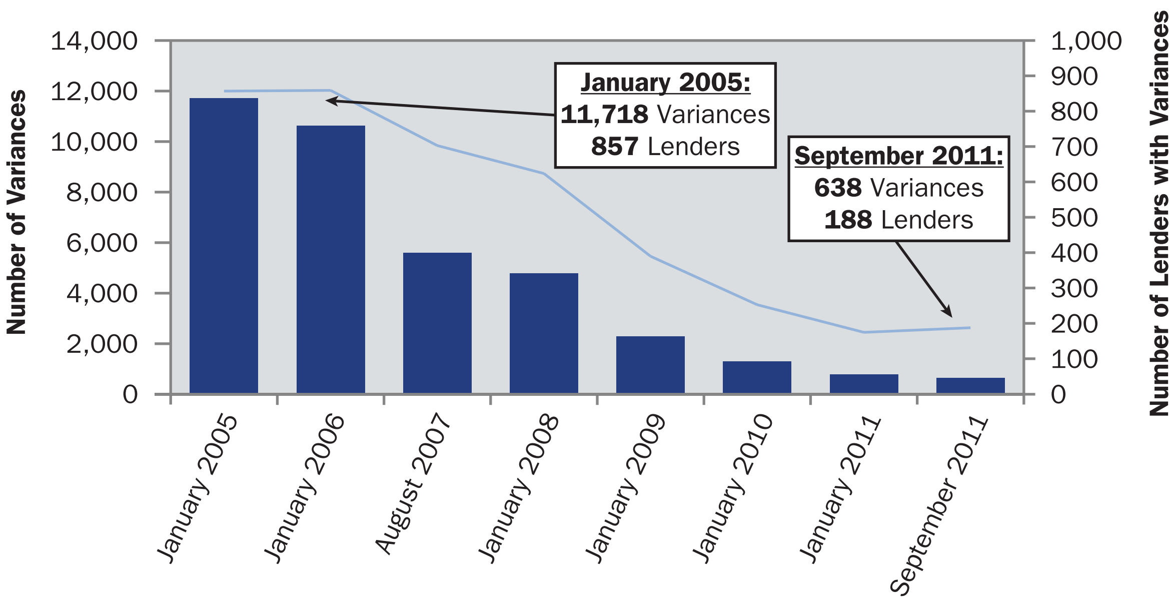
FHFA recognizes the critical role played by variances in setting underwriting standards and agreed with our recommendations to establish formal procedures for reviewing proposed changes to the enterprises' single-family underwriting standards and variances from them.[132]

Figure 21. Fannie Mae's Underwriting Standards for 2006 and 2011

	2006	2011
Collateral (LTV)	95	95
Capacity (Debt-to-Income)	36%	36%[a]
Creditworthiness (Credit Score)	N/A	660[b]

[a] The benchmark is 36% but can go up to 45% if there are strong compensating factors.
[b] Minimum FICO score is 660 if LTV is greater than 75%. If LTV is less than or equal to 75%, then minimum FICO score is 620.

Figure 22. Fannie Mae Variances Granted from 2005 to 2011

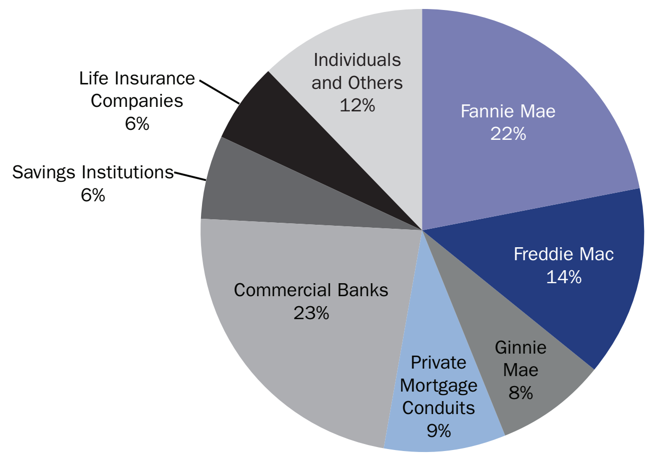


Multifamily

We have also found indications that the enterprises have relaxed underwriting standards for the multifamily mortgage loans they buy.[133]

During the housing crisis, private-sector financing for multifamily residences largely vanished even though demand for multifamily rental housing increased. The enterprises stepped into the financing gap by purchasing 85% of all multifamily loans in 2009.[134] By the end of 2012, the enterprises' market share had declined, but they were still dominant players; as shown in Figure 23 (see right), they collectively held 36% (or $305 billion) of the total outstanding debt from multifamily mortgage loans.[135]

Figure 23. Multifamily Mortgage Debt Outstanding for 2012



Ultimately, the value of the enterprises' considerable multifamily mortgage holdings depends on the underlying quality of the loans. As the financial crisis demonstrated, if loans are not well underwritten, made to eligible borrowers, and supported by adequate collateral, then the enterprises' investments in them may be exposed to undue risk. Thus, the enterprises' respective multifamily underwriting standards can significantly influence the quality of the loans that they buy.[136]

However, we found indications that the enterprises recently have relaxed their multifamily underwriting standards, which may translate to rising risk in their multifamily portfolios. For example, we found a steady increase in their partial or interest-only loans. Initially, borrowers pay little to no principal for these loans, but payments can soar as the partial or interest-only options expire.[137]

The enterprises purchased 85% of all multifamily loans in 2009.

In 2009, 34% and 40%, respectively, of the multifamily loans purchased by Fannie Mae and Freddie Mac were partial interest or interest only.[138] In 2011, these loan purchase rates rose to:

- 43% of Fannie Mae's multifamily loans, valued at $10 billion; and
- 62% of Freddie Mac's multifamily loans, valued at $11 billion.[139]

Fannie Mae has made other changes to its multifamily underwriting standards that potentially will increase credit risk (e.g., allowing borrowers with less operating income to finance larger loans).[140] Fannie Mae also allows lenders to approve loans in which the borrower's net operating income is less than the minimum allowable. Previously, such loans had been subject to the enterprise's review and preapproval.[141]

Freddie Mac also initiated plans to relax aspects of its underwriting standards. In April 2012, for example, the enterprise notified FHFA of its intent to revise underwriting standards for cash-out loans. These loans allow borrowers to trade mortgage equity for cash and

Figure 24. Typical Loan Characteristics

Characteristics	Multifamily Loans	Single-Family Loans
Enterprises' Outstanding Unpaid Principal Balance as of December 31, 2012	~$332 billion	~$4.4 trillion
Types of Properties	apartment complexes, senior housing, cooperatives, and student housing	houses and condos
Size of Property	5+ units	1-4 units
Owners' Use of Property	income	residence
Borrowers	legal entities	individuals
Average Loan Amount	$5-13 million	~$200,000
Typical Loan Terms	5, 7, or 10 years, with balloon payments due at maturity	30 years

are higher risk because they simultaneously increase borrowers' debt, while decreasing their equity in the properties. In 2011, Freddie Mac financed 207 loans with over $743 million of cash out, on average about $3.6 million per loan.[142]

In general, most discussions of mortgage market reform center around single-family loans, but a reformed market will also need to be structured to address characteristics specific to multifamily loans. (See Figure 24, above, for a summary of multifamily and single-family loan characteristics.) Multifamily properties have five or more units and vary in type from apartment complexes to senior housing. Because multifamily properties produce income, they operate like businesses. Borrowers of multifamily loans are usually legal entities such as companies or corporations.[143]

Tightening underwriting standards can lead to a portfolio with less risky loans but may also lower profits. On the other hand, relaxing underwriting standards may increase risk, which ultimately leads to heavier losses.

A typical multifamily loan is several million dollars; the average Fannie Mae multifamily loan is about $5 million, while Freddie Mac's average loan is $13 million.[144] Yet, the enterprises can hold multifamily loans that are over $500 million per property.[145] Lastly, the terms of multifamily loans are 5, 7, or 10 years, with a balloon payment due at maturity.[146] Balloon payments can either be paid off or refinanced.

With the specific nature of each type of loan in mind, business decisions to tighten or relax underwriting standards necessarily balance profit and risk. Tightening underwriting standards can lead to a portfolio with less risky loans but may also lower profits. On the other hand, as the housing crisis demonstrated, relaxing underwriting standards may produce increased profits along with increased risk, which ultimately leads to heavier losses.

Based on recent history, a reformed housing market should include a commitment to aggressively manage risks associated with underwriting both single-family and multifamily loans.

Robust Risk Management: Assessing and Mitigating Housing Market Risk

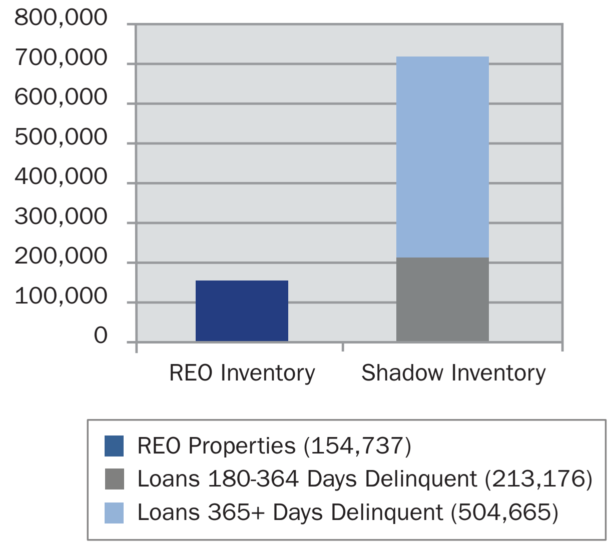
Managing risk is at the heart of what regulators do. Through our work, we have found instances where proactive risk management would have increased FHFA's awareness of and confidence in the enterprises' business practices.

For example, in one report we found that there were indicators as early as 2006 that could have led FHFA's predecessor agency to identify the heightened risk posed by processing abuses within Fannie Mae's default-related legal services network, which handles foreclosures for the enterprise. These indicators included rising foreclosures, deteriorating housing market conditions, consumer complaints, and media reports of foreclosure abuses. Despite such warning signs, the agency did not schedule comprehensive examination coverage of foreclosure issues until the middle of 2010.[147]

We have also reviewed FHFA's oversight of how the enterprises manage their REO properties (i.e., how they secure, repair, and sell foreclosed properties).[148]

The enterprises have faced surging foreclosure rates—for example, through 2011, they had an REO inventory of 180,000 units with related expenses of $8.5 billion; and as shown in Figure 25 (see above), there were over 717,000 mortgages as of December 31, 2012, on which payments had not been made for more than six months—over 4.5 times more than the enterprises' REO inventory for 2012.[149]

Figure 25. Enterprises' REO Properties and Shadow Inventory Through 2012



FHFA oversees the enterprises' REO risk management. At stake are both additional credit risk that may accrue to the enterprises as well as negative impacts on local communities, such as increased blight and crime, that may result where large numbers of foreclosures occur.[150]

Until recently, FHFA was not proactive in overseeing how the enterprises manage their REO risk. In one report, for example, we found that since 2008, FHFA has consistently listed the enterprises' large inventories of REO as a "critical concern," its most negative rating. But, despite identifying REO as a prominent and increasing risk, it did not conduct targeted examinations or other focused reviews regarding REO until 2011.[151]

Were the housing market to weaken again, the enterprises could be exposed to large losses from their REO inventory. For example, 2012 ended with the enterprises estimating that a 5% decline in nationwide home prices could increase their losses by over $17 billion.[152]

This REO risk of loss may have lately diminished due to improvement in the housing market. However, history has shown that the housing market can unexpectedly rise or fall. It is, therefore, critical for current and future regulators to manage risks robustly and proactively in order to provide for a continuing stable, liquid, and accessible mortgage market. Similarly, it is important for other market participants to be prepared to operate during good times and bad and to strive to align their interests.

The enterprises could be exposed to large losses from their REO inventory; they estimated that a 5% decline in home prices could increase their losses by over $17 billion.

Market-Aligned Mortgage Servicing: Congruent Incentives for Market Participants

The foreclosure crisis highlighted that it is important for the mortgage servicing industry to be prepared to operate efficiently under different market conditions. As our recent report showed, servicers generally do not have much incentive to help prevent foreclosures in bad times, which can cost homeowners and mortgage owners who do.[153]

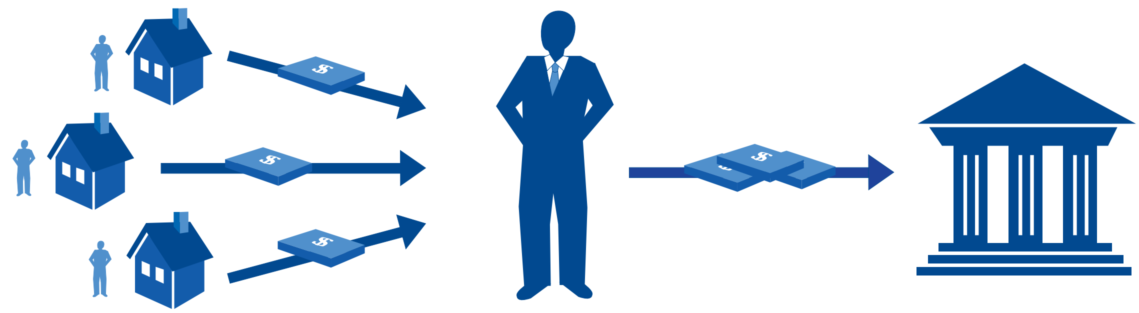
For example, consider what servicers are paid. They receive relatively small fees for their work—e.g., $250 annually for every $100,000 in mortgage debt serviced, or 25 **basis points**.[154] That fee is typically sufficient provided a mortgage remains current and the servicer's duties involve easily automated functions, such as receiving and passing along mortgage payments.[155] (See Figure 26, page 61, for a description of the mortgage servicing process.)

However, servicing troubled mortgages requires more individualized attention and results in higher costs. For example, in the case of delinquent loans, the servicer may need to contact borrowers to understand their financial situation, educate them about the impact of not paying a mortgage, explain options for avoiding foreclosure, and ultimately initiate foreclosure proceedings.[156] Interests between the enterprises and servicers may misalign when the enterprises have $100,000 at stake for every $250 the servicer stands to earn.[157]

Fannie Mae determined that specialty servicers—which operate pursuant to an alternative payment structure—might be able to improve outcomes for mortgages at risk of default. These servicers intensively contact borrowers, educate them on the impact of not paying, and explain options to avoid foreclosure. In general, we found the program to be sound but in need of closer FHFA oversight.[158]

In summary, our reports have repeatedly identified this need for closer, hands-on supervision and oversight by FHFA. In our experience, proactive oversight of each element of the housing finance system (e.g., originating, securing, and servicing loans and handling REO) is needed to ensure the system functions soundly.

Figure 26. The Mortgage Servicing Process



HOMEOWNERS	SERVICER	ENTERPRISE
• Make monthly payments under terms of mortgage	• Collects payments and calculates balances • Distributes principal and interest to mortgage owner, net of service fees • Performs loss mitigation or foreclosure, if required	• Owns or guarantees mortgages • Receives principal and interest or guarantee fee

Oversight: Lessons of the Present

OIG's work reveals recurring oversight issues that policymakers may want to consider as part of reforming the secondary mortgage market. Specifically, our work has found that it is important to:

- Equip: oversight bodies need the resources to do their jobs;
- Verify: regulated entities' decision making should be independently tested and validated; and
- Enforce: when rules are established, they must be enforced.

These oversight issues are discussed in detail below.

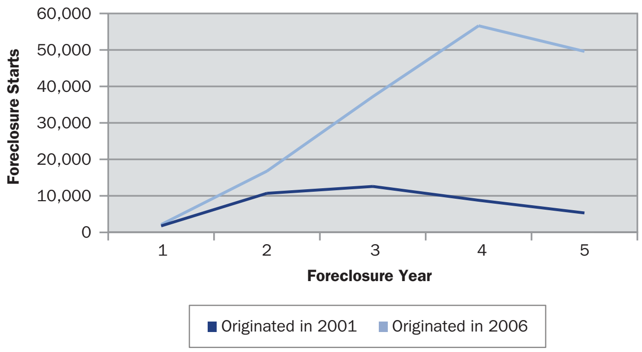
Equip: Providing Sufficient Supervisory Capacity

Ensuring that housing finance oversight bodies are equipped with sufficient resources to accomplish their missions is critical. If they do not have the resources to cover major risk areas timely, they will not be well positioned to identify and mitigate such risks.

This is particularly true with FHFA, which has critical responsibilities as the regulator of the GSEs and the conservator of the enterprises. However, senior agency officials and internal agency reviews have acknowledged that it has too few examiners to ensure efficient and effective GSE oversight.[159] Our reports have supported their assessment by demonstrating shortfalls in the agency's examination coverage.

For example, OIG has raised concerns about FHFA's resources and capacity to carry out its multiple responsibilities, particularly given its task of unifying a fragmented regulatory structure.[160] We followed up in a later review and confirmed that FHFA's limited capacity affected its ability to examine the GSEs. Due to examiner shortages, FHFA scaled back planned work during examinations, which often took longer than expected. We also identified shortfalls in the agency's examination coverage, particularly in the crucial area of REO. In general, FHFA agreed that it should better assess the relation between its examination capacity and the quality of its examinations.[161]

Figure 27. Freddie Mac Loans Originated in 2001 and 2006 Entering Foreclosure



As our work has shown, it is incumbent upon FHFA to ensure that adequate supervisory resources are in place, and housing finance oversight agencies must actively verify the mortgage market decision making under their purview.

Verify: Independently Testing and Validating Decision Making

We have repeatedly identified significant instances in which FHFA has displayed undue deference to enterprise decision making in its capacity as conservator. Without adequately testing or validating, the agency has deferred to the enterprises on key issues. The agency's actions in each case reflect its approach as conservator to delegate most business decisions to the enterprises.

However, our reports have shown that some matters are sufficiently important to warrant greater agency involvement, such as issues that touch on the causes of the housing crisis, the conservatorships, and the taxpayers' investment in the enterprises.

For example, our work demonstrated how FHFA relies on the enterprises to oversee and establish underwriting standards and to grant variances from them.[162]

Another report showed a similar pattern of accepting the enterprises' decision making without testing or validating their logic and conclusions. In general, we determined that FHFA did not require conservatorship approval for various major business decisions, such as a servicing program, which involved multiple transfers of MSR for over 700,000 loans with an unpaid principal balance over $130 billion.[163] The same report also showed that FHFA unduly relied on information provided by Fannie Mae when it issued a "no objection" response to the enterprise's request to make an investment of between $55 million and $70 million in order to protect an existing $40 million investment. On the same day as the request for approval was submitted, FHFA stated that given the complex nature of the transaction and the short decision time frame, the agency could not assess the reasonableness of the proposal. Yet, FHFA still made "no objection" to the transaction.[164]

Another report documented how FHFA approved a $1.35 billion settlement of mortgage repurchase claims that Freddie Mac asserted against Bank of America without testing the enterprise's underlying assumptions. Essentially, the settlement assumed that loans originated during the housing boom and purchased by Freddie Mac would behave no differently than loans bought before the boom.[165] However, an FHFA senior examiner—and Freddie Mac's internal auditors—observed a different foreclosure pattern associated with the housing boom era loans (i.e., loans originated around 2006). As shown in Figure 27 (see above), for these loans—many of which are higher risk—foreclosures peaked three to five years after origination, instead of two to three years for pre-boom loans originated in 2001.[166]

This difference was important because Freddie Mac did not review defaulted loans for repurchase claims if the defaults occurred more than three years after origination. That meant Freddie Mac had not reviewed for repurchase claims over 300,000 foreclosed loans originated between 2004 and 2007. These loans had an unpaid principal balance exceeding $50 billion.[167]

Even though the FHFA senior examiner raised concerns about Freddie Mac's loan review process more than six months before the agency approved the Bank of America settlement, FHFA did not timely act on or test the ramifications of the examiner's concerns before approving the settlement. Instead, the agency relied on the enterprise's analysis of the settlement without testing its underlying assumptions.[168]

After we issued our report, Freddie Mac changed its loan review process for repurchase claims. The enterprise now reviews all nonperforming loans originated between 2004 and 2007 for repurchase claims without regard to when they defaulted. We found in a follow-up report that such an expanded review may generate as much as $3.4 billion in additional revenue for Freddie Mac.[169]

Going forward, FHFA has generally agreed with our recommendations to take a more proactive oversight stance in response to the issues our work has raised. We believe these positive steps will help the agency identify and manage risks, but we have also found that this must be accompanied by a steadfast will to enforce compliance.

Enforce: Ensuring Regulatory Compliance

Even when FHFA has identified risks and taken steps to manage them, the agency has not consistently enforced its directives to ensure that identified risks are, in fact, adequately addressed. As conservator and regulator, the agency's authority over the enterprises is broad and includes the ability to enforce compliance with agency mandates. We have reported that FHFA's supervision and regulation of the GSEs could be strengthened by better exercising this authority when warranted.

For example, we determined that FHFA had not compelled Fannie Mae to comply with the requirement to have an effective program to manage operational risk—i.e., the risk of loss resulting from failed people, processes, systems, or external events. Effective operational risk management can help agency examiners to identify trends in such risks and focus their examinations accordingly.[170]

Between 2006 and early 2011, FHFA and its predecessor agency repeatedly identified Fannie Mae's lack of an acceptable operational risk management program. But, as Figure 28 (see below)

Figure 28. Supervisory Identification of Fannie Mae's Operational Risk Management Deficiencies

illustrates, FHFA and its predecessor did not compel Fannie Mae to create such a program, preferring less forceful supervisory means, such as years of repeated examinations and letters of concern and noncompliance.[171]

The benefit of stronger FHFA enforcement also extends to the FHLBanks. For example, we found that four FHLBanks have faced significant financial and operational difficulties since 2008, primarily because of their investments in high-risk mortgage securities. The agency has oversight responsibility over the FHLBanks and recognizes the need to ensure that they do not abuse their GSE status and engage in imprudent activities.[172]

One of our reports revealed, though, that FHFA had not established a consistent and transparent written enforcement policy for troubled FHLBanks classified as having "supervisory concerns." Specifically, of the four FHLBanks receiving this classification, FHFA took formal enforcement actions against only two. This has contributed to instances in which the agency may not have held these banks and their officers sufficiently accountable for engaging in questionable risk taking.[173]

Overall, our work has led us to conclude that sound supervision in the secondary mortgage market requires resources equal to the oversight mission. Further, some of these resources should be allocated to test and validate compliance and decision making by market participants. And, rules need to be enforced.

Not everything, though, can be fixed by better oversight. As we discuss below, any reform proposal will have to wrestle with inherent tensions between intersecting housing finance elements.

Balance: Lessons for the Future

Achieving housing finance reform will require balancing between complementary and sometimes competing factors in housing finance. Below, we summarize some of our work, which illustrates the tensions inherent in current housing finance oversight.

Overlapping Laws: HERA and EESA

FHFA's powers and responsibilities mainly come from two laws with different emphases: HERA, which focuses on the GSEs' financial soundness, and the subsequently enacted **Emergency Economic Stabilization Act (EESA)**, which, as relevant to FHFA, focuses on the welfare of existing homeowners.[174]

In July 2008, in the face of a turbulent market, HERA created FHFA to oversee the enterprises and the FHLBanks—vital components of the secondary mortgage market. Under HERA, the agency's mission is to provide supervision, regulation, and oversight of the GSEs in order to promote their safety and soundness, support housing finance and affordable housing, and facilitate a stable and liquid mortgage market.[175]

HERA also vested FHFA with the power to place the GSEs into conservatorship, if warranted. That power was invoked in September 2008, when due to their deteriorating financial conditions, the enterprises entered conservatorships overseen by FHFA. As conservator, FHFA's goal is to conserve and preserve the enterprises' assets.[176]

In contrast, EESA was enacted in October 2008, as the housing crisis deepened, to protect home values and investments, preserve homeownership and promote economic growth, and maximize returns to taxpayers. To preserve homeownership, EESA requires FHFA to implement a plan to maximize assistance to homeowners and to use its authority to encourage mortgage servicers that work with the enterprises to take advantage of federal programs to minimize foreclosures.[177]

In partly fulfilling its EESA mandate to preserve homeownership, FHFA worked with Treasury to set up HARP in 2009. This program allows borrowers (who might otherwise not qualify for refinancing) to take advantage of currently low mortgage interest rates and refinance their loans. In general, the program is geared toward borrowers who are current on their mortgage payments and includes underwater borrowers who owe more than their homes are worth. Through March 2013, 2.4 million homeowners have refinanced through HARP.[178]

Since early 2009, FHFA has also supported the enterprises' participation in HAMP. HAMP is intended to help struggling homeowners stay in their homes by reducing their monthly mortgage payments. To reduce payments, servicers may modify their loans by lowering interest rates, extending the payback periods (e.g., from 30 to 40 years), or forbearing principal (i.e., postponing collecting a portion of what they are owed).[179] Through March 2013, the enterprises had completed approximately 434,000 HAMP modifications. In addition, the enterprises made more than 1.4 million proprietary modifications outside of HAMP during the same period.[180]

Through March 2013, 2.4 million homeowners have refinanced through HARP, the enterprises completed approximately 434,000 HAMP modifications, and the enterprises made more than 1.4 million proprietary modifications outside of HAMP.

FHFA sees its support of mortgage modification and forbearance as consistent with both EESA's mandate to help homeowners and HERA's requirement to safeguard the enterprises' assets.[181] However, questions have arisen concerning the enterprises' participation in programs, such as HAMP, within Treasury's wider Making Home Affordable (MHA) program. Some critics argue that Treasury has employed the enterprises to manage MHA in ways that jeopardize their financial interests and has done so without adequately working with FHFA, thus potentially compromising its discretion as conservator and regulator.[182]

In responding to a congressional request to examine the controversy, we determined that FHFA has supported HAMP as a means to limit the enterprises' losses by minimizing costly foreclosures. At the same time, the agency has shown independence by prohibiting the enterprises from participating in other MHA programs that it viewed as being inconsistent with their financial soundness.[183]

The following minitutorial (see pages 66-67) highlights loan modification options under HAMP, HAMP Principal Reduction Alternative (PRA), and HARP.

Loan Modification and Principal Reduction

Following the financial crisis of 2008, a number of programs were established to help homeowners, who had difficulty making their mortgage payments, to avoid foreclosure on their houses. These programs included a range of possible options to lower a borrower's monthly mortgage payment, including a lower interest rate, extension of the loan term, and two measures involving the outstanding principal of the loan, principal forbearance and principal forgiveness.

In principal forbearance, a portion of the principal due is set aside and no interest is charged on that part of the loan for the remainder of the loan term.[184] The portion of the principal that is set aside is also not amortized; but the debt is not forgiven. Instead, it becomes a balloon payment that falls due when the owner sells the property, pays off the interest-bearing unpaid principal balance, or at the maturity of the original mortgage loan.[185]

In contrast, principal forgiveness results in a reduction in the amount the borrower owes. In addition to lowering the monthly payment, principal forgiveness usually results in the borrower having an improved equity position in the home as a consequence of having a lower loan balance. Equity is the difference between the actual value of the home and the amount the borrower still owes. Having increased equity can make it easier to refinance or sell the home.[186]

HAMP, one of the aforementioned foreclosure avoidance programs, was authorized by Congress under EESA in an effort to help struggling homeowners. In May 2013, the program was extended to December 31, 2015.[187]

HAMP provides for Treasury, through the GSEs, to offer financial incentives to mortgage servicers and borrowers to reach agreements on loan modifications.[188] The program is available to owner-occupants who owe up to $729,750 on their primary residence or one-unit property; $934,200 on a two-unit property; $1,129,250 on a three-unit property; or $1,403,400 on a four-unit property. The borrower has to be delinquent on the mortgage or default has to be "reasonably foreseeable."[189]

Under HAMP, payments on the mortgage are reduced to 31% of the borrower's gross monthly income by first reducing the interest rate on the mortgage, going down to a possible floor of 2%. If that is not sufficient to reach the 31% goal, the loan term can be extended up to 480 months. Finally, the servicer can offer principal forbearance, which delays repayment of part of the principal without requiring interest payments on that part.[190]

The mortgage servicer applies a mathematical formula to compare the net present value (NPV) of the house with loan modification with the NPV without modification of the loan. The NPV calculation, which was designed by Treasury, FHFA, FDIC, and other experts, is designed to determine if it will be more profitable for the servicer to modify the mortgage or foreclose. Under the rules, if a servicer will make more money by modifying the loan, resulting in a positive NPV, then the servicer is required to offer the borrower a modification and cease foreclosure efforts.[191]

In June 2010, Treasury expanded HAMP to include principal reduction for those borrowers whose homes were underwater, meaning they had a loan greater than 115% of what the house was currently worth.[192] Under HAMP PRA, incentives were offered to mortgage servicers as a percentage of each dollar of principal reduction.[193]

HAMP PRA has the same goal of reducing the monthly payment to 31% of gross income but begins with the principal reduction first before rate modification.[194] The program vests over three years. On the first, second, and third anniversaries of the loan modification agreement, if the borrower is current on his loan payments, the servicer reduces the unpaid loan principal by one-third of the predetermined PRA Forbearance Amount. At the end of three years of timely payments, the full PRA Forbearance Amount is forgiven.[195]

In addition to HAMP and HAMP PRA, FHFA and Treasury introduced a program in 2009 called HARP for borrowers whose loans are owned or guaranteed by the enterprises. It helps borrowers refinance their mortgage provided they have a good payment history for the past 12 months.[196]

HARP is the only refinance program that allows borrowers with little to no home equity to take advantage of low interest rates and take out a new mortgage. For those with an adjustable-rate mortgage, it allows them to obtain a fixed-rate mortgage that may lower their monthly payments. On average, homeowners are saving over $250 a month with HARP refinancing.[197]

Since the MHA program was launched in 2009, a total of 2,033,329 HAMP trials have begun, with 1,190,605 permanent modifications started. By the end of April 2013, there were 870,038 active permanent modifications.[198]

Under HAMP PRA, over 169,812 borrowers have started trial modifications, and by the end of April 2013, there were 117,711 active permanent modifications involving principal reduction.[199]

For example, although FHFA has supported modifying loans to help homeowners, it has decided against allowing the enterprises to forgive debt on mortgage loans. Thus, the enterprises do not participate in programs such as Treasury's HAMP PRA, which reduces the amount of mortgage debt in order to lower monthly payments for those whose homes are underwater.[200]

Additionally, our report assessing the conservatorships describes the mission tension arising between FHFA's mandated responsibilities to advance the enterprises' business interests and to help homeowners. For example, stricter underwriting standards, which can reduce risk for the enterprises, may also make mortgages harder to obtain. Home affordability programs, in essence, can have the opposite effect.[201]

Minimizing conflicting legal objectives and clarifying how participants should resolve potential tensions should be a goal for a reformed secondary mortgage market.

Blended Roles: FHFA as Regulator and Conservator

In a reformed housing finance market, an oversight body with a stake in business performance may find itself subject to tensions between promoting performance and ensuring that regulated entities act in a safe and sound manner. If such dual roles continue to exist in the future, we believe there is a need to clarify how those differing responsibilities should be balanced.

When assessing the conservatorships, we recognized the potential for conflict between FHFA's dual missions to both conserve and preserve the enterprises' assets as conservator and to examine their business practices for safety and soundness as regulator.[202] These dual roles can give rise to potential conflicts. For example, our assessment of the conservatorships found that FHFA faces challenges in ensuring its independence as a regulator. Specifically, FHFA's role as conservator is to direct the enterprises' business activities and operations. Meanwhile, its role as regulator is to independently review and critique the outcomes of those directives. So, the agency could find that, as regulator, it needs to critique its performance as conservator.[203]

In one instance of this potential conflict from early in the conservatorships, FHFA used examination staff—who review regulatory compliance, risk management, and other business performance—to help with conservator issues. In 2010 and 2011, the agency reorganized to separate its responsibilities as conservator and regulator, including returning the examination staff to their original duties.[204]

In general, senior FHFA employees have stated that the agency's roles as the enterprises' conservator and safety and soundness regulator are generally aligned. Specifically, the agency believes that, both as a conservator and as a regulator, it has an interest in ensuring that the enterprises conduct their businesses in a manner that limits risk taking. Overall, the agency's actions since becoming conservator have backed this up. In particular, FHFA has taken steps to reduce the risk associated with business practices that generated billions of dollars of credit losses.[205] Nonetheless, under different leadership the alignment of roles could diverge or one of the roles could become superior.

Further, FHFA has attempted to avoid conflicts between its conservator and regulator roles by delegating much of the management of the enterprises to their boards of directors and managers. However, such delegation of responsibility presents its own inherent risks, and if the agency were to become a more active conservator, that could increase the potential for tension between its dual roles.[206]

Siloed Practices: Harmonizing Business and Sharing Information

As part of its larger effort to prepare the housing finance market for reform, FHFA has undertaken several strategic initiatives to standardize and harmonize various aspects of the secondary mortgage market.

For example, in May 2010, FHFA announced the Uniform Mortgage Data Program, a long-term joint effort with the enterprises to create uniform data standards and collection processes. FHFA believes that a common framework will result in better lender efficiency and enterprise risk management. Likewise, common data standards are expected to lead to appraisers, lenders, servicers, etc., submitting more consistent data. The enterprises will deploy the data standards program in phases through a common platform that will include stakeholder input.[207]

Also, in September 2012, FHFA announced that the enterprises will launch a new representation and warranty framework for conventional loans sold or delivered after 2012. The framework aims to limit and clarify lenders' repurchase exposure and liability on mortgages originated in 2013 and thereafter. It is also part of a broader series of strategic initiatives directed toward seller/servicer contract harmonization, as outlined in FHFA's *A Strategic Plan for Enterprise Conservatorships*.[208]

For example, FHFA has instructed the enterprises to establish a single, consistent set of procedures for servicing mortgages they own or guarantee. Key elements of this Servicing Alignment Initiative include streamlined requirements, simplified loan modifications, and performance-based incentives for servicers to focus them on reviewing foreclosure alternatives in a timely manner.[209] According to the FHFA Acting Director, this alignment "should result in earlier servicer engagement to identify the best solution available for homeowners, given their individual circumstances."[210]

As part of these solutions, the initiative requires servicers to focus on remediating delinquencies. For example, foreclosure cannot start while borrowers and servicers are engaged in good-faith efforts to resolve delinquencies. Further, servicers must conduct formal reviews to ensure they have considered alternatives to foreclosure before starting the process. Even after foreclosure begins, servicers have financial incentives to keep helping borrowers pursue an alternative.[211]

In addition to harmonizing operations, the enterprises can benefit from sharing information and consistent application of servicing rules. For example, during our review of reported abuse by law firms processing enterprise foreclosures, we identified instances where Freddie Mac terminated problematic law firms while Fannie Mae continued to do business with some of them.[212] Similarly, another report disclosed that FHFA does not facilitate information sharing regarding high-risk counterparties even though the enterprises may use the same ones. As of September 2011, the two enterprises had separately identified over 300 servicers as high risk with a total risk exposure of $7.2 billion.[213] Although the enterprises separately monitor high-risk servicers, they do not communicate with each other about them, which can leave each vulnerable to the risks the other has identified. Indeed, in January 2000, a Fannie Mae executive discovered that a counterparty that worked with both enterprises had sold the same loans to more than one entity including Fannie Mae. In April 2002, Fannie Mae ended its relationship with the company due to possible fraud, but it did not report the termination to law enforcement or outside the enterprise. FHFA's predecessor agency was aware of the termination but not its basis.[214]

Consequently, Freddie Mac continued to conduct business with the company without intervention.

Over time, the enterprise increased its volume of business with the company, which ultimately collapsed, leaving the enterprise to file a $1.8 billion bankruptcy claim against the company.[215]

As the enterprises can benefit from sharing information, so can government agencies involved in housing finance. Although much of the focus on housing finance reform has been on clarifying the role of private entities such as the enterprises, overlapping government agencies also need clear missions with respect to the housing market. For instance, multiple federal consumer protection laws apply to residential mortgages. Historically, federal banking regulators such as the Office of the Comptroller of the Currency and FDIC enforced these laws. Recently, the new Consumer Financial Protection Bureau has taken on much of this responsibility.[216]

As one of our reports demonstrated, however, this crowded field can leave oversight gaps. For example, we found that FHFA does not review how the enterprises monitor contractual requirements related to federal consumer protection laws. Instead, like the enterprises, the agency relies on the work of other regulators. Consequently, FHFA was vulnerable to questions about why it does not monitor the enterprises' activities to ensure they are aligned with the public's interest (e.g., enforcement of consumer protection laws with respect to loans the enterprises purchase). In addition, we found that the enterprises were potentially subject to an increased economic risk from buying mortgages that were originated in violation of such federal laws.[217] In cases of overlapping regulatory oversight, FHFA and other affected regulatory bodies in a reformed market will benefit from clear jurisdictional boundaries.

Housing finance regulators may also benefit from information sharing. For instance, we have worked closely with other inspectors general who have an interest in housing issues. This collaborative effort led to a compendium of federal single-family mortgage programs.[218] We have also worked with HUD-OIG to report on recent initiatives by HUD and the GSEs to shrink their respective REO inventories and the steps our offices have taken to assess HUD's and the enterprises' REO activities.[219]

Whichever way policymakers shape the future housing finance market, we believe participants can benefit from avoiding or clarifying some of the inherent tensions outlined above. Clear guidance will help ease the transition into a reformed mortgage market and provide for its enduring stability.

Conclusion

We have presented here a more granular analysis of the soundness, oversight, and balance issues that will likely be important in any future housing finance market. Our observations are intended to inform the ongoing policy debate, and we look forward to continuing our work.

Appendices

Appendix A: Glossary and Acronyms

Glossary of Terms

Alternative A: A classification of mortgages in which the risk profile falls between prime and subprime. Alternative A (also known as Alt-A) mortgages are generally considered higher risk than prime due to factors that may include higher loan-to-value and debt-to-income ratios or limited documentation of the borrower's income.

Bankruptcy: A legal procedure for resolving debt problems of individuals and businesses; specifically, a case filed under one of the chapters of Title 11 of the U.S. Code.

Basis Points: Refers to hundredths of 1 percentage point. For example, 1 basis point is equivalent to 1/100 of 1 percentage point.

Bonds: Obligations by a borrower to eventually repay money obtained from a lender. The bondholder buying the investment is entitled to receive both principal and interest payments from the borrower.

Capital Gain (Loss): When a capital asset (e.g., stocks or bonds held as investments) is sold, the difference between the amount paid for the asset and the amount it is sold for is a capital gain or loss. Capital gains occur when the asset sells for more than paid, while capital losses occur when the asset is sold for less than the purchase price.

Capitalization: In the context of bank supervision, capitalization refers to the funds a bank holds as a buffer against unexpected losses. It includes shareholders' equity, loss reserves, and retained earnings. Bank capitalization plays a critical role in the safety and soundness of individual banks and the banking system. In most cases, federal regulators set requirements for adequate bank capitalization.

Carryforwards: A provision of tax law that allows current losses or certain tax credits to be utilized in future tax returns.

Collateral: Assets used as security for a loan that can be seized by the lender if the borrower fails to repay the loan.

Commercial Banks: Commercial banks are establishments primarily engaged in accepting demand and other deposits and making commercial, industrial, and consumer loans. Commercial banks provide significant services in originating, servicing, and enhancing the liquidity and quality of credit that is ultimately funded elsewhere.

Conforming Loan: A conforming loan is a conventional loan with an origination balance that does not exceed a specified amount (i.e., conforming loan limit). The enterprises are restricted by law to purchasing conforming loans, with the loan limits varying by unit size and region, e.g., high-cost areas. For 2013, the maximum general loan limit for a single-family one-unit dwelling is $417,000, while the maximum high-cost area loan limit for a single-family one-unit dwelling is $625,500.

Conservatorship: Conservatorship is a legal procedure for the management of financial institutions for an interim period during which the institution's conservator assumes responsibility for operating the institution and conserving its assets. Under the Housing and Economic Recovery Act of 2008, the enterprises entered into conservatorships overseen by FHFA. As conservator, FHFA has undertaken to preserve and conserve the assets of the enterprises and restore them to safety and soundness. FHFA also has assumed the powers of the boards of directors, officers, and shareholders; however, the day-to-day operational decision making of each company is still with the enterprises' existing management.

Credit Unions: Member-owned, not-for-profit financial cooperatives that provide savings, credit, and other financial services to their members. Credit unions pool their members' savings deposits and shares to finance their own loan portfolios rather than rely on outside capital. Members benefit from higher returns on savings, lower rates on loans, and fewer fees on average.

Default: Occurs when a mortgagor misses one or more payments.

Deferred Tax Assets: Deferred tax assets are recognized for temporary differences that will result in deductible amounts and for carryforwards. For example, a temporary difference is created between the reported amount and the tax basis of a liability for estimated expenses if, for tax purposes, those estimated expenses are not deductible until a future year.

Derivatives: Securities whose value depends on that of another asset, such as a stock or bond. They may be used to hedge interest rate or other risks related to holding a mortgage.

Derivative Gains (Losses): The enterprises acquire and guarantee primarily longer-term mortgages and securities that are funded with debt instruments. The companies manage the interest rate risk associated with these investments and funding activities with derivative agreements. The gains (losses) on derivative agreements are caused by changes in interest rates that, in turn, cause a net increase (decrease) in the fair value of these agreements.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010: Legislation that intends to promote the financial stability of the United States by improving accountability and transparency in the financial system, ending "too big to fail," protecting the American taxpayer by ending bailouts, and protecting consumers from abusive financial services practices.

Emergency Economic Stabilization Act: A 2008 statute that authorizes Treasury to undertake specific measures to provide stability and prevent disruption in the financial system and the economy. It also provides funds to preserve homeownership.

Equity: In the context of residential mortgage finance, equity is the difference between the fair market value of the borrower's home and the outstanding balance on the mortgage and any other debt secured by the home.

Fannie Mae: A federally chartered corporation that purchases residential mortgages and converts them into securities for sale to investors; by purchasing mortgages, Fannie Mae supplies funds to lenders so they may make loans to homebuyers.

Federal Home Loan Banks: The FHLBanks are 12 regional cooperative banks that U.S. lending institutions use to finance housing and economic development in their communities. Created by Congress, the FHLBanks have been the largest source of funding for community lending for eight decades. The FHLBanks provide funding to other banks but not directly to individual borrowers.

Federal Housing Administration: Part of HUD, FHA insures residential mortgages made by approved lenders against payment losses. It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934.

Foreclosure: A legal process used by a lender to obtain possession of a mortgaged property.

Freddie Mac: A federally chartered corporation that purchases residential mortgages, securitizes them, and sells them to investors; thus, Freddie Mac provides lenders with funds that can be used to make loans to homebuyers.

Ginnie Mae: A government-owned corporation within HUD. Ginnie Mae guarantees investors the timely payment of principal and interest on privately issued MBS backed by pools of government-insured and -guaranteed mortgages.

Government-Sponsored Enterprises: Business organizations chartered and sponsored by the federal government.

Government-Sponsored Enterprise Mortgage-Backed Securities Purchase Facility: The function of the GSE MBS Purchase Facility was to help improve the availability of mortgage credit to American homebuyers and mitigate pressures on mortgage rates. To promote the stability of the mortgage market, Treasury purchased GSE MBS in the secondary market. By purchasing these guaranteed securities, Treasury sought to broaden access to mortgage funding for current and prospective homeowners, as well as to promote market stability.

Guarantee: A pledge to investors that the guarantor will bear the default risk on a pool of loans or other collateral.

Hedging: The practice of taking an additional step, such as buying or selling a derivative, to offset certain risks associated with holding a particular investment, such as MBS.

Held-to-Maturity Security: A debt security (obligation or liability) that management intends to hold to its maturity or payment date and whose cash value is not needed until that date.

Housing and Economic Recovery Act: HERA, enacted in 2008, establishes OIG and FHFA, which oversee the GSEs' operations. HERA also expanded Treasury's authority to provide financial support to the GSEs.

Implied Guarantee: The assumption, prevalent in the financial markets, that the federal government will cover enterprise debt obligations.

Inspector General Act: Enacted in 1978, this statute authorizes establishment of offices of inspectors general, "independent and objective units" within federal agencies, that: (1) conduct and supervise audits and investigations relating to the programs and operations of their agencies; (2) provide leadership and coordination and recommend policies for activities designed to promote economy, efficiency, and effectiveness in the administration of agency programs and to prevent and detect fraud, waste, or abuse in such programs and operations; and (3) provide a means for keeping the head of the agency and Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for and progress of corrective action.

Inspector General Reform Act: Enacted in 2008, this statute amends the Inspector General Act to enhance the independence of inspectors general and to create the Council of the Inspectors General on Integrity and Efficiency.

Insurance Company: A company whose primary and predominant business activity is the writing of insurance and issuing or underwriting "covered products."

Interest Rate Swap: An interest rate swap is an agreement in which two parties make interest payments to each other for a set period based upon a notional principal (amount of principal of the underlying debt security). The notional principal is only used to calculate the interest payments; no risk is attached to it. Interest rate swaps commonly involve exchanging payments based on a fixed interest rate for payments based on a floating rate (e.g., London Interbank Offered Rate). The fixed rate is known as the swap rate.

Internal Controls: Internal controls are an integral component of an organization's management that provide reasonable assurance that the following objectives are achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reports, and (3) compliance with applicable laws and regulations. Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives and include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Joint and Several Liability: The concept of joint and several liability provides that each obligor in a group is responsible for the debts of all in that group. In the case of the FHLBanks, if any individual FHLBank were unable to pay a creditor, the other 11—or any 1 or more of them—would be required to step in and cover that debt.

Loan-to-Value: A percentage calculated by dividing the amount borrowed by the price or appraised value of the home to be purchased; the higher the loan-to-value (also known as LTV), the less cash a borrower is required to pay as down payment.

Mortgage-Backed Securities: MBS are debt securities that represent interests in the cash flows—anticipated principal and interest payments—from pools of mortgage loans, most commonly on residential property.

Noncontrolling Interest: A noncontrolling interest is the portion of equity (net assets) in a subsidiary not attributable directly or indirectly to a parent company. A noncontrolling interest is sometimes called minority interest and is reported in the consolidated statements of financial position. It is to be placed within the equity section but shown separately from the parent company's equity.

Operational Risk: Exposure to loss resulting from inadequate or failed internal processes, people, and systems or from external events (including legal events).

Options: Contracts that give the buyer the right, but not the obligation, to buy or sell a specified quantity of a commodity or other instrument at a specific price within a specified period of time, regardless of the market price of that instrument.

Preferred Stock: A security that usually pays a fixed dividend and gives the holder a claim on corporate earnings and assets superior to that of holders of common stock but inferior to that of investors in the corporation's debt securities.

Private-Label Mortgage-Backed Securities: MBS derived from mortgage loan pools assembled by entities other than GSEs or federal government agencies. They do not carry an explicit or implicit government guarantee, and the private-label MBS investor bears the risk of losses on its investment.

Real Estate Owned: Foreclosed homes owned by government agencies or financial institutions, such as the enterprises or real estate investors. REO homes represent collateral seized to satisfy unpaid mortgage loans. The investor or its representative then must sell the property on its own.

Securitization: A process whereby a financial institution assembles pools of income-producing assets (such as loans) and then sells an interest in the assets' cash flows as securities to investors.

Securitization Platform: A mechanism that connects capital market investors to borrowers by bundling mortgages into securities and tracking loan payments.

Senior Preferred Stock Purchase Agreements: Entered into at the time the conservatorships were created, the PSPAs authorize the enterprises to request and obtain funds from Treasury. Under the PSPAs, the enterprises agreed to consult with Treasury concerning a variety of significant business activities, capital stock issuance, dividend payments, ending the conservatorships, transferring assets, and awarding executive compensation.

Servicers: Servicers act as intermediaries between mortgage borrowers and owners of the loans, such as the enterprises or MBS investors. They collect the homeowners' mortgage payments, remit them to the owners of the loans, maintain appropriate records, and address delinquencies or defaults on behalf of the owners of the loans. For their services, they typically receive a percentage of the unpaid principal balance of the mortgage loans they service. The recent financial crisis has put more emphasis on servicers' handling of defaults, modifications, short sales, and foreclosures, in addition to their more traditional duty of collecting and distributing monthly mortgage payments.

Short Sale: The sale of a mortgaged property for less than what is owed on the mortgage.

Straw Buyer: A straw buyer is a person whose credit profile is used to serve as a cover in a loan transaction. Straw buyers are chosen for their ability to qualify for a mortgage loan, causing loans that would ordinarily be declined to be approved. Straw buyers may be paid a fee for their involvement in purchasing a property and usually never intend to own or occupy the property.

Swaption: An option on a swap that gives the holder the right, but not the obligation, to enter, for example, into an interest rate swap as either the payer or the receiver of the fixed side of the swap.

Thrift: A financial institution that ordinarily possesses the same depository, credit, financial intermediary, and account transactional functions as a bank but that is chiefly organized and primarily operates to promote savings and home mortgage lending rather than commercial lending.

Underwater: Term used to describe situations in which the homeowner's equity is below zero (i.e., the home is worth less than the balance of the loan(s) it secures).

Underwriting: The process of analyzing a loan application to determine the amount of risk involved in making the loan; it includes a review of the potential borrower's credit history and an assessment of the property value.

Valuation Allowance: Method of lowering or raising an object's current value by adjusting its acquisition cost to reflect its market value by offsetting another account. A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

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Acronyms and Abbreviations

Agency	Federal Housing Finance Agency
AHP	Affordable Housing Program
APA	Administrative Procedures Act
ATSC	Advanced Technology Systems, Inc.
Blue Book	*Quality Standards for Inspection and Evaluation*
BNC	BNC National Bank
CIGFO	Council of Inspectors General on Financial Oversight
CIGIE	Council of the Inspectors General on Integrity and Efficiency
CRS	Call Report System
DER	Division of Enterprise Regulation
Dodd-Frank	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
DOJ	Department of Justice
EESA	Emergency Economic Stabilization Act of 2008
Enterprises	Fannie Mae and Freddie Mac
EO	Executive Office
FDIC	Federal Deposit Insurance Corporation
FDIC-OIG	Federal Deposit Insurance Corporation Office of Inspector General
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
FHLBanks	Federal Home Loan Banks
FHLBank System	Federal Home Loan Bank System
FinCEN	Financial Crimes Enforcement Network
FIRREA	Financial Institutions Reform, Recovery and Enforcement Act of 1989
FMIC	Federal Mortgage Insurance Corporation
FSOC	Financial Stability Oversight Council
GAO	Government Accountability Office
GSEs	Government-Sponsored Enterprises
HAMP	Home Affordable Modification Program
HARP	Home Affordable Refinance Program
HERA	Housing and Economic Recovery Act of 2008
HUD	Department of Housing and Urban Development
HUD-OIG	Department of Housing and Urban Development Office of Inspector General
IRS-CI	IRS-Criminal Investigation
LTV	Loan-to-Value
MBS	Mortgage-Backed Securities
MHA	Making Home Affordable
MRA	Matter Requiring Attention
MSR	Mortgage Servicing Rights
NPV	Net Present Value
OA	Office of Audits
OAd	Office of Administration
OC	Office of Counsel
OE	Office of Evaluations

OI	Office of Investigations
OIG	Federal Housing Finance Agency Office of Inspector General
OPOR	Office of Policy, Oversight, and Review
OQA	Office of Quality Assurance
PPI	Personal Protected Information
PRA	Principal Reduction Alternative
PSPAs	Senior Preferred Stock Purchase Agreements
REO	Real Estate Owned
RMBS	Residential Mortgage-Backed Securities
SEC	Securities and Exchange Commission
SIGTARP	Office of the Special Inspector General for the Troubled Asset Relief Program
Treasury	Department of the Treasury
USPIS	Postal Inspection Service
Yellow Book	*Government Auditing Standards*

Appendix B: OIG Recommendations

In accordance with the provisions of the Inspector General Act, one of the key duties of OIG is to provide to FHFA recommendations that promote the transparency, efficiency, and effectiveness of the agency's operations and aid in the prevention and detection of fraud, waste, or abuse. Figure 29 (see page 85) summarizes OIG's formal recommendations that were made, pending, or closed during the reporting period. Figure 30 (see page 104) lists OIG's audit and evaluation reports for which all of the recommendations were closed in prior semiannual periods.

Figure 29. Summary of OIG Recommendations

No.	Recommendation	Report	Status
AUD-2013-013-1	FHFA should update OQA's policy to require management to provide written responses and corrective action timelines to OQA findings.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-013-2	FHFA should track the corrective action timelines provided by management and follow up on corrective actions based on those timelines.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-013-3	FHFA should implement a policy to escalate to the appropriate level of management when corrective action is not implemented by the reported deadline.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-013-4	FHFA should evaluate management corrective actions and document evidence supporting closure of its recommendations.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-013-5	FHFA should evaluate the roles and responsibilities of OQA across the agency and revise OQA's charter accordingly.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-013-6	FHFA should assess risks across all agency operations for purposes of planning OQA review coverage.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-013-7	FHFA should direct performance of reviews of those areas that pose the most significant risk to FHFA.	*FHFA Can Strengthen Controls over Its Office of Quality Assurance*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2013-012-1	FHFA should establish verification controls to ensure enterprise contractors are performing in accordance with agreed criteria and that any proposed waivers to the criteria are documented and submitted for FHFA review and approval.	*Additional FHFA Oversight Can Improve the Real Estate Owned Pilot Program*	Closed—Final action taken by FHFA.
AUD-2013-012-2	FHFA should clarify guidance regarding submission of financial statements and explanation of adverse financial events as part of the bidder qualification process.	*Additional FHFA Oversight Can Improve the Real Estate Owned Pilot Program*	Closed—Final action taken by FHFA.
AUD-2013-012-3	FHFA should issue formal guidance for the REO disposition program, including the REO Pilot Program, requiring a program plan with clearly defined goals and objectives, a program monitoring and oversight mechanism, criteria to measure and evaluate program success, and the means to assess alternative REO disposition strategies.	*Additional FHFA Oversight Can Improve the Real Estate Owned Pilot Program*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-011-1	FHFA should direct Fannie Mae to strengthen controls over deficiency collections by more fully considering time frames provided by states' statutes of limitation in prioritizing, coordinating, and monitoring collection of deficiencies from borrowers with the ability to repay.	*FHFA Can Improve Its Oversight of Fannie Mae's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-010-1	FHFA should evaluate periodically the efficiency and effectiveness of Freddie Mac's deficiency recovery strategies for the pursuit of borrowers with the ability to repay.	*FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-010-2	FHFA should review Freddie Mac's monitoring controls over its servicers, foreclosure attorneys, and collection vendors involved in deficiency recovery activities to ensure that oversight across these counterparties is maintained.	*FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2013-010-3	FHFA should direct Freddie Mac to enforce controls for its counterparties to deliver timely documents to deficiency recovery vendors necessary to calculate and pursue deficiencies, and provide for financial consequences for counterparties that fail to meet delivery deadlines.	*FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-010-4	FHFA should direct Freddie Mac to implement a control to consider time frames in state statutes of limitations when prioritizing, coordinating, and monitoring deficiency collection activity for borrowers with the ability to repay.	*FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-009-1	To strengthen its enterprise information security and privacy programs, FHFA should define and issue enterprise information security and privacy program requirements.	*Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-009-2	To strengthen its enterprise information security and privacy programs, FHFA should implement the workforce plan and ensure the plan of action addresses the need to have an adequate number of information technology examiners. Specifically, FHFA should provide an appropriate level of management oversight during the annual supervisory examination planning and execution processes to ensure completion of the annual plan and compliance with established information technology examination policies and procedures.	*Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-009-3	To strengthen its enterprise information security and privacy programs, FHFA should ensure that planning for future information technology examinations is based on fully executed risk assessments, as required by FHFA policy.	*Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2013-009-4	To strengthen its enterprise information security and privacy programs, FHFA should consistently deploy the automated tools needed for ongoing monitoring and tracking of previously identified security and privacy issues in order to enhance the efficiency and effectiveness of the examination process.	*Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-009-5	To strengthen its enterprise information security and privacy programs, FHFA should establish and document a process for placing formal reliance on the work of internal audit divisions at the enterprises.	*Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-008-1	FHFA should develop a risk-based plan to monitor the enterprises' oversight of their counterparties' compliance with contractual representations and warranties, including those related to federal consumer protection laws.	*FHFA Should Develop and Implement a Risk-Based Plan to Monitor the Enterprises' Oversight of Their Counterparties' Compliance with Contractual Requirements Including Consumer Protection Laws*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-1	To improve servicer compliance with escalated case requirements, FHFA should perform supervisory review and follow up to ensure that Freddie Mac requires its servicers to report escalated consumer complaint information—to include a negative response if servicers have not received any escalated complaints—on a monthly basis.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-2	To improve servicer compliance with escalated case requirements, FHFA should perform supervisory review and follow up to ensure that Freddie Mac requires its servicers to resolve escalated consumer complaint information within 30 days.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2013-007-3	To improve servicer compliance with escalated case requirements, FHFA should perform supervisory review and follow up to ensure that Freddie Mac requires its servicers to categorize resolved escalated consumer complaint information in accordance with resolution categories defined in the servicing guide.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-4	To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow up to ensure that Freddie Mac includes testing of servicers' performance for handling and reporting escalated cases as part of its reviews of servicers' performance.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-5	To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow up to ensure that Freddie Mac identifies and addresses servicer operational challenges with implementing the escalated case requirements as part of the testing of the servicers' performance for handling and reporting escalated cases.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-6	To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow up to ensure that Freddie Mac establishes penalties in the servicing guide, such as fines or fees, for servicers' lack of reporting escalated cases.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-7	To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow up to ensure that Freddie Mac expands the servicer scorecard and servicer performance evaluations to include reporting of escalated cases.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2013-007-8	To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow up to ensure that Freddie Mac provides information on escalated cases received from servicers to internal staff (the counterparty operational risk evaluation team) responsible for testing servicer performance.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-007-9	To improve its own oversight, FHFA should develop and implement FHFA examination guidance related to enterprise implementation and compliance with FHFA directives.	*Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-006-1	To enhance its oversight of FHLBank advances to insurance companies, FHFA should pursue memoranda of understanding allowing FHFA to obtain confidential supervisory and other regulatory information from the insurance regulators of states in the districts of those FHLBanks with the highest concentrations of insurance company lending—the FHLBanks of Des Moines, Indianapolis, Topeka, New York, and Cincinnati—to improve FHFA's ability to evaluate whether the FHLBanks are adequately assessing the condition and operations of their insurance company members.	*FHFA Can Enhance Its Oversight of FHLBank Advances to Insurance Companies by Improving Communication with State Insurance Regulators and Standard-Setting Groups*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-006-2	To enhance its oversight of FHLBank advances to insurance companies, FHFA should seek to participate in regular meetings of relevant National Association of Insurance Commissioners working groups to gather information on current and developing issues relevant to the FHLBanks.	*FHFA Can Enhance Its Oversight of FHLBank Advances to Insurance Companies by Improving Communication with State Insurance Regulators and Standard-Setting Groups*	Closed—Final action taken by FHFA.

No.	Recommendation	Report	Status
AUD-2013-004-1	FHFA should update its examination guide (*Supervision Reference and Procedures Manual, Credit Risk-Multifamily*), in consideration of industry standards, to include qualitative guidance for examiners to follow when determining the sampling size and testing coverage of loan files.	*FHFA's Oversight of the Asset Quality of Multifamily Housing Loans Financed by Fannie Mae and Freddie Mac*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-004-2	FHFA should require examiners to maintain documentation adequate to support adherence to the sampling methodology developed in the updated examination guide.	*FHFA's Oversight of the Asset Quality of Multifamily Housing Loans Financed by Fannie Mae and Freddie Mac*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-002-1	The FHFA contracting officer should review the total unallowable payments of $256,343 made to Advanced Technology Systems, Inc. (ATSC), under the contract/task order and recapture the amounts identified as not allocable ($21,329), unreasonable ($47,743), and unsupportable ($187,271).	*FHFA's Oversight of Contract No. FHF-10-F-0007 with Advanced Technology Systems, Inc.*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-002-2	The FHFA contracting officer should determine whether additional corrective actions are warranted to recapture additional unreasonable costs billed by ATSC to FHFA after November 2011. (OIG did not review charges submitted after November 30, 2011.)	*FHFA's Oversight of Contract No. FHF-10-F-0007 with Advanced Technology Systems, Inc.*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-002-3	The FHFA contracting officer's representative should revisit this contract/task order and perform the necessary analysis to ensure that ATSC employees had the education background and experience as required under the General Services Administration master contract. The FHFA contracting officer should recapture all expenses, when applicable, paid to the contractor for employees working in positions without proper qualifications.	*FHFA's Oversight of Contract No. FHF-10-F-0007 with Advanced Technology Systems, Inc.*	Recommendation partially agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2013-002-4	The Director of the Office of Budget and Financial Management should issue guidance to all acquisition staff and approving officials, including contracting officers and contracting officer's representatives, on: • cost allocation and proper procedures for assigning costs to contracts in accordance with benefits received and based on the appropriate cost objective; • proper procedures for ensuring that contract employees meet labor category qualifications specified in time and material/labor hour contracts; • proper procedures for obtaining sufficient justification prior to increasing funds, adjusting fixed labor rates, and approving payments on time and material contracts; • appropriate procedures for evaluating contractor price proposals and documenting the agency's pre-negotiation position prior to awarding contract modifications; and • appropriate use of contractor employees to substitute for internal agency positions and approving invoices based on contractual terms and provisions.	*FHFA's Oversight of Contract No. FHF-10-F-0007 with Advanced Technology Systems, Inc.*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2013-002-5	The FHFA contracting officer should remove the $105,000 of excess funds from contract line item number 1 to account for technical writing services ATSC was no longer required to perform under the contract line item number. Thereafter, the contracting officer should compare the new contract ceiling to the actual amount ATSC billed against contract line item number 1 and recapture any unallowable costs that exceed the new ceiling price.	*FHFA's Oversight of Contract No. FHF-10-F-0007 with Advanced Technology Systems, Inc.*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2012-008-1	FHFA should reassess the nondelegated authorities to ensure sufficient FHFA involvement with major business decisions.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-2	FHFA should evaluate the internal controls established by the enterprises, including policies and procedures, to ensure they communicate all major business decisions requiring approval to the agency.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2012-008-3A	FHFA should evaluate Fannie Mae's mortgage pool policy commutations to determine whether these transactions were appropriate and in the best interest of the enterprise and taxpayers. This evaluation should include an assessment of Fannie Mae's methodology used to determine the economic value of the seven mortgage pool policy commutations. This assessment should include a documented review of Fannie Mae's analysis, the adequacy of the model(s) and assumptions used by Fannie Mae to determine the amount of insurance in force, fair value of the mortgage pool policies, premiums forgone, any other factors incorporated into Fannie Mae's analysis, and the accuracy of the information supplied to FHFA.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-3B	FHFA should evaluate Fannie Mae's mortgage pool policy commutations to determine whether these transactions were appropriate and in the best interest of the enterprise and taxpayers. This evaluation should include a full accounting and validation of all of the cost components that comprise each settlement discount (risk in force minus fee charged), such as insurance premiums and time value of money applicable to each listed cost component.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.

No.	Recommendation	Report	Status
AUD-2012-008-4	FHFA should develop a methodology and process for conservator review of proposed mortgage pool policy commutations to ensure that there is a documented, sound basis for any pool policy commutations executed in the future.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-5	FHFA should complete actions to establish a governance structure at Fannie Mae for obtaining conservator approval of counterparty risk limit increases.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-6	FHFA should establish a clear timetable and deadlines for enterprise submission of transactions to FHFA for conservatorship approval.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-7	FHFA should develop criteria for conducting business case analyses and substantiating conservator decisions.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-8	FHFA should issue a directive to the enterprises requiring them to notify FHFA of any deviation from any previously reviewed action so that FHFA may consider the change and revisit its conservatorship decision.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Closed—Final action taken by FHFA.
AUD-2012-008-9	FHFA should implement a risk-based examination plan to review the enterprises' execution of and adherence to conservatorship decisions.	*FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2012-006-1	FHFA's Deputy Director of the Division of Enterprise Regulation (DER) and Office of Financial Analysis' Senior Associate Director should ensure that the agency analyzes opportunities to use call report system (CRS) information to facilitate supervision and regulation of the enterprises.	*FHFA's Call Report System*	Closed—Final action taken by FHFA.

No.	Recommendation	Report	Status
AUD-2012-006-2	FHFA's Deputy Director of DER and Office of Financial Analysis' Senior Associate Director should ensure that the agency supports identified opportunities for using CRS in its oversight planning and monitoring with detailed supervisory and support division requirements.	*FHFA's Call Report System*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2012-006-3	FHFA's Deputy Director of DER and Office of Financial Analysis' Senior Associate Director should ensure that the agency, if current CRS capabilities need improvement, directs divisions to work with FHFA's Office of Technology and Information Management and CRS system owners to enhance and improve CRS to meet FHFA's supervisory needs.	*FHFA's Call Report System*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-012-1	FHFA should ensure Fannie Mae takes the actions necessary to reduce servicer reimbursement processing errors. These actions should include utilizing its process accuracy data in a more effective manner and implementing a red flag system.	*Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-012-2	FHFA should require Fannie Mae to: • quantify and aggregate its overpayments to servicers regularly; • implement a plan to reduce these overpayments by (1) identifying their root causes, (2) creating reduction targets, and (3) holding managers accountable; and • report its findings and progress to FHFA periodically.	*Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-012-3	FHFA should publish Fannie Mae's reduction targets and overpayment findings.	*Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses*	Recommendation not accepted by FHFA; recommendation remains open and will continue to be monitored.

No.	Recommendation	Report	Status
EVL-2013-009-1	FHFA should establish a formal review process for compensatory fee settlements and significant MSR transfers.	*FHFA's Oversight of Fannie Mae's 2013 Settlement with Bank of America*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-008-1	FHFA's Deputy Director, Division of Home Loan Bank Regulation, should ensure that agency examiners thoroughly assess FHLBank compliance with MRAs and other supervisory requirements to remediate unsecured credit violations and risk management deficiencies during the 2013 and 2014 examination cycles.	*FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-008-2	FHFA's Deputy Director, in consultation with the General Counsel and others, should consider the use of informal or formal enforcement actions as appropriate to ensure the remediation of any further regulatory violations or failures to adhere to supervisory requirements.	*FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-005-1	FHFA should, preferably in consultation with FHA, develop definitions and performance measures that would permit Congress, financial market participants, and the public to assess the progress and the effectiveness of its initiative.	*FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees*	Recommendation not accepted by FHFA; recommendation remains open and will continue to be monitored.
EVL-2013-005-2	FHFA should assess the feasibility of establishing a formal working arrangement with FHA to assess such critical issues as: • (1) the implementation of their pricing initiatives and prospects for success in achieving their objectives, and (2) the potential for shifts of mortgage business and risks between government-supported or -guaranteed markets; • briefing the Federal Housing Finance Oversight Board and/or FSOC on the findings of the assessment; and • disclosing the assessment publicly in an appropriate format.	*FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees*	Recommendation not accepted by FHFA; recommendation remains open and will continue to be monitored.

No.	Recommendation	Report	Status
EVL-2013-04-1	FHFA should develop a policy for FHLBank site visits of AHP projects that includes guidance on their frequency, scope, and administration.	*FHFA's Oversight of the Federal Home Loan Banks' Affordable Housing Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-04-2	FHFA should conduct and report cross-cutting analyses of common issues and themes across the FHLBanks, using appropriate and analytically rigorous methods.	*FHFA's Oversight of the Federal Home Loan Banks' Affordable Housing Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-04-3	FHFA should analyze staffing levels needed to perform additional cross-cutting analyses and oversee FHLBank site visits of AHP projects, and take appropriate actions to meet those staffing targets.	*FHFA's Oversight of the Federal Home Loan Banks' Affordable Housing Programs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-03-1	FHFA should continue to monitor Freddie Mac's implementation of its counterparty risk management policies and procedures by: • ensuring that the independence and decisions of the enterprise's risk management staff are not overridden by business management staff; and • directing Freddie Mac Internal Audit to audit the counterparty credit risk management function annually.	*Case Study: Freddie Mac's Unsecured Lending to Lehman Brothers Prior to Lehman Brothers' Bankruptcy*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-03-2	FHFA should continue to pursue all possible avenues to recover the $1.2 billion in the Lehman bankruptcy proceedings.	*Case Study: Freddie Mac's Unsecured Lending to Lehman Brothers Prior to Lehman Brothers' Bankruptcy*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2013-03-3	FHFA should continue to develop an examination program and procedures encompassing enterprise-wide risk exposure to all of Freddie Mac's counterparties.	*Case Study: Freddie Mac's Unsecured Lending to Lehman Brothers Prior to Lehman Brothers' Bankruptcy*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
EVL-2013-001-1	FHFA should develop a long-term plan to strengthen its oversight of the enterprises' non-executive compensation through reviews or examinations, focusing on senior professional compensation. The plan should set priorities, ensure that available staffing resources are commensurate with them, and establish an appropriate time frame for its implementation. With respect to the reviews and examinations contemplated by its plan, the agency should consider including the following items as priorities: • the enterprises' general structures, processes, and cost controls for senior professional compensation; • the enterprises' controls over compensation offers to new hires; and • the enterprises' compliance with the pay freeze with respect to the use of promotions and changes in responsibility.	*FHFA's Oversight of the Enterprises' Compensation of Their Executives and Senior Professionals*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-009-1	FHFA should continue to monitor Freddie Mac's hedges and models to ensure the enterprise's portfolio is hedged within its approved interest rate limits.	*FHFA's Oversight of Freddie Mac's Investment in Inverse Floaters*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-009-2	FHFA should conduct periodic reviews and tests of Freddie Mac's information wall to confirm that the enterprise is not trading on nonpublic information.	*FHFA's Oversight of Freddie Mac's Investment in Inverse Floaters*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
EVL-2012-009-3	FHFA should ensure that supervisory policies are well-founded and coordinated and that the agency speaks with one voice by: • confirming its position or the agreement in writing as soon as practical if FHFA is going to take a position or believes it has come to an agreement with Freddie Mac regarding a particular investment product; and • ensuring that supervisory policies are based on the robust work of agency personnel and not reactions to media or other public scrutiny.	*FHFA's Oversight of Freddie Mac's Investment in Inverse Floaters*	Recommendation partially agreed to by FHFA; implementation of recommendation pending.
EVL-2012-009-4	Prior to issuing any public statement, FHFA should exercise due diligence to ensure that statements accurately reflect all relevant facts.	*FHFA's Oversight of Freddie Mac's Investment in Inverse Floaters*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-008-1	FHFA should consider revising FHFA's delegation of authorities to require FHFA approval of unusual, high-cost, new initiatives, like the High Touch Servicing Program.	*Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-008-2	FHFA should ensure that Fannie Mae does not have to pay a premium to transfer inadequately performing portfolios.	*Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
EVL-2012-008-3	Consistent with the control issues found in Fannie Mae's internal audit report on the High Touch Servicing Program, FHFA should ensure that Fannie Mae applies additional scrutiny and rigor to pricing significant MSR transactions. Specifically, FHFA should: • consider requiring Fannie Mae to assess the valuation methods of multiple MSR valuators in order to discern best practices; and • consider requiring two independent valuations in the case of larger MSR transactions (at a threshold to be determined by FHFA).	*Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-008-4	FHFA should assess the efficacy of the program and direct any necessary modifications. As the portfolios purchased under the program approach the five-year mark, FHFA should review both the underlying assumptions and the performance criteria for the High Touch Servicing Program.	*Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-007-1	FHFA and Freddie Mac should continue to carry out the loan review and related reforms they have initiated since OIG's original report on the Bank of America settlement with Freddie Mac was issued.	*Follow-up on Freddie Mac's Loan Repurchase Process*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-005-1	FHFA should continue its ongoing horizontal review of unsecured credit practices at the FHLBanks by: • following up on any potential evidence of violations of the existing regulatory limits and taking supervisory and enforcement actions as warranted; and • determining the extent to which inadequate systems and controls may compromise the FHLBanks' capacity to comply with regulatory limits and taking any supervisory actions necessary to correct such deficiencies as warranted.	*FHFA's Oversight of the Federal Home Loan Banks' Unsecured Credit Risk Management Practices*	Closed—Final action taken by FHFA.

No.	Recommendation	Report	Status
EVL-2012-005-2	FHFA should strengthen the regulatory framework around the FHLBanks' extension of unsecured credit by considering the utility of: • establishing maximum overall exposure limits; • lowering the existing individual counterparty limits; and • ensuring that the unsecured exposure limits are consistent with the FHLBank System's housing mission.	*FHFA's Oversight of the Federal Home Loan Banks' Unsecured Credit Risk Management Practices*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-001-1	FHFA should develop and implement a clear, consistent, and transparent written enforcement policy that: • requires troubled FHLBanks (those classified as having supervisory concerns) to correct identified deficiencies within specified time frames; • establishes consequences for their not doing so; and • defines exceptions to the policy.	*FHFA's Oversight of Troubled Federal Home Loan Banks*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-001-2	FHFA should develop and implement a reporting system that permits agency managers and outside reviewers to assess readily examination report findings, planned corrective actions and time frames, and their status.	*FHFA's Oversight of Troubled Federal Home Loan Banks*	Closed—Final action taken by FHFA.
EVL-2012-001-3	FHFA should consistently document key activities, including recommendations to remove and replace senior officers and other personnel actions involving FHLBanks.	*FHFA's Oversight of Troubled Federal Home Loan Banks*	Closed—Final action taken by FHFA.
EVL-2011-006-1	FHFA should promptly act on the specific, significant concerns raised by FHFA staff and Freddie Mac internal auditors about its loan review process.	*Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*	Recommendation partially agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
EVL-2011-006-2	FHFA should promptly initiate management reforms to ensure that senior managers are apprised of and timely act on significant concerns brought to their attention, particularly when they receive reports that the normal reporting and supervisory process is not working properly.	*Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*	Closed—Final action taken by FHFA.

Figure 30. Summary of OIG Reports Where All Recommendations Are Closed

Report	No. of Recommendations
FHFA's Oversight of the Enterprises' Efforts to Recover Losses from Foreclosure Sales (AUD-2013-001)	3
FHFA's Oversight of the Enterprises' Management of High-Risk Seller/Servicers (AUD-2012-007)	2
FHFA's Supervisory Risk Assessment for Single-Family Real Estate Owned (AUD-2012-005)	1
FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management (AUD-2012-004)	7
FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards (AUD-2012-003)	2
FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors (AUD-2012-001)	5
FHFA's Oversight of Fannie Mae's Default-Related Legal Services (AUD-2011-004)	3
Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation - 2011 (AUD-2011-003)	9
Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program - 2011 (AUD-2011-002)	5
Audit of the Federal Housing Finance Agency's Consumer Complaints Process (AUD-2011-001)	3
FHFA's Certifications for the Preferred Stock Purchase Agreements (EVL-2012-006)	2
Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Convention and Exposition (ESR-2012-004)	2
FHFA's Oversight of the Enterprises' Charitable Activities (ESR-2012-003)	2
Evaluation of FHFA's Management of Legal Fees for Indemnified Executives (EVL-2012-002)	2
Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs (EVL-2011-005)	4
Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk (EVL-2011-004)	3
Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program (EVL-2011-003)	1
Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs (EVL-2011-002)	8
Federal Housing Finance Agency's Exit Strategy and Planning Process for the Enterprises' Structural Reform (EVL-2011-001)	2

Appendix C: Information Required by the Inspector General Act and Subpoenas Issued

Section 5(a) of the Inspector General Act provides that OIG shall, not later than April 30 and October 31 of each year, prepare semiannual reports summarizing our activities during the immediately preceding six-month periods ending March 31 and September 30. Further, Section 5(a) lists more than a dozen categories of information that we must include in our semiannual reports.

Below, OIG presents a table that directs the reader to the pages of this report where the information required by the Inspector General Act may be found.

The text that follows further addresses the status of OIG's compliance with Sections 5(a)(6), (8), (9), (10), (11), (12), and (13) of the Inspector General Act. Finally, OIG provides information concerning administrative subpoenas that it issued during the semiannual period.

Source/Requirement	Pages
Section 5(a)(1)- A description of significant problems, abuses, and deficiencies relating to the administration of programs and operations of FHFA.	7-18
Section 5(a)(2)- A description of the recommendations for corrective action made by OIG with respect to significant problems, abuses, or deficiencies.	7-18 85-102
Section 5(a)(3)- An identification of each significant recommendation described in previous semiannual reports on which corrective action has not been completed.	88-95 97-101
Section 5(a)(4)- A summary of matters referred to prosecutive authorities and the prosecutions and convictions that have resulted.	19-32
Section 5(a)(5)- A summary of each report made to the Director of FHFA.	7-18
Section 5(a)(6)- A listing, subdivided according to subject matter, of each audit and evaluation report issued by OIG during the reporting period and for each report, where applicable, the total dollar value of questioned costs (including a separate category for the dollar value of unsupported costs) and the dollar value of recommendations that funds be put to better use.	7-18 107
Section 5(a)(7)- A summary of each particularly significant report.	7-18
Section 5(a)(8)- Statistical tables showing the total number of audit and evaluation reports and the total dollar value of questioned and unsupported costs.	7-18 107
Section 5(a)(9)- Statistical tables showing the total number of audit and evaluation reports and the dollar value of recommendations that funds be put to better use by management.	7-18 107
Section 5(a)(10)- A summary of each audit and evaluation report issued before the commencement of the reporting period for which no management decision has been made by the end of the reporting period.	107
Section 5(a)(11)- A description and explanation of the reasons for any significant revised management decision made during the reporting period.	107
Section 5(a)(12)- Information concerning any significant management decision with which the Inspector General is in disagreement.	107
Section 5(a)(13)- The information described under section 05(b) of the Federal Financial Management Improvement Act of 1996.	107

Audit and Evaluation Reports with Recommendations of Questioned Costs, Unsupported Costs, and Funds to Be Put to Better Use by Management

Section 5(a)(6) of the Inspector General Act, as amended, requires that OIG list its reports during the semiannual period that include questioned costs, unsupported costs, and funds to be put to better use. Section 5(a)(8) and section 5(a)(9), respectively, require OIG to publish statistical tables showing the dollar value of questioned and unsupported costs, and of recommendations that funds be put to better use by management. The audit, evaluation, and other reports that OIG issued during the reporting period did not include recommendations with dollar values of questioned costs, unsupported costs, or funds put to better use by management.

Audit and Evaluation Reports with No Management Decision

Section 5(a)(10) of the Inspector General Act, as amended, requires that OIG report on each audit and evaluation report issued before the commencement of the reporting period for which no management decision has been made by the end of the reporting period. There were no audit or evaluation reports issued before April 1, 2013, that await a management decision.

Significantly Revised Management Decisions

Section 5(a)(11) of the Inspector General Act, as amended, requires that OIG report information concerning the reasons for any significant revised management decision made during the reporting period. During the six-month reporting period ended September 30, 2013, there were no significant revised management decisions on OIG's audits and evaluations.

Significant Management Decision with Which the Inspector General Disagrees

Section 5(a)(12) of the Inspector General Act, as amended, requires that OIG report information concerning any significant management decision with which the Inspector General is in disagreement. During the current reporting period, there were no management decisions with which the Inspector General disagreed.

Federal Financial Management Improvement Act of 1996

The provisions of HERA require FHFA to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

For fiscal year 2012, FHFA received from GAO an unqualified (clean) audit opinion on its annual financial statements and internal control over financial reporting. GAO also reported that it identified no material weaknesses in internal controls or reportable instances of noncompliance with laws or regulations. GAO is required to perform this audit in accordance with HERA.

Several OIG reports published during the semiannual period identified specific opportunities to strengthen FHFA's internal controls. These reports are summarized on pages 7 through 18.

Subpoenas Issued

During the reporting period, OIG issued 92 subpoenas as summarized in Figure 31 (see below).

Figure 31. Subpoenas Issued for the Period April 1, 2013–September 30, 2013

Issuing Office	Number of Subpoenas
OA	12
OE	0
OI	80
Total	**92**

Appendix D: OIG Reports

See www.fhfaoig.gov for OIG's reports.

Audit Reports

FHFA Can Strengthen Controls over Its Office of Quality Assurance (AUD-2013-013, September 30, 2013).

Additional FHFA Oversight Can Improve the Real Estate Owned Pilot Program (AUD-2013-012, September 27, 2013).

FHFA Can Improve Its Oversight of Fannie Mae's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies (AUD-2013-011, September 24, 2013).

FHFA Can Improve Its Oversight of Freddie Mac's Recoveries from Borrowers Who Possess the Ability to Repay Deficiencies (AUD-2013-010, September 24, 2013).

Action Needed to Strengthen FHFA Oversight of Enterprise Information Security and Privacy Programs (AUD-2013-009, August 30, 2013).

Evaluation Reports

Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses (EVL-2013-012, September 18, 2013).

Reducing Risk and Preventing Fraud in the New Securitization Infrastructure (EVL-2013-010, August 22, 2013).

FHFA's Oversight of Fannie Mae's 2013 Settlement with Bank of America (EVL-2013-009, August 22, 2013).

Fannie Mae's Compliance with FHFA Email Retention Requirements (EVL-2013-011, August 16, 2013).

FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit (EVL-2013-008, August 6, 2013).

FHFA's Oversight of Capital Markets Human Capital (ESR-2013-007, August 2, 2013).

Home Affordable Refinance Program: A Mid-Program Assessment (EVL-2013-006, August 1, 2013).

FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees (EVL-2013-005, July 16, 2013).

FHFA's Oversight of the Federal Home Loan Banks' Affordable Housing Programs (EVL-2013-04, April 30, 2013).

Other Reports

Management Alert: Delay Implementing Advisory Bulletin No. 2012-02 (August 5, 2013).

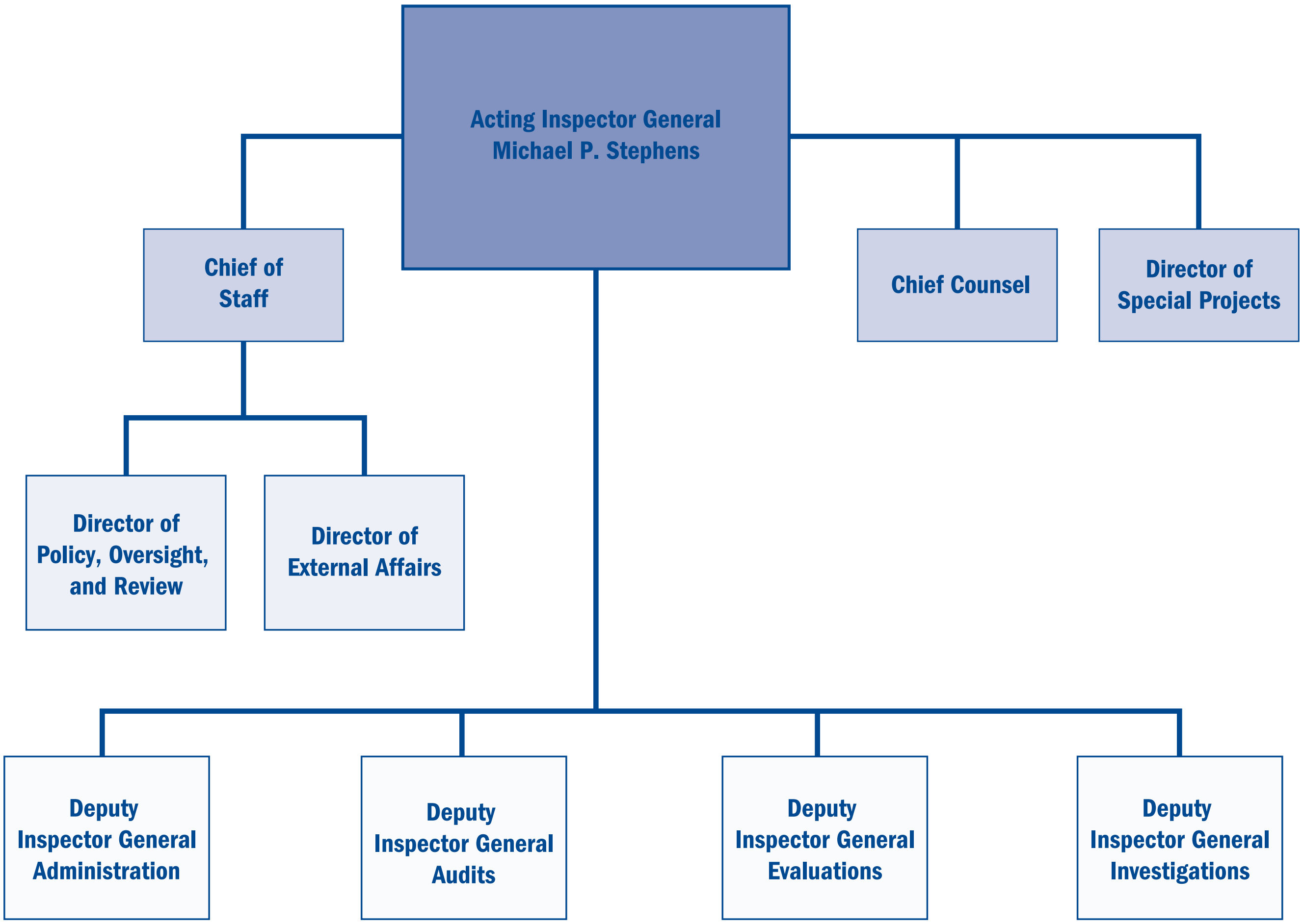
Servicer Mortgage Payment Remittance (SIR-2013-5, June 17, 2013).

Federal Home Loan Bank Collateral Verification Reviews (SIR-2013-4, June 17, 2013).

Public Company Accounting Oversight Board Criticisms of Public Accounting Firms that Do Business with the GSEs (May 3, 2013).

Joint Report on Federally Owned or Overseen Real Estate Owned Properties (May 2013).

Appendix E: OIG Organizational Chart



Appendix F: Description of OIG Offices and Strategic Plan

OIG Offices

Office of Audits

OA provides a full range of professional audit and attestation services for FHFA's programs and operations. Through its performance audits and attestation engagements, OA helps FHFA: (1) promote economy, efficiency, and effectiveness; (2) detect and deter fraud, waste, and abuse; and (3) ensure compliance with applicable laws and regulations. Under the Inspector General Act, inspectors general are required to comply with GAO's *Government Auditing Standards*, commonly referred to as the "Yellow Book." OA performs its audits and attestation engagements in accordance with the Yellow Book.

Office of Evaluations

OE provides independent and objective reviews, studies, survey reports, and analyses of FHFA's programs and operations. OE's evaluations are generally limited in scope. The **Inspector General Reform Act** of 2008 requires that inspectors general adhere to the *Quality Standards for Inspection and Evaluation*, commonly referred to as the "Blue Book," issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). OE performs its evaluations in accordance with the Blue Book.

Office of Investigations

OI investigates allegations of misconduct and fraud involving FHFA and the GSEs in accordance with CIGIE's *Quality Standards for Investigations* and guidelines that the Attorney General issues.

OI's investigations may address administrative, civil, and criminal violations of laws and regulations. Investigations may relate to FHFA or GSE employees, contractors, consultants, and any alleged wrongdoing involving FHFA's or the GSEs' programs and operations. Offenses investigated may include mail, wire, bank, accounting, securities, or mortgage fraud, as well as violations of the tax code, obstruction of justice, and money laundering.

To date, OI has opened over 300 criminal and civil investigations, but by their nature, these investigations and their resulting reports are not generally made public. However, if an investigation reveals criminal activity, OI refers the matter to DOJ for possible prosecution or recovery of monetary damages and penalties. OI reports administrative misconduct to management officials for consideration of disciplinary or remedial action.

Report fraud, waste, or abuse related to FHFA's programs and operations by visiting www.fhfaoig.gov/ReportFraud or calling (800) 793-7724.

OI also manages OIG's hotline that receives tips and complaints of fraud, waste, or abuse in FHFA's programs and operations. The hotline allows concerned parties to report their allegations to OIG directly and confidentially. OI honors all applicable whistleblower protections. As part of its effort to raise awareness of fraud, OI actively promotes the hotline through OIG's website, posters, emails to FHFA and GSE employees, and OIG's semiannual reports.

Executive Office

The Executive Office (EO) provides leadership and programmatic direction for OIG's offices and activities.

EO includes OC, which serves as the chief legal advisor to the Acting Inspector General and provides independent legal advice, counseling, and opinions to OIG about its programs and operations. OC also reviews audit and evaluation reports for legal sufficiency and compliance with OIG's policies and priorities. Additionally, it reviews drafts of FHFA regulations and policies and prepares comments as appropriate. OC also coordinates with FHFA's Office of General Counsel and manages OIG's responses to requests and appeals made under the Freedom of Information Act and the Privacy Act.

EO also includes the Office of Policy, Oversight, and Review (OPOR), which provides advice, consultation, and assistance regarding OIG's priorities and the scope of its evaluations, audits, and all other published reports. In addition, OPOR manages OIG's audit and evaluation report production process and produces special reports and white papers addressing complex housing finance issues.

The Office of External Affairs is also within EO, and it responds to inquiries from the press and members of Congress.

The Office of Special Projects is also within EO, and it supports other OIG offices on high-impact projects.

Office of Administration

The Office of Administration (OAd) manages and oversees OIG administration, including budget, human resources, safety, facilities, financial management, information technology, and continuity of operations. For human resources, OAd develops policies to attract, develop, and retain exceptional people, with an emphasis on linking performance planning and evaluation to organizational and individual accomplishment of goals and objectives. Regarding OIG's budget and financial management, OAd coordinates budget planning and execution and oversees all of OIG's procedural guidance for financial management and procurement integrity.

OAd also administratively supports the Chief of Staff and the Deputy Inspector General for Audits as they implement OIG's Internal Management Assessment Program, which requires the routine inspection of each OIG office to ensure that it complies with applicable requirements. OAd also administers OIG's Equal Employment Opportunity Program.

OIG's Strategic Plan

On September 7, 2011, OIG published a Strategic Plan to define its goals and objectives, guide development of its performance criteria, establish measures to assess accomplishments, create budgets, and report on progress. OIG will continue to monitor events; make changes to its Strategic Plan as circumstances warrant; and strive to remain relevant regarding areas of concern to FHFA, the GSEs, Congress, and the American people.

Within the Strategic Plan, OIG has established several goals that align with FHFA's strategic goals.

Strategic Goal 1—Adding Value

OIG will promote the economy, efficiency, and effectiveness of FHFA's programs and operations and assist FHFA and its stakeholders to solve problems related to the conservatorships and the conditions that led to them.

Strategic Goal 2—Operating with Integrity

OIG will promote the integrity of FHFA's programs and operations through the identification and prevention of fraud, waste, or abuse.

Strategic Goal 3—Promoting Productivity

OIG will deliver quality products and services to its stakeholders by maintaining an effective and efficient internal quality control program to ensure that OIG's results withstand professional scrutiny.

Strategic Goal 4—Valuing OIG Employees

OIG will maximize the performance of its employees and the organization.

Organizational Guidance

OIG has developed and promulgated policies and procedural manuals for each of its offices. These manuals set forth uniform standards and guidelines for the performance of each office's essential responsibilities and are intended to help ensure the consistency and integrity of OIG's operations.

Appendix G: Figure Sources

Figure 2. Federal Housing Finance Agency Office of Inspector General, "OQA Recommendations Remain Open for Extended Periods," *FHFA Can Strengthen Controls over Its Office of Quality Assurance*, AUD-2013-013, at 11 (September 30, 2013). Accessed: September 30, 2013, at www.fhfaoig.gov/Content/Files/AUD-2013-013.pdf.

Figure 3. Federal Housing Finance Agency Office of Inspector General, "Prescribed Risk Scoring Process Not Followed in Some Cases," *Additional FHFA Oversight Can Improve the Real Estate Owned Pilot Program*, AUD-2013-012, at 17 (September 27, 2013). Accessed: September 30, 2013, at http://fhfaoig.gov/Content/Files/AUD-2013-012.pdf.

Figure 4. Federal Housing Finance Agency Office of Inspector General, "Fannie Mae's Servicer Reimbursement Operations," *Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses*, EVL-2013-012, at 10 (September 18, 2013). Accessed: September 18, 2013, at www.fhfaoig.gov/Content/Files/EVL-2013-012.pdf.

Figure 5. Federal Housing Finance Agency Office of Inspector General, "Overview of Settlement," *FHFA's Oversight of Fannie Mae's 2013 Settlement with Bank of America*, EVL-2013-009, at 9 (August 22, 2013). Accessed: September 13, 2013, at http://fhfaoig.gov/Content/Files/EVL-2013-009.pdf.

Figure 6. Federal Housing Finance Agency Office of Inspector General, "FHFA Has Required the FHLBanks That Committed Violations to Take Corrective Actions Within Specified Timeframes," *FHFA's Oversight of the Federal Home Loan Banks' Compliance with Regulatory Limits on Extensions of Unsecured Credit*, EVL-2013-008, at 19 (August 6, 2013). Accessed: September 13, 2013, at http://fhfaoig.gov/Content/Files/EVL-2013-008.pdf.

Figure 7. Federal Housing Finance Agency Office of Inspector General, "FHFA," *Home Affordable Refinance Program: A Mid-Program Assessment*, EVL-2013-006, at 18 (August 1, 2013). Accessed: September 13, 2013, at http://fhfaoig.gov/Content/Files/EVL-2013-006.pdf.

Figure 8. Federal Housing Finance Agency Office of Inspector General, "The Amount by Which Guarantee Fees Must Rise in Order to Increase Private Sector Investment Is Unclear," *FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees*, EVL-2013-005, at 26 (July 16, 2013). Accessed: September 13, 2013, at http://fhfaoig.gov/Content/Files/EVL-2013-005_4.pdf.

Figure 10. Federal Housing Finance Agency, "The Housing Government-Sponsored Enterprises," *2011 Performance and Accountability Report*, at 14. Accessed: August 20, 2013, at www.fhfa.gov/webfiles/22756/FHFAPAR_2011.pdf.

Figure 11. Inside Mortgage Finance, "Mortgage & Asset Securities Issuance," *Mortgage Market Statistical Annual: Volume II: Secondary Market*, at 4 (2013).

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99 The factors discussed herein derive from OIG's audit, evaluative, investigative, and other efforts, and thus, there may be factors—or attributes of factors—that are not discussed but are nonetheless important to a safe, stable, and liquid mortgage market. For example, strong oversight of capitalization is critical to a vibrant secondary mortgage market, but it has been reported that prior to the conservatorships, the enterprises were required to hold very little capital to protect against losses (i.e., 0.45% to back their guarantees of MBS and 2.5% to back the mortgages in their portfolios; this compared to bank and thrift capital requirements of at least 4% of mortgage assets). Further, shortly before the commencement of the conservatorships, FHFA's predecessor determined that the enterprises were adequately capitalized. See Financial Crisis Inquiry Commission, "Fannie Mae and Freddie Mac: 'The Whole Army of Lobbyists,'" "2006: 'Increase Our Penetration Into Subprime,'" *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, at 39, 181 (January 2011). Accessed: September 30, 2013, at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf. It is not OIG's intention to discount these other factors or attributes; rather, OIG determined that

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