Federal Housing Finance Agency
Office of Inspector General

People Risk at FHFA's Regulated Entities

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Executive Summary

To accomplish their mission, FHFA and the regulated entities must maintain a skilled workforce. People risk, or human capital risk, can occur when an organization is unable to attract, develop, and retain a highly qualified, diverse workforce with specialized skills, which can jeopardize the institution from meeting its business objectives. People risk manifests across a range of human capital related issues. For example, people risk encompasses scenarios such as an organization not planning for the effect of retirements, an entity experiencing pervasive critical skill gaps, and individuals making decisions adverse to the institution.

The regulated entities have not been immune to the trends affecting the labor market over the past few years. Some of the regulated entities experienced higher attrition in 2021 and 2022, consistent with trends in the broader labor market, but one Enterprise reported that its turnover rate started declining in 2022. There has also been intense competition for skill sets, such as information technology and modeling, which are core to the regulated entities' mission. The regulated entities report that their inability to recruit and retain skilled employees could adversely affect their operations.

Factors inherent to the regulated entities and those outside of their control bear on people risk, and these factors sometimes both heighten and decrease the regulated entities' people risk. For example, certain FHLBanks are located in areas with a large candidate pool, but FHFA told us the FHLBanks are challenged to offer competitive salaries in those same areas. As another example, general labor market conditions influence attrition rates, with the regulated entities' voluntary turnover increasing in a stronger labor market and declining when the economy slows. Moreover, workplace flexibilities, especially in light of the COVID-19 pandemic, fundamentally changed the workforce dynamic, and thus, people risk. The regulated entities say their workplace flexibilities helped them recruit and retain talent; however, FHFA cited its concerns that increasing workplace flexibilities in the labor market increased turnover at one Enterprise.

This white paper provides an overview of people risk at FHFA's regulated entities. We also discuss people risk trends at the regulated entities and factors affecting their people risk.

TABLE OF CONTENTS ....

ABBREVIATIONS

CSS	Common Securitization Solutions, LLC
Enterprises	Fannie Mae and Freddie Mac
FHFA or Agency	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
OIG	Federal Housing Finance Agency Office of Inspector General

BACKGROUND

The Housing and Economic Recovery Act of 2008 created FHFA, which is responsible for the effective supervision, regulation, and housing mission oversight of Fannie Mae and Freddie Mac, collectively the Enterprises, and the 11 Federal Home Loan Banks (FHLBanks) (collectively, the regulated entities).[1] FHFA supervises the regulated entities by conducting examinations, ongoing monitoring, and assessing remediation of previously issued adverse examination findings. In addition, since September 2008, FHFA has served as conservator of the Enterprises.

FHFA's regulated entities employ numerous people supporting the nation's housing finance system.

- Fannie Mae is headquartered in Washington, DC, and employs approximately 8,000 staff.
- Freddie Mac is headquartered in McLean, Virginia, and has approximately 7,800 employees.
- CSS is headquartered in Bethesda, Maryland, and has approximately 350 staff.[2]
- The FHLBanks employ more than 3,000 personnel, with the individual FHLBanks' ranks ranging from less than 200 employees to approximately 500 employees. Each FHLBank's headquarters is in a different city, serving a different region of the country.[3]

To achieve their housing finance mission, FHFA's regulated entities require staff with complex technical skills, such as modeling and information technology. The regulated entities use models in their business decisions, home price forecasting, and financial reporting, among other activities. Concerning information technology, the regulated entities heavily depend on this skill set to run their operations and support housing finance, with a significant portion of Fannie Mae's staff in technology-related roles.

In public documents, the regulated entities highlight their dependence on people, with Fannie Mae and Freddie Mac underscoring that they are "highly dependent on the talents and efforts

[1] Common Securitization Solutions, LLC (CSS) is an affiliate of each Enterprise, not a separate "regulated entity" as the term is defined by statute (see 12 U.S.C. § 4502(20)). In this report, references to the "regulated entities" should also be read to apply to CSS, unless otherwise noted.

[2] Although headquartered in Maryland, CSS permits all employees to work fully remotely.

[3] See a full list of the FHLBanks at https://fhlbanks.com/directory/.

of…employees" and the FHLBanks stating the need for "talented employees to achieve…strategic business initiatives and enhance business performance." This dependence results in people risk when an organization, such as one of the regulated entities, is unable to attract, retain, and develop qualified, diverse staff and maintain adequate levels of staffing to accomplish its mission. People risk also includes an adverse outcome of an employee making decisions contrary to the institution or an organization not planning for the loss of institutional knowledge due to employees departing.

For fiscal year 2023, OIG identified FHFA's oversight of people risk at its regulated entities as one of the Agency's top management challenges.[4] In addition, FHFA's fiscal years 2022-2026 Strategic Plan prioritizes the Enterprises addressing human capital capabilities "to build a deep reservoir of talent and experience."[5] Both Enterprises identified people risk as a concern, too. In its 2022 Annual Report, Fannie Mae noted that people risk could "harm our ability to manage our business effectively, to successfully implement strategic initiatives, and ultimately could adversely affect our financial performance."[6] Similarly, Freddie Mac stated in its 2022 Annual Report that its "business and results of operations may be materially adversely affected if we are unable to attract and retain well-qualified and diverse employees across the company."[7]

Because people risk is an ongoing consideration for organizations, this white paper provides an overview of people risk at the regulated entities. We offer background and further explain this risk from our Fiscal Year 2023 Management and Performance Challenges memorandum. but this white paper is not intended as an assessment of people risk at the regulated entities. Although we focus on the entities' people risk here, FHFA must also manage its own people risk. We previously reported on and will continue to recommend actions the Agency should take to mitigate its own people risk, but that topic is beyond the scope of this paper.[8]

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[4] OIG, *FHFA Fiscal Year 2023 Management and Performance Challenges*, at 7 (October 6, 2022).

[5] FHFA, *Strategic Plan Fiscal Years 2022-2026*, at 8 (April 14, 2022).

[6] Fannie Mae, *2022 Annual Report (10-K)*, at 37.

[7] Freddie Mac, *2022 Annual Report (10-K)*, at 119.

[8] *See, e.g.*, OIG, *Despite FHFA's Recognition of Significant Risks Associated with Fannie Mae's and Freddie Mac's High-Risk Models, its Examination of Those Models Over a Six Year Period Has Been Neither Rigorous nor Timely* (March 25, 2020) (EVL-2020-001) and *Despite Prior Commitments, FHFA Has Not Implemented a Systematic Workforce Planning Process to Determine Whether Enough Qualified Examiners are Available to Assess the Safety and Soundness of Fannie Mae and Freddie Mac* (February 25, 2020) (AUD-2020-004).

PEOPLE RISK TRENDS AT THE REGULATED ENTITIES.................

An FHFA official told us one primary measure of people risk is turnover. Over the past few years, turnover fluctuated at some of the regulated entities, particularly at the Enterprises. Fannie Mae told us voluntary attrition was historically high throughout 2021 and 2022, but reported that turnover began declining in 2022 and reached historic lows as of mid-2023. Specifically, Fannie Mae reported vacancies in its 2021 and 2022 Annual Reports—an average of 8 percent to 9 percent of total positions and 10 percent to 12 percent of its technology-related positions. Freddie Mac stated in its 2022 Annual Report that voluntary employee turnover in 2022 remained high compared to historical experience. A Freddie Mac document shows its September 2022 overall voluntary turnover was three times its turnover level in 2020. An FHFA official told us that both Enterprises experienced significant turnover in positions within the multifamily division. In spite of the elevated employee turnover in 2021 and 2022, the Enterprises state that their voluntary attrition remains lower than peer company benchmarks.

An Agency official told us people risk at the FHLBanks is higher among certain specialized skills. For instance, certain FHLBanks faced turnover among information technology and risk management staff. FHFA found that an attrition rate of almost 18 percent at one FHLBank contributed to errors in its operations.

Although turnover provides a prime metric of people risk, key person departures also shape people risk. According to FHFA officials, one person leaving a regulated entity typically does not increase people risk. However, those same officials told us that several key people leaving in short order could have an outsized effect on people risk. Consistent with that view, the Enterprises reported in their 2022 Annual Reports that several senior-level departures at approximately the same time could have a material adverse effect on their businesses.

Both Enterprises experienced senior level attrition, especially since 2021. The Enterprises appointed new Chief Executive Officers shortly after their former leaders departed in 2021 and 2022. Other senior executives have departed the institutions, too. In the first half of 2022, 19 officers left Fannie Mae, including the Chief Operating Officer. As of September 2022, 12 of Freddie Mac's officer positions were vacant. As context, FHFA told us Fannie Mae has succession plans for 52 senior positions, and Freddie Mac's succession plans cover 68 senior roles.

Several senior executives departed the FHLBanks, too. Since 2021, the boards of directors at multiple FHLBanks appointed new Chief Executive Officers, as well as other positions such as Chief Risk Officer and Chief Financial Officer.[9] An FHFA official told us that losing a key person affects everything at the FHLBanks because of the interconnectedness of people risk.

CSS provided information to us that indicated voluntary attrition at the company is currently at the lowest rate since the entity began.

Succession Planning

Retaining adequate staff is a key part of managing people risk, and succession planning helps mitigate gaps that occur when key senior staff depart. The Enterprises told us they have focused on succession planning. One Enterprise told us that bolstering its senior level ranks elsewhere in the company exhausted its succession talent pool. In response, this Enterprise said it changed its succession planning approach. It now focuses on mitigating people risk for the most critical roles and piloted an effort to strengthen the talent pool for positions below the officer level. The other Enterprise says it enhanced its succession planning efforts, too. Its divisions can identify talent below the most senior levels and craft specific development for "high potential" employees.

Two Agency officials provided insight on succession planning with respect to the FHLBanks. The first FHFA official told us that succession planning is a central part of mitigating people risk. The second official explained that there are some fundamental issues with succession planning. The second Agency official went on to say if an FHLBank has a key person dependency, losing that individual affects everything at the FHLBank. Many of the FHLBank executives have been at the FHLBanks for 10 to 15 years or even for their entire careers; accordingly, the FHLBanks need to prepare for the eventual departure of these long-time executives, as stated by the first official with whom we spoke.

Diversity and Inclusion

Human capital encompasses diversity and inclusion, and the regulated entities publicly reported that diversity and inclusion has benefited their organizations. Fannie Mae reported in its 2022 Annual Report that it believes its diversity and inclusion efforts improved its recruitment and retention "at all levels" of its business, and Freddie Mac said in its 2022 Annual Report that diversity and inclusion better positioned it to serve its mission. As examples of the Enterprises' diversity and inclusion activities, Fannie Mae reported in its 2022 Annual Report that it had 10 employee resource groups that support diversity and inclusion, and Freddie Mac reported in its

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[9] Three of the Chief Executive Officers retired after serving from 12 years to more than 30 years at FHLBanks. As mentioned in the next section, FHFA told us that many FHLBank executives are long-serving FHLBank employees.

2022 Annual Report that it partnered with institutions that create career opportunities for underrepresented populations.

The FHLBanks' 2022 Combined Financial Report cited diversity and inclusion as a "strategic business priority" for each of the FHLBanks.[10] According to the report, "…diversity increases capacity for innovation and creativity and that inclusion…strengthens retention efforts." To that end, each FHLBank measures and reports on its performance implementing its diversity and inclusion plan.

The regulated entities publicly report on some of their workforce diversity measures. For instance, the Enterprises state in their 2022 Annual Reports that racial or ethnic minorities comprise more than 50 percent of their employees. The FHLBanks reported in its 2022 Combined Financial Report that as of December 31, 2022, 44 percent of its total workforce was female and 38 percent identified as minority. The rate of female and minority participation varied among the FHLBanks. In 2022, females represented 39 percent to 52 percent of the various FHLBanks' workforces and minorities comprised 13 percent to 68 percent.

FACTORS AFFECTING THE REGULATED ENTITIES' PEOPLE RISK..

Various factors shape the aforementioned people risk trends at the regulated entities. Some factors are internal to the organization, while others are external dynamics to which the entity must respond. Whether internal or external, several of the factors that affect the regulated entities' people risk can both increase and decrease people risk. For example, a regulated entity's employee retention generally will increase during an economic downturn, but the number of qualified candidates to fill job openings will typically decrease as well.

Internal Factors

Mission

An organization's mission can help it recruit and retain human capital. An FHFA official told us that the Enterprises' and CSS' housing finance missions attract talent. That official told us that a candidate who wants to advance housing finance and housing affordability might choose to work at the Enterprises. In its 2022 Annual Report, Fannie Mae said its mission and the "compelling nature" of its work appeal to applicants. Freddie Mac told us that its

[10] Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2022*, at 27.

mission-related work supporting financial market stability and affordable housing helped it recruit and retain senior management. Another Agency official told us the FHLBanks' mission is a key factor influencing people risk. However, that official went on to say the FHLBanks have to recruit candidates that are interested in their "specialized" focus.

Organizational Size

An organization's size affects people risk. The FHLBanks and CSS are relatively smaller when compared to the Enterprises. On the one hand, their smaller organizational size offers employees exposure to multiple facets of the entity, addressing the development aspect of people risk. On the other hand, retention is also an element of people risk, and a smaller regulated entity's fewer promotion possibilities (compared to a larger organization) increases the risk of employees departing for other opportunities. According to an FHFA official, the FHLBanks' small size affords employees familiarity with various aspects of the organization, while an employee within a large organization can remain siloed in one division. CSS told us its relatively small size and flatter organizational structure challenge it to retain employees after a few years. In response to this challenge, CSS has focused on attracting candidates who want to "take on larger roles," and also in developing its staff.

Geographic Location

An organization's geographical location influences its people risk. FHFA told us the Enterprises compete for personnel on a national level. Both Enterprises are headquartered in the Washington, DC, metropolitan area, but they have offices throughout the United States. For example, Fannie Mae indicates it has offices in Washington, DC, Virginia, and Texas, as well as regional offices. With a national footprint and high demand for technical skills (discussed later in this paper), the Enterprises recruit from a national talent pool.

In contrast, the Agency told us the FHLBanks' people risk is more geographically sensitive than the Enterprises, and location is a key factor in the FHLBanks' people risk. Factors such as talent pool size, compensation, and cost of living vary across the FHLBanks' locales and can heighten or reduce people risk. The 11 FHLBanks are located throughout the United States, ranging from the large metropolitan areas of New York City and San Francisco to smaller cities like Topeka, Kansas, and Des Moines, Iowa.[11] An FHFA official told us certain locales contain a greater concentration of skill sets relevant to the FHLBanks, but other markets have greater challenges drawing applicants with specialized skills. Furthermore, FHLBanks in particular markets have difficulty competing with companies that can offer

[11] For more information on the FHLBanks, see OIG, *An Overview of the Federal Home Loan Bank System* (Mar. 31, 2023) (WPR-2023-002).

higher salaries. In contrast, the lower cost of living in certain areas provides an advantage for other FHLBanks in attracting candidates.

Enterprise-Specific Factors

Unlike the other regulated entities, the Enterprises' conservatorships and uncertain political action contribute uniquely to their people risk. First, the conservatorships have been in place since September 2008, with no defined end. Additionally, both Enterprises highlight in their 2022 Annual Reports that the uncertainty of political action by Congress or the Administration – including if, and when, the conservatorships end, or if housing reform restructures or eliminates the Enterprises – may adversely affect their people risk. Second, the conservatorships impose compensation limitations,[12] including effectively restricting equity-based compensation. In their 2022 Annual Reports, both Enterprises cite the conservatorships' uncertainty and compensation constraints as a "disadvantage" in comparison to other companies in recruiting and retaining talent, especially executives. However, an FHFA official offered a counterbalance to the equity-based compensation restrictions, telling us some people may prefer a fixed, all-cash salary.

Nevertheless, an FHFA official and Freddie Mac told us that conservatorship is not currently a root contributor of people risk. The Agency official told us applicants and employees are well aware of the conservatorships, which have been in place for about 15 years. Moreover, Freddie Mac told us that although discussions of "winding down" the Enterprises in the early years of the conservatorship contributed to its people risk, the conservatorship currently does not contribute significantly to its overall people risk as employees and applicants better understand the nature of the conservatorship. Fannie Mae, however, told us that compensation constraints stemming from the conservatorship is the primary source of people risk for its executive team.

External Factors

Several external factors also affect the regulated entities' people risk.

Economic Conditions

According to an FHFA official, factors external to the Enterprises and CSS are the root causes and the greatest forces heightening their people risk. The official also said that people risk increased in late 2021 and 2022 because of a robust labor market and low unemployment. The Enterprises' attrition will decrease as the labor market slows, according to the official.

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[12] FHFA requires the Enterprises to limit base salaries for all executive officers (as defined in 12 C.F.R. § 1230.2) to a maximum of $600,000 and to defer at-risk earned executive officer compensation for a certain period. FHFA reviews compensation of other Enterprise executive officers as well.

Although some Enterprise staff departed for other opportunities with financial services, financial technology, and mortgage companies, the official pointed out that certain of those businesses are struggling financially now or have even closed.

Consistent with FHFA's statement about external factors' effect on Enterprise people risk, Fannie Mae told us labor market trends and the economy are the most significant influences on its people risk, with its attrition increasing and decreasing as those external trends change. According to the Enterprise, its voluntary attrition reached historical highs in 2021 and 2022 consistent with the broader labor market turnover. Furthermore, it currently has historically low turnover, which it attributes to market trends (i.e., recession concerns, inflation, and financial services and information technology layoffs).

The FHLBanks reported in their 2022 Combined Financial Report that some of them experienced higher employee turnover with more challenges attracting and retaining skilled key personnel beginning in 2021 because of labor market disruptions. Nevertheless, an FHFA official told us turnover is not a major issue at the FHLBanks, because their employees generally do not quickly leave these positions, especially as they reach more senior levels in the organization. According to the 2022 Combined Financial Report, FHLBank employees have an average tenure of nine years on the job. Furthermore, many FHLBank employees remain on the job to retirement, according to an Agency official.

Skill Shortages

The regulated entities employ people with specialized skills that are crucial to their businesses and are also in-demand in the marketplace, such as information technology and modeling.[13] Freddie Mac told us increasing external competition and demand for similar talent was the most significant contributor to its people risk.

An Agency official told us the Enterprises operate based on modeling and information technology, so they will constantly recruit talent with those skill sets. The FHFA official also told us the Enterprises compete with other organizations and contractors for those skills as well. With respect to information technology jobs, Fannie Mae reported in its 2022 Annual Report that 41 percent of its employees work in technology-related jobs and that competition was particularly high for employees with technology skills. In response to market pressures, Fannie Mae told us it expanded campus hiring of critical skills, such as information technology, modeling, and analytics.

An FHFA official told us the FHLBanks also face certain people risk issues common to other financial sector peers. For example, the Agency official told us it is a challenge for

[13] The Enterprises and the FHLBanks use models for various business activities (e.g., mortgage underwriting, home price forecasts, valuation, and risk management).

businesses, including the FHLBanks, to hire people with information technology skills because of the evolving business environment. The FHFA official went on to say modeling is a high-demand skill that is difficult to replace. The FHLBanks stated in their 2022 Combined Financial Report that there has been "intense" competition for skilled key personnel from inside and outside of the financial services industry, including the technology industry.

An FHFA official told us that evolving expectations for the FHLBanks creates strain on the FHLBanks' information technology and modeling resources. The Agency official gave an example of evolving expectations: the growth of artificial intelligence means organizations must evaluate and consider the extent of their skill sets to respond to this new technology. The FHFA official went on to say that information technology continues to change and businesses must attempt to keep pace with the changes. Although the FHLBank business model is mostly straightforward (e.g., advances and some mortgage acquisitions), according to the official, information technology and modeling will drive changes in the FHLBanks' business. As a result, it is important for the FHLBanks to recruit and retain employees with information technology and modeling skills.

Workplace Flexibilities

Similar to other factors affecting people risk, workplace flexibilities can both increase and decrease people risk. The COVID-19 pandemic fundamentally changed the workforce dynamic, with a rise in remote and hybrid work. The regulated entities say they offer flexibilities in the workplace, especially after the COVID-19 pandemic.

A 2022 FHFA document cited concern with remote work elevating people risk at one Enterprise. The Agency also noted a hybrid work environment contributed to that Enterprise's turnover and recruitment and retention challenges. On the other hand, Fannie Mae told us its flexible work philosophy might be one of the most significant mitigants to potential turnover, because its flexible culture differentiates it from competitors. Similar to Fannie Mae, CSS told us its flexible work environment is one reason it has been able to recruit talent. Freddie Mac reported in its 2022 Annual Report that it also evolved its workplace flexibilities during the pandemic and now uses a hybrid work approach.

According to the FHLBanks' 2022 Combined Financial Report, more remote-working opportunities have increased the competition in recruiting and retaining skilled key personnel. At the same time, the FHLBanks reported that they used a variety of programs, including a hybrid work schedule, to attract, develop, and retain talented employees.

CONCLUSIONS

People risk manifests at FHFA's regulated entities in various ways, with internal and external factors contributing to their people risk. Labor market dynamics, such as economic conditions and skill shortages, create stiff competition for the regulated entities to recruit and retain key talent, especially in crucial proficiencies. The regulated entities generally report that their missions attract talent, but they also say that workplace flexibilities, organizational size, and geographic location affect their people risk. In the presence of these factors and executive compensation restrictions, the Enterprises have had several senior officials depart since 2021, highlighting the importance of succession planning. While the Agency does not consider people risk as a top risk for the FHLBanks, it does acknowledge that people risk always exists and it is important for the FHLBanks to manage people risk through succession planning as well.

OBJECTIVE, SCOPE, AND METHODOLOGY ....

The objective of this white paper is to provide an overview of people risk at FHFA's regulated entities. To achieve this objective, we reviewed internal Agency and regulated entity documents, as well as publicly available documents. We also interviewed FHFA officials and obtained written responses to our inquiries from the Enterprises and CSS.

We provided FHFA with the opportunity to respond to a draft of this white paper. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this white paper.

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