Federal Housing Finance Agency
Office of Inspector General

Semiannual Report to the Congress

October 1, 2011, through March 31, 2012

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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 Federal Housing Finance Agency (FHFA or Agency) programs and operations; prevent and detect fraud, waste, or 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 its 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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A Message from the Inspector General

This is OIG's third Semiannual Report to the Congress. It discusses OIG's oversight of FHFA's programs and operations from October 1, 2011, through March 31, 2012.

FHFA is the safety, soundness, and mission regulator of the housing government-sponsored enterprises (GSEs) – the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Bank System (FHLBank System). And, since September 2008, the Agency has also served as the conservator of Fannie Mae and Freddie Mac (collectively, the Enterprises). In this capacity, FHFA oversees the Enterprises with the goal of preserving and conserving their assets. Further, since the inception of the conservatorships over three and one-half years ago, the federal government has provided $187.5 billion in financial support to ensure the Enterprises' solvency.

The Enterprises own or guarantee about 70% of all newly originated residential mortgages in the United States. As a result, FHFA's activities have potentially far reaching ramifications, affecting all aspects of housing policy and the welfare of millions of Americans. Given this reality, the need for vigilant oversight remains a high priority.

In this report, OIG summarizes the reports it issued during the reporting period. They include OIG's current assessment of FHFA's conservatorships of Fannie Mae and Freddie Mac and OIG's reviews of FHFA's oversight of: Freddie Mac's controls over mortgage servicing; Fannie Mae's single-family underwriting standards; troubled Federal Home Loan Banks (FHLBanks); legal fees for Enterprise executives; the Enterprises' charitable activities; and the Enterprise's participation in a convention. The report also describes a number of OIG investigations aimed at combating fraud in the housing market, such as the recent indictments of individuals who allegedly operated fraudulent loan modification and refinancing programs. Finally, the report also includes *Fannie Mae and Freddie Mac – Where the Taxpayers' Money Went*, which discusses how the federal support of the Enterprises has been spent, and Appendix D, which discusses certain trends that OIG has noted.

We hope you find this report useful.

Steve A. Linick
Inspector General
April 30, 2012

Steve A. Linick
Inspector General of the Federal Housing Finance Agency

EXECUTIVE SUMMARY

Executive Summary

OVERVIEW

This Semiannual Report discusses FHFA developments and the operations of OIG from October 1, 2011, through March 31, 2012.[a]

FHFA DEVELOPMENTS

FHFA is the safety, soundness, and mission regulator of the housing **GSEs**: Fannie Mae, Freddie Mac, and the FHLBank System. The FHLBank System is comprised of 12 regional FHLBanks and the Office of Finance. FHFA also has been the conservator of the Enterprises since September 2008.

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

As conservator, FHFA's powers include:

- taking over the assets of and operating the Enterprises with all the powers of their shareholders, directors, and officers; and
- preserving and conserving the assets and property of the Enterprises.

During the semiannual period, FHFA has exercised those powers by, among other things, releasing the results of its comparative analysis of principal reduction as a loss mitigation option; amending the Home Affordable Refinance Program (HARP) to attract more eligible borrowers; and initiating civil litigation against the City of Chicago. In its comparative analysis, FHFA argued that principal reduction results in a lower net present value to taxpayers than principal forbearance (which is currently offered to underwater borrowers). Therefore, the Agency decided to exclude principal reduction from the Enterprises' loss mitigation options.[b]

Additionally, FHFA and the Enterprises announced a number of changes to HARP, including removing the 125% loan-to-value (LTV) ceiling for fixed-rate mortgages; waiving certain representations and warranties that lenders make; and extending the end date for HARP until December 31, 2013.[1]

FHFA also filed a lawsuit against the City of Chicago, contesting its "Vacant Buildings Ordinance" as enforced against the Enterprises. The ordinance requires mortgage owners to conduct monthly inspections of mortgaged properties in order to determine if they are vacant, in which case the mortgage owners are required to pay a $500 fee to register the property. As mortgage owners, the Enterprises are required to comply with the ordinance, even if they have not foreclosed on a property or do not otherwise own it, and are subject to penalties up to $1,000 per day per property for noncompliance with any provision. FHFA alleges, among other things, that the ordinance impermissibly encroaches on its role as sole regulator and supervisor of the Enterprises.

[a] The Inspector General Act of 1978, 5 U.S.C. App. 3 § 5, requires that each inspector general compile a report of his or her office's operations for each six-month period ending Mar. 31 and Sept. 30.

[b] On the basis of new incentives offered by the Department of the Treasury, FHFA is reconsidering its analysis. As of Mar. 31, 2012, FHFA had not completed its reconsideration.

FHFA also issued a strategic plan for the next stage of the conservatorships and an initiative to dispose of real estate owned (REO). These and other FHFA developments are discussed in detail in this Semiannual Report.

OIG OPERATIONS

OIG published eight reports relating to FHFA's oversight of significant Enterprise and FHLBank issues.[c]

Enterprise Issues

During the reporting period, OIG published six reports addressing a variety of Enterprise issues. One report, *FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac* (WPR-2012-001, March 28, 2012),[d] provides background concerning the conservatorships of the Enterprises and assesses the conservatorships on their third anniversary. OIG found that, although FHFA has considerable discretion in defining its role, in certain circumstances it has opted to avoid active participation in or management of the Enterprises. OIG's reports have revealed instances in which the Agency, in its capacity as conservator, unduly deferred to the Enterprises' decisions. Similarly, OIG reports have found instances in which FHFA, in its capacity as regulator, was not proactive in its oversight and enforcement. These trends are discussed in detail in Appendix D of this Semiannual Report. Additionally, FHFA faces significant challenges in managing the conservatorships, including: (1) attempting to advance the Enterprises' business interests while assisting distressed homeowners; (2) serving simultaneously as both the Enterprises' conservator and regulator; and (3) balancing the uncertain future of the Enterprises.

Two other reports analyze FHFA's oversight of major functions of the Enterprises. The first report, *FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors* (AUD-2012-001, March 7, 2012),[e] showed that although FHFA and Freddie Mac have taken action to improve oversight of mortgage servicing, FHFA can enhance its supervision of the Enterprises' controls over mortgage servicing contractors. FHFA has not clearly defined its role regarding the oversight of servicers, has not sufficiently coordinated with other federal banking agencies about risks and supervisory concerns with individual servicers, and has not timely addressed emerging risks presented by mortgage servicing contractors. Moreover, FHFA has not established comprehensive regulations and guidance that provide for servicer management and oversight and does not adequately monitor servicing performance.

In the second report, *FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards* (AUD-2012-003, March 22, 2012),[f] OIG found that although FHFA has taken steps to ensure that mortgages purchased by the Enterprises conform to underwriting standards, the Agency's oversight of underwriting is limited and it relies largely on the Enterprises to oversee and establish underwriting standards. OIG concluded that the Agency can

[c] Seven of the reports are summarized in this Executive Summary. The eighth report pertains to FHFA's compliance with the Improper Payments Act and – with the other seven reports – is discussed in detail in Section 3.

[d] The full report is available at www.fhfaoig.gov/Content/Files/WPR-2012-001.pdf.

[e] The full report is available at www.fhfaoig.gov/Content/Files/AUD%202012-001.pdf.

[f] The full report is available at www.fhfaoig.gov/Content/Files/AUD-2012-003.pdf.

strengthen its oversight by creating formal processes for reviewing both the Enterprises' underwriting standards and variances from them. FHFA can also enhance its guidance for planning and conducting its examinations of the Enterprises' underwriting quality control.

OIG published three additional reports that evaluate various Enterprise expenses. The first report, *Evaluation of FHFA's Management of Legal Fees for Indemnified Executives* (EVL-2012-002, February 22, 2012),[g] provided background concerning tens of millions of dollars the Enterprises have spent defending themselves and former senior executives in class action lawsuits and other legal matters. OIG determined that these fees present FHFA with a difficult balance of interests. On the one hand, the Agency is interested in avoiding potential losses by effectively defending ongoing lawsuits against the Enterprises. On the other hand, FHFA has an interest in controlling significant costs, particularly the millions of dollars of payments made to attorneys and others involved in representing former senior executives.

OIG also concluded that FHFA had not independently validated the Enterprises' processes for determining the reasonableness or validity of legal services provided on behalf of their executives or the bills presented for such services.

In the complementary two reports, *FHFA's Oversight of the Enterprises' Charitable Activities* (ESR-2012-003, March 22, 2012)[h] and *Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Annual Convention and Exposition* (ESR-2012-004, March 22, 2012),[i] OIG respectively addressed FHFA's oversight of the Enterprises' charitable activities and their travel-related and sponsorship expenses associated with a Mortgage Bankers Association convention.

FHLBank Issues

Additionally, OIG published a report concerning FHLBank issues, *FHFA's Oversight of Troubled Federal Home Loan Banks* (EVL-2012-001, January 11, 2012).[j] Although OIG identified several positive actions FHFA has taken as part of its oversight of the FHLBanks, OIG found that FHFA can strengthen its oversight by improving policies, systems, and documentation standards. For example, FHFA does not have or does not implement formal written enforcement standards; instead, FHFA officials have broad discretion in determining the circumstances under which formal actions against troubled FHLBanks will be initiated. OIG determined that the absence of a consistent and transparent written FHFA enforcement policy, among other things, contributes to instances in which FHFA has not acted proactively to hold troubled FHLBanks and their officers sufficiently accountable for failing to correct identified risks or for engaging in questionable risk taking.

[g] The full report is available at www.fhfaoig.gov/Content/Files/EVL-2012-002.pdf.

[h] The full report is available at www.fhfaoig.gov/Content/Files/ESR-2012-003.pdf.

[i] The full report is available at www.fhfaoig.gov/Content/Files/ESR-2012-004.pdf.

[j] The full report is available at www.fhfaoig.gov/Content/Files/Troubled%20Banks%20EVL-2012-001.pdf.

Other Activities

OIG also engaged in investigative and outreach efforts during the reporting period. For example, OIG's investigations resulted in:

- a seventh conviction in the Taylor, Bean & Whitaker case, which involved a $2.9 billion fraud that included the submission of false financial statements to Freddie Mac and a government agency; and
- five indictments in the Horizon Property Holdings advance fee scheme case, which involved defrauding struggling homeowners out of approximately $5 million in exchange for false promises of assistance with mortgage modifications.

Further, OIG's outreach efforts include participation in the newly formed Residential Mortgage-Backed Securities (RMBS) Working Group. The RMBS Working Group operates as part of the Financial Fraud Enforcement Task Force (FFETF) and is intended to investigate misconduct in the residential **mortgage-backed securities (MBS)** market that contributed to the recent financial crisis. Other participants in the RMBS Working Group include the Department of Housing and Urban Development (HUD), the Securities and Exchange Commission (SEC), the Department of Justice (DOJ), the Federal Bureau of Investigation (FBI), the Internal Revenue Service (IRS), the Consumer Financial Protection Bureau (CFPB), the Financial Crimes Enforcement Network (FinCEN), and several state attorneys general.

Mortgage-Backed Securities (MBS): 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.

All of OIG's publicly disclosed investigations and its other activities are discussed in detail in this Semiannual Report.

REPORT ORGANIZATION

This Semiannual Report is organized as follows:

- Section 1, *OIG Description*, provides a brief overview of the organization.
- Section 2, *FHFA and GSE Operations*, describes the organization and operation of FHFA, Fannie Mae, Freddie Mac, and the FHLBanks. It also discusses notable developments that affect them.
- Section 3, *OIG's Accomplishments and Strategy*, describes OIG's oversight activities, including audits, evaluations, and investigations. It also discusses OIG's current priorities and future goals.
- Section 4, *OIG's Recommendations*, discusses OIG recommendations to improve FHFA and GSE operations and transparency and reports the implementation status for outstanding recommendations.
- Section 5, *Fannie Mae and Freddie Mac – Where the Taxpayers' Money Went*, discusses why the Department of the Treasury (Treasury) invested $185 billion – as of the end of 2011 – in the Enterprises; describes how Treasury's investment has been used; and examines

the prospects for Fannie Mae and Freddie Mac repaying Treasury's investment and emerging from conservatorships.

Additionally, the Semiannual Report includes Appendix D, *Trends Identified by OIG Reports*.

OIG REPORTING REQUIREMENTS

The Inspector General Act states that each inspector general is required, no later than April 30 and October 31 each year, to prepare semiannual reports summarizing the activities of his or her office during the preceding six-month periods ending March 31 and September 30.[k] The specific reporting requirements, as specified in the Inspector General Act, are listed in Appendix B.

[k] The Inspector General Act of 1978, 5 U.S.C. App. 3 § 5.

SECTION 1

OIG DESCRIPTION

Section 1: OIG Description

OIG began operations on October 12, 2010. It was established by the Housing and Economic Recovery Act of 2008 (HERA), which amended the Inspector General Act. OIG conducts audits, evaluations, investigations, and other law enforcement activities relating to FHFA's programs and operations to improve their efficiency and effectiveness while preventing fraud, waste, and abuse.

LEADERSHIP AND ORGANIZATION

On April 12, 2010, President Barack Obama nominated FHFA's first Inspector General, Steve A. Linick, who was confirmed by the Senate on September 29, 2010, and sworn into office on October 12, 2010. Previously, Mr. Linick held several leadership positions at DOJ between 2006 and 2010. Prior to that, Mr. Linick was an Assistant U.S. Attorney in the Central District of California (1994-1999) and later in the Eastern District of Virginia (1999-2006).

Mr. Linick received his Bachelor of Arts (1985) and Master of Arts (1990) in Philosophy from Georgetown University and his Juris Doctor (1990) from the Georgetown University Law Center.

OIG consists of the 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). OIG's Executive Office (EO) and Office of Administration (OAd) hold organization-wide responsibilities. (See Appendix E for OIG's organizational chart.)

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 the *Government Auditing Standards*, commonly referred to as the "Yellow Book," issued by the Government Accountability Office (GAO). 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 employees, contractors, consultants, and any alleged wrongdoing involving FHFA's or the GSEs' programs and operations. Investigations may include mail, wire, bank, accounting, securities, or mortgage fraud, as well as violations of the tax code, obstruction of justice, and laundering money.

To date, OI has opened numerous 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.

OI also manages OIG's **Hotline** for 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, e-mails to FHFA and GSE employees, and OIG's semiannual reports.

*OIG's **Hotline**:*
(800) 793-7724 or
OIGHOTLINE@FHFAOIG.GOV.

Executive Office

EO provides leadership and programmatic direction for OIG's offices and activities.

EO includes the Office of Counsel (OC), which serves as the chief legal advisor to the Inspector General and provides independent legal advice, counseling, and opinions to OIG about its programs and operations. OC reviews audit, investigation, and evaluation reports for legal sufficiency and compliance with OIG's policies and priorities. It also reviews drafts of FHFA regulations and policies and prepares comments as appropriate. Additionally, OC coordinates with FHFA's Office of General Counsel and manages OIG's responses to requests and appeals made under the Freedom of Information Act (FOIA) 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 is responsible for conducting special studies and developing the semiannual reports.

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 Opportunities program.

OIG'S STRATEGIC PLAN

OIG's full Strategic Plan *is available at www.fhfaoig.gov/Content/Files/Strategic%20Plan.pdf.*

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 defined 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 procedures manuals for each office. 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.

SECTION 2

FHFA AND GSE OPERATIONS

Section 2: FHFA and GSE Operations

FHFA

HERA – enacted on July 30, 2008, during the financial crisis – created FHFA as the successor to the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board. The Agency now supervises the Enterprises and the FHLBanks, which previously had been respectively regulated by the two predecessor entities. HERA also expanded Treasury's authority to financially support the GSEs.[2]

On September 6, 2008, due to their deteriorating financial conditions, the Enterprises entered conservatorships overseen by FHFA. At the time of the conservatorships, Treasury exercised its authority to financially support the Enterprises by making **preferred stock** investments in them pursuant to **Senior Preferred Stock Purchase Agreements (PSPAs)**.

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.

Senior Preferred Stock Purchase Agreements (PSPAs):
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 Treasury concerning a variety of significant business activities, capital stock issuance, dividend payments, ending the conservatorships, transferring assets, and awarding executive compensation.

FHFA AUTHORITY

FHFA serves as the regulator of the GSEs and conservator of the Enterprises. As regulator, the Agency's mission is to ensure that the GSEs operate in a safe and sound manner. As conservator, the Agency seeks to conserve and preserve Enterprise assets. FHFA also has property management responsibilities under the Emergency Economic Stabilization Act (EESA).

FHFA's Duties as Regulator Under HERA

The principal duties of the Director of FHFA, as a regulator, are to oversee the prudential operations of each regulated entity and to ensure that:

- each regulated entity operates in a safe and sound manner, and maintains adequate capital and internal controls;
- the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets, including activities relating to mortgages on housing for low- and moderate-income families;
- each regulated entity complies with the rules, regulations, guidelines, and orders issued under law;
- each regulated entity carries out its statutory mission only through activities that are authorized under law and consistent with the law; and
- the activities and procedures of each regulated entity are consistent with the public interest.[1]

HERA also requires that the Enterprises obtain Agency approval before offering new products; prohibits the Enterprises from providing unreasonable

[1] See 12 U.S.C. §§ 4513 et seq. for more information on FHFA's statutory duties as a regulator.

executive compensation; requires FHFA to establish prudential management and operational standards for the regulated entities; and forbids high ranking FHFA officials from receiving compensation from the Enterprises within two years of their departure from FHFA.

FHFA's Authority as Conservator

As a conservator, FHFA generally may conserve and preserve the assets of the Enterprises and specifically is authorized to:

- succeed to all rights, titles, powers, and privileges of the Enterprises and any shareholders, officers, or directors of such Enterprises;
- operate the Enterprises; and
- take such action as may be:
    - necessary to put the Enterprises in sound and solvent conditions; and
    - appropriate to carry on the businesses of the Enterprises and preserve and conserve their assets and property.[m]

In addition to those powers enumerated by HERA, FHFA has "such incidental powers as shall be necessary to carry out" its enumerated powers.[3] In 2009, FHFA interpreted its authorization to conserve and preserve the Enterprises' assets as its "top goal" for its conservatorships,[4] and often cites this goal.[n]

FHFA's Duties Under EESA

EESA requires that FHFA:

- implement a plan to maximize assistance to homeowners;
- use its authority to encourage the servicers of Fannie Mae and Freddie Mac mortgages, considering net present value, to take advantage of federal programs to minimize foreclosures;
- coordinate within the federal government concerning homeowner assistance plans; and
- submit monthly reports to Congress detailing the progress of its efforts.[5]

FANNIE MAE AND FREDDIE MAC

In 1938, Congress chartered Fannie Mae to help create stable funding for the U.S. housing and mortgage markets. Freddie Mac's charter followed in 1970 with a similar mission of supporting residential mortgage markets in addition to expanding opportunities for homeownership and affordable rentals.

[m] HERA at § 1145. For example, under HERA, FHFA can: (1) promulgate regulations regarding the conduct of the conservatorship; (2) take title to all books, records, or assets of the Enterprises; (3) take over the assets of the Enterprises; (4) collect all obligations and money due to the Enterprises; (5) act in the name of the Enterprises; and (6) create contracts to aid in its role.

[n] See Statement of Edward DeMarco Before the House Financial Services Committee, Subcommittee on Oversight and Investigations (Dec. 1, 2011) p. 3; see also *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending* (Feb. 21, 2012) p. 10 ("FHFA has reported on numerous occasions that, with taxpayers providing the capital supporting Enterprise operations, this 'preserve and conserve' mandate directs FHFA to minimize losses on behalf of taxpayers").

Primary Mortgage Market:
The market for newly originated mortgages.

Secondary Mortgage Market:
The market for buying and selling existing mortgages; this could be in the form of whole mortgage or MBS sales.

Both the primary and secondary mortgage markets are over-the-counter markets – there is no central exchange. Rather, loans are bought and sold through personal and institutional networks.

Conventional Conforming Mortgage Loans:
Mortgages that are not insured or guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, or the Department of Agriculture, and that meet the Enterprises' underwriting standards. Conforming mortgage loans have original balances below a specific threshold, set by law and published by FHFA, known as the "conforming loan limit." For 2012, the conforming loan limit is $417,000 for most areas of the contiguous United States, although generally it can increase to a maximum of $625,500 in specific higher cost areas.

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

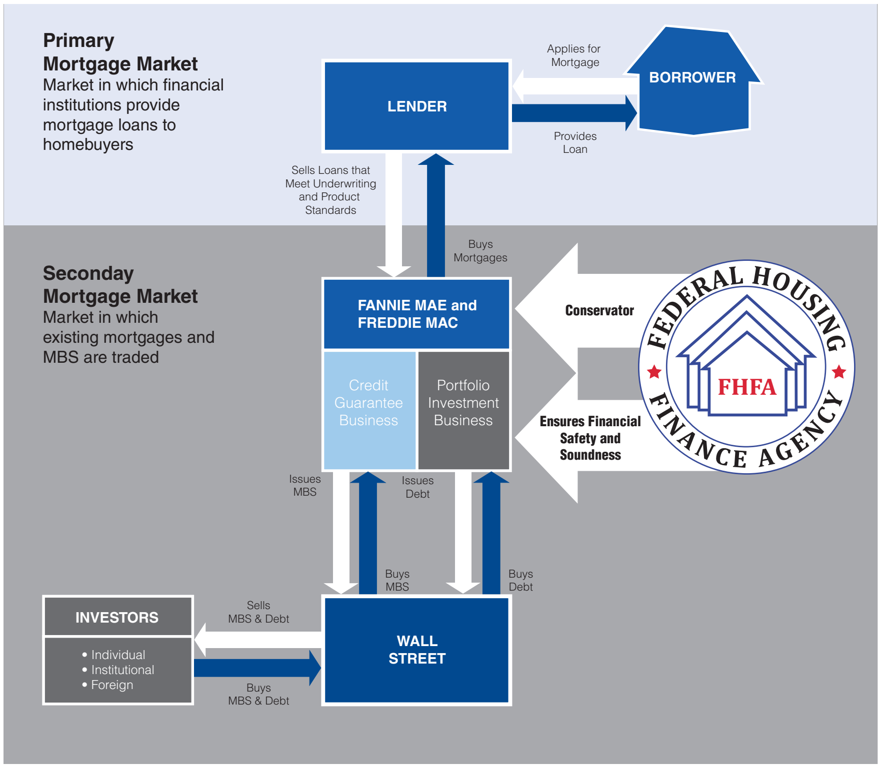
Implied Guarantee:
The assumption, prevalent in the financial markets, that the federal government will cover Enterprise debt obligations.

As Figure 1 (see below) illustrates, the Enterprises support the nation's housing finance system through the **secondary mortgage market**, but neither makes home loans directly. Instead, banks, credit unions, and other retail financial institutions originate home loans. Generally, lenders do not keep the mortgages they originate, but instead sell **conventional conforming mortgage loans** to the Enterprises.

The Enterprises typically securitize the loans they purchase by pooling them into MBS, which are then sold to investors. As part of this process, for a fee, the Enterprises **guarantee** payment of principal and interest on the MBS they sell. Alternatively, the Enterprises may hold these loans or buy MBS for their own investment portfolios, which are funded by issuing debt obligations.

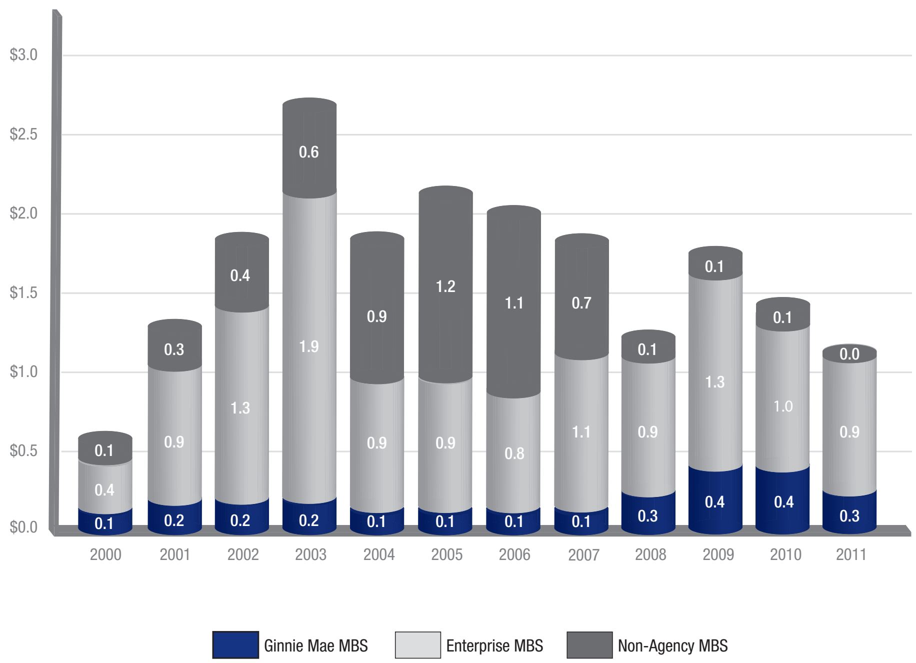
Historically, the Enterprises have benefited from an **implied guarantee** that the federal government would prevent default on their financial obligations. As a result, over time, the Enterprises' borrowing costs have been lower than those of other for-profit companies,[6] and the Enterprises assumed dominant positions in the residential housing finance market. (After the Enterprises were placed into conservatorships, the implied guarantee effectively became explicit.)[7]

Figure 1. Overview of Enterprises and FHFA's Role



Source: Government Accountability Office, *Financial Audit: Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements*, at 17 (Nov. 2011) (GAO/12-161) (online at http://gao.gov/assets/590/586278.pdf).

Figure 2. Primary Sources of MBS Issuances from 2000 to 2011 ($ trillions)



Source: Inside Mortgage Finance, *Volume II: Secondary Market: Mortgage Market Statistical Annual*, at 6 (2012).

As Figure 2 (see above) illustrates, after losing market share to non-agency competitors from 2004 through 2007, the Enterprises added to their dominant position 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. (For a detailed discussion of the Enterprises' role in the secondary market, the recent housing crisis, and the Enterprises' response to the crisis, see Section 5, *Fannie Mae and Freddie Mac – Where the Taxpayers' Money Went*.)

Enterprise Financial Performance and Government Support

As shown in Figure 3 (see page 20), the Enterprises securitized more lower quality mortgages in 2006 and 2007 than in subsequent years. The two years' higher default and delinquency rates stemmed from a greater percentage of **Alternative A (Alt-A)** loans, interest only loans, and loans made to borrowers with below average credit scores. These mortgages have caused the largest share of credit-related losses over the last several years.

Due to continued delinquencies and defaults, losses escalated and contributed to the Enterprises' rapid financial deterioration. In 2008, the year the Enterprises entered conservatorship, they reported combined losses of $109 billion, exceeding their total earnings for the preceding 21 years (see Figure 4, page 21). The Enterprises have continued to lose money since.

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

Figure 3. Mortgage Credit Quality by Origination Year

	Fannie Mae		Freddie Mac	
Year Originated	Serious Delinquency Rate[a]	Cumulative Default Rate	Serious Delinquency Rate[b]	Cumulative Default Rate
2006	11.81%	8.60%	10.82%	6.95%
2007	12.62%	9.03%	11.58%	7.49%
2008	5.64%	2.52%	5.65%	2.23%
2009	0.55%	0.17%	0.52%	0.17%
2010	0.24%	0.06%	0.25%	0.05%
2011	0.04%	0.00%	0.06%	0.00%

Sources: Fannie Mae, *2011 Credit Supplement*, at 7 (Feb. 29, 2012) (online at http://fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/q42011_credit_summary.pdf); Freddie Mac, *Fourth Quarter 2011 Financial Results Supplement*, at 26 (online at www.freddiemac.com/investors/er/pdf/supplement_4q11.pdf) (accessed Mar. 9, 2012); Freddie Mac, *2011 10-K Report*, at 163 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 16, 2012).

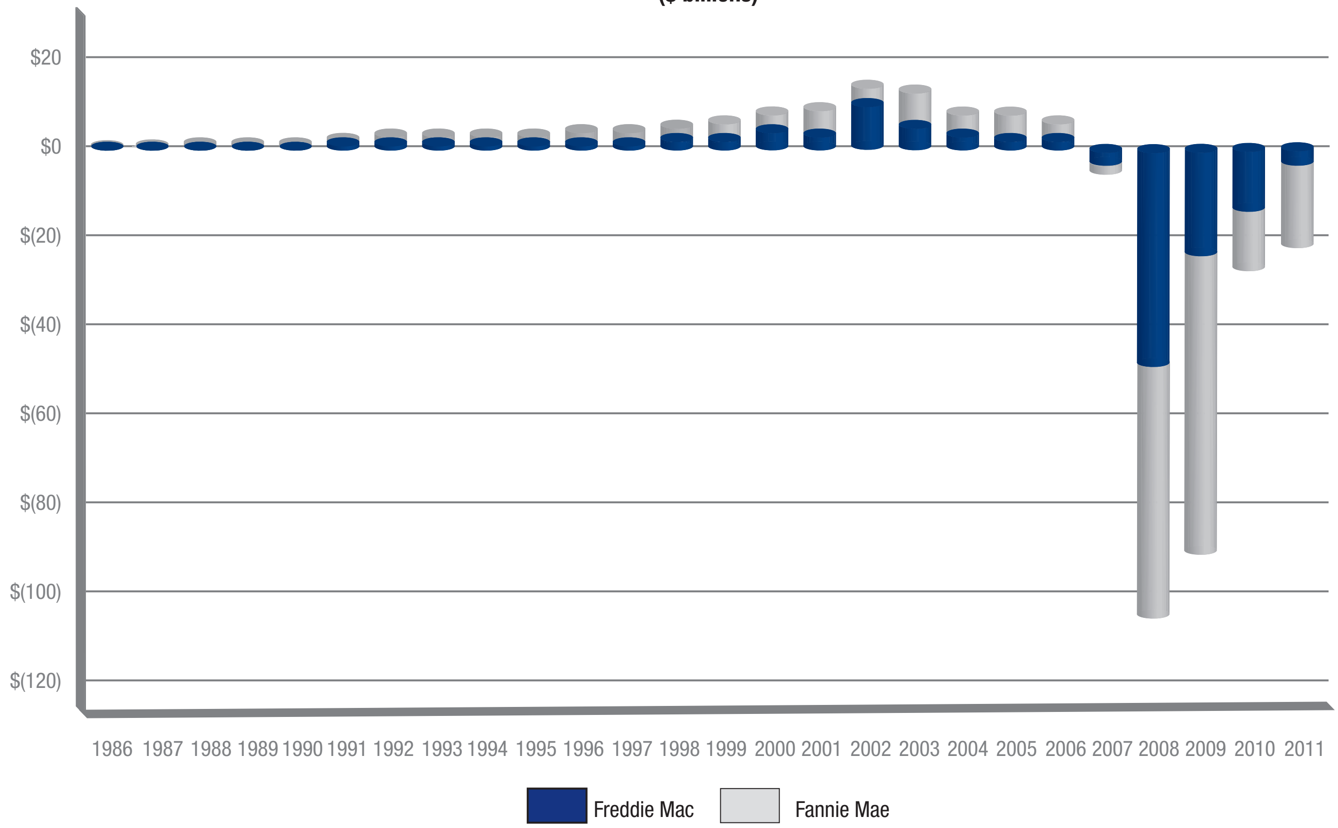
Notes:
[a] Serious delinquencies include loans past due 90 days or more and those where Fannie Mae or the mortgage holder has started the process to foreclose on the loan.
[b] Based on the number of loans that are three monthly payments or more past due or in the process of foreclosure.

For 2011, Fannie Mae reported a net loss of $16.9 billion. During the same period, Freddie Mac reported a net loss of $5.3 billion. The Enterprises' net losses from operations in 2011 were caused primarily by credit-related losses, **losses on derivative agreements**, and the **impairment of securities considered other than temporary** (see Figure 5, page 21).

Losses on Derivative Agreements:
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 using derivative agreements. In contrast with the Generally Accepted Accounting Principles treatment for many conventional instruments, such as loans, the Enterprises' derivative investments may sustain reported losses from interest rate driven variations in their current fair value.

Impairment of Securities Considered Other than Temporary:
Impairment of a security occurs when the fair value of the security is less than the amortized cost basis (i.e., whenever a security has an unrealized loss). If the impairment is judged to be other than temporary, the individual security must be written down to fair value. As currently defined under Generally Accepted Accounting Principles, the fair value of an asset is the amount at which that asset could be bought or sold in an orderly transaction between willing parties.

Figure 4. Enterprises' Annual Net Income (Loss) 1986-2011 ($ billions)



Sources: Federal Housing Finance Agency, *2010 FHFA Annual Report to Congress*, at 114, 131 (online at www.fhfa.gov/webfiles/21570/FHFA2010RepToCongress61311.pdf) (accessed Mar. 6, 2012); Fannie Mae, *2011 10-K Report*, at F-4 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10k_2011.pdf) (accessed Mar. 6, 2012); Freddie Mac, *2011 10-K Report*, at 85 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 21, 2012).

Figure 5. Enterprises' Summary of Net Loss from Operations for the Year Ended December 31, 2011 ($ billions)

	Fannie Mae	Freddie Mac
Net Interest Income	$ 19.28	$ 18.40
Credit-related Expenses	(27.50)	(11.29)
Loss on Derivative Agreements	(6.56)[a]	(9.75)
Impairment of Securities Considered Other than Temporary	(0.31)	(2.30)
Other Income (Expense)	(1.77)	(0.32)
Net Loss from Operations	**$ (16.86)**	**$ (5.26)**

Sources: Fannie Mae, *2011 10-K Report*, at 92 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10k_2011.pdf) (accessed Mar. 5, 2012); Freddie Mac, *2011 10-K Report*, at 85 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 21, 2012).

Note:
[a] Loss on Derivatives referenced to Table 10, p. 96 in the Fannie Mae 2011 10-K Report.

To offset the losses shown above, government support of the Enterprises since 2008 has totaled $187.5 billion pursuant to the PSPAs. Figure 6 (see below) breaks down, by quarter, Treasury's investment in the Enterprises through March 31, 2012. In accordance with the PSPAs' terms, the Enterprises must make quarterly dividend payments to Treasury at an annual rate equal to 10% of the outstanding investment. The rate shall increase to 12% if, in any quarter, the dividends are not paid in cash, until all accrued dividends have been paid in cash. To date, Treasury generally has had to increase its investment in the Enterprises to finance these dividend payments to itself. As of March 31, 2012, the Enterprises have used $41 billion of Treasury's investment to pay dividends due to Treasury under the PSPAs. Based on the Enterprises' projected losses, FHFA estimates that Treasury's investment through 2014 could range from $220 billion to $311 billion.[8]

Figure 6. Treasury Capital and Dividends Due Under PSPAs ($ billions)

Period Covered	Freddie Mac			Fannie Mae			Combined		
	Treasury Investment Under PSPA[a]	Dividends Due Treasury Under PSPA	Net Capital Provided to Enterprise	Treasury Investment Under PSPA[a]	Dividends Due Treasury Under PSPA	Net Capital Provided to Enterprise	Treasury Investment Under PSPAs[a]	Dividends Due Treasury Under PSPAs	Net Capital Provided to Enterprises
Third Quarter 2008	$13.8	$ -	$13.8	$ -	$ -	$ -	$13.8	$ -	$13.8
Fourth Quarter 2008	30.8	0.2	30.6	15.2	-	15.2	46.0	0.2	45.8
First Quarter 2009	6.1	0.4	5.7	19.0	-	19.0	25.1	0.4	24.7
Second Quarter 2009	-	1.1	(1.1)	10.7	0.4	10.3	10.7	1.5	9.2
Third Quarter 2009	-	1.3	(1.3)	15.0	0.9	14.1	15.0	2.2	12.8
Fourth Quarter 2009	-	1.3	(1.3)	15.3	1.2	14.1	15.3	2.5	12.8
First Quarter 2010	10.6	1.3	9.3	8.4	1.5	6.9	19.0	2.8	16.2
Second Quarter 2010	1.8	1.3	0.5	1.5	1.9	(0.4)	3.3	3.2	0.1
Third Quarter 2010	0.1	1.6	(1.5)	2.5	2.1	0.4	2.6	3.7	(1.1)
Fourth Quarter 2010	0.5	1.6	(1.1)	2.6	2.2	0.4	3.1	3.8	(0.7)
First Quarter 2011	-	1.6	(1.6)	8.5	2.2	6.3	8.5	3.8	4.7
Second Quarter 2011	1.5	1.6	(0.1)	5.1	2.3	2.8	6.6	3.9	2.7
Third Quarter 2011	6.0	1.6	4.4	7.8	2.5	5.3	13.8	4.1	9.7
Fourth Quarter 2011	0.1	1.7	(1.6)	4.6	2.6	2.0	4.7	4.3	0.4
First Quarter 2012	-	1.8	(1.8)	-	2.8	(2.8)	-	4.6	(4.6)
Total as of March 31, 2012	$71.3	$18.4	$52.9	$116.2	$22.6	$93.6	**$187.5**	**$41.0**	**$146.5**

Source: Federal Housing Finance Agency, *Data as of April 4, 2012 on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities*, at Tables 1-2 (online at www.fhfa.gov/webfiles/23873/TSYSupport%202012-04-04.pdf) (accessed Apr. 19, 2012).

Notes: Nonzero numbers may display as zero due to rounding.
[a] Excludes $1 billion in liquidation preference on the senior preferred stock position obtained by Treasury from each Enterprise upon initiation of the PSPA. The initial $1 billion is not a draw on Treasury's commitment under the agreement.

Additional Government Support

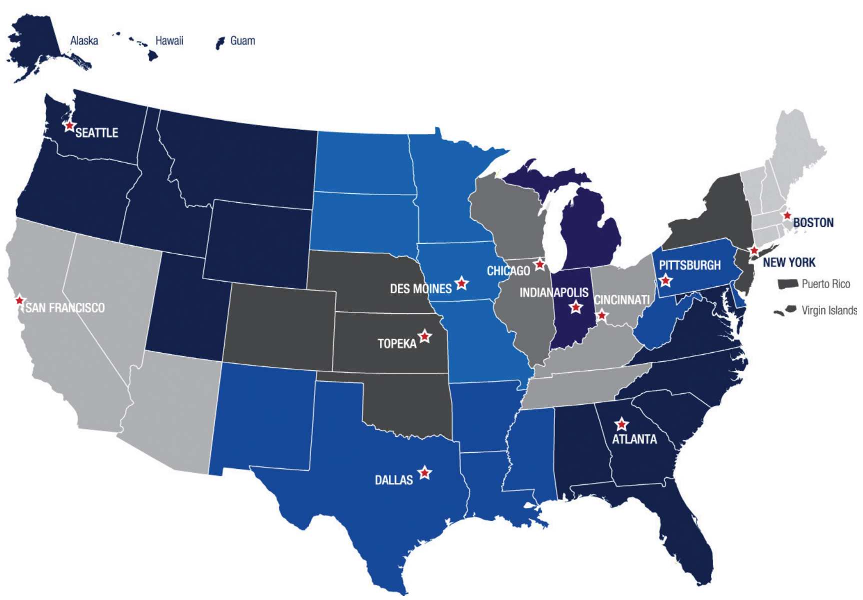
The Enterprises also benefited from extraordinary government measures to support the housing market overall. Since September 2008, the Federal Reserve and Treasury have purchased more than $1.3 trillion in Enterprise MBS, and the Federal Reserve has purchased an additional $135 billion of bonds issued by the Enterprises.[9]

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.

FHLBANKS

In 1932, Congress chartered the FHLBank System to make additional funding available for residential mortgage lending. The FHLBank System is currently comprised of 12 regional FHLBanks and the Office of Finance, which issues debt on the FHLBanks' behalf.[10] Each FHLBank is a separate legal entity that must adhere to specific management and **capitalization** criteria.[11] Figure 7 (see below) shows the FHLBanks' geographic areas.

Figure 7. Regional FHLBanks



Source: Federal Home Loan Bank of Boston, *The Federal Home Loan Bank System* (online at www.fhlbboston.com/aboutus/thebank/06_01_04_fhlb_system.jsp) (accessed Mar. 1, 2012).

FHLBanks are privately capitalized and each is cooperatively owned by the members it serves, which include financial institutions such as commercial banks, thrifts, insurance companies, and credit unions. Eligible financial institutions invest in FHLBank stock, which is not publicly traded, to become members.[12]

The primary business of the FHLBanks is to provide their members with low-cost funding for mortgage lending and other purposes. To do so, each FHLBank makes advances (i.e., loans) in a variety of maturities and structures to its members.

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

Private-Label MBS:
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.

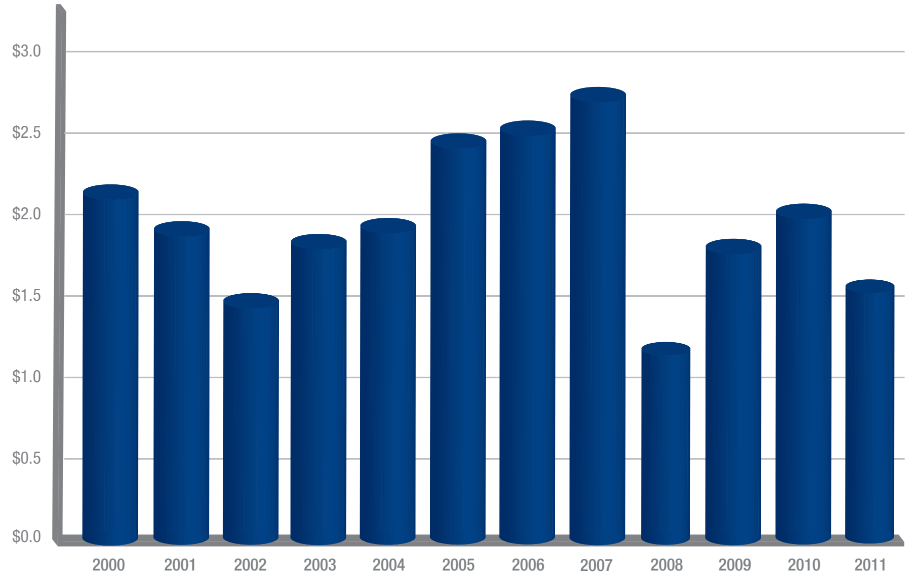
Joint and Several Liability:
The concept of joint and several liability provides that each obligor in a group is responsible for the debts of all in that group. In the case of the FHLBanks, if any individual FHLBank were unable to pay a creditor, the other 11 – or any one or more of them – would be required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

Such advances are **collateralized** by single-family mortgage assets, investment-grade securities, or, in some cases, agricultural and small business loans. Interest earned on advances is a primary revenue source for the FHLBanks.

The FHLBanks also maintain investment portfolios containing mortgage-related assets and some face heightened credit risks due to their larger holdings of **private-label MBS**.

To fund member advances, the FHLBanks issue debt through their Office of Finance.[13] In the event of a default on a debt obligation, each FHLBank is **jointly and severally liable** for losses incurred by other FHLBanks. Like Fannie Mae and Freddie Mac, the FHLBank System has also historically enjoyed cost benefits stemming from the implicit government guarantee of its debt obligations.

Figure 8. FHLBanks' Annual Net Income 2000-2011 ($ billions)



Sources: Federal Housing Finance Agency, *2010 FHFA Annual Report to Congress*, at 143 (online at www.fhfa.gov/webfiles/21570/FHFA2010RepToCongress61311.pdf) (accessed Mar. 6, 2012); Federal Home Loan Banks, *2011 Federal Home Loan Banks Combined Financial Report*, at F-5 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Mar. 29, 2012).

SELECTED FHFA, GSE, AND OTHER ACTIVITIES

OIG follows significant developments pertaining to FHFA and the GSEs, as discussed below.

FHFA Announces New Conservatorship Scorecard for the Enterprises and Reduces Executive Compensation

On March 9, 2012, FHFA released a Conservatorship Scorecard providing implementation guidelines for the goals that were set forth in the FHFA strategic plan. The scorecard contains objectives, measures, and a timeline for the Enterprises in carrying out the strategic plan.

The Agency also announced a new 2012 executive compensation program for the Enterprises, which reduces compensation for top executives by roughly 75% since the advent of the conservatorships, eliminates bonuses, and establishes a compensation target for new Chief Executive Officers (CEOs) at $500,000 per year. The program was established by FHFA in conjunction with Treasury and the boards of directors for the Enterprises and is detailed in the Enterprises' SEC filings.[14] Similarly, on April 4, 2012, Public Law No. 112-105 was enacted. Among other things, the law prohibits the Enterprises' senior executives from receiving bonuses while the Enterprises remain in conservatorship.

Pilot REO Property Sales in Hardest-Hit Areas

In August 2011, FHFA, Treasury, and HUD issued a Request for Information, soliciting input from the private sector on new and advantageous ways to sell single-family REO properties held in the portfolios of the Enterprises and the Federal Housing Administration (FHA). There were approximately 4,000 responses to the solicitation.

On February 27, 2012, FHFA announced a pilot REO Initiative that targets some of the nation's hardest-hit housing areas: Atlanta, Chicago, Las Vegas, Los Angeles, Phoenix, and parts of Florida.[15]

In its pilot phase, the REO Initiative allows qualified investors to purchase pools of foreclosed properties but requires them to rent the properties. This rental requirement is intended to provide relief for housing markets depressed by a high number of foreclosures, and increase rental options in these areas. Interested investors may now prequalify to bid on transactions in both the pilot and subsequent phases if they meet certain criteria. These criteria include: (1) financial capacity to acquire the assets; (2) sufficient knowledge of and expertise in financial and business matters to analyze and bear the investment risks; and (3) agreement to keep information about the REO Initiative confidential.

FHFA indicates the pilot phase's purpose is to examine investor interest in proposed activities to acquire various types of assets, and will consider:

- the location, size, and composition of asset pools;
- the types of structures and/or financing that improve seller returns and home values in markets hit by the recession;
- how investors bring in experienced local organizations to help stabilize communities; and
- how investors qualify for and participate in sales transactions.[16]

FHFA's Strategic Plan for the Enterprises

On February 21, 2012, FHFA released to Congress a strategic plan for the next phase of the conservatorships of the Enterprises. In the plan, FHFA outlines objectives and steps the Agency will undertake to fulfill its obligations as conservator. Specifically, the new strategic plan outlines three main goals for the next phase of the conservatorships:

- Build a new infrastructure for the secondary mortgage market.
- Gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations.
- Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

FHFA states that the first goal of building a new infrastructure recognizes that without the Enterprises the country would be without a secondary market for non-government insured mortgages. Currently, there is no private sector infrastructure capable of securitizing the approximately $105 billion per month in newly originated mortgages handled by the Enterprises. If they were no longer operating, mortgage interest rates likely would go up and loan availability would be limited. The strategic plan establishes the steps FHFA and the Enterprises will take to create the needed infrastructure, including a securitization platform, and national standards for mortgage securitization that Congress and market participants may use to develop the mortgage market of the future.

The second goal, contracting Enterprise operations, involves gradually shifting mortgage credit risk from the Enterprises to private investors and eliminating the direct funding of mortgages by the Enterprises.

The third goal, maintaining foreclosure prevention efforts and credit availability, recognizes that the work begun by the conservatorships over three years ago is not complete. Programs and strategies to ensure ongoing mortgage credit availability, assist troubled homeowners, and minimize taxpayer losses while restoring stability to housing markets continue to require energy, focus, and resources.

FHFA notes that the next chapter for the Enterprises will involve gradually reducing their dominant positions in the housing finance market and encouraging private capital to fulfill that role. FHFA further notes that the final chapter for the Enterprises ultimately must be determined by lawmakers; only Congress can abolish or modify the Enterprises' charters and create a new structure for housing finance. According to the Agency, its strategic plan envisions actions that will help establish a new secondary mortgage market, while leaving open all options for Congress and the Administration regarding the resolution of the conservatorships and the degree of government involvement in supporting the secondary mortgage market in the future.[17]

Residential Mortgage Servicing Settlement

On February 9, 2012, the federal government and 49 state attorneys general announced a $25 billion agreement with the nation's five largest mortgage **servicers** to address mortgage loan servicing and foreclosure abuses.[o] The agreement resulted from investigations by several federal agencies, including OIG, state attorneys general, and state banking regulators nationwide.

The joint federal-state agreement requires the servicers to implement comprehensive new mortgage loan servicing standards and commit $25 billion to resolve violations of state and federal law. These violations include servicers using "robo-signed" affidavits in foreclosure proceedings, deceptive practices in offering loan modifications, failing to offer alternatives before foreclosing on borrowers with federally insured mortgages, and filing improper documents in federal bankruptcy court.

Under the terms of the agreement, the servicers agreed collectively to dedicate $20 billion toward various forms of financial relief for borrowers, including principal reductions and refinancings for those with negative equity, principal forbearance for unemployed borrowers, anti-blight programs, short sales, transitional assistance, and other programs.

Mortgage servicers are required to fulfill their obligations within three years, and will receive incentives if they provide relief within the first 12 months. The agreement also requires servicers to pay $5 billion in cash to the federal and state governments. This includes $1.5 billion for a borrower payment fund to provide cash payments for qualifying homeowners foreclosed upon between January 1, 2008, and December 31, 2011, and $3.5 billion to repay public funds lost through servicer misconduct and to pay for housing counselors, legal aid, and other similar programs.[18]

Servicer:
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.

Home Affordable Modification Program Changes

On January 27, 2012, the Administration announced changes to the Home Affordable Modification Program (HAMP), which is a Treasury initiative that involves servicers agreeing to modify mortgages for borrowers facing default or foreclosure. The Administration extended the program by one year to December 31, 2013, and expanded program eligibility in order to reach a wider pool of distressed borrowers. These expanded requirements include:

- ***Ensuring that borrowers with debt beyond their mortgage can participate.*** Previously, if a borrower's first lien mortgage debt-to-income ratio was below 31% he or she was ineligible for a HAMP modification. However, many such homeowners struggle with other debt such as second liens and medical bills. The program now includes homeowners struggling with this secondary debt by offering an alternative evaluation opportunity with more flexible debt-to-income criteria;

[o] The servicers were: Bank of America Corporation, JPMorgan Chase & Co., Wells Fargo & Company, Citigroup Inc., and Ally Financial, Inc., see: www.justice.gov/opa/pr/2012/February/12-ag-186.html.

- ***Preventing additional foreclosures to support renters and stabilize communities.*** Eligibility will be expanded from owner-occupied residences only to occupied properties (i.e., properties occupied by owners or others). This is intended to provide critical relief to both renters and landlords, while further stabilizing affected communities; and

- ***Increasing incentives for modifications that help borrowers rebuild equity.*** Currently, HAMP includes an option for servicers to provide homeowners with a modification that includes a write down of the principal balance if borrowers are underwater (i.e., they owe more on their mortgages than their homes are worth). To further encourage investors to use principal reduction modifications, the Administration will:

    - ***Triple the incentives to encourage reducing principal for underwater borrowers.*** To date, the owner of a loan that qualifies for HAMP receives between 6 and 21 cents on the dollar to write down principal on that loan (depending on how much the LTV ratio changes). To increase the amount of principal that is written down, Treasury will triple the incentives, paying from 18 to 63 cents on the dollar; and

    - ***Offer principal reduction incentives for loans insured or owned by the Enterprises.*** HAMP borrowers who have loans owned or guaranteed by the Enterprises do not currently benefit from principal reduction loan modifications. To encourage the Enterprises to offer this assistance to their underwater borrowers, Treasury has notified FHFA that it will pay principal reduction incentives to Fannie Mae or Freddie Mac if they allow servicers to forgive principal in conjunction with a HAMP modification.[19]

In response to the HAMP modifications mentioned above, FHFA announced that the Enterprises will:

- continue to serve as Treasury's financial agents in implementing the announced changes;

- extend their use of **HAMP Tier 1** as the first modification option through 2013, in line with Treasury's HAMP extension; and

- not need to adopt further changes to implement the **HAMP Tier 2** option since it is based on the Enterprises' standard modification that FHFA announced and the Enterprises implemented in 2011 under the Servicing Alignment Initiative.[20]

FHFA has been asked to consider newly available HAMP incentives for **principal reduction**. The Agency previously released an analysis, as discussed below, concluding that principal reduction is not a cost-effective alternative

HAMP Tier 1:
HAMP was designed to help financially struggling homeowners avoid foreclosure by modifying loans to a level that is affordable for borrowers now and sustainable over the long term. The initial modification under HAMP is referred to as Tier 1. This modification option is for a loan secured by a property that is the borrower's principal residence (owner-occupied). A borrower may receive only one modification under HAMP Tier 1. No mortgage loan may be modified more than once in either Tier 1 or Tier 2. If a borrower is not eligible under Tier 1, he or she can be evaluated under the HAMP extension referred to as Tier 2.

HAMP Tier 2:
HAMP Tier 2 is an extension of HAMP Tier 1; both have been extended to the end of 2013. HAMP Tier 2 expands the population of eligible homeowners, utilizing additional evaluation criteria and extra incentives to servicers. Tier 2 includes owners who may have defaulted under Tier 1, borrowers for mortgages secured by a rental property (not occupied by the owner), and an array of other struggling homeowners. A borrower is eligible to receive up to a total of three modifications of three different mortgages under Tier 2, and servicers are eligible for payment reduction cost share incentives.

Principal Reduction:
A write down or forgiveness of a borrower's principal balance, in part or whole.

to **principal forbearance** in mitigating losses. FHFA is now re-assessing its analysis in light of these enhanced incentives.

FHFA Analysis of Principal Reductions

On January 31, 2012, FHFA informed Treasury and HUD that principal reduction programs supported by both agencies did not meet FHFA's primary goal of conserving and preserving the assets of the Enterprises and that neither Fannie Mae nor Freddie Mac would be permitted to participate in such programs. Earlier in the month, in response to congressional inquiries, FHFA released its analysis supporting its position. In a letter dated January 20, 2012, to Congressman Elijah E. Cummings, Ranking Member for the House Committee on Oversight and Government Reform, FHFA described the results of a comparative analysis of taxpayer losses from principal reduction versus principal forbearance.[21]

Enterprise Chief Executives Exit Announcements

On January 10, 2012, Fannie Mae announced Michael J. Williams will be stepping down as its CEO and Director. He will continue in his current position until the Board of Directors appoints his successor.[22]

On October 26, 2011, FHFA announced that the current CEO of Freddie Mac, Charles E. Haldeman Jr., will be stepping down in the next year. He will remain in the position until a replacement is found and the transition is completed.[23]

SEC Charges Against Former Fannie Mae and Freddie Mac Executives

On December 16, 2011, the SEC filed two civil enforcement complaints in the U.S. District Court for the Southern District of New York, charging six former Enterprise executives – but not the Enterprises – with securities fraud. The suits claim that the six executives violated various sections of and rules under the **Securities Act of 1933** and the **Securities Exchange Act of 1934**. The complaints allege the executives made material misstatements to investors and the public regarding the Enterprises' holdings of high-risk mortgage loans by claiming their risk was minimal and that their exposure to subprime loans was substantially less than was actually the case.

Specifically, in one complaint the SEC alleges that between December 2006 and August 2008, Fannie Mae executives made misleading statements about subprime mortgage loans and Alt-A mortgage loan holdings. For example, the complaint claims that in calculating its exposure to subprime loans, Fannie Mae did not include loan products specifically targeted to borrowers with weaker credit histories, including more than $43 billion of **expanded approval** loans. Similarly, in the other complaint the SEC alleges that between March 2007 and August 2008, Freddie Mac and its former executives made, or aided

Principal Forbearance:
A period of time during which the borrower pays interest, but does not make payments towards his or her mortgage's principal balance.

Securities Act of 1933:
Often referred to as the "truth in securities" law, it has two basic objectives: (1) require that investors receive financial and other significant information concerning securities being offered for public sale and (2) prohibit deceit, misrepresentation, and other security sales fraud.

Securities Exchange Act of 1934:
With this law, Congress created the SEC with broad authority over all aspects of the securities industry, including the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (e.g., the stock exchanges and the National Association of Securities Dealers). The law also prohibits certain types of market conduct such as material misrepresentations and insider trading, and provides the SEC with disciplinary powers over regulated entities and associated persons. The law also empowers the SEC to require periodic reporting of information by companies with publicly traded securities.

Expanded Approval:
A mortgage option that gives borrowers with blemished credit access to high-quality, low-cost, non-predatory loans. Expanded approval provides different levels of approval recommendations for loans and is only available to lenders that have been specifically approved to deliver and service such mortgage loans.

and abetted, misleading statements regarding the Enterprise's single-family subprime loan exposure.

The Fannie Mae executives charged in the first suit are former CEO Daniel H. Mudd, former Chief Risk Officer Enrico Dallavecchia, and former Executive Vice President of Fannie Mae's Single-Family Mortgage business Thomas A. Lund. The Freddie Mac executives named in the second suit are former Chairman of the Board and CEO Richard F. Syron, former Executive Vice President and Chief Business Officer Patricia L. Cook, and former Executive Vice President for the Single-Family Guarantee business Donald J. Bisenius.

The SEC seeks financial penalties, disgorgement of ill-gotten gains with interest, permanent injunctive relief, and permanent bars against the named executives from being officers and directors.

Fannie Mae and Freddie Mac entered into a non-prosecution agreement with the SEC whereby each Enterprise agreed to accept responsibility for its conduct and not to dispute, contest, or contradict the contents of an agreed-upon statement of facts. But, the Enterprises did not admit or deny liability.[24]

Fannie Mae and Freddie Mac Mortgage Data Implementation Timeline

In May 2010, FHFA announced a new Enterprise initiative to improve the data used for appraisals and other loan information. The Uniform Mortgage Data Program (UMDP) was developed to provide consistent standards for data and its collection. Under UMDP, FHFA seeks to make loan data submitted to the Enterprises more complete and uniform with regard to loan characteristics, borrower information, the property securing the loans, and the identity of the parties creating the transaction.[25]

On December 14, 2011, FHFA announced extended implementation dates for a key component of UMDP called the Uniform Loan Delivery Dataset (ULDD). The purpose of ULDD is to implement uniform loan delivery data standards and define the data that the Enterprises will require at loan delivery based on loan type, loan feature, or other requirements. ULDD's goal is to improve data accuracy, simplify the exchange of data, and increase confidence that loan data is accurate and complete.[26] The Enterprises have delayed the implementation date for ULDD to July 23, 2012, instead of March 2012.[27]

FHFA Vacant Building Ordinance Lawsuit

On December 12, 2011, FHFA filed a lawsuit in the U.S. District Court for the Northern District of Illinois against the City of Chicago contesting the city's amended "Vacant Buildings Ordinance" as enforced against the Enterprises. The ordinance seeks to address the problem of vacant properties by requiring mortgage owners to inspect mortgaged properties monthly in order to determine if they are vacant, in which case the mortgage owners must pay a $500 fee to register it as such. As mortgage owners, the Enterprises are required to comply with the ordinance even if they neither own nor have foreclosed on a property securing a mortgage. According to the ordinance, the city can levy up to $1,000 per day in fines and penalties for noncompliance.

FHFA contends that the ordinance subjects the Enterprises to regulation and supervision by the Chicago Department of Buildings instead of the Agency. In the lawsuit, FHFA indicates that it seeks to ensure that Chicago's proposed registration and licensing system will not interfere with Congress' intent for FHFA to serve as the Enterprises' sole supervisor and regulator. The Agency also claims the registration fee represents a tax on the Enterprises and FHFA as the conservator that is expressly precluded by long-standing congressional directive.[28]

Revisions to HARP Guidelines

On October 24, 2011, FHFA and the Enterprises announced a number of changes to HARP. These changes are intended to attract more eligible borrowers capable of benefiting from refinancing their home mortgages. Through HARP, underwater borrowers can refinance and take advantage of low interest rates and other benefits. HARP is available to borrowers with loans that were sold to the Enterprises on or before May 31, 2009, and have current LTV ratios greater than 80%.

Key elements of the new HARP provisions include:

- eliminating certain risk-based fees for borrowers who refinance into shorter-term mortgages and lowering fees for other borrowers;
- removing the current 125% LTV ceiling for fixed-rate mortgages backed by the Enterprises;
- waiving certain representations and warranties to which lenders commit when making loans owned or guaranteed by the Enterprises;
- eliminating the need for a new property appraisal where the Enterprises provide a reliable automated valuation model estimate; and
- extending the end date for HARP to December 31, 2013, for loans originally sold to the Enterprises on or before May 31, 2009.[29]

SECTION 3

OIG'S ACCOMPLISHMENTS AND STRATEGY

Section 3: OIG's Accomplishments and Strategy

From October 1, 2011, through March 31, 2012, OIG achieved several significant accomplishments, including: (1) issuing eight audit, evaluation, survey, and white paper reports; (2) participating in a number of criminal and civil investigations; and (3) reviewing and commenting on proposed FHFA rules.

OIG AUDITS AND EVALUATIONS

The title of each audit and evaluation report in this section is linked to the report on OIG's website.

During this semiannual period, OIG released eight reports, which are briefly summarized below.

Evaluations, Surveys, and White Papers

FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac (WPR-2012-001, March 28, 2012)

Although they were expected to be temporary, the conservatorships have been in place for over three years and there is no end in sight. Accordingly, OIG provided background on the history of the Enterprises leading up to the creation of the conservatorships and described FHFA's oversight of their operations since the commencement of the conservatorships. OIG also summarized pertinent issues raised in its reports, as follows.

As the Enterprises' regulator and conservator, FHFA has considerable discretion in defining its role and choosing its actions; therefore, its role as conservator has evolved over time. At the outset of the conservatorships, FHFA forbade the Enterprises from engaging in certain activities and retained approval authority over others. Soon thereafter, FHFA delegated day-to-day operational decision making to the Enterprises' directors and managers. Debate as to the proper parameters of the Agency's role as a conservator arose and continues. OIG believes that FHFA needs to assume a more active role. Thus, OIG's reports consistently have revealed two trends: (1) the Agency, in its role as a conservator, does not independently test and validate Enterprise decision making and (2) the Agency, in its role as a regulator, is not proactive in its oversight and enforcement. In addition, FHFA may not have enough examiners to meet its oversight responsibilities.

Further, FHFA faces significant challenges in managing the conservatorships of the Enterprises. These challenges include: (1) attempting to advance the Enterprises' business interests while assisting distressed homeowners and (2) simultaneously serving as both the Enterprises' conservator and regulator.

As if these challenges were not daunting enough, the uncertain future of the Enterprises overshadows all aspects of FHFA's regulatory and conservatorship efforts. Although FHFA recently published a strategic plan for the next phase of the conservatorships (which focuses on building infrastructure for a private secondary mortgage market), the best method for resolving the Enterprises is dependent on many variables that are outside of FHFA's control. These variables include the health of housing finance markets and debate about what the nation's mortgage finance system should look like. These variables are important to the American taxpayer, who has been financially supporting – and likely will continue to support – the Enterprises. Meanwhile, the practical issues of how FHFA should best manage the conservatorships need careful attention and oversight.

Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Annual Convention and Exposition (ESR-2012-004, March 22, 2012)

Fannie Mae and Freddie Mac spent over $600,000 in order to participate in the 2011 Mortgage Bankers Association Convention and Exposition (the Convention). Although this sum represents a modest portion of the Enterprises' annual expenditures, the topic has attracted considerable attention and OIG initiated a survey to review the Agency's oversight of the Enterprises' travel-related expenses.

OIG found that FHFA did not approve or review (prior to the event) the Enterprises' participation in the Convention or their decisions to sponsor it. Both FHFA and the Enterprises viewed the matter as entirely within the authorities delegated by FHFA to Fannie Mae and Freddie Mac. Freddie Mac claimed that the Convention presented "a cost-effective opportunity to educate, inform, and engage with hundreds of mortgage market executives on key issues affecting the housing industry." Fannie Mae expressed a similar view in its correspondence to FHFA.

Regarding the Enterprises' expenditures associated with their participation in the Convention, OIG found that the Enterprises' registration and travel-related expenses (e.g., airfare, hotel, and per diem) of $256,458, when viewed on a per capita basis, were comparable to those that would have been allowable for federal employees. However, other expenses accrued by the Enterprises were questionable and – in some cases – would not have been allowed for federal personnel. Specifically, the Enterprises paid $140,000 for sponsorships of the Convention and $140,415 for business meals and hosted dinners. OIG determined that, although business custom may often justify these kinds of expenditures, neither Enterprise articulated tangible benefits accruing from its sponsorships, hosted dinners, and other business meals that would have warranted the expenditures. Specifically, there is no indication that any business conducted by the Enterprises with their clientele at the Convention could not have been conducted as well without the largesse.

Prior to OIG's completion of the field work for this survey, FHFA's Acting Director issued a letter directing the Enterprises to no longer allow payments for conference sponsorships and to end expenditures on food at business meetings. In light of the new directive, OIG recommended that FHFA should: (1) ensure that the Enterprises conduct a comprehensive review of their travel and entertainment policies and revise them in a manner consistent with the new directive and (2) review the Enterprises' proposed policy revisions to ensure that they are consistent with the new directive and that the Enterprises have established appropriate controls to monitor compliance. FHFA agreed with these recommendations.

FHFA's Oversight of the Enterprises' Charitable Activities (ESR-2012-003, March 22, 2012)

At the time the conservatorships were established, both Fannie Mae and Freddie Mac were making substantial contributions to charitable organizations. In 2008, the Enterprises' total charitable giving and related expenses amounted to $73 million. Although funding charitable activities may have been appropriate for the Enterprises acting as private businesses, questions arose concerning whether it is still appropriate now that they rely on taxpayer funds to cover their annual losses. Therefore, OIG reviewed FHFA's oversight of the Enterprises' charitable programs.

The Enterprises' charitable giving has continued since the conservatorships were established, totaling $147 million from 2009 through 2011. However, OIG found that in December 2008, FHFA established controls to ensure that charitable giving is consistent with the Enterprises' housing missions, well managed and monitored, and not politically motivated. Additionally, in early 2010, FHFA issued a series of directives to phase out all of the Enterprises' charitable giving and established various target dates for doing so. The Enterprises' combined annual donations had leveled off at $50 million by the end of 2011; corporate donations are scheduled to end in 2013; and payments from the Freddie Mac Foundation, which was funded prior to the commencement of the conservatorships, are targeted to end in early 2015. In light of FHFA's controls over and planned phase out of the Enterprises' charitable activities, OIG recommended that FHFA: (1) continue to monitor the Enterprises' progress and (2) continue to require the Enterprises to issue timely, quarterly reports on their charitable activities via their websites. FHFA agreed with these recommendations.

Evaluation of FHFA's Management of Legal Fees for Indemnified Executives (EVL-2012-002, February 22, 2012)

The Enterprises have spent considerable sums to defend themselves and former senior executives in class action lawsuits and other legal matters. Notably, in the case of three former Fannie Mae senior executives, between 2004 and October 31, 2011, Fannie Mae paid $99.4 million in advances for legal expenses associated with their defense in lawsuits, investigations, and administrative actions. The lawsuits, now consolidated in a single securities fraud case pending in the District of Columbia, allege that the three executives supported questionable accounting practices that produced inflated prices of Fannie Mae stock, ultimately resulting in substantial shareholder losses. Discovery has been completed and the case awaits trial. Of the $99.4 million in advances, Fannie Mae has paid $37 million in advances since September 2008, when it entered into conservatorship overseen by FHFA. Freddie Mac has paid $10.2 million in advances for legal defense costs for former senior executives since its conservatorship commenced. FHFA, as the Enterprises' conservator, has approved these payments.

On December 16, 2011, the SEC filed suits in New York against six additional former Fannie Mae and Freddie Mac senior executives. To date, the Enterprises have advanced and continue to advance the executives' legal expenses. Members of Congress and others have questioned the amount and propriety of the legal expense payments, especially in light of the very large federal government investment in the Enterprises. FHFA and the Enterprises believe that, based on applicable law, the Enterprises are obliged to advance legal expenses of former and current executives, unless there is a final adjudication that they acted in bad faith.

OIG assessed FHFA's oversight of the Enterprises' payments of legal expenses incurred by former senior executives and found that FHFA confronts a challenging balance of interests. On the one hand, FHFA is interested in avoiding potential losses and is thus motivated to defend vigorously ongoing lawsuits against the Enterprises. On the other hand, FHFA has an interest in controlling significant costs, particularly the tens of millions of dollars of payments made to attorneys and others involved in representing former senior executives. Compounding these policy challenges, FHFA has some, albeit limited, tools available to curtail litigation. For example, FHFA recently issued a regulation that makes shareholder claims arising out of successful class action litigation the lowest priority in any reorganization of FHFA's regulated entities and that gives FHFA, the Enterprises' conservator, the discretion not to pay securities litigation claims during their conservatorships.

Based on the new regulation, Treasury's investment in the Enterprises will be accorded repayment priority ahead of litigation claims. The repayment priority, and the view that the Enterprises will not be able to earn enough to repay Treasury's investment and emerge from conservatorships means that, for all practical purposes, it is unlikely that the Enterprises will ever be in a position to pay litigation claims. FHFA recently made this argument in an effort to stay the pending District of Columbia securities fraud case. However, the effort was unsuccessful and the regulation is now the subject of legal challenge.

OIG believes that, given the significant amounts of taxpayer money involved and the issue's high visibility, FHFA must continue to scrutinize the Enterprises' legal fee advances in order to limit costs. Therefore, it recommended that FHFA: (1) work to limit legal expenses to the extent possible and reasonable and (2) continue to control costs of legal expenses. FHFA agreed with these recommendations.

FHFA's Oversight of Troubled Federal Home Loan Banks (EVL-2012-001, January 11, 2012)

As described in Section 2, the FHLBank System is a GSE consisting of 12 FHLBanks whose primary mission is to support housing finance. To carry out this mission, the FHLBank System's central Office of Finance issues debt at the relatively favorable rates available to GSEs. The FHLBanks then use the proceeds to make secured loans, known as advances, to their member financial institutions. These member financial institutions can then use the advances to originate mortgages.

FHLBanks may also invest in mortgage-related securities. Since 2008, four FHLBanks have faced significant financial and operational difficulties, primarily due to their investments in certain high-risk MBS.

FHFA has oversight responsibility for the FHLBanks and recognizes the need to ensure they do not abuse their GSE status and engage in imprudent activities. To this end, FHFA examination guidance states that the Agency generally will initiate a formal enforcement action, such as a cease and desist order, when it classifies an FHLBank as having the most significant "supervisory concerns" within the FHLBank System. Nonetheless, with respect to four FHLBanks that were classified as having supervisory concerns, OIG found that formal enforcement actions were not taken on two of them.

Further, although OIG identified several positive actions FHFA has taken as part of its oversight of the troubled FHLBanks (e.g., encouraging fiscally conservative dividend and investment practices, and closely monitoring the FHLBanks through examinations and ongoing communications), OIG also found that FHFA has not established policies, systems, and documentation standards that could strengthen its oversight. Specifically:

- FHFA has not established a written enforcement policy for troubled FHLBanks. Although FHFA examination guidance states that FHFA will take formal enforcement actions against FHLBanks with supervisory concerns, officials said the guidance does not constitute a specific Agency policy. Instead, FHFA officials have broad discretion in determining the circumstances under which formal actions against troubled FHLBanks will be initiated. OIG believes that the absence of a consistent and transparent written FHFA enforcement policy for troubled FHLBanks: (1) results in a lack of clarity regarding the circumstances under which the Agency will initiate formal actions; (2) contributes to instances in which FHFA has not acted proactively to hold troubled FHLBanks and their officers sufficiently accountable for failing to correct identified risks or for engaging in questionable risk taking; and (3) impedes outside reviews of its oversight activities.

- FHFA does not have an automated management information system that provides ready access to current information about the deficiencies identified in its examinations and the status of efforts to address them. Instead, FHFA uses manual reporting processes that limit the Agency's capacity to identify trends in examination findings and the progress made by particular FHLBanks in correcting identified deficiencies.
- FHFA does not consistently document substantive interactions with FHLBanks, including instances in which the Agency has suggested that an FHLBank remove senior officers. The absence of a record is inconsistent with Agency policy and impedes oversight.

In light of these findings, OIG recommended that FHFA: (1) develop and implement a written enforcement policy for troubled FHLBanks that ensures they correct significant deficiencies within specified periods and establishes consequences for not doing so; (2) develop and implement an automated management reporting system for FHLBank examination findings; and (3) consistently document key interactions with FHLBanks. FHFA agreed with these recommendations.

Audits

FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards (AUD-2012-003, March 22, 2012)

The Enterprises purchase mortgages from lenders and either keep them as investments or package and sell them to other investors. During the first 10 months of 2011, Fannie Mae purchased nearly 2.1 million loans valued at $427 billion. To be eligible for purchase, a mortgage must satisfy the Enterprises' underwriting standards or have the Enterprises' approval to vary from them. During the housing boom, these variances from the underwriting standards effectively relaxed underwriting standards and thus contributed to Fannie Mae's credit losses and credit-related expenses. OIG assessed FHFA's oversight of Fannie Mae's single-family mortgage underwriting standards and the internal controls over them.

Although FHFA has taken steps to ensure that mortgages purchased by the Enterprises conform to underwriting standards (e.g., informally reviewing Fannie Mae's proposed credit policy changes, which may or may not affect underwriting standards and variances from them), the Agency's oversight of underwriting is limited.

OIG concluded that the Agency can strengthen its oversight by creating formal processes for reviewing both the Enterprises' underwriting standards and variances from them. FHFA can also enhance its guidance for planning and conducting its examinations of the Enterprises' underwriting quality control.

FHFA relies on the Enterprises to oversee and establish underwriting standards and to grant variances. OIG found that the number of Fannie Mae variances – and in effect its underwriting standards – have fluctuated substantially over time. For example, in 2005 when standards were loose, Fannie Mae authorized over 11,000 variances. Between January 2005 and August 2007, Fannie Mae began rescinding variances, which tightened underwriting standards. Fannie Mae had over 600 variances as of September 2011. Given the correlation of variances to underwriting standards, FHFA should establish formal guidance and procedures for its review of underwriting standards and variances from them.

In 2011, FHFA conducted a targeted examination that included Fannie Mae's quality control of compliance with underwriting standards. This was a positive step, but additional examination guidance is needed to ensure that Agency examinations are thoroughly and consistently performed. In addition, the examinations should consider the impact of variances that Fannie Mae has already approved.

By taking added measures to strengthen its oversight of underwriting standards and related examinations, FHFA can increase its assurance that the Enterprises are operating in a safe and sound manner and that, as conservator, its goal of preserving and conserving Enterprise assets is achieved.

OIG recommended that FHFA's: (1) Division of Housing Mission and Goals formally establish a policy for its review process of underwriting standards and variances, including escalation of unresolved issues reflecting potential lack of agreement and (2) Division of Examination Program and Support enhance existing guidance for assessing adherence to underwriting standards and variances from them. The Agency agreed with these recommendations.

FHFA's Controls to Detect and Prevent Improper Payments (AUD-2012-002, March 9, 2012)

Federal agencies regularly make payments to program beneficiaries, grantees, vendors, and contractors. Some of these payments are considered "improper" as they may be made to the incorrect recipients, for the wrong amounts, at the wrong times, or for other improper reasons. Therefore, as required by the Improper Payments Information Act of 2002 (IPIA) (as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA)), federal agencies should reduce and recapture erroneous payments, and intensify efforts to eliminate payment error, waste, fraud, and abuse. And, in accordance with Office of Management and Budget (OMB) directives, the head of each agency must periodically review all programs and activities that the relevant agency head administers and identify, estimate, report, and publish all programs and activities that may be susceptible to significant improper payments. Additionally, for improper payments estimated to be in excess of $10 million, the agency must report the potential actions it is taking to reduce and recapture them.

Additionally, IPIA requires an inspector general to determine, each fiscal year, whether his or her agency is in compliance with IPIA by reviewing the agency's improper payment reporting in its annual Performance and Accountability Report or Annual Financial Report and accompanying materials. An inspector general is expected to complete his or her review and determination within 120 days of the agency's publication of its reports.

On February 15, 2012, FHFA determined that the law and implementing guidance relating to program-specific risk assessments for each program or activity under IPIA are not applicable to FHFA. These provisions apply only to "payments" made with federal government funds, and FHFA's funds by law are not to be construed as government or public funds. Also, because FHFA does not make "payments" with federal funds, FHFA is not required to conduct program-specific risk assessments even if the payments FHFA makes were to fall within the specified dollar thresholds that trigger program assessments.

Although the IPIA's applicable provisions were limited by the definition of "payment," OIG concluded that FHFA complied with IPIA, as amended by IPERA, and the criteria established in the relevant OMB policy. OIG further determined that, although FHFA is not required to do so, the Agency is abiding by the intent of IPIA, IPERA, and the related OMB directives. Specifically, FHFA established controls to detect and prevent improper payments. These findings are consistent with GAO's opinion, issued in connection with FHFA's fiscal year 2011 financial statements audit, indicating that FHFA had effective internal controls over financial reporting as of September 30, 2011.

FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors (AUD-2012-001, March 7, 2012)

The Enterprises routinely purchase mortgages from mortgage originators in order to provide liquidity for continued lending in support of the nation's housing finance system. With respect to the mortgages that they purchase, the Enterprises enter into contracts with mortgage servicers to collect mortgage payments, set aside taxes and insurance premiums in escrow, forward interest and principal payments to the contractually designated party, and respond to payment defaults. As of June 30, 2011, Freddie Mac had a mortgage servicing portfolio containing approximately 12 million mortgages with an unpaid principal balance of nearly $1.8 trillion.

Troubled loans have increased substantially since 2008, and mortgage servicers have had to respond to increased defaults by expending extra effort (e.g., modifying and foreclosing mortgages). In late 2010, the federal agencies that regulate and supervise banks conducted an interagency review of foreclosure processing at 14 large mortgage servicers. The agencies found critical weaknesses in the mortgage servicers' foreclosure governance processes, foreclosure document preparation procedures, and oversight and monitoring of third-party vendors, including foreclosure attorneys.

In light of these findings, OIG initiated a performance audit to assess whether FHFA has an effective supervisory control structure and sufficient examination coverage and oversight activities to adequately and timely identify and mitigate risks involving mortgage servicing contractors. The audit covered FHFA's supervision of Freddie Mac.

OIG found that FHFA and Freddie Mac have taken action to improve their oversight of mortgage servicing, but noted some areas in which FHFA could enhance its supervision of the Enterprises' controls over mortgage servicing contractors.

FHFA has not clearly defined its role regarding oversight of servicers, has not sufficiently coordinated with other federal banking agencies about risks and supervisory concerns with individual servicers, and has not timely addressed emerging risks presented by mortgage servicing contractors. Moreover, FHFA has not established comprehensive regulations and guidance that provide for servicer management and oversight and does not adequately monitor servicing performance.

As early as 2008, FHFA had information indicating that mortgage servicing represented a heightened risk to the Enterprises, but FHFA did not devote added attention to servicing issues until August 2010. These emerging risk indicators included the increasing number and dollar value of mortgage payment defaults, the concentration of servicing risk among a limited number of large servicers, the surge in bank failures, and the escalation of enforcement actions against problem banks, many of which performed mortgage servicing for Freddie Mac. Further, when FHFA commenced its examination coverage beginning in 2010, it did not adequately assess the operational risks posed by Freddie Mac's servicing contractors, consider the primary federal regulators' reports of examination and enforcement actions, or analyze servicer reviews conducted by other federal agencies.

In light of these control deficiencies, FHFA is not assured that the risk associated with Freddie Mac's servicing operations is being sufficiently managed. In addition, Freddie Mac has developed a more robust servicer performance management program that it estimates could yield significant credit loss savings. However, Freddie Mac currently does not plan to implement its program for all servicers. OIG accordingly believes that FHFA may be able to generate additional funds to be put to better use, beyond what Freddie Mac is currently targeting, by directing the Enterprise to implement its servicer performance management program across a larger cross section of its servicers.

OIG therefore recommended that the Agency: (1) establish and implement regulations or guidance concerning mortgage servicing oversight and risk management; (2) direct Freddie Mac to take the necessary steps to implement servicer performance metrics for a larger cross section of servicers to achieve additional credit loss savings; and (3) improve existing procedures for coordination with other federal agencies that oversee mortgage servicers.

FHFA agreed with the second and third recommendations and disagreed with an aspect of the first. However, FHFA provided additional comments that resolved the disagreement.

OIG AUDIT, EVALUATION, AND SURVEY PLAN

OIG maintains an Audit, Evaluation, and Survey Plan that focuses strategically on the areas of FHFA's operations posing the greatest risks and providing the greatest benefits to the Agency, Congress, and the public. Developed with input from an independent third party, the plan responds to current events and feedback from FHFA officials, members of Congress, and others.

The Audit, Evaluation, and Survey Plan FY 2012 *is available at www.fhfaoig.gov/Content/Files/Audit%20Evaluation%20and%20Survey%20Plan%202012.pdf.*

Broadly, OIG's audits, evaluations, and surveys cover the following FHFA activities:

- ***Regulating the Enterprises and managing their conservatorships.*** This includes efforts to prevent foreclosures, mitigate losses, service mortgage loans, and manage and sell foreclosed properties. These are particularly high-risk areas because Treasury has invested $187.5 billion of taxpayer dollars in the Enterprises and minimizing future costs depends on efficient, effective, and transparent FHFA supervision to conserve Enterprise resources and meet statutory mandates.
- ***Overseeing FHLBanks and their associated risks.*** These activities include unsecured lending and advance and collateral management.
- ***Reviewing internal operations, such as privacy and allegations of fraud, waste, or abuse.***

The Audit, Evaluation, and Survey Plan identifies a number of other ongoing and planned reviews of specific FHFA programs.[p]

OIG INVESTIGATIONS

OI has made significant contributions to a range of mortgage-related investigations. As of March 31, 2012, OI had numerous open investigations. In many of these investigations, OIG is working in conjunction with one or more other law enforcement agencies, such as DOJ, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), the FBI, the Department of Housing and Urban Development Office of Inspector General (HUD-OIG), the Federal Deposit Insurance Corporation Office of Inspector General (FDIC-OIG), or state and local entities nationwide.

[p] OIG's plan is dynamic and will be revised as necessary.

Although most of these investigations remain confidential, details about several matters have been publicly disclosed, as described below.

Taylor, Bean & Whitaker

On March 20, 2012, Delton DeArmas, the former chief financial officer of Taylor, Bean & Whitaker Mortgage Corporation (TBW), pled guilty to federal charges that include making false statements and conspiring to commit bank and wire fraud for his role in a more than $2.9 billion fraud scheme that contributed to the failures of TBW and Colonial Bank. From 2005 through August 2009, he and other co-conspirators engaged in a scheme to defraud financial institutions that had invested in a TBW-owned lending facility called Ocala Funding LLC (Ocala). Ocala obtained funds for mortgage lending for TBW from the sale of asset-backed commercial paper. Deutsche Bank and BNP Paribas, among others, purchased commercial paper from Ocala.

Shortly after Ocala was established, DeArmas learned there were inadequate assets backing its commercial paper, a deficiency referred to internally at TBW as a "hole" in Ocala. DeArmas knew that the hole grew over time to more than $700 million, and he learned from the CEO that the hole was more than $1.5 billion at the time of TBW's collapse. DeArmas admitted he was aware that, in an effort to cover up the hole and mislead investors, a subordinate who reported to him had falsified Ocala collateral reports and periodically sent the falsified reports to Ocala's investors and to other third parties. DeArmas also acknowledged that he and the CEO deceived investors by providing them with a false explanation for the hole in Ocala.

DeArmas also admitted that he directed a subordinate to inflate an account receivable balance for loan participations in TBW's financial statements. DeArmas acknowledged that he knew the falsified financial statements were subsequently provided to Freddie Mac and the Government National Mortgage Association (Ginnie Mae) to support the renewal of TBW's authority to sell and service securities issued by them. When TBW closed and filed bankruptcy, Freddie Mac suffered significant losses.

DeArmas is expected to be sentenced in the near future. In addition to DeArmas' plea, in April 2011, a jury in the Eastern District of Virginia found Lee Bentley Farkas, the chairman of TBW, guilty of 14 counts of conspiracy and bank, securities, and wire fraud. Farkas was sentenced to 30 years in prison on June 30, 2011. Six other individuals have also been convicted and sentenced for their roles in the TBW fraud scheme, including: Paul Allen, former CEO of TBW, who was sentenced to 40 months in prison; Raymond Bowman, former president of TBW, who was sentenced to 30 months in prison; Desiree Brown, former treasurer of TBW, who was sentenced to 72 months in prison; Catherine Kissick, former senior vice president of Colonial Bank and head of its Mortgage Warehouse Lending Division (MWLD), who was sentenced to 96 months in prison; Teresa Kelly, former operations supervisor for Colonial Bank's MWLD, who was sentenced to 3 months in prison; and Sean Ragland, a former senior financial analyst at TBW, who was sentenced to 3 months in prison.

In addition, all of the TBW conspirators, with the exception of DeArmas, have been suspended and debarred from doing business with the federal government, or have debarment proceedings pending against them.

The case was prosecuted by the DOJ Criminal Division's Fraud Section and the United States Attorney's Office for the Eastern District of Virginia. The investigation was conducted jointly with SIGTARP, the FBI, HUD-OIG, and FDIC-OIG. FinCEN and the SEC also provided support to the investigation.

Flahive Law Corporation

On March 8, 2012, Gregory Thomas Flahive, Cynthia Renee Flahive, and Michael Kent Johnson, all attorneys with the Flahive Law Corporation, were charged in California State Court with grand theft and conspiracy for their role in a fraudulent loan modification scheme.

This investigation was initiated after many clients of the Flahive Law Corporation complained to the California State Bar, the Better Business Bureau, and/or the State of California Department of Justice about loan modification services offered by them. The Flahive Law Corporation advertised their loan modification services by flyers and radio and television infomercials, and charged up-front fees of up to $2,500 from homeowners for loan modification services that were not performed.

A majority of the clients had conventional loans. Some of the loans became delinquent, resulting in foreclosure and losses to the Enterprises. OIG assisted the California Attorney General's Office and SIGTARP in this investigation.

Horizon Property Holdings/Cydney Sanchez

On December 1, 2011, Horizon Property Holdings employees Jewel Hinkles (aka Cydney Sanchez), Bernadette Guidry, Jesse Wheeler, Cynthia Corn, and Brent Medearis were indicted on mail and bankruptcy fraud charges in the Eastern District of California. According to the indictment, from 2008 through at least February 2010, Horizon received approximately $5 million in fees from people who were facing foreclosure, in exchange for false promises that Horizon would assist them to secure mortgage modifications.

Hinkles and her conspirators allegedly told homeowners that for a substantial up-front payment and a monthly fee they would save the homeowners' residences from foreclosure. The indictment further alleges that contrary to these representations, the conspirators failed to arrange for the modification of the homeowners' mortgages.

This is a joint investigation with the U.S. Postal Inspection Service, the FBI, and the Stanislaus County District Attorney's Office.

OIG INVESTIGATIONS STRATEGY

OIG and its law enforcement partners are engaged in a number of investigations that, by their nature, cannot be made public at this time. OIG 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-Criminal Investigations; SIGTARP; FinCEN; and other federal, state, and local agencies. During this reporting period, as in the past, OI has continued to work closely with FinCEN to review allegations of mortgage fraud for follow-up investigations and to determine where OIG can best assign special agents to investigate fraud against the GSEs. OIG also pursues innovative approaches to ensure its investigations are prosecuted timely. For example, OIG has provided dedicated OIG investigative counsels with substantial criminal prosecution experience to U.S. Attorneys' Offices to help prosecute OIG's investigations. In addition, OIG has partnered with a number of state attorneys general to pursue shared law enforcement goals.

OIG 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. From October 1, 2011, through March 31, 2012, OIG reviewed eight proposed regulations and policies. OIG provided substantive comments on several, which are discussed below.[q]

1. **FHFA Revised Conservatorship Delegations/Operating Protocol for Delegations (OIG Comments Submitted on May 10, 2011, and March 23, 2012)**

   As OIG noted in its second Semiannual Report (September 30, 2011), FHFA proposed Revised Conservatorship Delegations/Operating Protocol for Delegations (Revised Delegations) to replace delegations made to the Enterprises in November 2008. The proposed Revised Delegations advise the Enterprises of the actions they may take in the ordinary course of their business and those actions they must submit to FHFA for approval. OIG commented upon FHFA's proposal in May of 2011. On March 20, 2012, FHFA circulated for comment amended Revised Delegations, and OIG reiterated its earlier position. FHFA has not issued the final Revised Delegations. The substance of OIG's comments and their resolution will be published at a later date.

[q] As a matter of policy, OIG notes that it has commented on a draft rule in the semiannual period when a comment is made, and then OIG substantively discusses the rule and its comments in a later semiannual report once the rule is finalized and published.

2. **FHFA Draft Proposed Rule: Federal Home Loan Bank Community Support Requirements (RIN 2590-AA38, OIG Comments Submitted on August 29, 2011)**

   As OIG noted in its second Semiannual Report, FHFA is statutorily required to establish a community support standard that takes lending to first-time homebuyers into account.[r] FHFA drafted a proposed rule to transfer this responsibility, along with the task of monitoring FHLBank member compliance with the standard and with the Community Reinvestment Act of 1977, from FHFA to the FHLBanks themselves. OIG acknowledged that the applicable legislation does not require FHFA itself to monitor FHLBank member compliance, but noted that the duty to establish a community support standard is FHFA's alone. OIG recommended that FHFA either review and approve community support programs proposed by each FHLBank, or provide the FHLBanks with a list of eligible community support programs from which they could select programs. On November 10, 2011, FHFA released a revised proposed rule that continues to shift compliance monitoring responsibilities from FHFA to the FHLBanks, but which – instead of tasking the FHLBanks with developing the community support standard – includes a list of activities eligible for consideration as providing support for first-time homebuyers.

3. **FHFA Draft Proposed Rule: Production of FHFA Records, Information and Employee Testimony in Legal Proceedings (No RIN Number Specified, OIG Comments Submitted on December 20, 2011)**

   FHFA forwarded OIG a draft proposed rule to establish controls over whether, when, and how its current or former employees may testify regarding official matters or produce official records or information in connection with legal proceedings to which FHFA is not a party. The draft proposed rule covers both FHFA and OIG personnel. Due to ongoing discussions between FHFA and OIG on this draft, the substance of OIG's comments and their resolution will be published at a later date.

4. **FinCEN Draft Proposed Rule: Suspicious Activity Reporting and Anti-Money Laundering Program Requirements (RIN 1506-AB14, OIG Comments Submitted on January 9, 2012)**

   On January 9, 2012, OIG formally commented on a rule proposed by FinCEN to extend the Bank Secrecy Act's suspicious activity reporting and anti-money laundering program requirements to the Enterprises. Because the Enterprises already are subject to reporting requirements under HERA, the proposed rule has the potential to create duplicative reporting systems for them. Consequently, FinCEN and FHFA advise that

[r] See 12 U.S.C. § 1430(g).

they ultimately plan to supplant HERA's requirement for the Enterprises to report to FHFA (when they have purchased or sold a fraudulent loan or financial instrument or suspect a possible fraud relating to the purchase or sale of any loan or financial instrument), and replace it with the reporting requirements set forth in FinCEN's proposed rule. OIG's comment supported the basic premise of FinCEN's proposed rule, which is to streamline the reporting requirements, but took issue with some of the technical aspects of the rule insofar as they appear to conflict with HERA's mandates and are intended to replace them through regulation. To ensure that the Enterprises are in compliance with HERA, OIG also suggested that FinCEN modify the provisions concerning safe harbors, the universe of covered entities, and the categories of transactions that require reporting.

5. **FHFA Draft Final Rule: Prudential Management and Operations Standards (RIN 2590-AA13, OIG Comments Submitted on January 20, 2012)**

   HERA requires FHFA to establish prudential standards relating to the management and operations of Fannie Mae, Freddie Mac, and the FHLBanks.[s] FHFA must hold the entities accountable to these standards, which shall address certain topics specified by HERA, including but not limited to the entities' internal controls, information systems, internal audit systems, management of risk, liquidity, asset and investment portfolio growth, and various other items. The Agency drafted a proposed final rule to establish those standards. OIG has commented on the draft. FHFA has not yet published the proposed final rule, so the substance of OIG's comments and their resolution will be published at a later date.

6. **FHFA Draft Proposed Rule: Housing Goals (RIN 2590-AA12, OIG Comments Submitted on January 26, 2012)**

   Pursuant to Section 1128 of HERA, FHFA drafted a proposed rule to establish annual housing goals. To satisfy the law, the rule establishes annually adjustable benchmarks governing mortgage purchases by the Enterprises from 2012 through 2014. Due to ongoing discussion between FHFA and OIG on this proposed rule, the substance of the comments and their resolution will be published at a later date.

7. **FHFA Final Rule: Freedom of Information Act Implementation (RIN 2590-AA44, OIG Comments Submitted Throughout Drafting Process)**

   On January 31, 2012, FHFA issued a final rule changing its procedures for handling FOIA requests. Among other changes, the rule establishes a

[s] Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, § 1108.

protocol for handling FOIA requests directed to or involving OIG. The Agency and OIG worked closely to produce the final rule.

8. **FHFA Final Rule: Privacy Act Implementation (RIN 2590-AA46, OIG Comments Submitted Throughout Drafting Process)**

   On January 31, 2012, FHFA issued a final rule revising its existing Privacy Act regulation. Among other changes, the rule establishes a protocol for handling Privacy Act requests directed to or involving OIG. The Agency and OIG worked closely to produce the final rule.

OIG COMMUNICATIONS AND OUTREACH EFFORTS

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

Hotline

OIG OI operates a **Hotline**, which allows concerned parties to report directly and in confidence information regarding possible fraud, waste, or abuse related to FHFA or the GSEs. OIG honors all applicable whistleblower protections. As part of its effort to raise awareness of fraud and how to combat it, OIG promotes the Hotline through its website, posters, e-mails targeted to FHFA and GSE employees, and the semiannual reports.

*OIG's **Hotline**:*
(800) 793-7724 or
OIGHOTLINE@FHFAOIG.GOV.

David Z. Seide, Director of Special Projects, speaks at the opening meeting of the RMBS Working Group.

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 (VA), the Department of Agriculture (USDA), Treasury's Office of Financial Stability (which manages the Troubled Asset Relief Program); and their inspectors general; and other law enforcement organizations. To further its mission, OIG coordinates with these agencies to exchange best practices, case information, and professional expertise. During the semiannual period ended March 31, 2012, representatives of OIG participated in the following cooperative activities:

- ***RMBS Working Group***. On January 27, 2012, the Attorney General issued a memorandum announcing the formation of the RMBS Working Group as a part of FFETF. The RMBS Working Group is led by five co-chairs: the Assistant Attorney General of the DOJ Criminal Division; SEC's Director of Enforcement; the Attorney General of the State of New York; the U.S. Attorney for the District of Colorado; and the Assistant Attorney General of the DOJ Civil Division. The working group is designed to investigate misconduct in the market for MBS. Specifically, the RMBS Working Group seeks to streamline and strengthen current and future efforts to identify, investigate, and prosecute instances of wrongdoing in packaging, selling, and valuing RMBS. The RMBS Working Group consists of federal, state, and local partners including OIG, HUD, DOJ, FinCEN, the SEC, the FBI, the IRS-CI, and the CFPB.

- ***Federal Housing Inspectors General.*** As noted in the second Semiannual Report, OIG spearheaded the creation of a new interagency working group, the Federal Housing Inspectors General. In addition to OIG, this group includes the Offices of Inspector General for other federal agencies with primary responsibility for federal housing, including HUD, VA, and USDA. In November 2011, the Federal Housing Inspectors General published the *Compendium of Federal Single Family Mortgage Programs and Related Activities*, which guides readers through its members' roles and missions and describes single-family mortgage programs at members' agencies. The Federal Housing Inspectors General members continue to collaborate on multiple joint initiatives, including criminal investigations and audits in areas of common interest.

- ***CIGIE.*** OIG is an active participant of CIGIE.
  - o The Inspector General serves on the CIGIE Inspection and Evaluation Committee, which provides leadership for improving agency effectiveness by maintaining professional standards; develops protocols for reviewing management issues that cut across departments and agencies; promotes advanced program evaluation techniques; and fosters awareness of evaluation and inspection practices in the inspector general community. The Committee also provides input to CIGIE's Professional Development Committee with regard to inspectors' training and development needs.
  - o The Inspector General also serves as vice chairman of the CIGIE Suspension and Debarment Working Group, which is charged with improving the effectiveness of federal suspension and debarment practices.

Brian D. Miller, the Inspector General of the General Services Administration, and Steve A. Linick, Inspector General of the Federal Housing Finance Agency, made presentations at the Association of Government Accountants National Leadership Conference on February 17, 2012.

The Compendium of Federal Single Family Mortgage Programs and Related Activities *is available at www.fhfaoig.gov/Content/Files/compendium.pdf.*

- ***Council of Inspectors General on Financial Oversight.*** The Inspector General is an active member of the Council of Inspectors General on Financial Oversight, which was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to facilitate information sharing among member agencies responsible for financial oversight.
- ***FFETF.*** OIG actively participates in FFETF, a broad coalition of state and federal law enforcement agencies, prosecutors, and other entities. The President established FFETF in November 2009 to investigate and prosecute significant financial crimes, ensure just and effective punishment for those who perpetrate them, recover proceeds for victims, and address discrimination in the lending and financial markets. Within the FFETF, OIG has begun working with its task force partners to combat mission relevant financial crimes. OIG also participates in several FFETF working groups such as:
    - the Mortgage Fraud Working Group;
    - the Recovery Act, Procurement, and Grant Fraud Working Group; and
    - the Securities and Commodities Fraud Working Group.
- ***Other Partnerships.*** OIG has established partnerships with several federal agencies to share data, analyze internal complaints, and identify trends. These agencies include FinCEN, SIGTARP, HUD-OIG, the FBI, and the Secret Service. Each of OIG's partnerships with these agencies is designed to enhance interagency cooperation. These partnerships focus the participating agencies' combined investigative resources on identifying, investigating, and prosecuting those involved in fraud related to the entities regulated by the participants.

Communicating with Congress

To fulfill his responsibility to keep Congress fully apprised of OIG's oversight of FHFA and the GSEs, the Inspector General meets regularly with members of Congress and their staffs to brief them on OIG's reports, organization, and strategy.

During the six-month period ended March 31, 2012, the Inspector General provided two formal statements to Congress:

- On December 1, 2011, the Inspector General submitted a Statement for the Record for the House Subcommittee on Oversight and Investigations hearing on "Oversight of the Federal Housing Finance Agency."

- On December 13, 2011, the Inspector General testified before the Senate Committee on Banking, Housing and Urban Affairs hearing on "Oversight of the Federal Housing Finance Agency Part II."

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

SECTION 4

OIG'S RECOMMENDATIONS

Section 4: OIG's Recommendations

In accordance with the provisions of the Inspector General Act, one of the key duties of OIG is to provide recommendations to FHFA that promote the transparency, efficiency, and effectiveness of the Agency's operations and aid in the prevention and detection of fraud, waste, or abuse. The following table summarizes OIG's formal recommendations to date and notes the status of their implementation.

Figure 9. Summary of OIG's Recommendations

No.	Recommendation	Report	Status
ESR-2012-004-1	FHFA should ensure that the Enterprises conduct a comprehensive review of their travel and entertainment policies, and revise them in a manner consistent with the January 25, 2012, guidance.	*Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Annual Convention and Exposition*	Recommendation agreed to by FHFA; implementation of recommendation pending.
ESR-2012-004-2	FHFA should review the Enterprises' proposed revisions to ensure that they are drafted in a manner consistent with the guidance provided by FHFA and that the Enterprises have established appropriate controls to monitor compliance.	*Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Annual Convention and Exposition*	Recommendation agreed to by FHFA; implementation of recommendation pending.
ESR-2012-003-1	FHFA should continue to monitor the Enterprises' progress in phasing out their charitable activities.	*FHFA's Oversight of the Enterprises' Charitable Activities*	Recommendation agreed to by FHFA; implementation of recommendation pending.
ESR-2012-003-2	FHFA should continue to require the Enterprises to issue timely, quarterly reports on their charitable activities via their websites.	*FHFA's Oversight of the Enterprises' Charitable Activities*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-002-1	FHFA should work to limit legal expenses to the extent possible and reasonable by: • narrowing the reach of future indemnification agreements; • considering making greater use of Directors & Officers insurance; and • continuing to invoke the new FHFA regulation establishing the primacy of claims in a receivership, in an effort to curtail costly litigation.	*Evaluation of FHFA's Management of Legal Fees for Indemnified Executives*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-002-2	FHFA should continue to control costs of legal expenses by: • identifying the best elements of Fannie Mae's and Freddie Mac's programs for administering advances and indemnification of legal expenses and developing standardized legal billing practices for both Enterprises; and • further developing FHFA oversight procedures.	*Evaluation of FHFA's Management of Legal Fees for Indemnified Executives*	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 timeframes; • 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 timeframes, and their status.	*FHFA's Oversight of Troubled Federal Home Loan Banks*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2012-001-3	FHFA should document consistently 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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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.
EVL-2011-006-2	FHFA should initiate 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 Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-005-1	FHFA should assess: (1) the extent to which examination capacity shortfalls may have adversely affected the examination program and (2) potential strategies to mitigate risks, such as achieving efficiencies in the assignment of examiners or the examination process.	*Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
EVL-2011-005-2	FHFA should monitor the development and implementation of the examiner accreditation program and take needed actions to address any shortfalls.	*Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-005-3	FHFA should consider using detailees from other federal agencies, retired annuitants, or contractors to augment its examination program in the near term to midterm.	*Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-005-4	FHFA should report periodically to Congress and the public, which might include the augmentation of existing reports, on the Agency's examiner capacity shortfalls, such as the number of examiners needed to meet its responsibilities; the progress in addressing these shortfalls, including status of examiner recruitment and retention efforts; and the development and implementation of its examiner accreditation program.	*Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-004-1	FHFA should closely monitor Fannie Mae's implementation of its operational risk management program.	*Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-004-2	FHFA should take decisive and timely actions to ensure the implementation of the program if Fannie Mae fails to establish an acceptable and effective operational risk program by the end of the first quarter of 2012.	*Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-004-3	FHFA should ensure that Fannie Mae has qualified personnel to implement its operational risk management program.	*Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-003-1	FHFA should engage in negotiations with Treasury and the Enterprises to amend the Financial Agency Agreements, under which the Enterprises administer and enforce HAMP, by incorporating specific dispute resolution provisions so that the parties may discuss differences that arise in its administration and establish strategies by which to resolve or mitigate them.	*Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program*	Closed – Final action taken by FHFA.
EVL-2011-002-1.1	FHFA should review the disparity in compensation levels between the Enterprises' executives and the senior executives of housing-related federal entities that are providing critical support to the housing finance system.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-002-1.2	FHFA should review the extent to which federal financial support for the Enterprises may facilitate their capacity to meet certain performance targets and, by extension, the capacity of their executives to achieve high levels of compensation that may not be warranted.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-002-1.3	FHFA should review the potential challenges the Enterprises might face in recruiting and retaining technical expertise, which might include the employment or objective metrics to assess these issues and the extent to which existing compensation levels may need to be revised.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-002-2.1	FHFA should establish written criteria and procedures for reviewing annual performance and assessment data, as well as their recommended executive compensation levels.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-002-2.2	FHFA should conduct independent testing and verification, perhaps on a random basis, to gain assurance that the Enterprises' bases for developing recommended individual executive compensation levels is reasonable and justified.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.

No.	Recommendation	Report	Status
EVL-2011-002-2.3	FHFA should create and implement policies to ensure that all key executive compensation documents are stored consistently and remain readily accessible to appropriate Agency officials and staff.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-002-3.1	To improve transparency, FHFA should post on its website information about executive compensation packages, the Enterprises' corporate performance goals and performance against those goals, and related trend data.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-002-3.2	To improve transparency, FHFA should post on its website links to the Enterprises' securities filings.	*Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*	Closed – Final action taken by FHFA.
EVL-2011-001-1	FHFA should establish timeframes and milestones, descriptions of methodologies to be used, criteria for evaluating the implementation of the initiatives, and budget and financing information necessary to carry out its responsibilities.	*Federal Housing Finance Agency's Exit Strategy and Planning Process for the Enterprises' Structural Reform*	Closed – Final action taken by FHFA.
EVL-2011-001-2	FHFA should develop an external reporting strategy, which might include the augmentation of existing reports, to chronicle FHFA's progress, including the adequacy of its resources and capacity to meet multiple responsibilities and mitigate any shortfalls.	*Federal Housing Finance Agency's Exit Strategy and Planning Process for the Enterprises' Structural Reform*	Closed – Final action taken by FHFA.
AUD-2012-003-1	FHFA's Division of Housing Mission and Goals should formally establish a policy for its review process of underwriting standards and variances including escalation of unresolved issues reflecting potential lack of agreement.	*FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2012-003-2	FHFA's Division of Examination Program and Support should enhance existing examination guidance for assessing adherence to underwriting standards and variances from them.	*FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2012-001-1	FHFA's Division of Enterprise Regulation (DER) should establish and implement more robust regulations or guidance governing counterparty oversight and risk management for mortgage servicing. The regulations or guidance should include requirements for: (1) contracting with servicers, including a contractual provision authorizing FHFA's access to relevant servicer information; (2) promptly reporting on material poor performance and non-compliance by servicers; and (3) minimum, uniform standards for servicing mortgages owned or guaranteed by the Enterprises.	*FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors*	Recommendation partially agreed to by FHFA; implementation of recommendation pending.
AUD-2012-001-2	FHFA's DER should direct Freddie Mac to take the necessary steps to monitor and track the performance of its servicers to reasonably assure achievement of credit loss savings by: (1) implementing servicer account plans for the servicers without account plans that are under consideration to receive a plan and (2) taking action to maximize credit loss savings among the remaining servicers that are not under consideration for account plans.	*FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2012-001-3	FHFA's DER should improve its existing procedures and controls governing coordination with other federal agencies that have oversight jurisdiction with respect to the Enterprises' mortgage servicers.	*FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-004-1	FHFA should review the circumstances surrounding its not identifying the foreclosure abuses at an earlier stage and develop potential enhancements to its capacity to identify new and emerging risks.	*FHFA's Oversight of Fannie Mae's Default-Related Legal Services*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2011-004-2	FHFA should develop and implement comprehensive examination guidance and procedures, together with supervisory plans, for default-related legal services.	*FHFA's Oversight of Fannie Mae's Default-Related Legal Services*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-004-3	FHFA should develop and implement policies and procedures to address poor performance by default-related legal services vendors that have contractual relationships with both of the Enterprises.	*FHFA's Oversight of Fannie Mae's Default-Related Legal Services*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-003-1	FHFA should document, disseminate, and implement a privacy training plan and implementation approach.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Closed – Final action taken by FHFA.
AUD-2011-003-2	FHFA should identify those employees that would benefit from additional job-specific or role-based privacy training based on increased responsibilities related to personally identifiable information (PII).	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Closed – Final action taken by FHFA.
AUD-2011-003-3	FHFA should develop and implement targeted, role-based training for employees whose job functions require additional job-specific or role-based privacy training.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-003-4	FHFA should develop and implement additional training for employees about System of Records Notice (SORN) requirements, focusing on the inadvertent creation of systems of records. This training should stress the legal ramifications potentially associated with creating systems of records prior to publishing a SORN.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-003-5	FHFA should strengthen its privacy-related procedures to ensure SORNs are completed prior to systems becoming operational.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Closed – Final action taken by FHFA.
AUD-2011-003-6	FHFA should require system owners of four FHFA systems with PII to prepare privacy impact assessments according to a checklist or template.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Closed – Final action taken by FHFA.
AUD-2011-003-7	FHFA should document the privacy impact assessments conducted for proposed rules of the Agency as required by Section 522.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Closed – Final action taken by FHFA.
AUD-2011-003-8	FHFA should establish a process for the completion of template- or checklist-based privacy impact assessments and modify policies and procedures as necessary.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011*	Closed – Final action taken by FHFA.

No.	Recommendation	Report	Status
AUD-2011-003-9	FHFA should ensure privacy risk is continuously assessed on systems in production, including when functionalities change or when a major update is done. The Chief Privacy Officer should document, disseminate (to system owners and the Chief Information Security Officer), and implement policies and procedures for continuous monitoring of information systems containing PII after they are placed in production. The policies and procedures at a minimum should: • document the privacy-related security controls that are to be monitored to protect information in an identifiable form and information systems from unauthorized access, use, disclosure, disruption, modification, or destruction; • determine the frequency of the privacy-related security controls monitoring and reporting process to the privacy office; • document review of reports generated by the monitoring of the privacy-related security controls; and • if necessary, take action on results of monitoring and document results of action taken.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation–2011*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-002-1	FHFA should finalize, disseminate, and implement an Agency-wide information security program plan in accordance with NIST SP 800-53 Rev.3.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011*	Closed – Final action taken by FHFA.
AUD-2011-002-2	FHFA should update its information security policies and procedures to address all applicable NIST SP 800-53 Rev.3 components.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011*	Closed – Final action taken by FHFA.
AUD-2011-002-3	FHFA should develop, disseminate, and implement an Agency-wide information categorization policy and methodology.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-002-4	FHFA should develop, disseminate, and implement a process to monitor compliance with Plans of Action and Milestones.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011*	Closed – Final action taken by FHFA.
AUD-2011-002-5	FHFA should establish controls for tracking, monitoring, and remediating weaknesses noted in vulnerability scans.	*Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011*	Closed – Final action taken by FHFA.

No.	Recommendation	Report	Status
AUD-2011-001-1A	FHFA should design and implement written policies, procedures, and controls governing the receipt, processing, and disposition of consumer complaints that: • define FHFA's and the Enterprises' roles and responsibilities regarding consumer complaints; • require the retention of supporting documentation for all processing and disposition actions; • require a consolidated management reporting system, including standard record formats and data elements, and procedures for categorizing and prioritizing consumer complaints; • ensure timely and accurate responses to complaints; • facilitate the analysis of trends in consumer complaints received and use the resulting analyses to mitigate areas of risk to the Agency; • safeguard PII; and • ensure coordination with OIG regarding allegations involving fraud, waste, or abuse.	*Audit of the Federal Housing Finance Agency's Consumer Complaints Process*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-001-1B	FHFA should assess the sufficiency of allocated resources, inclusive of staffing, in light of the additional controls implemented to strengthen the consumer complaints process.	*Audit of the Federal Housing Finance Agency's Consumer Complaints Process*	Closed – Final action taken by FHFA.
AUD-2011-001-1C	FHFA should determine if there are unresolved consumer complaints alleging fraud to ensure that appropriate action is taken promptly.	*Audit of the Federal Housing Finance Agency's Consumer Complaints Process*	Closed – Final action taken by FHFA.

SECTION 5

FANNIE MAE AND FREDDIE MAC – WHERE THE TAXPAYERS' MONEY WENT

Section 5: Fannie Mae and Freddie Mac – Where the Taxpayers' Money Went

Following an unprecedented rise in housing prices, the housing market began collapsing in late 2006. This had widespread, adverse impacts on those financial institutions heavily concentrated in mortgage financing, such as Fannie Mae and Freddie Mac. To prevent the Enterprises' insolvency, from September 6, 2008, through the end of 2011, Treasury invested approximately $185 billion in them. Treasury's actions have resulted in controversy and questions have arisen concerning why Fannie Mae and Freddie Mac required such federal intervention, how the Enterprises have used Treasury's extraordinary investment, and who may have benefited from it. In a nutshell, it is believed that the investment permitted Fannie Mae and Freddie Mac to avoid insolvency, which – given their dominant positions in housing finance and the trillions of dollars of securities issued – could have caused the collapse of the U.S. housing finance system. Additional consequences of Treasury's intervention include that the Enterprises' shareholders lost almost all their investments, but the Enterprises' bond holders and investors in guaranteed MBS were protected. More importantly, homeowners and other participants in the housing market indirectly benefited from Treasury's buttressing of the market.

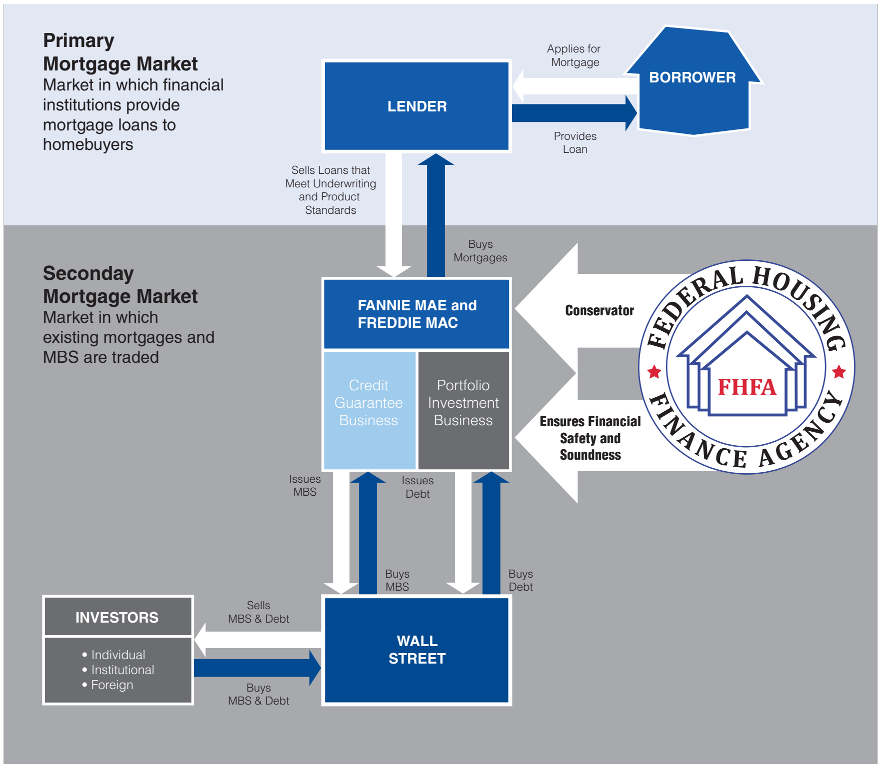
BACKGROUND

About the Enterprises

Fannie Mae and Freddie Mac fulfill their obligations to provide liquidity to the housing finance system by supporting the secondary mortgage market. The Enterprises purchase residential mortgages that meet their underwriting criteria from loan sellers. The loan sellers can then use the sales proceeds to originate additional mortgages. The Enterprises can hold the mortgages in their own investment portfolios or package them into MBS that are, in turn, sold to investors. For a fee, the Enterprises guarantee the payment of mortgage principal and interest on the MBS they sell.

As depicted in Figure 10 (see page 67), to finance their purchase of billions of dollars of mortgage loans, the Enterprises: (1) borrow funds from large individual, institutional, and foreign investors and (2) create and sell MBS.

Figure 10. Overview of Enterprises and FHFA's Role



Source: Government Accountability Office, *Financial Audit: Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements*, at 17 (Nov. 2011) (GAO/12-161) (online at http://gao.gov/assets/590/586278.pdf).

Provisions for Loan Losses in the Enterprises' Portfolios

Inevitably, some homeowners will encounter difficulty making their mortgage payments. If a homeowner stops making payments, the Enterprise has to account for the revenue shortfall related to an owned or guaranteed mortgage. The Enterprises have established special accounts or reserves to cover losses incurred on loans they own in their investment portfolios. They typically contribute to these accounts every quarter. These quarterly contributions to reserves are called **provisions for loan losses** in that they provide against future losses. Provisions for loan losses – and the reserves they fund – can be attributable to a specific loan or can be based on the general expectation that a portion of the loans in the portfolio as a whole will **default**.

MBS Guarantees

With respect to **mortgage guarantees** associated with the MBS that Fannie Mae and Freddie Mac sell, they collect a monthly fee to ensure the payment of principal and interest to MBS investors. This fee – spread over the life of the pool of loans that comprise a particular MBS – is intended to cover that small portion of loans that are expected to default. And, similar to the practice for

Provision for Loan and Guarantee Losses:
An accounting concept that refers to the reduction of current income to establish a reserve fund for mortgage losses.

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

Mortgage Guarantees:
Historically, the Enterprises purchased mortgages and securitized them while providing a guarantee to investors that if the mortgagor defaulted, the Enterprise would make timely principal and interest payments to the securitization trust, which in turn would make payments to the security holder.

the loans they retain in their own portfolios, the Enterprises establish reserves for losses on the MBS portfolios they guarantee.[t]

Defaults and Foreclosures

After a homeowner defaults on a loan that the Enterprises own or guarantee, a loan servicer – typically, a vendor hired to collect mortgage payments, set aside taxes and insurance premiums, forward principal and interest obligations to mortgage owners, and respond to payment defaults – may commence **foreclosure** on behalf of the Enterprises. Foreclosure is designed to recover the proceeds of a defaulted loan through the sale of the mortgaged property. Once the servicer has foreclosed on a loan and taken the title on the property, the Enterprise essentially erases – or **charges off** – the unpaid mortgage balance from its accounting records. Following charge off, if the Enterprise sells the property to a third party, the sales price will offset losses.

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

Charge Off:
An accounting term describing the elimination of an asset, such as a mortgage loan, from a company's books. It does not necessarily imply a reduction in the company's assets, depending on the allowance established for loan losses.

The Enterprises aim to sufficiently contribute to their loan loss and guarantee portfolio reserves to cover these losses. However, with the collapse of the housing market and the ensuing financial crisis, losses on loans and payment on guarantee obligations vastly exceeded the Enterprises' abilities to cover their losses.

The Financial Crisis and Its Effect on the Enterprises

The Crisis

The Bubble Inflated

From 2001 until it reached its peak in 2006, the U.S. housing market experienced a rapid increase in real estate values.[u] During this time, prices of single-family homes increased by an average of more than 12% annually. Home price appreciation was accompanied by a rapid increase in mortgage indebtedness. Total mortgage debt outstanding in the U.S. more than doubled, from $5.1 trillion in 2000 to $11.2 trillion in the second quarter of 2008. This swift escalation of home prices and mortgage indebtedness is often referred to as the "housing bubble."

During the housing bubble, Fannie Mae's mortgage-related assets and guarantees increased from $1.3 trillion in 2000 to $3.1 trillion in 2008, or approximately 11% annually. Likewise, Freddie Mac's mortgage-related assets and guarantees similarly increased from $1 trillion in 2000 to $2.2 trillion in 2008, or 11% annually.

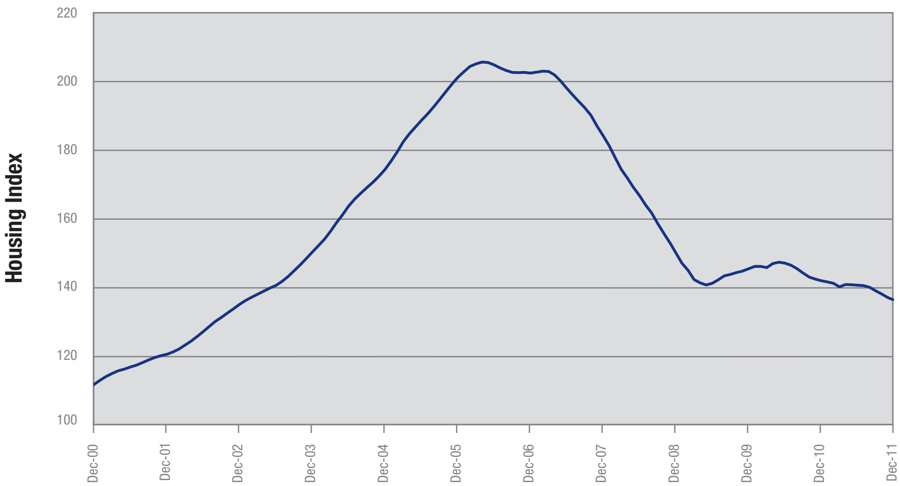
[t] Fannie Mae uses the term "guaranty fee," whereas Freddie Mac uses the term "management and guarantee fee." This report refers to them both as "guarantee fees."

[u] Over a longer period, between 1997 and 2006, home values increased 124%.

The Bubble Burst

In 2007, housing prices began to plummet and loan delinquencies and defaults significantly increased. As reflected in Figure 11 (see below), after more than doubling over six years, home prices fell by 27% between 2006 and 2008.

Figure 11. Average Single-Family Residence Prices, 2000-2011



Source: Standard & Poor's, *S&P/Case-Shiller Home Price Indices: Home Price Index Levels, (December 2011) (20-City Composite Seasonally Adjusted)* (online at www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/en/us/?indexId=spusa-cashpidff--p-us----) (accessed Apr. 10, 2012).

The Impact

The collapse of housing prices had widespread, adverse impacts on many sectors of the U.S. economy, particularly for those financial institutions and investors that were heavily concentrated in mortgage financing, such as Fannie Mae and Freddie Mac. The Enterprises had grown rapidly with only a thin capital cushion to provide protection against losses. The capital they were required to hold to protect them from losses on their investment portfolio and guarantee obligations met regulatory standards but fell well below capital levels maintained by many large financial institutions.[v] Hence, the Enterprises were not prepared for a sharp nationwide decline in housing prices. When housing prices for the United States overall fell by an average of 9% in 2007, the Enterprises' businesses began to come under increasing stress. By early 2008, both institutions were experiencing financial difficulties and, as more and more homeowners became delinquent on their mortgages, their rates of seriously delinquent (i.e., 90 or more days delinquent) owned or guaranteed loans rapidly exceeded levels experienced during the preceding decade.

The financial crisis has produced unprecedented losses for the Enterprises. Fannie Mae lost $5 billion in the second half of 2007 and another $4.5 billion through the first half of 2008. Freddie Mac lost $3.7 billion in the second

[v] In 2007, Federal Reserve Board Chairman Ben S. Bernanke said:

> Because of both regulatory requirements and the force of market discipline, banks hold much more capital than GSEs [government-sponsored enterprises] hold. The very largest bank holding companies generally hold equity capital equal to 6 percent or more of assets, and the largest regional banks generally have capital ratios of about 8 percent. (As I am sure you are keenly aware, community banks often have a capital-to-assets ratio exceeding 10 percent.) In comparison, the GSEs hold capital equal to roughly 3.5 percent of assets. The justification for the low capital holdings of GSEs relative to banks is unclear. The largest banks are more diversified than the GSEs; and although banks likely assume greater credit risks, they probably are less subject to interest-rate risk than are GSEs. Moreover, the recent experience of the GSEs suggests that they are subject to at least as much operational risk as the large banks.

Board of Governors of the Federal Reserve System, *Statement of Chairman Ben S. Bernanke* (Mar. 6, 2007) (online at www.federalreserve.gov/newsevents/speech/bernanke20070306a.htm).

half of 2007 and $1 billion during the first half of 2008. Subsequently, the collapse in the market for MBS in the fall of 2008 resulted in even larger losses for both entities. For the full year 2008, Fannie Mae and Freddie Mac together recorded losses of more than $100 billion ($58.7 billion and $50.1 billion, respectively). To put these losses into perspective, over the 37-year period from 1971 to mid 2008, Fannie Mae and Freddie Mac earned $95 billion, less than they lost in 2008 alone. And the losses continued; from 2008 through the end of the third quarter of 2011 the Enterprises lost $261 billion.[30w] In other words, the losses incurred during the conservatorships are more than double the cumulative net income the Enterprises reported as public companies.[31]

The Conservatorships

In July of 2008, HERA was enacted. Among other things, HERA strengthened the regulator's ability to place the Enterprises in conservatorships and authorized it to place them into receiverships.[x] Additionally, HERA empowered Treasury to provide financial assistance to Fannie Mae and Freddie Mac through the end of 2009.

On September 6, 2008, Fannie Mae and Freddie Mac entered conservatorships overseen by FHFA.[y] Among the key reasons FHFA cited for taking this action were concerns about: the Enterprises' financial conditions, their ability to raise capital and to continue funding themselves, and "the critical importance each company has in supporting the residential mortgage market in this country."[32]

At the same time, and in coordination with FHFA, Treasury exercised its authority under HERA to provide support to the Enterprises to ensure their solvency. In taking this action, former Treasury Secretary Henry Paulson stated that Treasury had concluded – based on a thorough review of the financial condition of the Enterprises, their projected ability to withstand difficult market conditions, and the need to provide stability to unsettled financial markets – that it was necessary both to place them in conservatorships and to set up a process for providing financial support to them, as needed.[33]

Treasury's financial support has been in the form of purchases of senior preferred stock issued by the Enterprises in accordance with PSPAs. Under the terms of the PSPAs, whenever an Enterprise's liabilities exceed its assets (as determined using **Generally Accepted Accounting Principles (GAAP)**), Treasury provides cash sufficient to eliminate that deficit in exchange for an increase in the value of the senior preferred stock.[34] The PSPAs thus provide the Enterprises a financial backstop.[35] Since establishing the conservatorships, Treasury has made equity investments in the Enterprises almost every quarter and, by the end of 2011, the cumulative amount of such taxpayer investments stood at $185 billion, as shown in Figure 12 (see page 71).[z]

Generally Accepted Accounting Principles (GAAP):
A set of rules and conventions promulgated by national industry boards (in the United States, the Financial Accounting Standards Board) as standard accounting practice for that country.

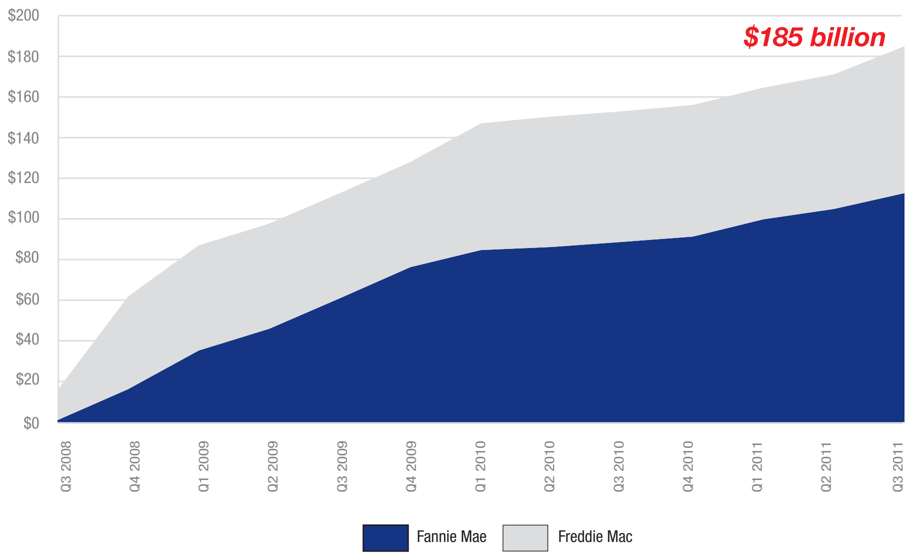
[w] As depicted in Figure 15, the Enterprises' cumulative losses exceed the amount of Treasury's investment by $78 billion. When the conservatorships commenced, the Enterprises had $78 billion in capital available, and this capital partially offset losses and the need for additional Treasury investment.

[x] Under the previous statute governing federal oversight of the Enterprises, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Pub. L. No. 102-550, the Enterprises' regulator, OFHEO, had the authority to place an Enterprise in conservatorship, but not receivership.

[y] For a more complete discussion of the impact of placing the Enterprises in conservatorships, see *FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac* (WPR-2012-001, Mar. 28, 2012) (available at www.fhfaoig.gov/Content/Files/WPR-2012-001.pdf).

[z] This figure, $185 billion, includes the $2 billion initial commitment fee. Treasury was issued stock representing this fee as payment for agreeing to invest in the Enterprises as required.

Figure 12. Enterprise Quarterly Deficits Since Conservatorship ($ billions)



Source: Federal Housing Finance Agency, *Data as of December 14, 2011 on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities,* at Table 1 (online at www.fhfa.gov/webfiles/22856/) (accessed Feb. 29, 2012).

Initially, the Enterprises were to receive no more than $200 billion from Treasury. The PSPAs were subsequently revised to increase this amount to $400 billion. The PSPAs were amended a second time to increase the investment ceiling to $400 billion over the amount actually drawn as of December 31, 2012 (less any positive equity – which is unlikely – at that date). To illustrate, given the investment of $185 billion at the end of 2011, if no more cash were drawn before December 31, 2012 (and stockholder equity is zero or less on that date), then the ceiling will be $585 billion ($185 billion plus $400 billion).

The Enterprises' PSPAs and amendments are available at www.fhfa.gov/Default.aspx?Page=364.

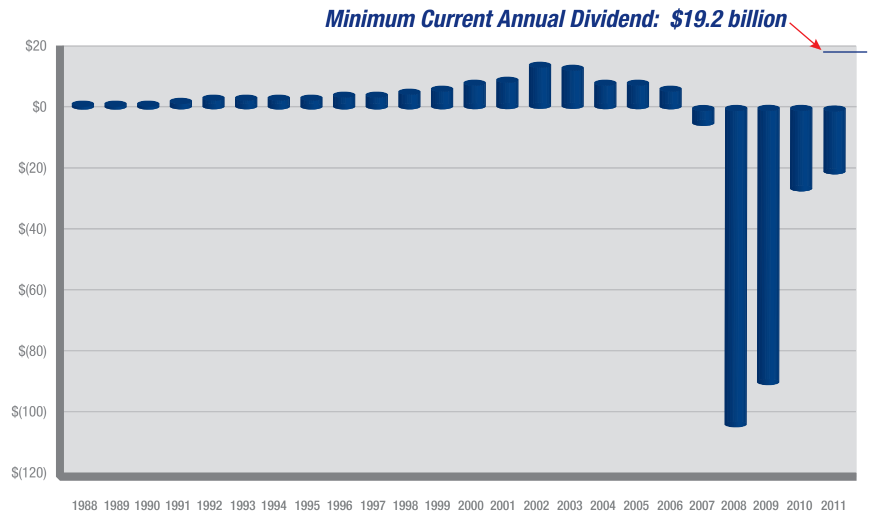
As a condition of receiving financial support under the PSPAs, the Enterprises agreed to pay Treasury quarterly dividends at an annual rate of 10% on Treasury's outstanding investment.

The Enterprises' dividend obligations, which are exacerbated by the 10% annual rate, are so large that they have yet to earn enough to pay them annually. Consequently, Treasury has had to advance additional sums to the Enterprises to pay dividends. As of the end of 2011, Treasury's investment in the Enterprises, excluding the amount needed to fund the dividend payments, is $151 billion.[36] (Treasury's investment of $185 billion also includes $32 billion in advances to pay dividends and $2 billion in fees assessed against the Enterprises at the inception of the PSPAs.) According to FHFA and the Enterprises, the likelihood of the Enterprises ever earning enough to repay the full amount invested is remote.[aa]

[aa] The Acting FHFA Director noted in a Sept. 2011 speech: "It ought to be clear to everyone at this point, given the Enterprises' losses since being placed into conservatorship and the terms of the Treasury's financial support agreements, that the Enterprises will not be able to earn their way back to a condition that allows them to emerge from conservatorship." Federal Housing Finance Agency, *Statement of Acting Director Edward J. DeMarco* (Sept. 19, 2011) (online at www.fhfa.gov/webfiles/22617/NCSpeech91911.pdf). Similarly, in their 2011 annual public filings, both Enterprises independently reported that, "there is significant uncertainty as to our long-term financial sustainability."

This is illustrated in Figure 13 (see below), which compares the current dividend amount to the Enterprises' net annual income since 1988.

Figure 13. Combined Enterprise Net Income (Loss) vs. Current Treasury Dividend ($ billions)



Sources: Federal Housing Finance Agency, *2008 FHFA Annual Report to Congress*, at 110, 127 (online at www.fhfa.gov/webfiles/2335/FHFA_ReportToCongress2008508rev.pdf) (accessed Feb. 29, 2012); Fannie Mae, *2010 10-K Report,* at F-4 (online at www.fanniemae.com/ir/pdf/earnings/2010/10k_2010.pdf) (accessed Feb. 29, 2012); Freddie Mac, *2010 10-K Report*, at 208 (online at www.freddiemac.com/investors/er/pdf/10k_022411.pdf) (accessed Apr. 21, 2012); Fannie Mae, *2011 Third Quarter 10-Q Report*, at 102 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/q32011.pdf) (accessed Feb. 29, 2012); Freddie Mac, *2011 Third Quarter 10-Q Report*, at 104 (online at www.freddiemac.com/investors/sec_filings/index.html) (accessed Feb. 29, 2012).

On the basis of Treasury's outstanding investment of $185 billion and the annual dividend rate of 10% (paid quarterly at a rate of 2.5%), the Enterprises' current annual dividend payment is $19.2 billion.[bb] As depicted in Figure 13, even in their best year, 2002, when they earned $14 billion, the Enterprises failed to earn the $19.2 billion that would be needed to pay an annual dividend on Treasury's $185 billion investment as of the end of 2011.

ENTERPRISE GAINS, LOSSES, AND USE OF FUNDS FOR THE PERIOD 2008 THROUGH THE THIRD QUARTER 2011

Summary of Gains, Losses, and Use of Funds

Large businesses like the Enterprises typically analyze financial performance of all of their business lines to gain an understanding of the dynamics of each particular segment of their operations. As discussed in more detail below, and as summarized in Figure 14 (see page 73), with the exception of their multifamily business lines, the Enterprises suffered losses in all of their operations.

[bb] If the computation were made once a year, then the 10% rate would be assessed against the balance, resulting in a smaller payment of $18.5 billion.

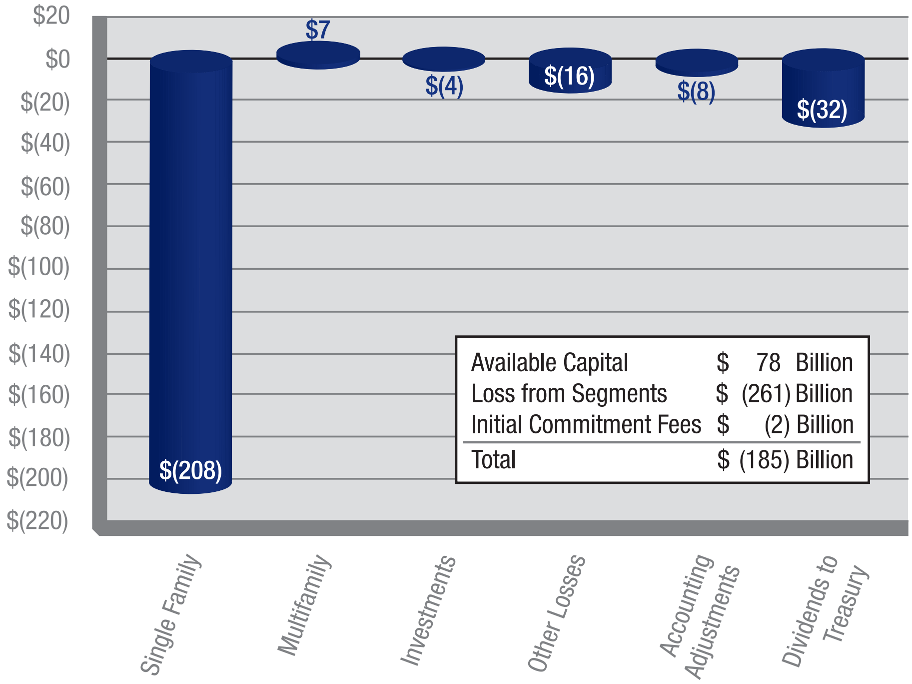
Figure 14. Sources of Gains, Losses, and Use of Funds for the Period 2008 Through the Third Quarter 2011[cc]

Single Family	Loss
Multifamily	Gain
Investments	Loss
Other	Loss
Accounting Adjustments	Loss
Dividends to Treasury	Dividend Payment

Source: Federal Housing Finance Agency, *Conservator's Report on the Enterprises' Financial Performance Third Quarter 2011*, at 9 (online at www.fhfa.gov/webfiles/22855/Conservator'sReport3Q2011F122111F.pdf) (accessed Apr. 5, 2012).

As discussed above, the Enterprises' cumulative losses as of the end of the third quarter of 2011 totaled $261 billion, but they had $78 billion in unobligated capital at the beginning of 2008. (Additionally, $2 billion in fees were assessed against the Enterprises at the inception of the PSPAs and these fees are included in Treasury's $185 billion investment.) This unobligated capital partially mitigated the need for Treasury investment. Figure 15 (see below) quantifies the relative losses, dividend obligations, and gain on Enterprise operations, through the third quarter of 2011.

Figure 15. Enterprise Gains, Losses, and Dividend Obligation 2008 Through Third Quarter 2011 ($ billions)



Source: Federal Housing Finance Agency, *Conservator's Report on the Enterprises' Financial Performance Third Quarter 2011*, at 9 (online at www.fhfa.gov/webfiles/22855/Conservator'sReport3Q2011F122111F.pdf) (accessed Apr. 5, 2012).

[cc] FHFA publishes a quarterly Conservator's Report on Fannie Mae's and Freddie Mac's financial performance and condition, to enhance public understanding of their financial performance leading up to and during conservatorship. The reports include the sources of Enterprise losses and capital deficits and Enterprise loss mitigation activity. The reports are available at www.fhfa.gov/Default.aspx?Page=172. For purposes of this discussion, OIG uses the categories of losses/gains that FHFA publishes in its Conservator's reports.

Figure 15 (see page 73) clearly demonstrates that the bulk of the Enterprises' losses were incurred in its single-family business: owning and guaranteeing home mortgages. Moreover, the vast majority of the Enterprises' losses in their single-family business lines are attributable to single-family loans made from 2004 through 2008.

Single Family

As discussed above, the Enterprises purchase single-family mortgages from lenders. The Enterprises then either hold the mortgages in their investment portfolios or package and sell them as MBS. The Enterprises typically guarantee payment of principal and interest on the MBS they sell in exchange for guarantee fees.

As shown in Figure 15 (see page 73), after accounting for revenues from new and existing loans (e.g., guarantee fees), the Enterprises' single-family business line had a net loss (i.e., expenses exceeding income) of $208 billion since 2008. As described below, and depicted in Figure 16 (see page 75), Fannie Mae's and Freddie Mac's loss-related expenses totaled $218 billion and these expenses were predominantly associated with MBS guarantees.[dd]

Retained Mortgage Loans

During the conservatorships, the Enterprises accrued $86 billion in expenses (called provisions) related to mortgage loans held on their books, as shown in Figure 16 (see page 75). However, this sum is affected by a recent accounting change. Prior to 2010, these losses related solely to those loans the Enterprises purchased from third parties and immediately placed into their portfolios (without securitizing and selling them to investors). Beginning in 2010, changes in accounting rules required the Enterprises to account for loans they had guaranteed in the same way as loans they owned and held on their books. Thus, the Enterprises reduced their **reserve for MBS guarantee losses** and increased their reserves for retained mortgages losses.

Reserve for Guarantee Losses:
An accounting phrase meaning a reserve fund on the balance sheet that is created in anticipation of future losses on loans guaranteed by the Enterprises. It has the effect of reducing income in the current period.

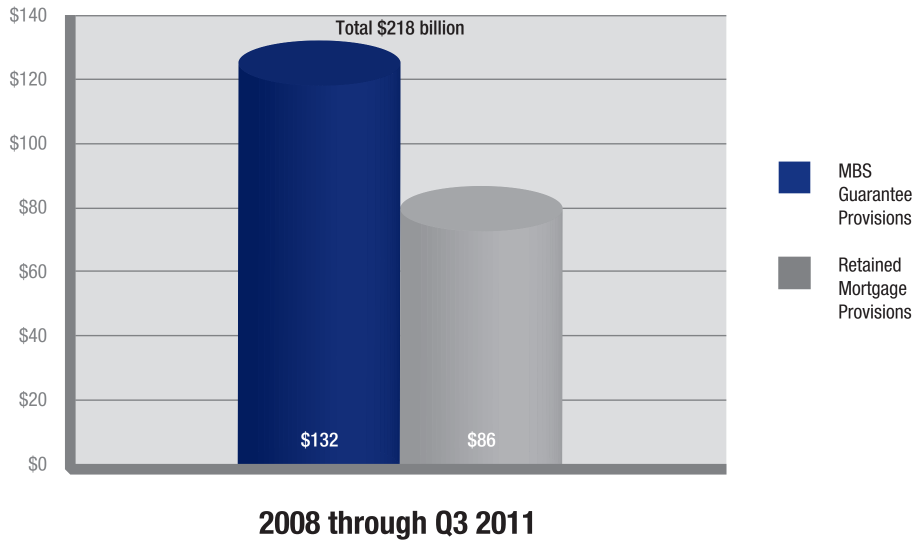
Securitization:
A process whereby a financial institution assembles pools of income-producing assets (such as loans) and then sells an interest in the assets' cash flows as securities to investors.

MBS Guarantees

The Enterprises expanded their MBS business rapidly beginning in the mid 1990s. By 2008, the amount of the Enterprises' guarantees on mortgages that were **securitized** into MBS was nearly seven times the amount held in their investment portfolios.[37] As the housing market collapsed and homeowners failed to make interest and principal payments for securitized loans, the Enterprises satisfied their guarantee obligations and made required periodic payments to MBS investors. As shown in Figure 16 (see page 75), in spite of the 2010 accounting change, the Enterprises' provisions for losses related to their guarantee business totaled $132 billion during the conservatorships.

[dd] As discussed above under the heading "Provisions for Loan Losses in the Enterprises' Portfolios" (see page 67), the Enterprises maintain reserve accounts to pay losses on retained mortgages and MBS guarantees. The periodic funding of these accounts, which has increased as a consequence of the housing crisis, is an expense for the Enterprises.

Figure 16. Enterprise Provisions for Losses on MBS Guarantees vs. Retained Mortgages ($ billions)



Sources: Fannie Mae, *2011 10-K Report*, at 101 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10k_2011.pdf) (accessed Apr. 10, 2012); Freddie Mac, *2011 10-K Report*, at 170, 235 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 5, 2012); Freddie Mac, *2009 10-K Report*, at 257 (online at www.freddiemac.com/investors/er/pdf/10k_022410.pdf) (accessed Apr. 10, 2012); Freddie Mac, *Form 10-Q: For The Quarterly Period Ended September 30, 2011*, at 121 (online at www.freddiemac.com/investors/sec_filings/index.html) (accessed Apr. 16, 2012); Fannie Mae, *Form 10-Q: For The Quarterly Period Ended September 30, 2011*, at 33 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/q32011.pdf) (accessed Apr. 16, 2012).

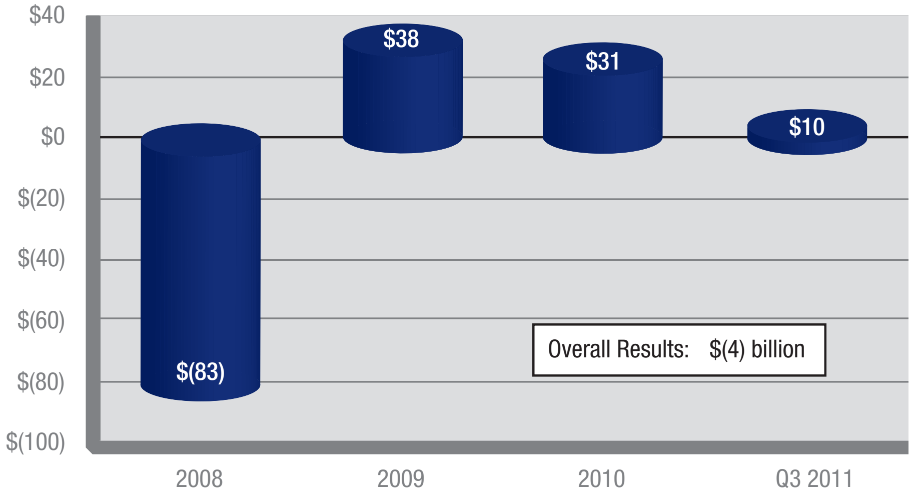
Multifamily

Like their single-family business, the Enterprises participate in mortgages secured by multifamily buildings, acquiring, holding, or securitizing them into MBS. As shown in Figure 15 (see page 73), results from this business segment contributed a gain of $7 billion from 2008 through the end of the third quarter of 2011.

Investments

During the same timeframe, investments contributed $4 billion in overall losses, as shown in Figure 15 (see page 73). Figure 17 (see page 76) shows, however, that the Enterprises lost $83 billion on their investments in 2008, and that since that time annual gains have partially offset the 2008 results. Investment results are largely comprised of private-label MBS and derivative performance.

Figure 17. Investments Gains and (Losses) 2008 Through Third Quarter 2011 ($ billions)[ee]



Source: Federal Housing Finance Agency, *Conservator's Report on the Enterprises' Financial Performance Third Quarter 2011*, at 14 (online at www.fhfa.gov/webfiles/22855/Conservator'sReport3Q2011F122111F.pdf) (accessed Apr. 5, 2012).

Adjustable Rate Mortgages (ARMs): Mortgages whose interest rate changes periodically and usually in relation to the change of another interest rate.

Payment Option ARMs or Option ARMs: A special type of ARM, which enables the borrower to choose among various monthly payment levels.

Private-Label MBS

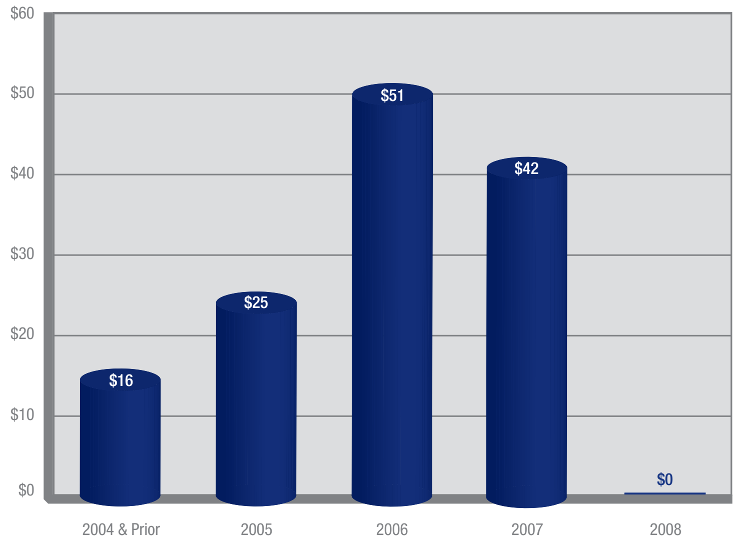
From 2004 through 2007, as reflected in Figure 18 (see page 77), the Enterprises bought substantial quantities of private-label MBS. Such securities typically offered higher yields than either their own such securities or the mortgages they held in their investment portfolios. Further, in part, the mortgages backing these securities often were issued to low- and moderate-income homebuyers, whom the Enterprises had a legislative mission to serve.[ff]

With the downturn in the overall housing market, the value of private-label MBS held by the Enterprises plummeted as well. Freddie Mac noted in its financial statements for 2010, that the "decline has been particularly severe for subprime, **option [Adjustable Rate Mortgages (ARMs)]**, and Alt-A and other loans" held in MBS.[38] Freddie Mac cited high unemployment, a large inventory of seriously delinquent mortgage loans and unsold homes, tight credit conditions, and weak consumer confidence as contributing to the poor performance of these securities. Further, subprime loans that back these securities have had significantly greater concentrations in states that have experienced the greatest distress during the economic downturn, such as California, Florida, Arizona, and Nevada. Loans in these states have experienced among the highest delinquency rates, and the credit losses associated with such loans have been among the highest in the country.[39] Nonetheless, steep declines in the value of the Enterprises' private-label MBS in 2008 have been offset by income from them and partial recovery of MBS prices since then.

[ee] Results for "Investments" include derivatives and MBS performance.

[ff] Federal Reserve Board Chairman Ben S. Bernanke said, "By borrowing at this preferential rate and purchasing assets (including MBS) that pay returns considerably greater than the Treasury rate, the GSEs can enjoy profits of an effectively unlimited scale." Bernanke went on to say, "the GSE portfolio purchases may create benefits for home purchase mortgages extended to lower-income households, to low- and moderate-income first-time homebuyers, and to buyers of homes in lower-income neighborhoods." Board of Governors of the Federal Reserve System, *Statement of Chairman Ben S. Bernanke* (Mar. 6, 2007) (online at www.federalreserve.gov/newsevents/speech/bernanke20070306a.htm).

Figure 18. New Acquisitions of Subprime and Other Private-Label MBS ($ billions)



Sources: Fannie Mae, *2010 10-K Report*, at 124 (online at www.fanniemae.com/ir/pdf/earnings/2010/10k_2010.pdf) (accessed Apr. 10, 2012); Freddie Mac, *2010 10-K Report*, at 218 (online at www.freddiemac.com/investors/er/pdf/10k_022411.pdf) (accessed Apr. 10, 2012).

Derivatives

As the Enterprises accumulated investments in mortgages and MBS, they were exposed to significant risks affecting the value of their mortgage-related assets. Like many sophisticated investors, they entered into **derivatives** contracts. Such **hedging** activities are intended to manage or moderate the possible financial impact from these risk factors. Derivatives can function as a form of risk management such that when the value of the underlying asset declines, the value of the derivative contract rises and vice versa. Changes in the value of these derivatives holdings are generally expected to offset fluctuations in the value of the Enterprises' portfolios of mortgages and MBS. Thus, as MBS values have increased – and moderated the Enterprises' private-label MBS losses – the values of derivative contracts have declined.

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.

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

Other Losses

Losses attributable to the write down of low-income housing tax credits during the fourth quarter of 2009 are included in "Other Losses" shown in Figure 15. Because the Enterprises currently are not generating taxable income, the credits, which they had previously acquired, have no practical present value to them. Therefore, they sought Treasury's approval to sell their credits to entities that have net operating income and thus potential tax liability that the credits can offset. Treasury denied their requests. The write down of these credits for both Enterprises contributed $8 billion of the $16 billion loss.

Accounting Adjustments

The Enterprises make changes to their accounting policies when they are required to do so. This is usually driven by changes in GAAP, which the Enterprises observe. For example, in 2010 a change in GAAP required the Enterprises to report on their balance sheets the amount of mortgages outstanding that are included in MBS that they guaranteed. This resulted in a one-time $8 billion loss for the Enterprises, as shown in Figure 15 (see page 73).

Dividends to Treasury

Through the third quarter of 2011, the Enterprises have paid Treasury $32 billion in dividends. Of course, as discussed above, Treasury advanced the dividend payments to the Enterprises.

PUTTING THE LOSSES IN PERSPECTIVE: WINNERS AND LOSERS

As of the end of the last quarter prior to the conservatorships (i.e., June 30, 2008), the Enterprises had $1.6 trillion in short- and long-term outstanding debt; $3.7 trillion worth of MBS guarantees; and stockholders' equity of only $54 billion. With mounting losses and without Treasury funding, it is likely the Enterprises would have found themselves with insufficient funds to make scheduled debt payments and satisfy MBS guarantee obligations.

Losers: Stockholders

According to the PSPAs, no dividends can be paid to the Enterprises' **preferred** or **common shareholders** (with the exception of Treasury) without Treasury's approval or until Treasury is fully repaid. Additionally, Treasury received the right to purchase 80% of the Enterprises' stock for a nominal amount. Both of these measures rendered the Enterprises' common shares virtually worthless. For example, Fannie Mae's shares closed at $4.74 on the Friday before conservatorship. As recently as March 9, 2012, they traded for $0.32 per share on the Over-The-Counter Bulletin Board (Fannie Mae's and Freddie Mac's shares are no longer traded on the New York Stock Exchange); similarly, Freddie Mac's shares, which closed at $5.10 on the Friday before conservatorship, have fallen to $0.326 per share as of March 9, 2012. Other factors also have impaired the Enterprises' share prices. Their share prices had deteriorated substantially before the conservatorships, and, had the Enterprises been forced to liquidate, common shareholders would not have received a return on their investment until all creditors and senior classes of shareholders had been paid in full.[40]

In short, the PSPAs give priority in repayment to Treasury ahead of any other preferred or common shareholders. Thus, the preferred and common shareholders of Fannie Mae and Freddie Mac did not benefit by Treasury's actions. They effectively lost their investments.

Creditors vs. Shareholders:
Creditors, also called lenders, expect to earn interest that will be paid according to contractual terms.

Common shareholders are the owners of a company and can receive dividends if the company declares them.

Preferred shareholders cannot vote on shareholder matters, though they do receive preference over common shareholders if the company becomes insolvent and its assets are distributed.

Winners: Holders of Bonds and Guaranteed MBS

Treasury's investment effectively made explicit the federal government's implicit guarantee of the Enterprises' debt. Further, by placing the Enterprises in conservatorship and committing to making capital investments in them, FHFA and Treasury provided assurance that the Enterprises would, in turn, be able to make contractually required payments to future **creditors**.

Neither Enterprise publishes a comprehensive list of creditors. However, foreign central banks, commercial banks, fund managers, insurance companies, state and local governments, corporate pensions, individuals, and nonprofit foundations invested in the Enterprises' debt and guaranteed MBS. For example, in the year before the conservatorships, Fannie Mae sold bonds to the following categories of investors: foreign central banks (44%), fund managers (26%), commercial banks (17%), insurance companies (6%), state and local governments (4%), retail (2%), and corporate pensions (1%).[41]

More importantly, allowing the Enterprises to meet their debt and guarantee obligations enabled them to continue to support the secondary market. As the Congressional Research Service has noted:

> A failure or default by Fannie [Mae] or Freddie [Mac] would have severely disrupted financial markets around the world. If the [Enterprises'] portfolios of mortgage loans and MBS had to be liquidated, prices would plunge, the secondary market for mortgages would be decimated, and the supply of new mortgage credit might be severely restricted. These market disruptions would have negative impacts on the economy as a whole.[42]

Further, since September 2008, the private sector has almost entirely abandoned the secondary mortgage market, and the Enterprises and Ginnie Mae have stepped up to fill the void. In 2010, Enterprise and Ginnie Mae guaranteed MBS comprised 96% of newly issued MBS. Additionally, Treasury's intervention has provided assurance to future creditors and MBS investors that they, too, will get their money back if they transact business with the Enterprises.

OUTLOOK

From September 2008 through the end of 2011, Treasury invested $185 billion in the Enterprises. FHFA projects three scenarios for the future capital draws by both Fannie Mae and Freddie Mac through the end of calendar year 2014.[43]

Under these projections, the amount of the additional payments that Treasury would make to each Enterprise depends on the outlook for home prices – e.g., whether prices continue to fall, if so, by how much and for how long – and when and how strongly circumstances turn around so prices begin to increase. According to the most recent projections, which FHFA released in October 2011, additional taxpayer financing for the Enterprises ranges from $37 billion to as much as $128 billion through the end of 2014.[gg] In other words, total Treasury support for the Enterprises is currently expected to range from a low of $220 billion to a high of $311 billion.

[gg] However, the projections reported are not expected outcomes. They are modeled projections in response to "what if" scenarios involving assumptions about Enterprise operations, loan performance, macroeconomic and financial market conditions, and house prices. The projections do not define the full range of possible outcomes and actual outcomes may be very different. This effort should be interpreted as an analysis of the sensitivity of future Enterprise capital draws to possible house price paths.

FHFA provided the Enterprises with key assumptions for each scenario. The Enterprises used their respective internal models to project their financial results based on the assumptions provided by FHFA. While this effort achieves a degree of comparability between the Enterprises, it does not allow for actions that the Enterprises might undertake in response to the economic conditions specified in the scenarios. Those Enterprise-specific business changes could lead to results that differ from those presented in the projections.

APPENDICES

Appendix A: Glossary and Acronyms

GLOSSARY OF TERMS

Adjustable Rate Mortgages: Mortgages whose interest rate changes periodically and usually in relation to the change of another interest rate.

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

American Recovery and Reinvestment Act of 2009: Enacted in 2009, this legislation authorizes a series of measures intended to create jobs and promote investment and consumer spending.

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 (the Bankruptcy Code).

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.

Charge Off: An accounting term describing the elimination of an asset, such as a mortgage loan, from a company's books. It does not necessarily imply a reduction in the company's assets, depending on the allowance established for loan losses.

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

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.

Conventional Conforming Mortgage Loans: Mortgages that are not insured or guaranteed by the Federal Housing Administration, the

Department of Veterans Affairs, or the Department of Agriculture, and that meet the Enterprises' underwriting standards. Conforming mortgage loans have original balances below a specific threshold, set by law and published by FHFA, known as the "conforming loan limit." For 2012, the conforming loan limit is $417,000 for most areas of the contiguous United States, although generally it can increase to a maximum of $625,500 in specific higher cost areas.

Creditors vs. Shareholders: Creditors, also called lenders, expect to earn interest that will be paid according to contractual terms. Common shareholders are the owners of a company and can receive dividends if the company declares them. Preferred shareholders cannot vote on shareholder matters, though they do receive preference over common shareholders if the company becomes insolvent and its assets are distributed.

Debarment: Disqualification of a firm or an individual from contracting with the government or participating in government non-procurement transactions for a specific period of time. The grounds for debarment include conviction for fraud or similar offenses.

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

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.

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.

Expanded Approval: A mortgage option that gives borrowers with blemished credit access to high-quality, low-cost, non-predatory loans. Expanded approval provides different levels of approval recommendations for loans and is only available to lenders that have been specifically approved to deliver and service such mortgage loans.

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 Home Loan Mortgage Corporation: A federally chartered corporation that purchases residential mortgages, securitizes them, and sells them to investors; this provides lenders with funds that can be used to make loans to homebuyers.

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.

Federal National Mortgage Association: 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.

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

Generally Accepted Accounting Principles: A set of rules and conventions promulgated by national industry boards (in the United States, the Financial Accounting Standards Board) as standard accounting practice for that country.

Government National Mortgage Association: 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.

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

HAMP Tier 1: HAMP was designed to help financially struggling homeowners avoid foreclosure by modifying loans to a level that is affordable for borrowers now and sustainable over the long term. The initial modification under HAMP is referred to as Tier 1. This modification option is for a loan secured by a property that is the borrower's principal residence (owner-occupied). A borrower may receive only one modification under HAMP Tier 1. No mortgage loan may be modified more than once in either Tier 1 or Tier 2. If a borrower is not eligible under Tier 1, he or she can be evaluated under the HAMP extension referred to as Tier 2.

HAMP Tier 2: HAMP Tier 2 is an extension of HAMP Tier 1; both have been extended to the end of 2013. HAMP Tier 2 expands the population of eligible homeowners, utilizing additional evaluation criteria and extra incentives to servicers. Tier 2 includes owners who may have defaulted under Tier 1, borrowers for mortgages secured by a rental property (not occupied by the owner), and an array of other struggling homeowners. A borrower is eligible to receive up to a total of three modifications of three different mortgages under Tier 2, and servicers are eligible for payment reduction cost share incentives.

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

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

Impairment of Securities Considered Other than Temporary: Impairment of a security occurs when the fair value of the security is less than the amortized cost basis (i.e., whenever a security has an unrealized loss). If the impairment is judged to be other than temporary, the individual security must be written down to fair value. As currently defined under Generally Accepted Accounting Principles, the fair value of an asset is the amount at which that asset could be bought or sold in an orderly transaction between willing parties.

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.

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 one or more of them – would be required to step in and cover that debt.

Lien: The lender's right to have a specific piece of the debtor's property sold if the debt is not repaid. With respect to residential mortgages, the noteholder retains a lien on the house (as evidenced by the mortgage or deed of trust) until the loan is repaid.

Losses on Derivative Agreements: 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 using derivative agreements. In contrast with the Generally Accepted Accounting Principles treatment for many conventional instruments, such as loans, the Enterprises' derivative investments may sustain reported losses from interest rate driven variations in their current fair value.

Mortgage Guarantees: Historically, the Enterprises purchased mortgages and securitized them while providing a guarantee to investors that if the mortgagor defaulted, the Enterprise would make timely principal and interest payments to the securitization trust, which in turn would make payments to the security holder.

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.

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

Payment Option ARMs: A special type of ARM, which enables the borrower to choose among various monthly payment levels.

Personally Identifiable Information: Information that can be used to identify an individual, such as name, date of birth, social security number, or address.

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.

Primary Mortgage Market: The market for newly originated mortgages.

Principal Forbearance: A period of time during which the borrower pays interest, but does not make payments towards his or her mortgage's principal balance.

Principal Reduction: A write down or forgiveness of a borrower's principal balance, in part or whole.

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.

Provision for Loan and Guarantee Losses: An accounting concept that refers to the reduction of current income to establish a reserve fund for mortgage losses.

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.

Reserve for Guarantee Losses: An accounting phrase meaning a reserve fund on the balance sheet that is created in anticipation of future losses on loans guaranteed by the Enterprises. It has the effect of reducing income in the current period.

Secondary Mortgage Market: The market for buying and selling existing mortgages; this could be in the form of whole mortgage or MBS sales. Both the primary and secondary mortgage markets are over-the-counter markets – there is no central exchange. Rather, loans are bought and sold through personal and institutional networks.

Securities Act of 1933: Often referred to as the "truth in securities" law, it has two basic objectives: (1) require that investors receive financial and other significant information concerning securities being offered for public sale and (2) prohibit deceit, misrepresentation, and other security sales fraud.

Securities Exchange Act of 1934: With this law, Congress created the SEC with broad authority over all aspects of the securities industry, including the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (e.g., the stock exchanges and the National Association of Securities Dealers). The law also prohibits certain types of market conduct such as material misrepresentations and insider trading, and provides the SEC with disciplinary powers over regulated entities and associated persons. The law also empowers the SEC to require periodic reporting of information by companies with publicly traded securities.

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.

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 Treasury concerning a variety of significant business activities, capital stock issuance, dividend payments, ending the conservatorships, transferring assets, and awarding executive compensation.

Seriously Delinquent Loan: A loan that has been in default for at least 90 days.

Servicer: 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.

Subprime Mortgages: Mortgages given to less than creditworthy borrowers, typically with a credit score of less than 620.

Suspension: The temporary disqualification of a firm or individual from contracting with the government or participating in government programs, pending the outcome of an investigation, an indictment, or based upon adequate evidence that supports claims of program violations. A suspension means that an individual or entity is immediately excluded from participating in further federal executive branch procurement and non-procurement programs. Suspension frequently leads to debarment.

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).

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ACRONYMS AND ABBREVIATIONS

Agency- Federal Housing Finance Agency

Alt-A- Alternative A

ARM- Adjustable Rate Mortgages

Blue Book- Quality Standards for Inspection and Evaluation

CEO- Chief Executive Officer

CFPB- Consumer Financial Protection Bureau

CIGIE- Council of the Inspectors General on Integrity and Efficiency

Convention- Mortgage Bankers Association Convention and Exposition

DER- Division of Enterprise Regulation

DOJ- United States Department of Justice

EESA- Emergency Economic Stabilization Act

Enterprises- Fannie Mae and Freddie Mac

EO- Executive Office

Fannie Mae- Federal National Mortgage Association

FBI- Federal Bureau of Investigation

FDIC-OIG- Federal Deposit Insurance Corporation Office of Inspector General

FFETF- Financial Fraud Enforcement Task Force

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

FOIA- Freedom of Information Act

Freddie Mac- Federal Home Loan Mortgage Corporation

GAAP- Generally Accepted Accounting Principles

GAO- United States Government Accountability Office

Ginnie Mae- Government National Mortgage Association

GSEs- Government-Sponsored Enterprises

HAMP- Home Affordable Modification Program

HARP- Home Affordable Refinance Program

HERA- Housing and Economic Recovery Act of 2008

HUD- United States Department of Housing and Urban Development

HUD-OIG- United States Department of Housing and Urban Development Office of Inspector General

IPERA- Improper Payments Elimination and Recovery Act of 2010

IPIA- Improper Payments Information Act of 2002

IRS- Internal Revenue Service

LTV- Loan-to-Value

MBS- Mortgage-Backed Securities

MWLD- Mortgage Warehouse Lending Division

OA- Office of Audits

OAd- Office of Administration

OC- Office of Counsel

Ocala- Ocala Funding LLC

OE- Office of Evaluations

OFHEO- Office of Federal Housing Enterprise Oversight

OI- Office of Investigations

OIG- Federal Housing Finance Agency Office of Inspector General

OMB- Office of Management and Budget

OPOR- Office of Policy, Oversight, and Review

PII- Personally Identifiable Information

PSPAs- Senior Preferred Stock Purchase Agreements

REO- Real Estate Owned

Revised Delegations- Revised Conservatorship Delegations/ Operating Protocol for Delegations

RMBS- Residential Mortgage-Backed Securities

SEC- Securities and Exchange Commission

SIGTARP- Office of the Special Inspector General for the Troubled Asset Relief Program

SORN- System of Records Notice

TBW- Taylor, Bean & Whitaker Mortgage Corporation

Treasury- United States Department of the Treasury

ULDD- Uniform Loan Delivery Dataset

UMDP- Uniform Mortgage Data Program

USDA- United States Department of Agriculture

VA- United States Department of Veterans Affairs

Yellow Book- Government Auditing Standards

Appendix B: Information Required by the Inspector General Act

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 its 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 OIG must include in its semiannual reports. These categories include, among other things, "a summary of each audit report … issued before the commencement of the reporting period for which no management decision has been" rendered (Section 5(a)(10)), and "a description and explanation of the reasons for any significant revised management decision made during the reporting period" (Section 5(a)(11)).

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.

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.	5-6 34-43 102-106
Section 5(a)(2)- A description of the recommendations for corrective action made by OIG with respect to significant problems, abuses, or deficiencies.	34-43 57-62
Section 5(a)(3)- An identification of each significant recommendation described in previous semiannual reports on which corrective action has not been completed.	57-62
Section 5(a)(4)- A summary of matters referred to prosecutive authorities and the prosecutions and convictions that have resulted.	43-46
Section 5(a)(5)- A summary of each report made to the Director of FHFA.	34-43
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.	34-43
Section 5(a)(7)- A summary of each particularly significant report.	34-43
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.	98
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.	98
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.	99
Section 5(a)(11)- A description and explanation of the reasons for any significant revised management decision made during the reporting period.	99

Source/Requirement	Pages
Section 5(a)(12)- Information concerning any significant management decision with which the Inspector General is in disagreement.	99
Section 5(a)(13)- The information described under section 05(b) of the Federal Financial Management Improvement Act of 1996.	99

The paragraphs below address the status of OIG's compliance with Sections 5(a)(8), (9), (10), (11), (12), and (13) of the Inspector General Act.

AUDIT AND EVALUATION REPORTS WITH QUESTIONED AND UNSUPPORTED COSTS

During this semiannual period, OIG has released eight reports:

- FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac (WPR-2012-001, March 28, 2012)
- Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Annual Convention and Exposition (ESR-2012-004, March 22, 2012)
- FHFA's Oversight of the Enterprises' Charitable Activities (ESR-2012-003, March 22, 2012)
- Evaluation of FHFA's Management of Legal Fees for Indemnified Executives (EVL-2012-002, February 22, 2012)
- FHFA's Oversight of Troubled Federal Home Loan Banks (EVL-2012-001, January 11, 2012)
- FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards (AUD-2012-003, March 22, 2012)
- FHFA's Controls to Detect and Prevent Improper Payments (AUD-2012-002, March 9, 2012)
- FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors (AUD-2012-001, March 7, 2012)

These reports evaluated and audited certain aspects of the Agency's operations and its compliance with certain federal requirements. These reports do not include dollar values for questioned and unsupported costs.

AUDIT AND EVALUATION REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE BY MANAGEMENT

FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors (AUD-2012-001, March 7, 2012) contains recommendations that funds be put to better use by management. OIG is in the process of calculating the precise amount of these funds.

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 the beginning of the reporting period that are awaiting 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 March 31, 2012, 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 2011, 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 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 34 through 43.

Appendix C: OIG Reports

See www.fhfaoig.gov for complete copies of OIG's reports.

EVALUATION REPORTS

Fannie Mae's and Freddie Mac's Participation in the 2011 Mortgage Bankers Association Annual Convention and Exposition (ESR-2012-004, March 22, 2012).

FHFA's Oversight of the Enterprises' Charitable Activities (ESR-2012-003, March 22, 2012).

Evaluation of FHFA's Management of Legal Fees for Indemnified Executives (EVL-2012-002, February 22, 2012).

FHFA's Oversight of Troubled Federal Home Loan Banks (EVL-2012-001, January 11, 2012).

AUDIT REPORTS

FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards (AUD-2012-003, March 22, 2012).

FHFA's Controls to Detect and Prevent Improper Payments (AUD-2012-002, March 9, 2012).

FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors (AUD-2012-001, March 7, 2012).

OTHER REPORTS

FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac (WPR-2012-001, March 28, 2012).

Appendix D: Trends Identified by OIG Reports[hh]

OIG reports have identified a variety of deficiencies in FHFA's operations that reflect two significant and related themes. First, FHFA often relied on the Enterprises' determinations without independently testing and validating them, thereby giving undue deference to Enterprise decision making. Second, FHFA was not proactive in its oversight and enforcement efforts. As detailed below, both themes have emerged in multiple reports. Further, FHFA may not have enough examiners to meet its regulatory and conservatory oversight responsibilities.

FHFA'S LACK OF INDEPENDENT TESTING AND VALIDATION OF ENTERPRISE DECISION MAKING

Six OIG reports reflect that a side effect of FHFA's delegation of most business decisions to the Enterprises is that the Agency's oversight is not proactive and often relies on the Enterprises' review and corporate governance processes. However, OIG believes that some matters are sufficiently important to warrant greater involvement and scrutiny by the Agency.

Deferral to Freddie Mac's Analysis of Repurchase Claim Exposure

At the end of 2010, FHFA approved a $1.35 billion settlement of mortgage repurchase claims that Freddie Mac asserted against Bank of America. In approving the settlement, FHFA relied on Freddie Mac's analysis of the settlement without testing the assumptions underlying the Enterprise's existing loan review process. An OIG report found that FHFA did not act timely or test concerns about limitations in Freddie Mac's existing loan review process for mortgage repurchase claims raised by an FHFA senior examiner months prior to the settlement.[ii] The senior examiner was concerned the loan review process Freddie Mac used for repurchase claims failed to account adequately for changes in foreclosure patterns among loans originated during the housing boom. According to the senior examiner, this could potentially cost the Enterprise a considerable amount of money. Freddie Mac's internal auditors independently identified concerns about the process and, in June 2011, recommended that the issue be studied further. Following the release of OIG's report, FHFA suspended future Enterprise mortgage repurchase settlements premised on the Freddie Mac loan review process and set in motion activities to test the assumptions underlying the loan review process.

Limited Oversight of the Enterprises' Administration of HAMP

In early 2009, the Enterprises began participating in HAMP, which involves servicers agreeing to modify mortgages for borrowers facing default or foreclosure. The Enterprises entered into five-year agreements with Treasury

[hh] Appendix D is derived from *FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac*, please see www.fhfaoig.gov/Content/Files/WPR-2012-001.pdf.

[ii] For OIG's *Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America*, please see www.fhfaoig.gov/Content/Files/EVL-2011-006.pdf.

to manage the program and oversee participants' compliance with program requirements. An OIG report found that FHFA largely removed itself from overseeing the negotiations of the agreements and did not engage in any substantive review to evaluate the agreements' feasibility and risks or the Enterprises' suitability to serve as Treasury's financial agents. This lack of engagement may have contributed to the agreements' omission of significant details concerning payments to the Enterprises, the scope of their responsibilities, and processes to resolve differences. As a consequence of the omissions, significant problems developed in these areas almost from the beginning, requiring FHFA and the Enterprises to devote substantial time and resources to resolve ambiguities.[jj]

Incomplete Analysis of Executive Compensation at Fannie Mae and Freddie Mac

For 2009 and 2010, the Enterprises awarded their top six officers over $35 million in compensation. FHFA reviewed and approved these compensation awards based on the Enterprises' determinations and recommendations. However, an OIG report found that FHFA did not test or validate the means by which the Enterprises calculated their recommended compensation levels and did not consider factors that might have resulted in reduced executive compensation costs.[kk]

Insufficient Transaction Testing

Transaction testing is the method employed by financial institution examiners to arrive at independent impressions about the financial and operational conditions of an institution (e.g., mortgage company, bank, etc.) as well as its compliance with applicable laws and regulations. An example of transaction testing would be reviewing a regulated entity's loan files to test the veracity of statements concerning loan underwriting and performance. During an evaluation of FHFA's capacity to examine the GSEs, a senior FHFA manager acknowledged to OIG that examiners too often accept assertions made by Enterprise managers rather than validate such assertions through appropriate transaction testing.[ll] This may be related to FHFA having too few examiners to ensure the efficiency and effectiveness of its examination program. As illustrated below, this is also indicative of the second emerging trend: that the Agency was not proactive in its oversight and enforcement efforts.

Limited Oversight of Legal Expenditures

Between 2004 and October 31, 2011, Fannie Mae paid out $99.4 million in legal expenses for the defense of lawsuits, investigations, and administrative actions against three former senior executives. The Enterprise also paid considerable addition sums for other executives. Additionally, Freddie Mac has paid $10.2 million in legal defense costs for former senior executives since its conservatorship began. To their credit, Fannie Mae and Freddie

[jj] For OIG's *Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program*, please see www.fhfaoig.gov/Content/Files/EVL-2011-003.pdf.

[kk] For OIG's *Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*, please see www.fhfaoig.gov/Content/Files/Exec%20Comp%20DrRpt%2003302011%20final,%20signed.pdf.

[ll] For OIG's *Evaluation of Whether FHFA has Sufficient Capacity to Examine the GSEs*, please see www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf.

Mac have taken steps to manage costs associated with lawsuits against their indemnification-eligible directors and officers. However, an OIG report found that – despite the Enterprises' large outlays for legal expenses – the Agency has never independently validated the Enterprises' processes for determining the reasonableness or the validity of the legal services provided on behalf of their executives or the bills presented for such services.[mm]

Insufficient Allocation of Resources to Processing Consumer Complaints

In 2011, OIG conducted an audit of the Agency's consumer complaints process and concluded that FHFA's oversight of the receipt, processing, and disposition of consumer complaints of fraud, waste, and abuse (including foreclosure abuses) was inadequate.[nn] The Agency had failed to prioritize consumer complaints, and this had consequences. For example, FHFA did not identify complaints requiring resolution in advance of time-sensitive events like foreclosure or other legal proceedings. Consequently, borrowers might not have received help in time. The lack of prioritization and process also cost FHFA the opportunity to perform routine substantive analyses to identify trends and potential risk areas. Such information could have served as an early warning system for emerging problems, such as the foreclosure document controversy. Finally, the failure to focus on consumer complaints meant the Agency missed important fraud allegations. For example, in June 2008, serious allegations of fraud involving TBW were reported to OFHEO; yet, OFHEO, and subsequently FHFA, did not provide adequate follow up on the allegations. TBW turned out to be a $2.9 billion mortgage fraud case, one of the largest in history, and involved significant losses to Freddie Mac. Freddie Mac's losses may have been less had the 2008 fraud allegation received prompt attention.

FHFA WAS NOT PROACTIVE IN OVERSIGHT AND ENFORCEMENT

As illustrated by multiple reports described below, OIG has identified instances in which FHFA was not proactive in its oversight and enforcement. Accordingly, within its regulatory functions, the Agency faces challenges in its ability to identify new and emerging risks potentially impacting the GSEs; establish guidelines and policies governing Enterprise oversight; and provide strong, consistent enforcement for violations of policy.

FHFA Did Not Identify Emerging Risks that Could Impact the GSEs

OIG's work has raised concerns about the Agency's ability to identify and act on early indicators of risk.

For example, there were indicators as early as 2006 that could have led FHFA (and its predecessor) to appreciate the heightened risk posed by

[mm] For OIG's *Evaluation of FHFA's Management of Legal Fees for Indemnified Executives*, please see www.fhfaoig.gov/Content/Files/EVL-2012-002.pdf.

[nn] For OIG's *Audit of the Federal Housing Finance Agency's Consumer Complaints Process*, please see www.fhfaoig.gov/Content/Files/AUD-2011-001.pdf.

foreclosure processing abuses within Fannie Mae's default-related legal services network.[oo] Indicators such as a significant increase in foreclosures accompanying the deterioration of the housing market, consumer complaints alleging improper foreclosures, contemporaneous media reports of foreclosure abuses, and public court filings in Florida and elsewhere highlighting such abuses should have triggered careful assessment and action by FHFA. Notwithstanding these indicators, FHFA did not devote added attention to this issue until August 2010.

A recent OIG report on mortgage servicing identified another instance in which the Agency missed opportunities to identify risks.[pp] As of June 30, 2011, Freddie Mac had a mortgage servicing portfolio containing approximately 12 million mortgages with an unpaid principal balance of nearly $1.8 trillion. When the Enterprises purchase mortgages, they enter into contracts with mortgage servicers to collect mortgage payments, set aside taxes and insurance premiums in escrow, forward interest and principal payments to the contractually designated party, and respond to payment defaults. As early as 2008, FHFA had information indicating that mortgage servicing represented a heightened risk to the Enterprises. Specifically, through its off-site monitoring activities, FHFA noted a substantial increase in the number of the Enterprises' delinquent loans starting in 2008. In early 2009, FHFA became aware of servicers' poor performance and weaknesses in Freddie Mac's oversight of its servicers. Yet, FHFA did not take timely or appropriate action to address these indicators. Even now, FHFA has not clearly defined its role regarding servicers or sufficiently coordinated with federal banking regulators about risks and supervisory concerns with individual servicers.

FHFA Has Not Always Established Guidelines and Policies Governing Enterprise Oversight

Even when FHFA has identified risks, the Agency has not always managed those risks by establishing sufficient regulations or guidance. For example, the recent servicing report found that FHFA has not developed sufficient regulations or guidance governing the Enterprises' oversight and risk management of servicers.[qq] Specifically, FHFA has not established and implemented effective Enterprise regulations or guidance controlling the reporting of critical servicer information and establishing baseline requirements for mortgage servicing. Instead, FHFA relies on the Enterprises to individually monitor counterparty risk as part of their ongoing risk management activities.

Similarly, as described in OIG's recent report on default-related legal services, FHFA has not developed sufficient regulations or guidance governing the Enterprises' oversight and risk management of default-related legal services. In its report, OIG found that FHFA has neither an ongoing risk-based supervisory plan detailing examination and continuous supervision of default-related legal services, nor finalized examination guidance and procedures for use in performing targeted examinations and monitoring of such services.[rr] Moreover, FHFA does not have a formal process to address

[oo] For OIG's audit of *FHFA's Oversight of Fannie Mae's Default-Related Legal Services*, please see www.fhfaoig.gov/Content/Files/AUD-2011-004.pdf.

[pp] For OIG's audit of *FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors*, please see www.fhfaoig.gov/Content/Files/AUD%202012-001.pdf.

[qq] For OIG's audit of *FHFA's Supervision of Freddie Mac's Controls over Mortgage Servicing Contractors*, please see www.fhfaoig.gov/Content/Files/AUD%202012-001.pdf.

[rr] For OIG's audit of *FHFA's Oversight of Fannie Mae's Default-Related Legal Services*, please see www.fhfaoig.gov/Content/Files/AUD-2011-004.pdf.

performance problems associated with law firms that have relationships – either through direct contract or through its loan servicers – with both of the Enterprises.

FHFA Has Not Consistently Enforced Directives for Violations of Policy

Even in instances in which FHFA has identified risks and taken steps to manage those risks, the Agency has not been consistent in enforcing its directives to ensure that the risks are, in fact, adequately addressed. As Fannie Mae's conservator and regulator, FHFA's authority over the Enterprise is broad and includes the ability to discipline or remove Enterprise personnel to ensure compliance with Agency mandates. However, an OIG report found that FHFA has not exercised this or other authorities to compel Fannie Mae's compliance with the requirement to have an effective operational risk management program.[ss] Fannie Mae's lack of an acceptable and effective operational risk management program may have resulted in missed opportunities to strengthen oversight of law firms with which it contracts to process foreclosures.

Further, FHFA's insufficient enforcement is not limited to the Enterprises. Since at least 2008, four FHLBanks have faced significant financial and operational difficulties, primarily due to their investments in certain high-risk mortgage securities. FHFA has oversight responsibility for the FHLBanks and recognizes the need to ensure that they do not abuse their GSE status and engage in imprudent activities. Yet, an OIG report found that FHFA has not established a consistent and transparent written enforcement policy for the FHLBanks classified as having the most "supervisory concerns" within the FHLBank system.[tt] This has contributed to instances in which FHFA has not acted to proactively hold FHLBanks classified as "supervisory concerns" and their officers sufficiently accountable for engaging in questionable risk taking.

FHFA MAY NOT HAVE ENOUGH EXAMINERS TO MEET ITS OVERSIGHT RESPONSIBILITIES

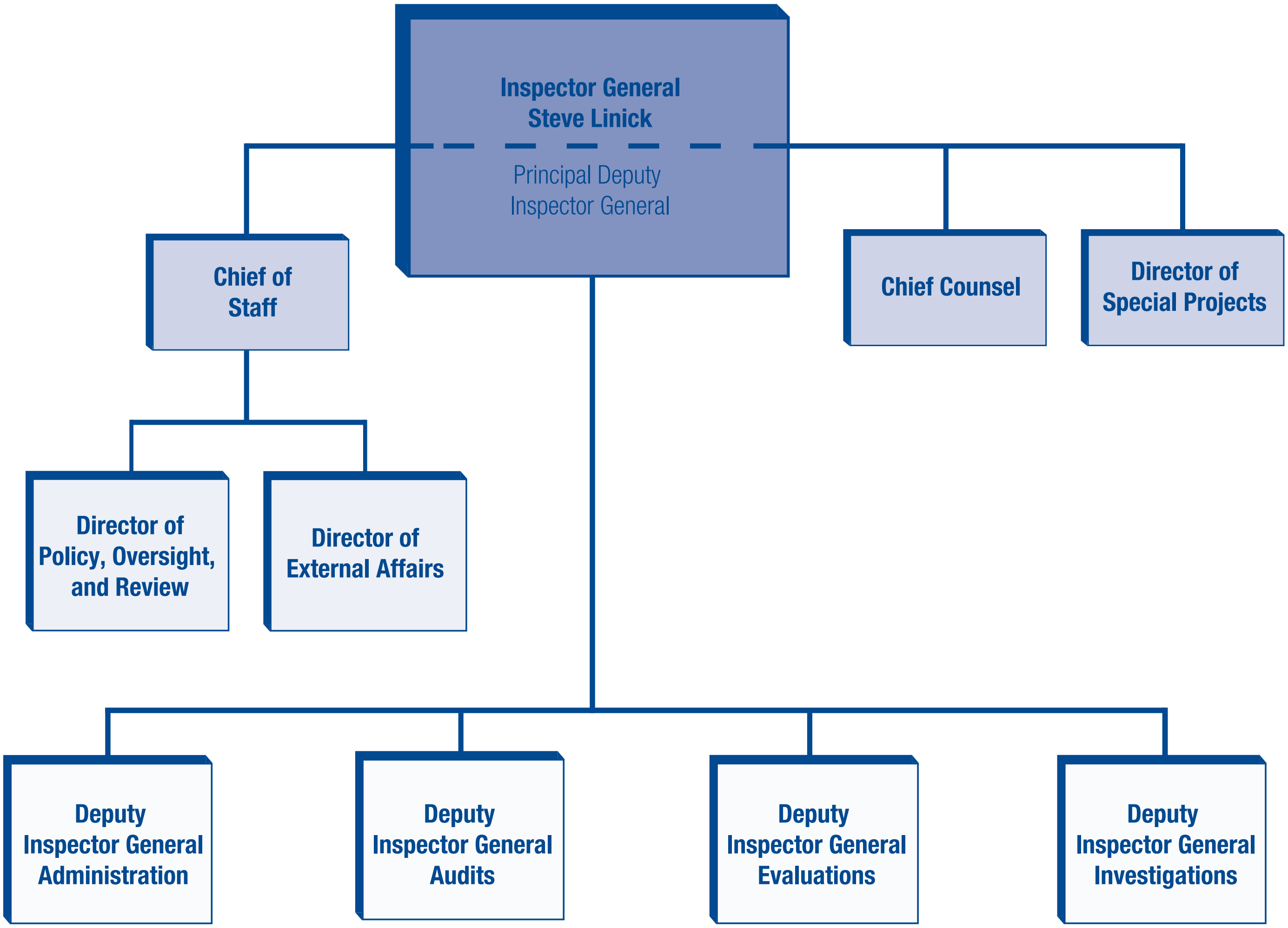
FHFA has critical regulatory responsibilities with respect to the GSEs and conservator responsibilities regarding the Enterprises. To satisfy these responsibilities, Congress provided FHFA significant budget and hiring authority. Nonetheless, an OIG report noted that the Agency has too few examiners to ensure the efficiency and effectiveness of its GSE oversight program; due to examiner shortages, FHFA has scaled back planned work during examinations, and examinations have often taken much longer than expected to complete.[uu] Additionally, OIG has identified shortfalls in the Agency's examination coverage, particularly in the crucial area of REO. These limitations stem from insufficient examination capacity and make FHFA's early identification of possible risks more challenging.

[ss] For OIG's *Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk*, please see www.fhfaoig.gov/Content/Files/EVL-2011-004.pdf.

[tt] For OIG's evaluation of *FHFA's Oversight of Troubled Federal Home Loan Banks*, please see www.fhfaoig.gov/Content/Files/Troubled%20Banks%20EVL-2012-001.pdf.

[uu] For OIG's *Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs*, please see www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf.

Appendix E: OIG Organizational Chart



Appendix F: Enterprises' Performance Metrics

Figure 19. The Enterprises' Earnings and Profitability for the Year Ended December 31, 2011 ($ millions)

Earnings and Profitability	Fannie Mae	Freddie Mac
Mortgage Loans	$ 138,462	$ 86,282
Investment Securities	4,247	12,791
Other Interest Earning Assets	234	67
Interest Expense on Debt Obligations	(123,662)	(80,743)
Net Interest Income	19,281	18,397
Provision for Credit Losses	(27,498)	(11,287)
Derivative Gains (Losses)	(6,562)[a]	(9,752)
Losses on the other than Temporary Impairment of Securities	(308)	(2,301)
Administrative Expenses	(2,370)	(1,506)
Other, Net	602	1,183
Net Loss from Operations	**$ (16,855)**	**$ (5,266)**

Sources: Fannie Mae, *2011 10-K Report*, at 92, 93 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10k_2011.pdf) (accessed Mar. 5, 2012); Freddie Mac, *2011 10-K Report*, at 85, 86 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 21, 2012).

Note:
[a] Loss on Derivatives referenced to Table 10, p. 96 in the Fannie Mae 2011 10-K Report.

Figure 20. The Enterprises' Single-Family REO Activity Summary for the Year Ended December 31, 2011 (number of properties)

REO Activity	Fannie Mae	Freddie Mac
Beginning Balance	162,489	72,093
Total Acquisitions	199,696	98,656
Total Dispositions	(243,657)	(110,194)
Ending Inventory	**118,528**	**60,555**

Sources: Fannie Mae, *2011 10-K Report*, at 168 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10k_2011.pdf) (accessed Mar. 5, 2012); Freddie Mac, *2011 10-K Report*, at 167 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 21, 2012).

Appendix G: Endnotes

1. Federal Housing Finance Agency, *FHFA, Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers* (Oct. 24, 2011) (online at www.fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf).

2. Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, § 1117.

3. HERA at § 1145.

4. Federal Housing Finance Agency, *Statement of Director James B. Lockhart*, at 12 (July 30, 2009) (online at www.fhfa.gov/webfiles/14715/FHFA1stAnnSpeechandPPT73009.pdf).

5. Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343, § 110.

6. Government Accountability Office, *Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, at 3 (Sept. 2009) (GAO/09-782) (online at www.gao.gov/new.items/d09782.pdf).

7. United States Department of the Treasury, Written Testimony by Secretary of the Treasury Timothy F. Geithner Before the Senate Committee on Banking, Housing & Urban Affairs (Mar. 15, 2011) (online at www.treasury.gov/press-center/press-releases/Pages/tg1103.aspx).

8. Federal Housing Finance Agency, *FHFA Updates Projections of Potential Draws for Fannie Mae and Freddie Mac* (Oct. 27, 2011) (online at www.fhfa.gov/webfiles/22737/GSEProjf.pdf).

9. Federal Housing Finance Agency, *Data as of April 4, 2012 on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities*, at Tables 3-5 (online at www.fhfa.gov/webfiles/23873/TSYSupport%20 2012-04-04.pdf) (accessed Apr. 16, 2012).

10. Federal Housing Finance Agency, *The FHLBank System* (online at www.fhfa.gov/Default.aspx?Page=22) (accessed Apr. 21, 2012).

11. FHLBanks Office of Finance, *History of Service* (online at www.fhlb-of.com/ofweb_userWeb/pageBuilder/mission--history-29) (accessed Apr. 21, 2012).

12. *Id.*; FHLBanks, *Frequently Asked Questions: Federal Home Loan Bank Advances* (online at www.fhlbanks.com/overview_faqs_advances.htm) (accessed Apr. 21, 2012).

13. FHLBanks Office of Finance, *Funding* (online at www.fhlb-of.com//ofweb_userWeb/pageBuilder/funding-30) (accessed Apr. 21, 2012);

FHLBanks, *Frequently Asked Questions: Federal Home Loan Bank Advances* (online at www.fhlbanks.com/overview_faqs_advances.htm) (accessed Apr. 21, 2012).

14. Federal Housing Finance Agency, *FHFA Announces New Conservatorship Scorecard for Fannie Mae and Freddie Mac; Reduces Executive Compensation* (Mar. 9, 2012) (online at www.fhfa.gov/webfiles/23438/ExecComp3912F.pdf).

15. Federal Housing Finance Agency, *FHFA Announces Pilot REO Property Sales in Hardest-Hit Areas* (Feb. 27, 2012) (online at www.fhfa.gov/webfiles/23403/REOPR22712F.pdf).

16. Federal Housing Finance Agency, *FHFA Announces Interested Investors May Pre-Qualify For REO Initiative* (Feb. 1, 2012) (online at www.fhfa.gov/webfiles/23196/REO2112F.pdf).

17. Federal Housing Finance Agency, *FHFA Sends Congress Strategic Plan for Fannie Mae and Freddie Mac Conservatorships* (Feb. 21, 2012) (online at www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf); Federal Housing Finance Agency, *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending* (Feb. 21, 2012) (online at www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf).

18. Department of Justice, *Federal Government and State Attorneys General Reach $25 Billion Agreement with Five Largest Mortgage Servicers to Address Mortgage Loan Servicing and Foreclosure Abuses* (Feb. 9, 2012) (online at www.justice.gov/opa/pr/2012/February/12-ag-186.html).

19. The White House, *Fact Sheet: President Obama's Plan to Help Responsible Homeowners and Heal the Housing Market, Expanding HAMP Eligibility to Reduce Additional Foreclosures and Help Stabilize Neighborhoods* (Feb. 1, 2012) (online at www.whitehouse.gov/the-press-office/2012/02/01/fact-sheet-president-obama-s-plan-help-responsible-homeowners-and-heal-h).

20. Federal Housing Finance Agency, *Statement of FHFA Acting Director Edward J. DeMarco on the Announced Changes to HAMP* (Jan. 27, 2012) (online at www.fhfa.gov/webfiles/23110/FHFAStmtHampChanges12712F.pdf).

21. Letter from Edward J. DeMarco, Acting Director, FHFA, to Elijah E. Cummings, Ranking Member, Committee on Oversight and Government Reform (Jan. 20, 2012) (online at www.fhfa.gov/webfiles/23056/PrincipalForgivenessltr12312.pdf); Federal Housing Finance Agency, *FHFA Releases Analysis on Principal Forgiveness As Loss Mitigation Tool* (Jan. 23, 2012) (online at www.fhfa.gov/webfiles/23057/FHFAltrPrincipalForgiveness12312F.pdf).

22. Fannie Mae, *Fannie Mae Chief Executive Will Step Down Pending Appointment of a Successor* (Jan. 10, 2012) (online at www.fanniemae.com/portal/about-us/media/corporate-news/2012/5607.html).

23. Federal Housing Finance Agency, *FHFA Announces Freddie Mac Board and Management Changes* (Oct. 26, 2011) (online at www.fhfa.gov/webfiles/22735/FRECH102611.pdf).

24. U.S. Securities and Exchange Commission, *SEC Charges Former Fannie Mae and Freddie Mac Executives With Securities Fraud* (Dec. 16, 2011) (online at www.sec.gov/news/press/2011/2011-267.htm).

25. Federal Housing Finance Agency, *Fannie Mae and Freddie Mac Launch Joint Effort to Improve Loan and Appraisal Data Collection New Program to Boost Risk Management Capabilities* (May 24, 2010) (online at www.fhfa.gov/webfiles/15748/Uniform_Mortgage_Data_Program.pdf).

26. Freddie Mac, *Uniform Loan Delivery Dataset* (Dec. 14, 2011) (online at www.freddiemac.com/sell/secmktg/uniform_delivery.html).

27. Federal Housing Finance Agency, *FHFA Announces New Timeline for Fannie Mae and Freddie Mac Mortgage Data Implementation* (Dec. 14, 2011) (online at www.fhfa.gov/webfiles/22833/MortData121411F.pdf).

28. Federal Housing Finance Agency, *FHFA Sues the City of Chicago Over Vacant Buildings Ordinance* (Dec. 12, 2011) (online at www.fhfa.gov/webfiles/22832/Chicago_Lawsuit_121211.pdf).

29. Federal Housing Finance Agency, *FHFA*, *Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers* (Oct. 24, 2011) (online at www.fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf).

30. Federal Housing Finance Agency, *Conservator's Report on the Enterprises' Financial Performance Third Quarter 2011*, at 9 (online at www.fhfa.gov/webfiles/22855/Conservator'sReport3Q2011F122111F.pdf) (accessed Apr. 16, 2012). This is a comprehensive income figure (upon which Treasury investments are calculated); net income figures reported by the Enterprises may differ.

31. Federal Housing Finance Agency, *FHFA Report to Congress 2010*, at 114, 131 (online at www.fhfa.gov/webfiles/21570/FHFA2010RepToCongress61311.pdf) (accessed Feb. 29, 2012).

32. Federal Housing Finance Agency, *Statement of FHFA Director James B. Lockhart* (Sept. 7, 2008) (online at www.treasury.gov/press-center/press-releases/Documents/fhfa_statement_090708hp1128.pdf).

33. U.S. Department of the Treasury, *Statement by Secretary Henry M. Paulson, Jr.* (Sept. 7, 2008) (online at www.treasury.gov/press-center/press-releases/Pages/hp1129.aspx).

34. Federal Housing Finance Agency, *Mortgage Market Note U.S. Treasury Support for Fannie Mae and Freddie Mac*, at 3 (Jan. 20, 2010) (online at www.fhfa.gov/webfiles/15362/MMNote_10-1_revision_of_MMN_09-1A_01192010.pdf).

35. *Id.*

36. Federal Housing Finance Agency, *Data as of January 2, 2012 on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities*, at Table 2 (online at www.fhfa.gov/webfiles/23193/TSYSupport1312012.pdf) (accessed Apr. 11, 2012); Freddie Mac, *2011 10-K Report*, at 127 (online at www.freddiemac.com/investors/er/pdf/10k_030912.pdf) (accessed Apr. 11, 2012); Fannie Mae, *2011 10-K Report*, at 9 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10k_2011.pdf) (accessed Apr. 11, 2012).

37. Fannie Mae, *2008 10-K Report*, at 170 (online at www.fanniemae.com/ir/pdf/earnings/2008/form10k_022609.pdf) (accessed Mar. 12, 2012); Freddie Mac, *2008 10-K Report*, at 127 (online at www.freddiemac.com/investors/er/pdf/10k_031109.pdf) (accessed Mar. 29, 2012).

38. Freddie Mac, *2010 10-K Report*, at 96 (online at www.freddiemac.com/investors/er/pdf/10k_022411.pdf) (accessed Feb. 29, 2012).

39. *Id.*

40. 12 U.S.C. § 4617(c).

41. Fannie Mae, *Review of Funding Activities for 2009*, at 2 (Dec. 2009) (online at www.fanniemae.com/resources/file/debt/pdf/fundingnotes/fundingnotes_12_09.pdf).

42. Congressional Research Service, *Fannie Mae and Freddie Mac in Conservatorship*, at 4 (Sept. 15, 2008) (online at http://fpc.state.gov/documents/organization/110097.pdf).

43. Federal Housing Finance Agency, *FHFA Releases Projections Showing Range of Potential Draws for Fannie Mae and Freddie Mac* (Oct. 21, 2010) (online at www.fhfa.gov/webfiles/19409/Projections_102110.pdf). For this purpose, FHFA used three house price path projections with a "current baseline" in which the decline in house prices hits bottom in the first quarter of 2012 and then prices rise by 15% through the end of 2014; a second scenario in which near-term growth is stronger but prices end up at the same level as the baseline by the end of 2014; and a "deeper second recession" projection in which house prices bottom out in mid-2012 and then rise by 23% by mid-2015 (dates and figures are approximate).

Federal Housing Finance Agency
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