Federal Housing Finance Agency Office of Inspector General

Semiannual Report to the Congress

April 1, 2011, through September 30, 2011

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FHFA-OIG's Mission

The mission of the Federal Housing Finance Agency Office of Inspector General (FHFA-OIG) is to: promote the economy, efficiency, and effectiveness of Federal Housing Finance Agency (FHFA or the Agency) programs and operations; prevent and detect fraud, waste, or abuse in FHFA 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, FHFA-OIG conducts independent and objective audits, evaluations, surveys, risk assessments, and investigations; keeps the head of FHFA, Congress, and the American people fully and currently informed of problems and deficiencies relating to FHFA programs and operations; and works collaboratively with FHFA staff and program participants to ensure the success of FHFA programs and operations.

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A Message from the Inspector General

This second FHFA-OIG Semiannual Report covers the office's activities and operations for the period from April 1, 2011, through September 30, 2011.

The continuing fragility of the nation's housing market remains a significant source of ongoing concern. Further, 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 Banks (FHLBanks) – continue to be key players in that market. FHFA faces significant challenges under these circumstances. In addition to serving as the GSEs' safety and soundness regulator, FHFA has now acted as the conservator of Fannie Mae and Freddie Mac (the Enterprises) for more than three years. During that period, the federal government has committed approximately $169 billion to the Enterprises, thereby ensuring their continued solvency.

FHFA-OIG provides independent and objective assessments of the work of FHFA. Since the office began operations in October of last year, it has issued 10 reports, which reveal a number of emerging trends. FHFA-OIG credits FHFA with several accomplishments and for identifying areas where improvements should be made. But FHFA-OIG's reports identified deficiencies in FHFA operations that appear to reflect two significant themes. First, the reports identified specific instances in which FHFA has relied on work done by the Enterprises without independently testing and validating that work, thereby according undue deference to Enterprise decision-making. Second, the reports discussed situations in which FHFA's allocation of resources may have affected its ability to oversee the Enterprises and enforce its directives. As the work of the office continues, it expects to issue additional reports assessing the operations of the Agency and its impact on the GSEs.

The office has also actively assisted law enforcement efforts aimed at combating systemic mortgage fraud. FHFA-OIG's law enforcement agents played a central role in obtaining convictions of multiple individuals connected with the Taylor, Bean & Whitaker fraud scheme – among the largest mortgage fraud schemes in history – which Freddie Mac claimed caused it losses of approximately $1.8 billion. Currently, FHFA-OIG is involved in a variety of continuing mortgage fraud investigations across the nation.

We remain mindful of the privilege afforded us to serve our fellow citizens and of the importance of our work. We look forward to working with our colleagues throughout the federal government and remain grateful for the support of Congress, FHFA, and others.

Steve A. Linick
Inspector General
October 31, 2011

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

EXECUTIVE SUMMARY

Executive Summary

OVERVIEW

This Semiannual Report discusses the operations of FHFA-OIG from April 1, 2011, through September 30, 2011.[a]

FHFA is the safety and soundness regulator of the housing **GSEs**: Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLBank System), which is comprised of 12 regional FHLBanks. 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 that include Fannie Mae, Freddie Mac, and the FHLBanks.

For a description of the Government-Sponsored Enterprises, see Section 2: "Operations of FHFA and the GSEs."

As conservator, FHFA's powers include:

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

FHFA has exercised those powers by replacing senior executives and members of the Enterprises' boards of directors, as well as reviewing and approving senior executive compensation and all Enterprise transactions greater than $50 million.

FHFA also has instituted several initiatives intended to improve the Enterprises' internal operations, mitigate their credit losses, and enhance the availability of information in the secondary mortgage market. For example, FHFA, the Department of Housing and Urban Development (HUD), and the Enterprises studied alternative fee structures for mortgage servicers. On the basis of this study, FHFA recently issued for public comment two alternative compensation structures for mortgage servicers. Additionally, FHFA, on behalf of the Enterprises, filed civil lawsuits against 18 financial services firms that marketed **private-label mortgage-backed securities (MBS)** to the Enterprises. The lawsuits allege that the financial services firms failed to perform proper due diligence as underwriters of the securities that the Enterprises purchased.

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.

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

Emerging Themes from FHFA-OIG Reports

An important facet of FHFA-OIG's mission is promoting transparency in FHFA's program administration and oversight of GSE operations. FHFA-OIG also seeks to promote public understanding of matters affecting FHFA, the GSEs, and housing policy. In light of these objectives, FHFA-OIG has published 10 audit and evaluation reports as of September 30, 2011.

The reports credit FHFA's work in several areas, both as regulator and conservator. For example, FHFA-OIG has found:

[a] The Inspector General Act of 1978, 5 U.S.C. App. 3 § 5, requires that each inspector general compile a report of operations for the preceding six months for the periods ending March 31 and September 30.

- FHFA has eliminated **golden parachute** compensation awards to terminated Enterprise executives;
- no evidence that FHFA's independence has been compromised in connection with the Making Home Affordable (MHA) programs;
- FHFA has taken steps to mitigate its shortage of qualified examiners;
- FHFA has taken steps that may improve Enterprise repurchase claims recoveries, thereby reducing Enterprise losses; and
- FHFA has positively responded to FHFA-OIG's recommendations to improve FHFA's effectiveness and efficiency and reduce its vulnerability to fraud, waste, or abuse.

Golden Parachute:
A term used to describe special compensation arrangements, such as cash, special bonuses, stock options, or vesting of previously awarded compensation, between a company and its senior executives in case the company is acquired or if an individual is fired or involuntarily separated.

On the other hand, FHFA-OIG also has identified deficiencies in FHFA operations, and these deficiencies appear to reflect two significant and related themes. First, FHFA often relied on determinations of the Enterprises without independently testing and validating them, thereby giving undue deference to Enterprise decision-making. Second, FHFA's allocation of resources may have affected its ability to oversee the Enterprises and enforce its directives. As detailed below, both themes have emerged in multiple reports.

I. FHFA Has Not Independently Tested and Validated Enterprise Decision-Making

In four reports to date, FHFA-OIG identified significant instances in which FHFA has displayed undue deference to Enterprise decision-making. Without adequately testing or validating data, FHFA has deferred to the Enterprises regarding: (1) Freddie Mac's assessment of mortgage repurchase claim issues involving Bank of America; (2) the Enterprises' participation in MHA; (3) the Enterprises' decisions regarding executive compensation; and (4) numerous transactions of the Enterprises.

The Agency's actions in each case reflect its approach as conservator to delegate most business decisions to the Enterprises. In each case, it relied upon review and corporate governance processes already in place at the Enterprises. However, FHFA-OIG concluded that some matters are sufficiently important to warrant greater involvement and scrutiny by the Agency.

FHFA Deferred 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 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 FHFA-OIG report found that FHFA did not act timely or test concerns raised by an FHFA senior examiner about limitations in Freddie Mac's existing loan review process for mortgage repurchase claims.[1] The senior examiner was concerned that the loan review process Freddie

For more information about FHFA's approval of Freddie Mac's repurchase claim settlement with Bank of America, see pages 36-37 of this report, or examine the full text of the Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America.

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.

FHFA Provided Limited Oversight of the Enterprises' Administration of the Home Affordable Modification Program

For more information about FHFA's oversight of the Enterprises' relationships with Treasury, see pages 40-42 of this report, or examine the full text of the Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program.

The Department of the Treasury (Treasury) initiated the MHA programs. A key initiative of MHA is the Home Affordable Modification Program (HAMP), which involves servicers agreeing to modify mortgages for borrowers facing default or foreclosure. In early 2009, the Enterprises began participating in HAMP. They started modifying mortgages in their portfolios and entered into five-year agreements with Treasury to manage the program and oversee participants' compliance with program requirements. An FHFA-OIG report found that FHFA largely removed itself from overseeing the negotiations of the five-year agreements.[2] FHFA believed its appropriate role was to ensure the Enterprises were legally authorized to administer HAMP, not to participate actively in negotiations between the Enterprises and Treasury. Thus, FHFA did not engage in any formal substantive review to evaluate the agreements' feasibility, risks, or the suitability of the Enterprises 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.

FHFA Did Not Fully Analyze Factors Related to Executive Compensation at Fannie Mae and Freddie Mac

For more information about FHFA's oversight of the Enterprises' executive compensation, see pages 28-29 of FHFA-OIG's inaugural Semiannual Report, or examine the full text of the Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs.

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 FHFA-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.[3] These factors included the lower levels of compensation paid to senior officials at federal agencies supporting the housing market and whether compensation awards should be discounted to reflect the significant level of federal financial support provided to the Enterprises.

FHFA Does Not Perform Sufficient Transaction Testing of Enterprise Activities

For more information about FHFA's examination capacity, see pages 37-39 of this report, or examine the full text of the Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs.

Transaction testing is the method employed by financial institution examiners to arrive at independent impressions about the financial and operational conditions of an institution, 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 FHFA-OIG that examiners too often accept assertions made by Enterprise managers rather than validate such assertions through appropriate transaction testing.[4]

II. FHFA's Resource Allocations May Have Affected Its Ability to Oversee the GSEs and Enforce Its Directives

In four reports, FHFA-OIG identified instances in which FHFA's resource allocations may have affected its ability to oversee the GSEs and enforce its directives. For example, FHFA may have too few examiners to meet its oversight responsibilities. In addition, FHFA may not have assigned sufficient priority and resources to handle consumer complaints or address new and emerging risks that may impact the GSEs. Additionally, FHFA-OIG found that FHFA (along with its predecessor agency, the Office of Federal Housing Enterprise Oversight (OFHEO)) has permitted five years of compliance delays by Fannie Mae, which has been under directives to implement an effective operational risk management program.

FHFA May Not Have Enough Examiners to Meet Its Regulatory and Conservatorship 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 FHFA-OIG report noted that FHFA-OIG had previously found shortfalls in the Agency's examination coverage, and this finding was corroborated by statements of senior FHFA officials.[5] Internal Agency reviews also corroborated that FHFA has too few examiners to ensure the efficiency and effectiveness of its examination program. Additionally, only 34% of the Agency's line examiners are accredited federal financial examiners. FHFA has taken steps to mitigate its shortage of qualified examiners, but it needs to move quickly and aggressively in this area. Last winter, for example, the Acting Director announced and implemented a substantial restructuring of FHFA's supervision units and reassigned numerous staff. These steps, which also include plans to add examination staff and implement an examiner accreditation program, are designed to enhance FHFA's supervision program.

For more information about FHFA's examination capacity, see pages 37-39 of this report, or examine the full text of the Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs.

For more information about FHFA's organizational restructuring, see page 33 of this report.

Further, although FHFA's near-term plans include hiring up to 44 additional staff in the supervision divisions, FHFA-OIG concluded that there is substantial uncertainty as to whether this number of additional examiners will enable FHFA to overcome its examination capacity shortfalls and ensure the success of the Agency's 2011 reorganization of its examination structure.

For more information about FHFA's handling of consumer complaints, see pages 47-48 of this report, or examine the full text of the Audit of the Federal Housing Finance Agency's Consumer Complaints Process*.*

For more information about FHFA's oversight of the Enterprises' default-related legal services activities, see pages 42-43 of this report, or examine the full text of FHFA's Oversight of Fannie Mae's Default-Related Legal Services*.*

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

For more information about FHFA's oversight of Fannie Mae's management of operational risk, see pages 39-40 of this report, or examine the full text of the Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk*.*

FHFA Did Not Allocate Sufficient Resources to Handle Consumer Complaints

Due in part to deteriorating financial conditions in the housing market, FHFA and OFHEO experienced a substantial increase in consumer complaints about the Enterprises. A number of these complaints contained important information about alleged foreclosure processing abuses and fraud.[b] However, an FHFA-OIG report found that FHFA did not adequately process consumer complaints.[6] This deficiency occurred because FHFA did not establish sound internal controls and did not assign sufficient priority and resources to complaint processing. For example, FHFA-OIG found that FHFA assigned only two employees – on a part-time basis – to handle consumer complaints.

FHFA Did Not Identify and Address New and Emerging Risks Potentially Impacting the GSEs

FHFA did not begin to schedule comprehensive examination coverage of foreclosure issues, including allegations of abuse by its default-related legal services vendors, until after news stories about alleged abuses surfaced in mid-2010. FHFA had not previously considered risks associated with foreclosure processing to be significant. However, an FHFA-OIG report found that there were multiple indications of foreclosure issues prior to mid-2010 that could have led FHFA to foresee the heightened potential for risk in foreclosure processing abuses.[7] These indications included significant increases in the volume of foreclosures (which accompanied the collapse of the housing market), rising consumer complaints alleging improper foreclosures, contemporaneous media reports about foreclosure abuses by the Enterprises' law firms, and public court filings highlighting such abuses.

FHFA Has Not Enforced Directives Regarding Fannie Mae's Operational Risk Program

Between 2006 and 2011, FHFA and OFHEO repeatedly found that Fannie Mae had failed to establish an acceptable and effective **operational risk** management program despite outstanding Agency requirements to do so.[8] FHFA possesses broad authority to enforce its directives. However, an FHFA-OIG report found that FHFA did not take decisive action to compel Fannie Mae's compliance.

FHFA-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/her office during the preceding six-month periods ending March 31 and September 30.[c] The specific reporting requirements, as stipulated in the Inspector General Act, are listed in Appendix B.

[b] For example, in June 2008, an investigative reporter complained that a mortgage lender, Taylor, Bean & Whitaker, with which Freddie Mac did a large volume of business, was fraudulently selling loans. The complaint was not properly pursued by FHFA, and it was not referred to law enforcement. Due to an unrelated investigation, in April 2011, a jury convicted the lender's chairman of participating in a multibillion dollar scheme against Freddie Mac and others, as described further on page 49.

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

The above-described reports issued since April 1, 2011; two additional audit reports; FHFA-OIG's investigative activities; and other FHFA, FHFA-OIG, and GSE developments are discussed in detail in this Semiannual Report.

ORGANIZATION OF THIS REPORT

This Semiannual Report is organized as follows:

- Section 1, *Description of FHFA-OIG*, provides a brief overview of the organization.
- Section 2, *Operations of FHFA and the GSEs*, describes the organization and operation of FHFA, Fannie Mae, Freddie Mac, and the FHLBanks and discusses notable developments related to FHFA-OIG's oversight of these organizations.
- Section 3, *Accomplishments and Strategy of FHFA-OIG*, describes FHFA-OIG's oversight activities, including audits, evaluations, and investigations. It also discusses FHFA-OIG's current priorities and goals for the future.
- Section 4, *FHFA-OIG's Recommendations*, discusses selected FHFA-OIG recommendations to improve the operations and transparency of FHFA and the GSEs. It also provides an update on the implementation of each outstanding recommendation.

Additionally, this Semiannual Report includes, as background, *An Overview of the Home Foreclosure Process*. This overview illustrates for readers the rights and obligations of each party with respect to an appropriately executed home foreclosure process in order to provide context for this high-profile, often controversial aspect of the housing crisis.

SECTION 1

DESCRIPTION OF FHFA-OIG

Section 1: Description of FHFA-OIG

FHFA-OIG began operations on October 12, 2010. Established by the Housing and Economic Recovery Act of 2008 (HERA), which amended the Inspector General Act, FHFA-OIG conducts, supervises, and coordinates audits, investigations, and other activities relating to the programs and operations of FHFA.

LEADERSHIP AND ORGANIZATIONAL STRUCTURE

The first FHFA Inspector General, Steve A. Linick, was nominated by President Barack Obama on April 12, 2010; confirmed by the Senate on September 29, 2010; and sworn into office on October 12, 2010. Prior to commencing service as the FHFA Inspector General, Mr. Linick served from 2006 to 2010 in several leadership positions at the Department of Justice (DOJ). Previously, Mr. Linick was an Assistant U.S. Attorney, first in the Central District of California (1994-1999), and subsequently in the Eastern District of Virginia (1999-2006).

FHFA-OIG is comprised of the Inspector General, his senior staff, and the FHFA-OIG offices. FHFA-OIG's principal operating offices are the Office of Audits (OA), the Office of Evaluations (OE), and the Office of Investigations (OI). Offices with organization-wide responsibilities are the Executive Office (EO) and the Office of Administration (OAd). FHFA-OIG's organizational chart can be found in Appendix D.

Office of Audits

OA provides a full range of professional audit and attestation services covering the programs and operations of FHFA. Through its financial and performance audits and attestation engagements, OA seeks to: (1) promote economy, efficiency, and effectiveness in the administration of FHFA's programs; (2) detect and deter fraud, waste, or abuse in FHFA's activities and operations; 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, and analyses of FHFA's programmatic and operational activities. OE's evaluations are generally limited in scope and completed more quickly than traditional audits.

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

George Grob, currently Deputy Inspector General for Evaluations, delivers an instructional seminar on evaluations.

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 the programs and operations of FHFA and the GSEs. OI adheres to CIGIE's *Quality Standards for Investigations* and guidelines issued by the Attorney General.

OI's investigations focus on allegations of wrongdoing and may address administrative, civil, and criminal violations of laws and regulations. The target of an FHFA-OIG investigation can be an agency employee, contractor, or consultant or any person or entity involved in alleged wrongdoing affecting FHFA's or the GSEs' programs and operations. To date, OI has opened numerous criminal and civil investigations, which by their nature are not made public. These investigations involve issues such as accounting fraud, mail fraud, wire fraud, securities fraud, bank fraud, mortgage fraud, false statements, obstruction of justice, money laundering, and tax code violations.

If an investigation reveals criminal activity, OI will refer the matter to DOJ for possible prosecution or recovery of monetary damages and penalties. If administrative misconduct is found, OI will forward the report to the appropriate management officials for consideration of disciplinary or remedial action. OI investigative reports are generally not public documents.

Further, OI manages FHFA-OIG's Hotline, which is available to receive and process tips and complaints regarding fraud, waste, or abuse affecting FHFA's programs and operations. The Hotline allows concerned parties to report

*The FHFA-OIG **Hotline** can be reached at (800) 793-7724 or via e-mail at OIGHOTLINE@FHFA.GOV.*

their allegations to FHFA-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 the FHFA-OIG website, posters, targeted e-mails to FHFA and GSE employees, and the Semiannual Reports.

Executive Office

EO provides leadership and programmatic direction for all FHFA-OIG offices and activities.

EO includes the Office of Counsel (OC). OC serves as the chief legal advisor to the Inspector General and supports FHFA-OIG by providing independent legal advice, counseling, and opinions concerning FHFA-OIG's programs and operations. OC reviews audit, investigation, and evaluation reports for legal sufficiency and compliance with FHFA-OIG's policies and priorities. It also reviews drafts of FHFA regulations and policies and prepares comments as appropriate. Additionally, OC coordinates with the FHFA Office of General Counsel and manages FHFA-OIG's responses to requests and appeals made under the Freedom of Information Act and the Privacy Act.

EO also includes the Office of Policy, Oversight, and Review (OPOR), which provides advice, consultation, and assistance regarding FHFA-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 Report.

Office of Administration

OAd provides management and oversight of FHFA-OIG's administrative functions, including human resources, budget development and execution, financial management, information technology, facilities and property management, safety, and continuity of operations. With respect to 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 FHFA-OIG's budget and financial management, OAd coordinates budget planning and execution and oversees all of FHFA-OIG's procedural guidance for financial management and procurement integrity.

OAd also provides administrative support to the Chief of Staff and the Deputy Inspector General for Audits as they manage FHFA-OIG's Internal Management Assessment Program, which requires the regular inspection of each FHFA-OIG office to ensure compliance with applicable requirements. Additionally, FHFA-OIG's Equal Employment Opportunities program is housed in OAd.

FHFA-OIG'S STRATEGIC PLAN

On September 7, 2011, FHFA-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. FHFA-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.

The full text of the Strategic Plan is available at www.fhfaoig.gov/Content/Files/Strategic%20 Plan.pdf.

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

Strategic Goal 1 – Adding Value

FHFA-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

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

Strategic Goal 3 – Promoting Productivity

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

Strategic Goal 4 – Valuing FHFA-OIG Employees

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

PERFORMANCE PLAN AND ORGANIZATIONAL GUIDANCE

FHFA-OIG has also developed and implemented an Annual Performance Plan, which specifies objective, measurable performance goals for each year of FHFA-OIG's operation. The Annual Performance Plan describes the organization's plan to achieve its performance goals and the performance indicators and metrics that will be used to measure progress. It also identifies FHFA-OIG's major management challenges. FHFA-OIG plans to develop, quarterly and annually, performance reports comparing its progress with the benchmarks set forth in the Annual Performance Plan.

FHFA-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 FHFA-OIG's operations.

SECTION 2

OPERATIONS OF FHFA AND THE GSEs

Section 2: Operations of FHFA and the GSEs

FHFA

HERA was enacted on July 30, 2008, in the midst of the financial crisis. It created FHFA as the successor agency to OFHEO and the Federal Housing Finance Board (FHFB). OFHEO had been established in 1992 to regulate Fannie Mae and Freddie Mac. Prior to HERA's enactment, OFHEO had functioned as an independent agency within HUD. FHFB was established in 1989 as the regulator of the nation's 12 FHLBanks. FHFA now regulates and supervises Fannie Mae, Freddie Mac, and the FHLBanks.

FHFA AUTHORITIES

HERA

Under HERA, FHFA oversees the GSEs' operations. HERA authorizes FHFA to:

- ensure the GSEs operate "in a safe and sound manner, including maintenance of adequate capital and internal controls;"
- establish criteria for investments the GSEs may hold in their portfolios;
- establish risk-based capital requirements for the GSEs;
- require the GSEs to increase their capital;
- review and approve GSE executive compensation;
- review and approve any new products that Fannie Mae or Freddie Mac propose to offer;
- establish affordable housing goals for Fannie Mae and Freddie Mac;
- enforce compliance with housing goals; and
- appoint itself conservator or receiver of the GSEs.

On September 6, 2008, weeks after HERA's enactment, the Enterprises were placed into conservatorships overseen by FHFA due to their deteriorating financial conditions. As conservator, FHFA assumed all the powers of the shareholders, directors, and officers, with the goal of preserving and conserving the assets and property of the Enterprises.[9]

HERA also expanded the authority of Treasury to provide financial support to the GSEs.[10] At the time the conservatorships were created, Treasury exercised that authority when it began to make **preferred stock** investments in Fannie Mae and Freddie Mac 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 a preferred stock investment facility for each Enterprise. Under the PSPAs, the Enterprises agreed to consult Treasury concerning a variety of significant business activities, capital stock issuance and dividend payments, ending the conservatorships, transferring assets, and awarding executive compensation.

Emergency Economic Stabilization Act

Soon after the Enterprises were placed into conservatorships, and as the financial crisis continued, the Emergency Economic Stabilization Act (EESA) was enacted on October 3, 2008. With respect to the housing market, EESA contains provisions to protect home values and investments, preserve homeownership and promote economic growth, and maximize returns to the taxpayer.[11]

To preserve homeownership, EESA requires FHFA to implement a plan to maximize assistance to homeowners and to use its authority to encourage the servicers of Fannie Mae and Freddie Mac mortgages to take advantage of federal programs to minimize foreclosures.[12] In addition, EESA requires FHFA to coordinate with Treasury on homeowner assistance plans and to submit monthly reports to Congress detailing the progress of its efforts.

FANNIE MAE AND FREDDIE MAC

Fannie Mae was chartered in 1938 to support the creation of stable funding in the U.S. housing and mortgage markets. Freddie Mac was chartered in 1970 with a similar mission to provide stability for the nation's residential mortgage markets and expand opportunities for home ownership and affordable rental housing.

As Figure 1 (see page 20) illustrates, Fannie Mae and Freddie Mac support the nation's housing finance system through the **secondary mortgage market.** Neither Enterprise makes home loans directly to borrowers; rather, banks, credit unions, and other retail financial institutions originate home loans. Generally, lenders do not retain the mortgages they originate as assets on their own books. Instead, they often sell **conventional conforming mortgage loans** soon after origination to Fannie Mae or Freddie Mac. The Enterprises thus provide liquidity for mortgage lenders.

The Enterprises typically securitize the loans they purchase by aggregating or pooling them into MBS, which are then sold to investors. As part of the securitization process, and to reduce investors' risk, the Enterprises **guarantee** payment of principal and interest on their MBS in exchange for a fee. Alternatively, the Enterprises may hold these loans or purchase MBS for their own investment portfolios, which are funded through issuance of debt obligations.

The Enterprises have historically benefited from an **implied guarantee** that the federal government would prevent default on their financial obligations.[13] After the Enterprises were placed into conservatorships, this guarantee effectively became explicit.[14] As a result, over time, the cost of borrowing for the Enterprises has been lower than that for other for-profit companies.[15]

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.

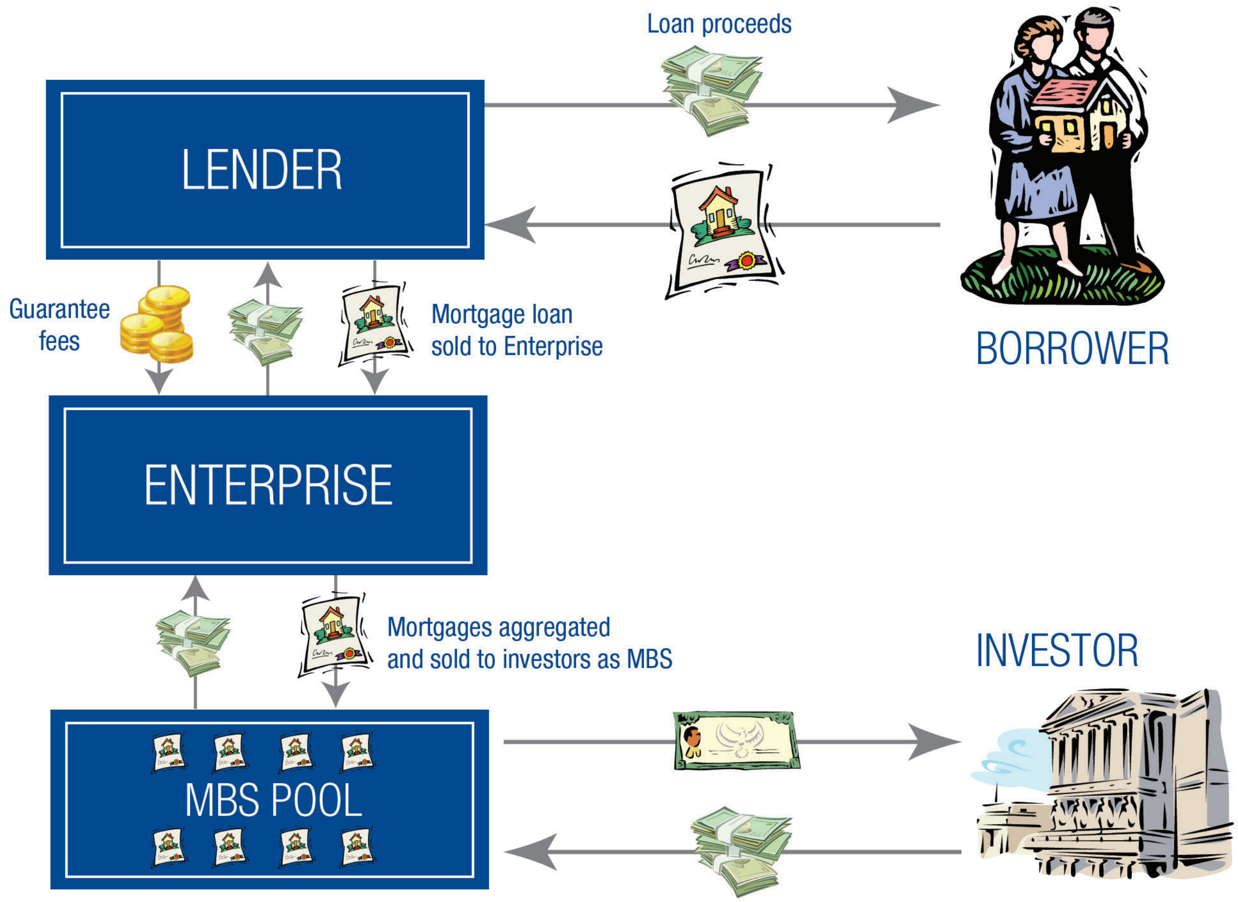
Both the primary and secondary mortgage markets are over-the-counter markets – there is no central exchange. Rather, loans are bought and sold through personal and institutional networks.

Conventional Conforming Mortgage Loans:
Conventional mortgage loans are 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 2011, 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 the collateral pool of loans, thereby ensuring the timely payment of principal and interest owed to investors.

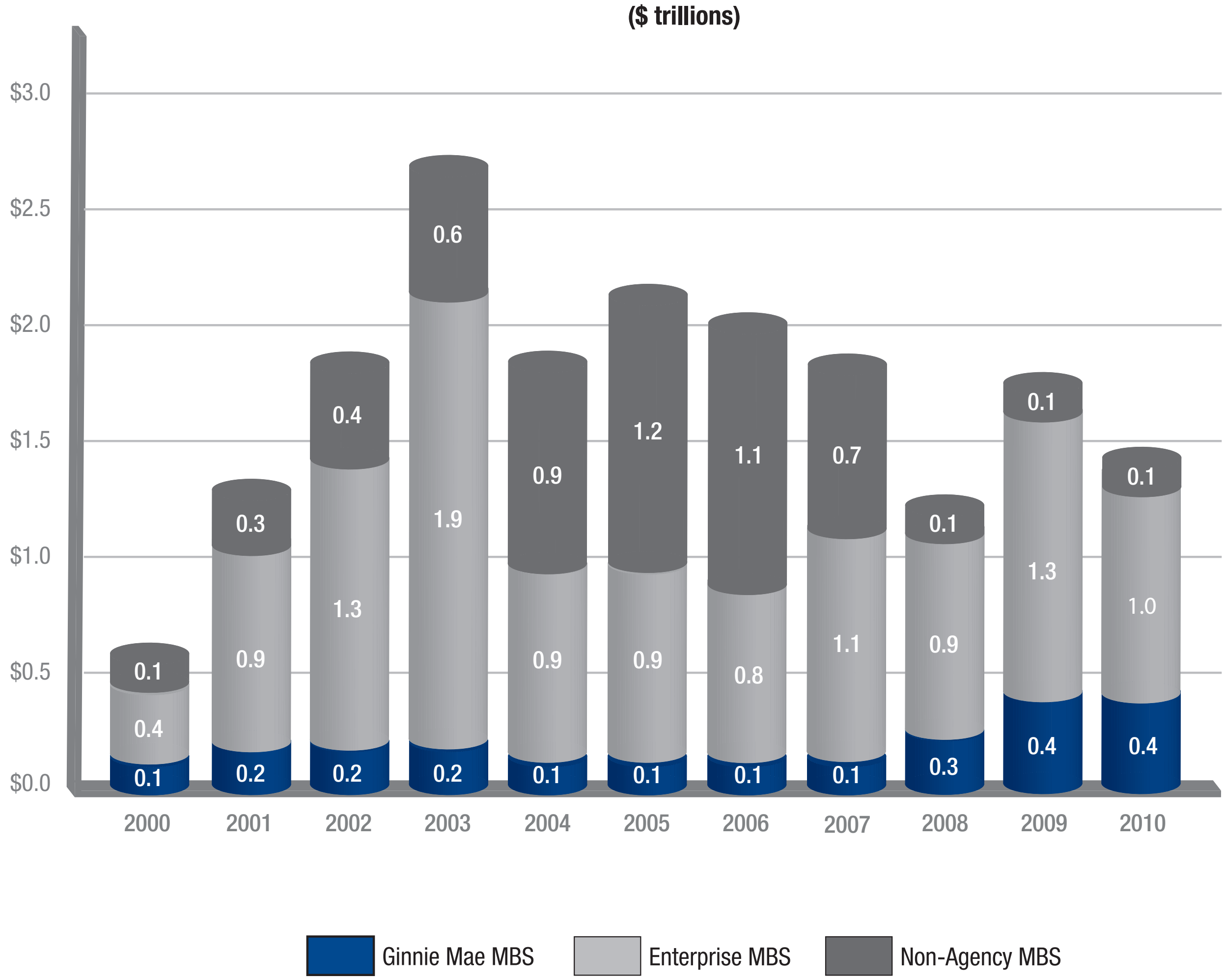
Implied Guarantee:
The assumption, prevalent in the financial markets, that the federal government will cover GSE debt obligations.

Figure 1. Mortgage Origination and Securitization Process



With the federal government's financial support, the Enterprises added to their dominant position in the residential housing finance market as the housing crisis continued and private-sector financing for the secondary market nearly disappeared, as Figure 2 illustrates.

Figure 2. Primary Sources of MBS Issuances from 2000 to 2010 ($ trillions)

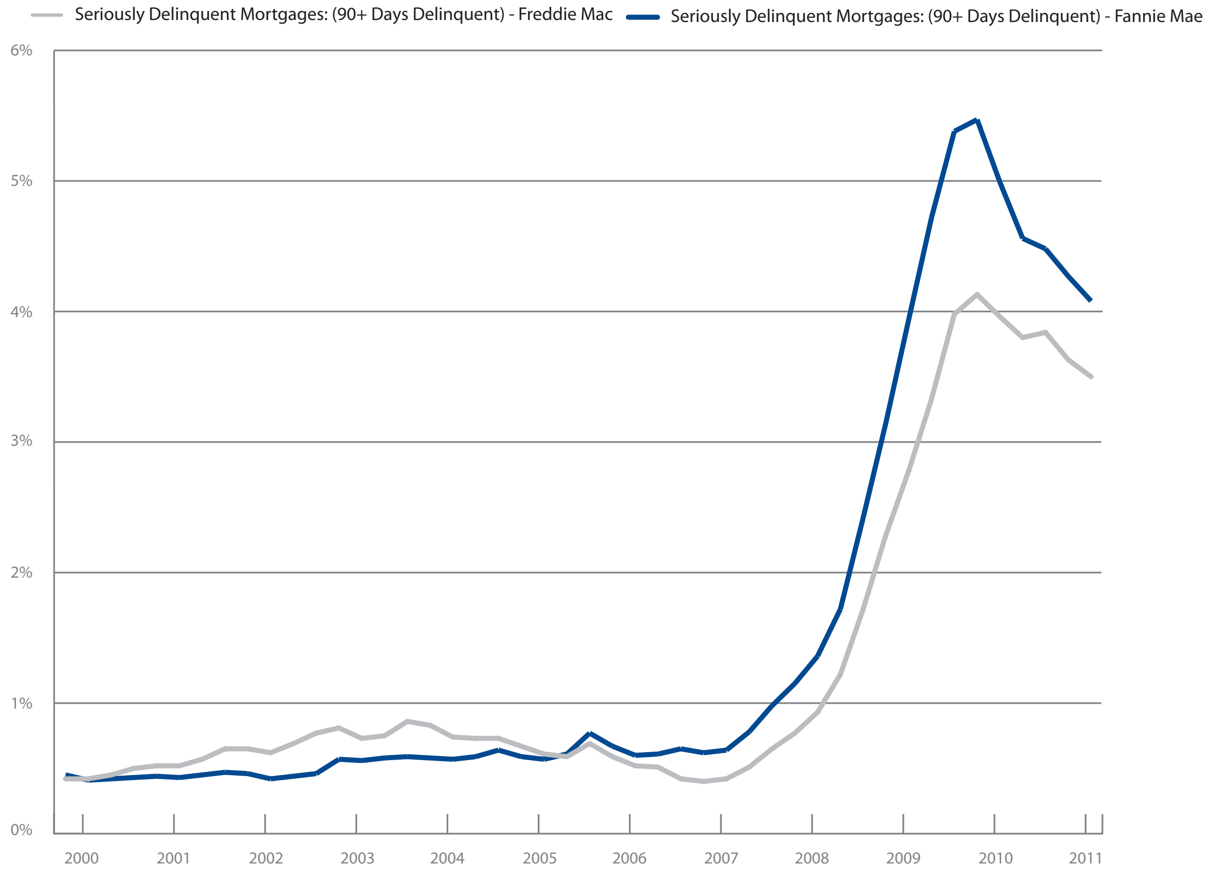


Source: Inside Mortgage Finance, *2011 Mortgage Market Statistical Annual.*

Enterprise Financial Performance and Government Support

As Figure 3 (see page 22) indicates, delinquencies on home mortgages, including those owned or guaranteed by the Enterprises, began to rise in 2007 and reached unprecedented levels in 2009.

Figure 3. Enterprise Delinquency Rates 2000 to 2011

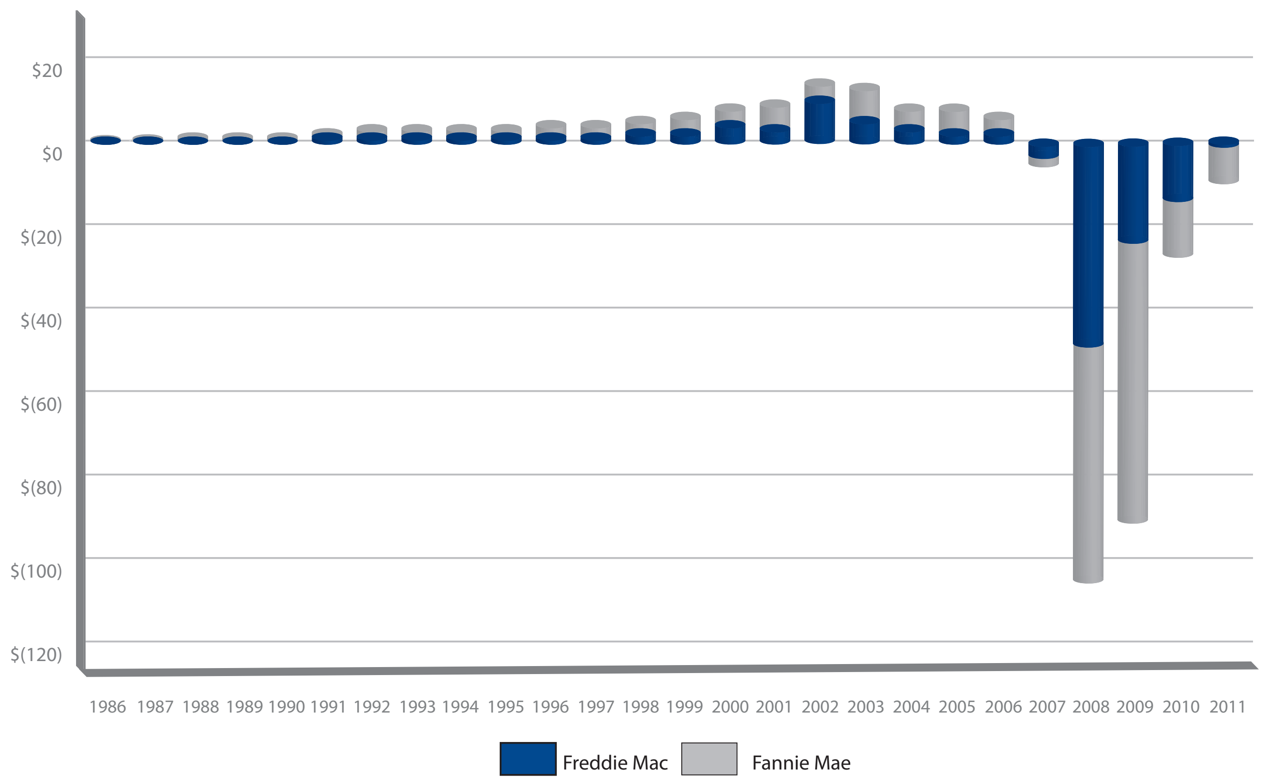


Sources: Fannie Mae, *Monthly Summary* (online at www.fanniemae.com/ir/monthly/index.jhtml) (accessed Oct. 20, 2011); Freddie Mac, *Monthly Volume Summaries* (online at www.freddiemac.com/investors/volsum/) (accessed Oct. 20, 2011); Freddie Mac, *Financial Archives* (online at www.freddiemac.com/investors/archives.html#mvs) (accessed Oct. 20, 2011).

As a result of these delinquencies, losses escalated and drove rapid financial deterioration at the Enterprises. As shown in Figure 4 (see page 23), during the year they went into conservatorships, 2008, the Enterprises reported combined losses of $109 billion, a figure that exceeded their cumulative earnings during the preceding 21 years. The Enterprises have continued to lose money since, although the magnitude of their annual losses diminished to $28 billion in 2010.

Financial performance continued to improve for both Enterprises in the first half of fiscal year 2011, although both companies continued to report losses. Fannie Mae reported a net loss of $9.4 billion for the first half of 2011, while Freddie Mac reported a net loss of $1.4 billion for that period. The comparable figures for the first half of 2010 were losses of $12.8 billion and $11.4 billion, respectively.

Figure 4. Enterprises' Annual Net Income (Loss) 1986-2010 and the Six Months Ended June 30, 2011 ($ 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 Sept. 23, 2011); Fannie Mae, *2009 and 2010 Fannie Mae 10-K Reports*, at F-4 (online at www.fanniemae.com/ir/sec/index.jhtml?s=SEC+Filings) (accessed Sept. 23, 2011); Freddie Mac, *2009 and 2010 Freddie Mac 10-K Reports,* at 208, 174 (online at www.freddiemac.com/investors/sec_filings/index.html) (accessed Sept. 23, 2011); Fannie Mae, *2011 Fannie Mae Second Quarter 10-Q Report*, at 94 (online at www.fanniemae.com/ir/pdf/earnings/2011/q22011.pdf) (accessed Sept. 23, 2011); Freddie Mac, *2011 Freddie Mac Second Quarter 10-Q Report*, at 102 (online at www.freddiemac.com/investors/er/pdf/10q_2q11.pdf) (accessed Sept. 23, 2011).

To offset these losses, government support of the Enterprises since 2008 also has been unprecedented. Figure 5 (see page 24) breaks down, by quarter, Treasury's investment in the Enterprises through September 30, 2011. Treasury has provided $169 billion pursuant to the PSPAs. In accordance with the terms of the PSPAs, 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 Treasury. As of September 30, 2011, $32.1 billion of Treasury's investment had been used to pay dividends back to Treasury. FHFA estimates, based on the Enterprises' projected losses, that Treasury's investment in them could range from $220 billion to $311 billion through 2014.[16]

Figure 5. Treasury Capital and Dividends Due Under PSPAs ($ billions)

Period Covered	Freddie Mac			Fannie Mae			Combined		
	Treasury Investment Under PSPA	Dividends Due Treasury Under PSPA	Net Capital Provided to Enterprise	Treasury Investment Under PSPA	Dividends Due Treasury Under PSPA	Net Capital Provided to Enterprise	Treasury Investment Under PSPAs	Dividends Due Treasury Under PSPAs	Net Capital Provided to Enterprises
Third Quarter 2008	$13.8	$0.0	$13.8	$ 0.0	$0.0	$0.0	$13.8	$0.0	$13.8
Fourth Quarter 2008	30.8	0.2	30.6	15.2	0.0	15.2	46.0	0.2	45.8
First Quarter 2009	6.1	0.4	5.7	19.0	0.0	19.0	25.1	0.4	24.7
Second Quarter 2009	-	1.1	(1.1)	10.7	0.4	10.3	10.7	1.6	9.1
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	14.2	15.3	2.4	12.9
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	-	1.6	(1.6)	-	2.5	(2.5)	-	4.1	(4.1)
Total as of September 30, 2011	$65.2	$14.9	$50.3	$103.8	$17.2	$86.6	**$169.0**	**$32.1**	$136.9

Source: Federal Housing Finance Agency, *Data as of September 30, 2011 on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities* (online at www.fhfa.gov/webfiles/22692/TSYSupport09302011.pdf) (accessed Oct. 7, 2011). Nonzero numbers may display as zero due to rounding.

Additional Government Support

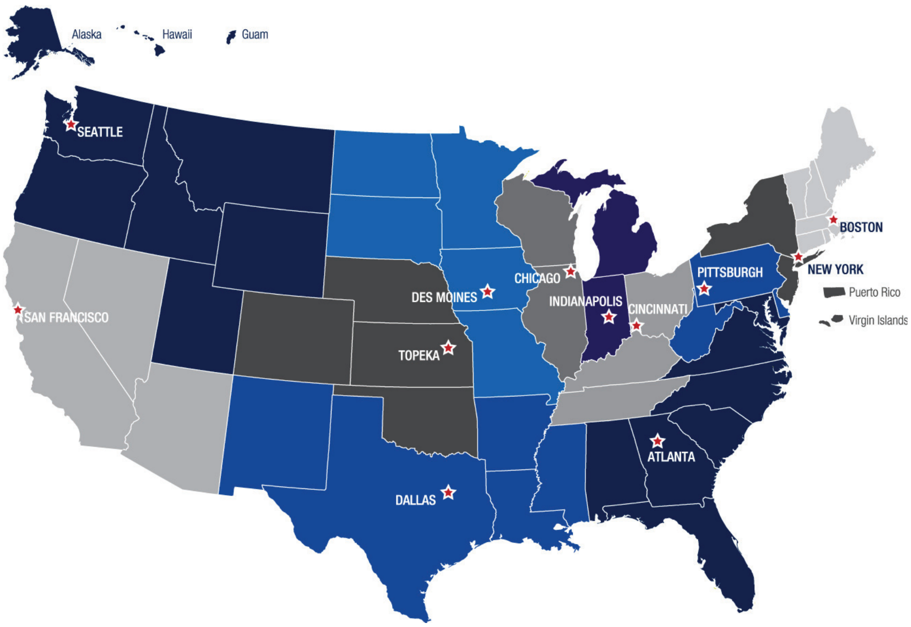
The Enterprises also benefited from exceptional government measures to support the housing market overall. Since September 2008, the Federal Reserve and Treasury have purchased more than $1.3 trillion in Enterprise MBS, and the Federal Reserve has purchased an additional $135 billion of bonds issued by the Enterprises.[17]

FHLBANKS

The FHLBank System was created in 1932 to improve the availability of funds 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.[18] The 12 FHLBanks are each separate legal entities that must adhere to specific management and capitalization criteria.[19] The geographic areas that comprise the FHLBank System are shown in the map in Figure 6 (see page 25).

The 12 FHLBanks are privately capitalized. Each regional FHLBank is cooperatively owned by the members it serves, which include financial

Figure 6. Map of the Regional FHLBanks



Source: Federal Home Loan Bank of Boston, *The Federal Home Loan Bank System* (online at www.fhlbboston.com/aboutus/thebank/08_01_04_fhlb_system.jsp) (accessed Sept. 23, 2011).

institutions, such as commercial banks, thrifts, insurance companies, and credit unions. Eligible financial institutions invest in stock of the FHLBanks to become members. FHLBank stock is not publicly traded.[20]

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

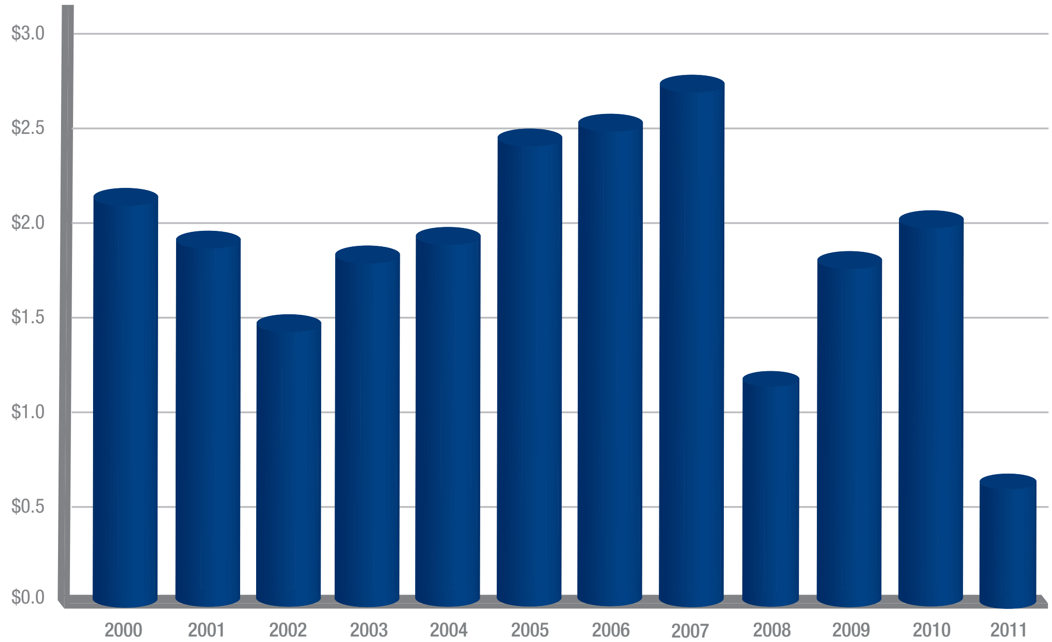
The FHLBanks also maintain investment portfolios containing mortgage-related assets, and some face heightened credit risks due to their larger holdings of private-label MBS.

To fund member advances, the FHLBanks issue debt securities through their Office of Finance.[21] 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.

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

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 would be required to step in and cover that debt.

Figure 7. FHLBanks' Annual Net Income 2000-2010 and the Six Months Ended June 30, 2011 ($ billions)



Sources: Federal Housing Finance Agency, *2008 FHFA Annual Report to Congress*, at 141 (online at www.fhfa.gov/webfiles/2335/FHFA_ ReportToCongress2008508rev.pdf) (accessed Sept. 23, 2011); Federal Home Loan Banks, *2010 Federal Home Loan Banks Combined Financial Report*, at F-5 (online at www.fhlb-of.com/ofweb_userWeb/resources/10yrend.pdf) (accessed Sept. 23, 2011); Federal Home Loan Banks, *2011 Federal Home Loan Banks Combined Financial Report*, at F-3 (online at www.fhlb-of.com/ofweb_userWeb/resources/11Q2end.pdf) (accessed Sept. 23, 2011).

SELECTED FHFA PROGRAMS AND ACTIVITIES

FHFA-OIG follows developments in the programs and operations of FHFA and the GSEs. A number of developments are discussed below.

Conforming Loan Limit

The Enterprises are required by law to purchase single-family mortgages with origination balances below the conforming loan limit. As of October 1, 2011, the maximum conforming loan limit for high cost areas for single-family properties decreased to $625,500 from $729,750. As required by HERA, loans originated on or after October 1, 2011, will use the permanent high cost area loan limits established by FHFA. The formula used to determine this limit was 115% of the local median home price, up to a maximum of $625,500 for a single-family property in the continental United States.[22]

For more information on the conforming loan limit, see page 19 of this report.

Mortgage Servicing Compensation

Concerns arose regarding servicer compensation for nonperforming loans and that this compensation difficulty could adversely impact lenders and homeowners. In response, in January 2011, FHFA announced a joint initiative with the Enterprises and HUD to review future alternative fee structures for mortgage **servicers**. The main goals of the initiative were to:

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.

- improve service for borrowers;
- reduce financial risk to servicers;
- provide guarantors flexibility for better management of non-performing loans; and
- promote continued ease of trading for MBS investors.

The joint initiative explored alternatives to the current industry standard structure for mortgage servicing compensation, which consists of a fixed percentage of the serviced loans' unpaid principal balance. It sought to evaluate the potential impact of these alternatives on industry participants and submitted solutions for public comment.

On September 27, 2011, FHFA released two alternative mortgage servicing compensation structures for public comment. One proposal would create a reserve account within the current servicing compensation structure to cover non-performing loan servicing costs. The alternative proposal would create a fee-for-service compensation model. The goal of the fee-for-service model is to link servicer compensation more closely to actual services performed. FHFA is seeking comments on these two proposals for 90 days from the date of the announcement.[23]

Private-Label MBS Lawsuits

On July 27, 2011, FHFA filed suit on behalf of the Enterprises against UBS Americas, Inc. (UBS), several affiliated entities, and individual UBS employees. Subsequently, on September 2, 2011, FHFA filed further actions against 17 additional financial services firms:

- Ally Financial Inc., formerly known as GMAC, LLC
- Bank of America Corporation
- Barclays Bank PLC
- Citigroup, Inc.
- Countrywide Financial Corporation
- Credit Suisse Holdings (USA), Inc.
- Deutsche Bank AG
- First Horizon National Corporation
- General Electric Company
- Goldman Sachs & Co.
- HSBC North America Holdings, Inc.
- JPMorgan Chase & Co.

- Merrill Lynch & Co./First Franklin Financial Corp.
- Morgan Stanley
- Nomura Holding America Inc.
- The Royal Bank of Scotland Group PLC
- Societe Generale

The lawsuits also name individual employees of each firm as well as affiliates. The lawsuits allege violations of federal, state, and common laws related to the offer and sale of certain residential private-label MBS purchased by the Enterprises. These suits do not pertain to the Enterprises' investments in or guarantees of conventional conforming mortgage loans. Rather, at issue are separate investments the Enterprises made in private-label MBS that were created and sold by the companies named as defendants.

FHFA's principal complaint is that the companies allegedly failed to perform proper due diligence as required in their capacity as **underwriter** for their securities offerings. The lawsuits also allege that the firms' disclosure documents contained misstatements and omissions about the mortgage loans underlying the private-label MBS, including materially false or inadequate characterizations of the mortgage borrowers' creditworthiness, the quality of the origination process, and practices used to evaluate and approve the loans.

Underwriter:
In the context of the securities markets, an underwriter is an entity that purchases newly issued bonds from the issuer and resells them to investors. In their role as marketing and sales agents, underwriters have specific obligations to disclose accurate and pertinent information about such bond offerings, many of which are stated in the Securities Act of 1933.

FHFA seeks damages and civil penalties under the Securities Act of 1933 and for state securities law violations to recover losses incurred by the Enterprises due to investments in the firms' MBS offerings. In the cases of Ally Financial Inc., Countrywide Financial Corporation, Deutsche Bank AG, General Electric Company, Goldman Sachs & Co., JPMorgan Chase & Co., Merrill Lynch & Co., Morgan Stanley, and UBS, FHFA also seeks punitive damages.[24]

Bank of America Private-Label MBS Settlement

On June 29, 2011, Bank of America announced it will pay $8.5 billion to a group of 22 investors to settle claims that they were sold poor quality MBS. The MBS involved in the settlement were issued by Countrywide Financial, which was purchased by Bank of America in 2008. On August 30, 2011, FHFA, on behalf of the Enterprises, filed an Appearance and Conditional Objection in reference to the proposed settlement between Bank of America and the 22 investors included in the settlement. FHFA filed the objection in order to obtain additional pertinent information regarding the matter. However, FHFA noted it was not aware of a basis upon which it would raise a substantive objection to the proposed settlement. FHFA indicated the proposed settlement's loan servicing and document deficiency improvements were considered positive and expressed encouragement that a number of significant market participants supported the deal. By submitting its filing, FHFA reserved its right to object to the settlement if the need should arise.[25]

Disposition of Real Estate Owned Properties

FHFA, Treasury, and HUD issued a Request for Information (RFI) on August 11, 2011, soliciting proposals to address the inventory of single-family **real estate owned (REO)** properties held by the Enterprises and the Federal Housing Administration (FHA). As of June 30, 2011, the Enterprises collectively owned 196,318 REO properties.[26] The stated goal of the RFI is to gather information and explore means to address the current and future REO inventory, increase private investment in the housing market, maximize value to taxpayers, and support rental and affordable housing needs.

The RFI seeks feedback and strategies to:

- reduce the REO portfolios of the Enterprises and FHA in a cost-effective manner;
- reduce average loan loss severities of the Enterprises and FHA relative to individual distressed property sales;
- address property repair and rehabilitation needs;
- respond to economic and real estate conditions in specific regions;
- assist in neighborhood and home price stabilization efforts; and
- develop analytic approaches to determine the appropriate disposition strategy for individual properties, whether sale, rental or, in certain instances, demolition.

FHFA, Treasury, and HUD have indicated that the RFI's objectives could be best achieved through "REO to rental structures" such as:

- programs for previous homeowners to rent properties or for current renters to become owners; and
- strategies through which REO assets could be used to support markets with a strong demand for rental units and a substantial volume of REO.

The agencies are also open to additional ideas regarding strategic planning, transactions, and venture investment.[27] The RFI envisioned proposals for transactions between $50 million and $1 billion in value, including both single-family and condominium REO properties. The deadline for responses was September 15, 2011.[28]

Real Estate Owned (REO):
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.

Credit Rating Agency:
Credit rating agencies provide their opinions on the creditworthiness of institutional borrowers and their financial obligations. While the Securities and Exchange Commission recognizes 10 credit rating agencies as Nationally Recognized Statistical Rating Organizations, 3 (S&P, Moody's, and Fitch) are considered the most prominent. Their credit scales used for long-term obligations (those of 13 months or longer) are listed below, descending from highest-rated to lowest:

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa1	CCC+	CCC+
Caa2	CCC	CCC
Caa3	CCC-	CCC-
Ca	CC	CC
C	C	C
	D	D

High-quality, "investment grade" debt is rated Baa3/BBB- or higher; lower-rated obligations are typically referred to as "high-yield" or "junk" debt. A "D" from S&P or Fitch indicates actual default.

Standard & Poor's Downgrade

Standard & Poor's Rating Services (S&P), a prominent **credit rating agency**, announced on August 5, 2011, that the long-term sovereign credit rating for Treasury debt was lowered to AA+ from AAA. To date, S&P is the only major credit rating agency to take such an action. Of the other two major rating agencies, Moody's Investors Service (Moody's) affirmed its top credit rating of Aaa for Treasury obligations on August 2, 2011, and Fitch Ratings (Fitch) affirmed its top AAA credit rating on August 16, 2011. Highly rated institutions tend to be able to borrow funds in the bond markets more readily and at a lower cost.

As a result of the downgrade, the outlook (i.e., prospects for future changes in creditworthiness) for the GSEs was deemed "negative" by S&P. On August 8, 2011, S&P lowered the credit ratings on Fannie Mae and Freddie Mac to AA+ from AAA. Additionally, the credit ratings on 10 of the 12 FHLBanks and the FHLBank System's senior debt were lowered to AA+ from AAA. S&P noted that the downgrades were directly related to these entities' reliance on the U.S. government.[29]

In response to the downgrade of the GSEs' debt, FHFA's Acting Director announced that the downgrades would have no effect on FHFA's calculation of risk-based capital for the GSEs.[30]

Completion of Resolution Funding Corporation Obligation

On August 5, 2011, FHFA announced that the 12 FHLBanks had satisfied their obligation to pay interest on Resolution Funding Corporation (RefCorp) bonds issued from 1989 to 1991. RefCorp bonds were originally authorized by Congress and issued to help finance the resolution of failing savings and loans. Under the original repayment agreement, the federal government required the FHLBanks to pay RefCorp $300 million per year towards repayment of the RefCorp obligation. Since 1999 each FHLBank has been required to pay 20% of its net earnings – reduced by contributions to the FHLBanks' affordable housing programs – to service the RefCorp obligation.

In anticipation of this event, the 12 FHLBanks signed a Joint Capital Enhancement Agreement on February 28, 2011. Under the agreement's terms, beginning September 30, 2011, each FHLBank will allocate 20% of its annual net income to a restricted retained earnings account until the account balance equals 1% of the bank's outstanding consolidated obligations. Amendments were approved by the FHFA Acting Director on August 5, 2011, making the allocation of restricted retained earnings part of each FHLBank's capital plan. FHFA monitors the FHLBanks' compliance with their capital plans.[31]

Bank of America Servicing Rights

On August 3, 2011, FHFA, acting in its capacity as conservator, approved Fannie Mae's payment of approximately $500 million to Bank of America in return for the transfer of loan servicing rights on mortgages owned or guaranteed by Fannie Mae from Bank of America to other loan servicers. In the aftermath of that approval, members of Congress and others have raised questions about the payment. FHFA's Acting Director has publicly stated that the transfer of servicing rights made sense for Fannie Mae and Bank of America.[32] FHFA-OIG is currently reviewing this transaction.

FHFA-OIG recently released an evaluation (Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America) *discussing Freddie Mac's settlement with Bank of America on repurchase claims.*

FHFA 2010 Annual Report

On June 13, 2011, FHFA delivered its 2010 *Report to Congress*, which presented FHFA's examination findings for Fannie Mae, Freddie Mac, and the FHLBank System.

Fannie Mae and Freddie Mac each received composite examination ratings reflecting "critical supervisory concerns." FHFA cited continuing and forecasted credit losses on mortgages originated in 2005 through 2007 as a principal factor in these ratings and identified credit risk, operational risk, modeling risk, and retention of leadership and personnel as key challenges for both Enterprises. With respect to FHFA's conservatorship duties, the report noted that, under the oversight and guidance of FHFA as conservator and regulator, the Enterprises have improved underwriting standards for loan purchases in the past two years. It also noted, "another way FHFA minimized losses was to require the Enterprises to enforce existing contractual representation and warranty loan repurchase agreements with lenders."

With respect to the FHLBank System, FHFA described the overall condition of the FHLBanks of Boston, Chicago, Pittsburgh, and Seattle as "present[ing] supervisory concerns," while the FHLBanks of Atlanta and San Francisco presented supervisory concerns that were more limited in nature. The FHLBanks of Cincinnati, Dallas, Des Moines, Indianapolis, New York, and Topeka were described as "satisfactory." Additionally, FHFA's review of the FHLBanks' Office of Finance noted several supervisory concerns. FHFA concluded that "although the financial condition and performance of the FHLBanks generally stabilized in 2010, the FHLBanks continued to be negatively affected by exposure to private-label MBS and declines in advances (loans to members)."[33]

FHFA-OIG plans to conduct several reviews centering on the FHLBanks, including such topics as advance and collateral management, capital, troubled banks, organizational structure, and affordable housing programs.

For further information on private-label MBS, see page 4 of this report.

Servicing Alignment Initiative

On April 28, 2011, FHFA introduced the Servicing Alignment Initiative, which directed the Enterprises to align their guidance for servicers of delinquent mortgages they own or guarantee. Historically, each Enterprise had set forth different requirements for handling delinquent loans. The new directive seeks to establish consistent, transparent standards for servicing delinquent mortgage loans. It includes cash incentives for exemplary performance, as well as monetary penalties for underperformance.[34] It addresses four aspects of delinquent loan servicing: borrower contact, delinquency management practices, loan modifications, and foreclosure timelines.

For more information on the role of the servicer, see page 75 of this report.

- **Borrower Contact** The new directive calls for earlier, more frequent contact between the servicer and the homeowner. It specifies standards for call center service levels and servicers' solicitations for borrower assistance measures, such as loan modifications. The directive also sets forth a standard for such interactions known as "Quality Right Party Contact," under which the servicer must establish a rapport with the borrower; determine the reason for the delinquency, the borrower's plans for the property, and his or her ability to make the mortgage payments; set payment expectations and educate the borrower on appropriate assistance programs; and obtain a commitment to resolve the delinquency. The servicer must be able to provide proof that it honored these standards with respect to each delinquent loan, upon the Enterprise's request.

As noted in further detail in Section 3, FHFA-OIG has recently released reports discussing the performance of Fannie Mae's Retained Attorney Network and its management of operational risks.

- **Delinquency Management** The new directive sets forth a uniform requirement that servicers timely acknowledge certain events pertaining to borrowers, including receipt of requests for assistance. Servicers must also provide borrowers consistent information about the evaluation process and timeline, the foreclosure process, and instances when foreclosure actions may not be halted. Additionally, they must evaluate the assistance programs that may be appropriate, such as HAMP and Home Affordable Foreclosure Alternatives (HAFA), simultaneously for each borrower. They must also implement measures that will provide borrowers with continuity throughout the process of delinquency resolution.
- **Loan Modifications** Both Enterprises must conform to guidelines previously published by Fannie Mae that provide standards for evaluating borrowers for modifications, permissible lengths for modification trial periods, documentation requirements, and credit bureau reporting.[d]
- **Foreclosure Timelines** The new guidance sets forth consistent timing standards for foreclosure processing steps and standardizes the circumstances under which the Enterprises may assess penalties against their servicers for noncompliance.[35]

According to FHFA, the Servicing Alignment Initiative is intended to provide superior service to borrowers with clearer and more consistent borrower communications, efficient processing of loan modifications, a fair foreclosure process, increased servicer accountability, and, ultimately, reduced taxpayer losses through improved loan servicing.

Risk Retention Proposal

On March 31, 2011, the Federal Reserve Board, HUD, the Federal Deposit Insurance Corporation (FDIC), FHFA, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission (SEC) issued a proposed rule to implement the credit risk-related requirements of the

[d] The relevant announcement is Fannie Mae Servicing Guide Announcement SVC 2011-03, *Updates to Fannie Mae's Mortgage Modification Requirements*, published April 4, 2011.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act requires sponsors of certain classes of new bond issuances, including MBS, to retain not less than 5% of the credit risk of the underlying assets, such as mortgage loans. The Dodd-Frank Act also includes several exceptions to these requirements, such as an exemption for MBS collateralized exclusively by qualified residential mortgages (QRMs). The proposed rule would limit the definition of QRMs to loans of very high credit quality, as indicated by criteria such as borrower credit history, payment terms, and loan-to-value ratio.

The proposed rule also includes investor disclosure requirements for certain material information designed to provide investors and the agencies with an efficient way to monitor compliance with risk-retention requirements. Last, it would specify that the Enterprises' guarantee of principal and interest would constitute qualifying risk retention for as long as the Enterprises are in conservatorship or receivership with capital support from the federal government.[36] Comments on the proposed rule were due to the agencies by August 1, 2011.[37]

FHFA Organizational Restructuring

FHFA implemented an organizational restructuring of its safety and soundness and housing mission offices; the reorganization was announced on February 2, 2011. According to FHFA, the restructuring is intended to promote greater consistency and uniformity in the examinations of the GSEs. As part of the reorganization, a new housing mission team will focus on policy matters involving the conservatorships, including loss mitigation activities, public reporting on the GSEs' activities, affordable housing, the state of the secondary mortgage market, and activities related to the Dodd-Frank Act.

SECTION 3

ACCOMPLISHMENTS AND STRATEGY OF FHFA-OIG

Section 3: Accomplishments and Strategy of FHFA-OIG

From April 1, 2011, through September 30, 2011, FHFA-OIG recorded several significant accomplishments. These included: (1) issuing eight audit and evaluation reports; (2) participating in a number of significant criminal and civil investigations; and (3) reviewing and commenting on proposed FHFA rules.

FHFA-OIG AUDIT AND EVALUATION ACTIVITIES

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

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

Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America (EVL-2011-006, September 27, 2011)

In December 2010, FHFA, in its capacity as conservator of the Enterprises, approved two agreements totaling $2.87 billion that settled mortgage repurchase claims asserted against Bank of America. Freddie Mac's $1.35 billion settlement with Bank of America could serve as a precedent for future repurchase settlements. Fannie Mae and Freddie Mac have purchased millions of mortgages from loan sellers, such as Bank of America. The contracts under which the Enterprises purchased the mortgages provide them with the right to require the sellers to repurchase mortgages that do not meet the underwriting criteria represented and warranted by them.

FHFA-OIG began a review after members of Congress and others questioned the adequacy of the settlements. During the review, two individuals independently reported their concerns about the Freddie Mac-Bank of America settlement.

Accordingly, FHFA-OIG initiated an evaluation of that agreement. FHFA-OIG found that FHFA senior management did not timely address significant concerns raised about Freddie Mac's loan review process and its ramifications on the underlying settlement. Specifically, FHFA-OIG made three findings:

- First, in mid-2010, prior to the Bank of America settlement, an FHFA senior examiner raised serious concerns about limitations in Freddie Mac's existing loan review process for mortgage repurchase claims, which, according to the senior examiner, could potentially cost Freddie Mac a considerable amount of money. Freddie Mac's internal auditors independently identified concerns about the process at the end of 2010. These concerns merited prompt attention by FHFA because they potentially involve significant recoveries for Freddie

Mac and, ultimately, the taxpayers. Further, unless examined and addressed, the underlying problems are susceptible to recurrence.

- Second, FHFA did not act timely or test the ramifications of these concerns prior to approving the Bank of America settlement. FHFA-OIG did not independently validate Freddie Mac's existing loan review process and, therefore, does not reach any final conclusion about it. Nevertheless, by relying on Freddie Mac's analysis of the settlement without testing the assumptions underlying the Enterprise's existing loan review process, FHFA senior managers may have inaccurately estimated the risk of loss to Freddie Mac.
- Third, following the initiation of FHFA-OIG's evaluation, FHFA, to its credit, 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. Additionally, other findings tend to support the validity of the concerns about the process. For example, on June 6, 2011, Freddie Mac's internal auditors issued an audit opinion that the Enterprise's internal governance controls over this process were "Unsatisfactory." Furthermore, at the end of 2010 and then again in mid-2011, a Freddie Mac senior manager advised the board of directors that the Enterprise could recover more from future repurchase claims if it uses a more expansive loan review process.

In light of these findings, FHFA-OIG recommended that FHFA:

- promptly act on the specific and significant concerns raised by FHFA staff and Freddie Mac internal auditors about Freddie Mac's loan review process; and
- initiate management reforms to ensure that senior managers are apprised of and timely act on significant concerns brought to their attention.

FHFA agreed in principle with FHFA-OIG's recommendations, noting that it has already begun to take actions in response. However, FHFA noted that it "has not changed its view that the settlement was … appropriate and reasonable" and does not concur with all of the inferences that could be drawn from the report.

Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs (EVL-2011-005, September 23, 2011)

FHFA's examination program is the primary means by which it supervises and regulates the GSEs. The Agency's 120 line examiners carry out the program through periodic examinations, but FHFA's Acting Director has stated that FHFA has too few examiners to fulfill its oversight responsibilities.

In 2011, to its credit, FHFA initiated efforts to address the shortage of examiners. First, it developed a plan to hire about 26 examiners, which will increase the Agency's examination staff by about 22%. Second, FHFA reorganized the structure of its examination program to strengthen its oversight of the GSEs.

FHFA-OIG initiated an evaluation to assess both the extent of FHFA's current examination capacity and its efforts to hire examination staff. FHFA-OIG found significant shortfalls in the Agency's examination coverage, particularly in the areas of REO and default-related legal services. Furthermore, statements by senior FHFA officials and internal Agency reviews corroborate that FHFA has too few examiners overall to ensure the efficiency and effectiveness of its examination program. Due to examiner shortages, FHFA has scaled back planned work during examinations, and examinations have often taken much longer than expected to complete.

Further, the efficiency and effectiveness of FHFA's examination program is at risk due to a shortage of accredited examiners. Although FHFA's examiners have diverse professional skills, Agency data indicate that only 34% of its 120 non-executive examiners are accredited federal financial examiners.[e] However, the Agency does not yet have an accreditation program in place to improve this condition. Other federal financial regulators, such as the FDIC, generally require all of their examiners to be accredited or enrolled in accreditation programs as a condition of employment.

FHFA has sought to address these challenges. Although this is a positive response, the Agency has expressed concern that its current hiring initiative will neither enable it to overcome its examination capacity shortfalls nor ensure the effectiveness of its 2011 reorganization. For example, FHFA's Enterprise core examination teams will be staffed by only 13 examiners each – approximately half of the 20-25 examiners that FHFA's Chief Operating Officer estimated to be necessary. FHFA also said that there would not be enough examiners to help ensure the success of its 2011 reorganization of its GSE examination structure.

Moreover, FHFA has not reported upon its examination capacity shortfalls in a systematic manner. Given FHFA's critical responsibilities, it is essential that it keep Congress, the Executive Branch, and the public fully and currently informed about its examination capacity.

In light of these findings, FHFA-OIG recommended that FHFA:

- assess: (1) the extent to which examination capacity shortfalls may have adversely affected GSE examination quality and (2) potential strategies to mitigate risks, such as achieving efficiencies in the assignment of examiners or the examination process;

[e] Agency officials told FHFA-OIG that many of its examiners have alternative credentials and experiences in critical areas such as financial analysis, accounting, and the mortgage industry, and that this professional diversity enhances the quality of FHFA's work products, including its examinations. Nonetheless, Agency officials conceded that the lack of accreditation of many of its examiners impedes the efficiency and effectiveness of its examination program.

- monitor the development and implementation of the examiner accreditation program and take needed actions to address any shortfalls;
- consider using detailees from other federal agencies, retired annuitants, or contractors to augment its examination program in the near- to mid-term; and
- 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; progress in addressing these shortfalls, including the status of examiner recruitment and retention efforts; and the development and implementation of its examiner accreditation program.

FHFA agreed with these recommendations and noted that it had already begun to take steps to support their implementation.

Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk (EVL-2011-004, September 23, 2011)

FHFA views operational risk management as an important financial safety and soundness challenge facing the Enterprises. The Agency defines operational risk as the risk of loss resulting from failures in people, processes, or systems, or from external events (such as foreclosure abuses). In September 2008, FHFA issued guidance requiring the Enterprises to develop and implement programs to identify, report, and remedy operational risks. Effective operational risk management programs can assist FHFA's safety and soundness examiners to identify trends in such risks and focus their examinations accordingly.

FHFA reported that Fannie Mae has not taken adequate steps to establish an acceptable and effective operational risk management program. FHFA-OIG initiated an evaluation to assess FHFA's oversight of Fannie Mae's efforts to establish an acceptable operational risk management program.

FHFA-OIG found that between 2006 and early 2011 FHFA and OFHEO repeatedly determined that Fannie Mae had not established an acceptable and effective operational risk management program despite outstanding requirements to do so. Nonetheless, FHFA has not taken decisive action to compel Fannie Mae to create and administer an acceptable and effective operational risk management program. As Fannie Mae's regulator and conservator, FHFA's authority over the Enterprise is broad and includes the ability to discipline or remove Enterprise personnel to ensure compliance with Agency mandates. To date, FHFA has not exercised this or other authorities to compel Fannie Mae's compliance with the operational risk requirement. Instead FHFA has pursued the matter principally through less forceful supervisory means, such as conducting operational risk examinations and issuing Matters Requiring Attention, which were ineffective during the period.

Fannie Mae's lack of an acceptable and effective operational risk management program may have resulted in missed opportunities to strengthen the oversight of law firms with which it contracts to process foreclosures. For example, in a May 2006 internal report, Fannie Mae learned that attorneys acting on its behalf in Florida and elsewhere had filed false documents in foreclosure proceedings. The report further stated that Fannie Mae did not oversee the quality of its attorneys' representation or the legal positions taken by them. Nonetheless, in a 2011 preliminary report, FHFA concluded that Fannie Mae still had not acted on the recommendations to improve its attorney oversight contained in the 2006 report.

According to FHFA, Fannie Mae has recently made improvements in its operational risk program, and the Agency expects that the Enterprise will have an acceptable program in place no later than the first quarter of 2012. Given Fannie Mae's history of non-compliance, FHFA-OIG believes that the Agency must exercise maximum diligence and take forceful action to ensure Fannie Mae meets the Agency's expectations in this regard. Otherwise, FHFA's safety and soundness examination program, as well as its delegated approach to conservatorship management, may be adversely affected.

In light of these findings, FHFA-OIG recommended that FHFA:

- closely monitor Fannie Mae's implementation of its operational risk management program;
- 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; and
- ensure Fannie Mae has qualified personnel in place to administer its operational risk management program appropriately.

While FHFA agreed with the report's recommendations, it disagreed that foreclosure abuses may have been prevented had Fannie Mae established an effective operational risk program. In response, given the factual record, FHFA-OIG maintains that strengthened law firm oversight could have detected, if not prevented, the abuses by attorneys.

Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program (EVL-2011-003, August 12, 2011)

FHFA-OIG evaluated FHFA's oversight of the Enterprises' participation in MHA, a Treasury initiative established in response to the financial crisis. The Enterprises began to participate in MHA in early 2009. One key MHA program initiative, HAMP, involves mortgage servicers agreeing to modify mortgage terms (e.g., lower the monthly payment) for borrowers facing imminent default or foreclosure.

The Enterprises participate in HAMP through modification of loans in their portfolios. They also administer and enforce the program for other loan servicers as Treasury's financial agents under financial agency agreements (FAAs).

Questions arose concerning the Enterprises' participation in MHA programs. Some argued that Treasury employed the Enterprises to manage MHA in ways that jeopardize their financial interests and did so without adequate consultation and coordination with FHFA, potentially compromising its independence as the Enterprises' conservator and regulator.

FHFA-OIG initiated an evaluation to assess the relationship between FHFA and Treasury in the context of FHFA's oversight of Enterprise participation in MHA programs. FHFA-OIG found no evidence that when developing and implementing MHA programs Treasury had compromised FHFA's independence as the Enterprises' conservator and regulator. EESA requires FHFA to coordinate within the federal government in developing and implementing loan modification programs such as HAMP. FHFA has supported HAMP as a means to limit the Enterprises' credit losses by minimizing costly foreclosures. At the same time, FHFA has exhibited independence by prohibiting the Enterprises from participating in other MHA programs it views as being inconsistent with their financial soundness.

However, FHFA did not play an active role in reviewing and negotiating Treasury's FAAs with the Enterprises. The FAAs represented long-term commitments of significant resources at a time when there were substantial concerns about the Enterprises' financial and operational capacity. Nevertheless, FHFA limited its review to ensuring that the Enterprises were legally authorized to enter into the FAAs and did not review their substance. As a consequence, key terms were left undefined, such as the scope of the work to be performed by the Enterprises; the terms under which they would be compensated; and the process for resolving disputes. Significant problems developed in these areas, requiring FHFA and the Enterprises to devote substantial time and resources to their resolution. Thus, FHFA-OIG found that FHFA's conservatorship interests would have been better served if FHFA had played a more active role during the negotiation and review of the FAAs.

In early 2010, Treasury, FHFA, and the Enterprises developed a new method for reviewing and approving tasks assigned to the Enterprises under the FAAs. It represents a significant improvement compared to the process contained in the initial FAAs. However, the continued lack of a specific dispute resolution process in the revised approach increases the risk that disputes among parties will not be resolved efficiently.

In light of these findings, FHFA-OIG recommended that FHFA engage in negotiations with Treasury and the Enterprises to amend the FAAs by incorporating a specific dispute resolution process under which the parties may discuss differences that arise in the Enterprises' administration of HAMP and establish strategies by which to resolve or mitigate them. In its response, FHFA concurred with the recommendation. It plans to engage the Enterprises (separately) and Treasury to establish more specific dispute resolution procedures.

FHFA's Oversight of Fannie Mae's Default-Related Legal Services (AUD-2011-004, September 30, 2011)

For more information on robo-signing, see page 80 of this report.

In 1997, Fannie Mae established its Retained Attorney Network (RAN) to acquire default-related legal services associated with foreclosure, bankruptcy, loss mitigation, eviction, and REO closings. In August 2010, news reports alleged that RAN attorneys had engaged in inappropriate foreclosure practices, such as routinely filing false documents in court proceedings and "robo-signing."

FHFA commenced a special review of Fannie Mae's RAN in late 2010 to determine whether the program met safety and soundness standards, to evaluate the design and implementation of the RAN, and to identify vulnerabilities in its control structure. As of September 30, 2011, FHFA had not released the results of its review.

On February 25, 2011, a member of Congress requested that FHFA-OIG examine "widespread allegations of abuse by … law firms hired to process foreclosures as part of" the RAN, and Fannie Mae's and FHFA's efforts "to investigate these allegations and implement corrective action." Pursuant to the request, FHFA-OIG performed an audit to assess FHFA's oversight of Fannie Mae's default-related legal services performed by law firms within the RAN.

FHFA-OIG found that FHFA can strengthen its oversight of default-related legal services. FHFA recognized the importance of its oversight of the Enterprises' default-related legal services and gradually accumulated information on the attorney network programs of Fannie Mae and Freddie Mac. However, FHFA did not schedule comprehensive examination coverage of foreclosure issues, including allegations of abuse by RAN law firms, until mid-2010. FHFA had not previously considered risks associated with foreclosure processing to be significant. Instead, FHFA focused its examination resources on assessing areas it deemed high-risk, such as the Enterprises' management of credit risk.

Also, there were indicators prior to mid-2010 that could have led FHFA to identify the heightened risk posed by foreclosure processing within Fannie Mae's RAN. These indicators included significant increases in foreclosures, which accompanied the deterioration of the housing market, consumer complaints alleging improper foreclosures, contemporaneous media reports about foreclosure abuses by Fannie Mae's law firms, and public court filings in Florida and elsewhere highlighting such abuses. Although as of September 30, 2011, FHFA's management had not published the results of its special review of Fannie Mae's RAN, the examiners' preliminary findings confirm that at least one of these indicators – deteriorating industry conditions – should have provided adequate warning of the increased risk associated with default-related legal services.

FHFA needs to develop procedures to identify and assess new or heightened risks as it simultaneously addresses historic risks with which it is familiar. FHFA had 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 supervision of such services. Consequently, FHFA has limited assurance that foreclosure processing abuses will be prevented and detected through its supervisory activities.

Additionally, FHFA has not developed formal policies to address poor performance by law firms that have relationships – either directly through contract or through loan servicers – with both Enterprises. FHFA-OIG identified instances in which Freddie Mac terminated law firms that processed foreclosures on its behalf for poor performance, but Fannie Mae continued to use these firms. FHFA did not specifically review such terminations and, therefore, lacks assurance that law firms with histories of deficient performance do not jeopardize the safety and soundness of the Enterprises.

In light of these findings, FHFA-OIG recommended that FHFA:

- review the circumstances surrounding FHFA's not identifying the RAN foreclosure abuses at an earlier stage and develop potential enhancements to its capacity to identify new and emerging risks;
- develop and implement comprehensive examination guidance and procedures together with supervisory plans for default-related legal services; and
- 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 agreed with FHFA-OIG's recommendations. Following the reporting period, on October 18, 2011, FHFA directed Fannie Mae and Freddie Mac "to transition away from current foreclosure attorney network programs and move to a system where mortgage servicers select qualified law firms that meet certain minimum, uniform criteria."[38]

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

Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011 (AUD-2011-003, September 30, 2011)

The Consolidated Appropriations Act of 2005 requires that each federal agency designate a Chief Privacy Officer (CPO) and implement comprehensive privacy and data protection procedures governing its collection, use, sharing, disclosure, transfer, storage, and security of information relating to agency employees and the public. Additionally, the Consolidated Appropriations Act requires the inspector general of each agency to conduct periodic reviews of the agency's implementation of the Consolidated Appropriations Act.

A comprehensive privacy program helps to ensure that risks related to the collection, storage, transmission, and destruction of **personally identifiable information (PII)** are mitigated. A strong privacy program also provides a framework for an agency to consider the implications of business decisions as they pertain to PII. Additionally, a privacy program should help maintain public trust and confidence in an organization, protect its reputation, and protect against legal liability by providing the safeguards necessary to minimize the risk of unintended disclosure of PII.

FHFA-OIG contracted with Clifton Gunderson LLP to conduct a performance audit to fulfill its responsibilities for a periodic review of FHFA's privacy program and its implementation, including compliance with the statutory and regulatory requirements concerning the protection of PII. Specific sub-objectives of the audit were to determine whether FHFA implemented comprehensive privacy and data protection procedures as required by the Consolidated Appropriations Act, and whether it accurately reported on its use of PII.

The report noted that FHFA's privacy program had a number of strengths, such as a policy on the use and protection of PII. However, FHFA did not meet all of the Consolidated Appropriations Act's key requirements for developing and implementing comprehensive privacy and data protection procedures. Specifically, the audit identified that FHFA had not:

- completed a required privacy program baseline report summarizing FHFA's use of PII and establishing the control framework for privacy protection (the report was submitted to FHFA-OIG after completion of audit field work in August 2011);
- designed a job-specific privacy training program to ensure FHFA employees and contractors are familiar with privacy protection roles and responsibilities;
- established a process for timely publication of required System of Records Notices (SORNs) that describe the existence and character of the subject systems of records containing PII before they become operational;

- prepared Privacy Impact Assessments of all systems that contain PII and documented assessments made of Agency-proposed rules to help ensure protection of PII was adequately considered in the systems' development and rulemaking process; or
- implemented a process for FHFA's Privacy Office to monitor information systems containing PII after they are placed into production.

Addressing these control deficiencies in privacy and data protection procedures will strengthen FHFA's privacy program, further protect individuals from the impact of breaches that occur, and contribute to ongoing efforts to achieve reasonable assurance of adequate PII security.

The report contained nine recommendations to strengthen FHFA's privacy program by improving controls over privacy documentation, training, and systems. Several of the recommendations made in the report relate to privacy practices that have not been incorporated into the Agency's policies and procedures. Absent formal policies and procedures, FHFA cannot ensure consistent privacy program implementation across all Agency operations and protect the confidentiality, integrity, and availability of privacy information consistent with statutory and regulatory requirements.

FHFA agreed with the report's recommendations.

Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011 (AUD-2011-002, September 29, 2011)

The Federal Information System Management Act of 2002 (FISMA) requires agencies to develop, document, and implement agency-wide information security programs to protect their information and information systems, including those provided or managed by another agency, contractor, or other source. Additionally, FISMA requires agencies to undergo an annual independent evaluation of their information security programs and practices and an assessment of compliance with FISMA. Moreover, FISMA requires the National Institute of Standards and Technology (NIST) to issue standards and guidelines for federal information and systems, including minimum security requirements. NIST has defined an overall information security risk management framework.

Additionally, the Office of Management and Budget (OMB) has issued guidance related to information security, including plans of action and milestones (POA&Ms) for addressing findings from security control assessments, security impact analyses, and continuous monitoring activities. POA&Ms provide a roadmap for continuous agency security improvement and assist agency officials with prioritizing corrective action and resource allocation.

FHFA-OIG contracted with Clifton Gunderson LLP to conduct a performance audit to fulfill its FISMA responsibilities for an annual independent evaluation of FHFA's information security program. The objective of the audit was to evaluate the effectiveness of FHFA's information security program and practices and its compliance with FISMA and related information security policies, procedures, standards, and guidelines.

Although FHFA's information security program has a number of strengths, including but not limited to its information system security training, system-level planning, risk assessment, access authorization, and continuous control monitoring, FHFA-OIG found that a number of security practices can be improved. Specifically, FHFA had not:

- finalized, disseminated, and implemented a NIST-recommended organization-wide information security program plan that defines such key requirements as security-related roles and responsibilities and security program controls;
- updated its policies and procedures to address completely all of the NIST-recommended components within the control families applicable to the FHFA information system;
- developed, disseminated, and implemented an information categorization policy and methodology;
- implemented adequate procedures for tracking and monitoring correction of weaknesses or deficiencies through POA&Ms; and
- implemented adequate procedures for ensuring remediation of weaknesses noted in network vulnerability assessments.

Addressing these control deficiencies in information security practices will strengthen FHFA's information security program and contribute to ongoing efforts to achieve reasonable assurance of adequate security over information resources.

In light of these findings, FHFA-OIG recommended that FHFA:

- finalize the Agency-wide information security program plan;
- update policies and procedures to address all NIST requirements and recommendations applicable to the FHFA information security environment;
- develop and implement an information categorization policy and methodology;

- establish a process to monitor compliance with procedures, including timely completion of POA&Ms; and
- track and monitor remediation actions to address weaknesses identified in network vulnerability assessments.

FHFA agreed with FHFA-OIG's recommendations.

Audit of the Federal Housing Finance Agency's Consumer Complaints Process (AUD-2011-001, June 21, 2011)

The current national housing crisis has left millions of existing borrowers, communities, and investors struggling with delinquent and defaulted mortgages, loan modifications, and foreclosures. At the same time, consumers suffering from the effects of the crisis increasingly filed complaints with the Enterprises and FHFA, their conservator and regulator. FHFA staff estimated that 70-75% of all complaints filed with the Agency pertained to the Enterprises.

As a result, Congress and others expressed interest in whether FHFA adequately responded to consumer complaints including, but not limited to, complaints involving fraud, waste, or abuse. These complaints run the gamut from difficulties obtaining information from the Enterprises to allegations of potential criminal activity. FHFA-OIG initiated an audit to assess how FHFA processed consumer complaints.

FHFA-OIG found that FHFA did not adequately process consumer complaints. Specifically, the Agency did not:

- sufficiently define its role in processing complaints received by FHFA or the Enterprises;
- develop and maintain a consolidated system for receiving and processing complaints;
- establish effective procedures for evaluating complaints alleging potential criminal conduct and for referring such complaints to law enforcement authorities;
- consistently follow up on consumer complaints referred to the Enterprises;
- comply with its own records management policy;
- perform routine substantive analyses to identify overall trends in complaints and assess the timeliness of responses to complainants;
- comply with safeguards for PII received from complainants; or
- prioritize complaints or assess the timeliness of responses to complaints.

These deficiencies occurred because FHFA did not establish a sound internal control environment governing consumer complaints, including formal policies and procedures for processing complaints received by the Agency and the Enterprises. Additionally, FHFA did not assign the complaint processing function sufficient priority, did not allocate adequate resources to the function (it assigned two individuals from its public relations staff to carry out the function), and did not provide effective oversight including performance reporting on the resolution of complaints (the Agency was unable to identify the total number of complaints received during the audit period and report the disposition of each complaint). As a result, FHFA lacks assurance that complaints, including those alleging fraud, waste, or abuse, such as improper foreclosures, were appropriately addressed in an efficient and effective manner in order to minimize risks.

In light of these findings, FHFA-OIG recommended that FHFA:

- draft and implement written policies, procedures, and controls governing the receipt, processing, and disposition of consumer complaints and allegations of fraud that, among other things, define the related roles and responsibilities for FHFA and the Enterprises and provide for consultation with FHFA-OIG to process allegations of fraud;
- assess the sufficiency of resources allocated to the complaints process; and
- determine whether there are unresolved complaints alleging fraud or other potential criminal activity.

FHFA agreed with FHFA-OIG's recommendations.

FHFA-OIG AUDIT AND EVALUATION PLAN

FHFA-OIG maintains a detailed Audit and Evaluation Plan that focuses strategically on the areas of FHFA's operations posing the greatest risks and providing the greatest potential benefits to FHFA, Congress, and the public. Originally developed with input from an independent, third-party risk assessment, the Audit and Evaluation Plan reflects continuous feedback from FHFA-OIG's reviews of current events and comments from FHFA officials, members of Congress, and others.[f]

Broadly, FHFA-OIG's audit and evaluation strategies include reviews of the following FHFA activities:

- Regulatory efforts and its management of the Enterprise conservatorships. Areas of focus include foreclosure prevention and loss mitigation efforts, mortgage loan servicing controls, and foreclosed property management and sales processes. These are

[f] FHFA-OIG's plan is dynamic and will be revised as necessary.

particularly high-risk areas because Treasury has invested $169 billion of taxpayer funds in the Enterprises. As conservator, FHFA must regulate and oversee the Enterprises in an efficient, effective, and transparent manner so as to minimize taxpayer costs, conserve Enterprise resources, and meet all statutory mandates.

- Oversight of the FHLBanks and their associated risks, including investment portfolio management and concentrations, credit underwriting, and administration.
- Internal operations, such as privacy and allegations of fraud, waste, or abuse.

The Audit and Evaluation Plan identifies a number of other ongoing and planned reviews of specific FHFA programs.

FHFA-OIG INVESTIGATION ACTIVITIES

OI has made significant contributions to a range of mortgage-related investigations. As of September 30, 2011, OI had 48 investigations under way. While many of them remain confidential, FHFA-OIG and its law enforcement partners, which include federal agencies, U.S. Attorneys' Offices, and state and local entities nationwide, have released details about several high-profile mortgage fraud investigations involving Colonial Bank and Taylor, Bean & Whitaker Mortgage Corporation (TBW), Marshall Home and Margaret Broderick, and Home Owners Protection Economics, Inc. (HOPE). Each is detailed below.

Colonial Bank and TBW

On June 30, 2011, **Lee Bentley Farkas**, former chairman and owner of TBW, was sentenced to 30 years in prison. He was also ordered to forfeit approximately $38.5 million for his role in a $2.9 billion fraud scheme that contributed to the failure of TBW and Colonial Bank. He had previously been convicted on April 19, 2011, of offenses including conspiracy, wire fraud, bank fraud, and securities fraud.

TBW originated, purchased, sold, and serviced residential mortgage loans. It also pooled loans as collateral for MBS guaranteed by Freddie Mac and the Government National Mortgage Association (Ginnie Mae). At one time, TBW was one of the largest privately held mortgage lending companies in the United States. Colonial Bank was one of the 25 largest banks in the United States.

Beginning in early 2002, TBW began to experience significant cash flow problems. In an effort to cover these shortfalls, a group of conspirators devised various schemes that involved defrauding Colonial Bank (which provided short-term funding to mortgage lending companies like TBW), Ocala Funding LLC (Ocala), a TBW special purpose entity, and U.S. taxpayers.

By the middle of 2009, the conspirators had diverted nearly $3 billion from Colonial Bank and Ocala, attempted to misappropriate over $500 million from Treasury, and filed numerous false records with Freddie Mac, Ginnie Mae, and the SEC. Additionally, the conspirators allegedly covered up the diversions by selling loans owned by Colonial Bank to Freddie Mac without paying Colonial Bank for the loans. As a result, the conspirators caused Freddie Mac and Colonial Bank to believe that each had undivided ownership interests in thousands of the same loans. TBW and Colonial Bank both failed in 2009. Freddie Mac reported losses and filed a proof of claim of nearly $1.8 billion in TBW's bankruptcy proceeding.

Federal prosecutors have charged and convicted six other defendants for their roles in the fraud scheme:

- **Paul R. Allen.** On June 21, 2011, the former chief executive officer of TBW was sentenced to 40 months in prison after pleading guilty on April 1, 2011, to one count of conspiracy to commit bank and wire fraud and one count of making false statements. The SEC also has civil charges pending against Allen for violations of the Securities Exchange Act of 1934.
- **Sean W. Ragland.** On June 21, 2011, the former senior financial analyst for TBW was sentenced to three months in prison after pleading guilty to one count of conspiracy on March 31, 2011.
- **Catherine Kissick.** On June 17, 2011, the former head of Colonial Bank's Mortgage Warehouse Lending Division was sentenced to eight years in prison after pleading guilty to one count of conspiracy on March 2, 2011. The SEC also has civil charges pending against Kissick for violations of the Securities Exchange Act of 1934.
- **Teresa Kelly.** On June 17, 2011, the former operations supervisor in Colonial Bank's Mortgage Warehouse Lending Division was sentenced to three months in prison after pleading guilty to one count of conspiracy on March 16, 2011. Additionally, Kelly was debarred from federal procurement contracts and government programs. Her **debarment** is effective beginning the date of her **suspension**, May 6, 2011, through May 5, 2014. The SEC also has civil charges pending against Kelly for violations of the Securities Exchange Act of 1934.
- **Raymond Bowman.** On June 10, 2011, the former president of TBW was sentenced to 30 months in prison after pleading guilty on March 14, 2011, to one count of conspiracy and one count of making false statements to federal agents.
- **Desiree Brown.** On June 10, 2011, the former treasurer of TBW was sentenced to six years in prison after pleading guilty to one count of conspiracy on February 24, 2011. The SEC also has civil charges pending against Brown for violations of the Securities Exchange Act of 1934.

For more information on suspension and debarment, please see page 59 of this report.

Debarment:
Disqualification of a firm or 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 for similar offenses.

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.

In addition, on September 27, 2011, federal prosecutors won a $3.5 billion restitution judgment against the seven defendants convicted in this case. Farkas and Brown were held liable for the full amount; Allen and Ragland were held liable for $2.6 billion; and Bowman, Kissick, and Kelly were held liable for $500 million. The $3.5 billion judgment is a joint and several obligation, meaning that each defendant is responsible for payment of amounts up to the named limits, and an overall total of $3.5 billion.

FHFA-OIG's investigation partners in these cases include the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), the FBI, the Office of Inspector General for the Federal Deposit Insurance Corporation (FDIC-OIG), the Office of Inspector General for the Department of Housing and Urban Development (HUD-OIG), Internal Revenue Service-Criminal Investigation (IRS-CI), and the SEC. The Financial Crimes Enforcement Network (FinCEN) also provided investigative support. Additionally, the cases are being prosecuted by the Fraud Section of the Criminal Division at DOJ and the U.S. Attorney's Office for the Eastern District of Virginia.

Marshall Home and Margaret Broderick

On July 1, 2011, Marshall E. Home, of Tucson, Arizona, was arrested by the FBI and FHFA-OIG Special Agents as a result of a criminal complaint filed in the U.S. District Court for the District of Arizona charging him with two counts of false claims in bankruptcy. He was indicted on these charges on July 13, 2011. On September 7, 2011, Home and his wife, Margaret E. Broderick, were charged in a superseding indictment.

Home and Broderick allegedly operated the "Individual Rights Party; Mortgage Rescue Service." Home and Broderick charged individuals undergoing foreclosure proceedings $500, purportedly to make the foreclosure process stop. Their website advised that the property of individuals who used their service would become part of a "larger overall bankruptcy liquidation."

The superseding indictment further alleges that on March 20, 2011, Home filed in the U.S. Bankruptcy Court in Tucson an Involuntary Petition in Bankruptcy, which sought to place the United States into bankruptcy. According to the superseding indictment, Home and Broderick falsely told the Bankruptcy Court that they had a financial claim of over $250 billion against the United States. Subsequently, Home and Broderick filed or caused to be filed in the U.S. Bankruptcy Court 173 false claims relating to individuals participating in the "Mortgage Rescue Service." Many of these false bankruptcy claims involved loans guaranteed by the Enterprises.

In addition, Home allegedly registered the name "Federal National Mortgage Association" with the Arizona Secretary of State as a trade name. The Federal National Mortgage Association is the official name of Fannie Mae. Home was not an authorized representative of Fannie Mae and did not have authority to convey property owned by the Enterprise. Yet, Home and Broderick filed and caused to be filed with county recorders deeds for real property that had been acquired by Fannie Mae. These deeds purported to transfer title from Fannie Mae to the "Independent Rights Party." Home and Broderick also inappropriately transferred properties owned by Freddie Mac. Home and Broderick conducted purported transfers with at least 28 properties, valued at over $8 million. These transfers interfered with the Enterprises' rights in the properties, causing them losses.

Finally, the superseding indictment alleges that Home and Broderick then rented these properties to unsuspecting tenants, who paid them security deposits and rent to which they were not entitled. This investigation is being conducted jointly by the FBI and FHFA-OIG.

Home Owners Protection Economics, Inc

On August 8, 2011, four individuals were arrested pursuant to a 20-count indictment that was unsealed in the U.S. District Court for the District of Massachusetts, charging Christopher S. Godfrey, of Delray Beach, Florida; Dennis Fischer, of Highland Beach, Florida; Vernell Burris Jr., of Boynton Beach, Florida; and Brian M. Kelly, of Boca Raton, Florida, with conspiracy, wire fraud, mail fraud, and misuse of a government seal.

According to the indictment, Godfrey was the president and Fischer was the vice president and treasurer of a Florida company called HOPE. Burris was the manager and primary trainer of HOPE telemarketers, and Kelly was one of the principal telemarketers as well as a trainer for other HOPE telemarketers.

The indictment alleges that from January 2009 through May 2011, the defendants made, and instructed their employees to make, a series of misrepresentations to induce financially distressed homeowners seeking a federally funded home loan modification to pay HOPE a $400–$900 up-front fee in exchange for HOPE's home loan modifications, modification services, and "software licenses." Many of these distressed homeowners' loans are held or guaranteed by the Enterprises. According to the indictment, these misrepresentations included claims that homeowners were virtually guaranteed, with HOPE's assistance, to receive a loan modification under the federal government's HAMP. Additional misrepresentations to homeowners included that HOPE was affiliated with the homeowner's mortgage lender, that the homeowner had been approved for a home loan modification, that homeowners could stop making mortgage payments while they waited for HOPE to arrange their loan modification, and that HOPE would refund the customer's fee if the modification was not successful.

In exchange for these up-front fees, HOPE allegedly sent its customers a do-it-yourself application package that was nearly identical to the HAMP application, which the federal government provides free of charge. HOPE instructed customers to fill out the application and submit it to their mortgage lender. According to the indictment, the HOPE customers who used the provided forms to apply for loan modifications had no advantage in the application process, and, in fact, most of their applications were denied. Through these misrepresentations, HOPE was able to persuade thousands of homeowners collectively to pay it more than $3 million in fees. This case is being jointly investigated with the U.S. Attorney's Office for the District of Massachusetts, SIGTARP, IRS-CI, the U.S. Marshals Service, the Office of the Attorney General of Florida, the Palm Beach County Sheriff's Office, and the Delray Beach, Florida Police Department.

FHFA-OIG INVESTIGATIONS STRATEGY

As mentioned, FHFA-OIG and its law enforcement partners are engaged in 48 non-public investigations. FHFA-OIG intends to develop further its close working relationships with other law enforcement agencies, including DOJ and the U.S. Attorneys' Offices, FinCEN, DOJ and local Mortgage Fraud Working Groups (MFWGs), the Secret Service, the FBI, HUD-OIG, FDIC-OIG, IRS-CI, SIGTARP, and other federal, state, and local agencies. During the reporting period, OI worked closely with FinCEN to review allegations of mortgage fraud for follow-up investigations and to determine geographic areas in the United States to which FHFA-OIG may assign special agents to investigate frauds targeting the GSEs. Drawing on the FinCEN data for these tasks allows FHFA-OIG more effectively to identify and target areas with the highest risk of fraud. FHFA-OIG will also pursue an innovative approach to ensure the timely prosecution of investigations. Specifically, FHFA-OIG will offer to U.S. Attorneys' Offices dedicated FHFA-OIG investigative counsels – attorneys who possess substantial criminal prosecution experience – to assist with the prosecution of FHFA-OIG's investigations. In addition, FHFA-OIG has undertaken law enforcement outreach efforts to a number of state attorneys general.

FHFA-OIG REGULATORY ACTIVITIES

Consistent with the Inspector General Act, FHFA-OIG considers whether proposed legislation and regulations related to FHFA are effective, efficient, economical, legal, and susceptible to fraud and abuse. From April 1, 2011, through September 30, 2011, FHFA-OIG reviewed 20 new or proposed FHFA policies and regulations and provided substantive comments on several, which are discussed below.[g]

1. **Joint Agency Steering Committee's Proposed Rules on Incentive-based Executive Compensation (RIN 2590-AA42, FHFA-OIG Comments Submitted on March 28, 2011)**

   Pursuant to Section 956 of the Dodd-Frank Act, seven federal financial regulators proposed jointly to issue rules requiring their respective regulated entities to disclose information pertaining to

[g] It is FHFA-OIG policy to note that comments were made on a "draft" rule during the semiannual period and then follow up with a substantive discussion of the rule in a later semiannual report once the "draft" rule is completed and published. Three "draft" rules that FHFA-OIG noted in its inaugural Semiannual Report have yet to be finalized: *FHFA Draft Final Rule on Executive Compensation* (RIN 2590-AA12); *FHFA Draft Re-Proposed Rule on Golden Parachute and Indemnification Payments* (RIN 2590-AA08); and *FHFA Draft Enterprise New Activity Protocol* (RIN 2590-AA17). The *Joint Agency Steering Committee's Proposed Rules on Incentive-based Executive Compensation*, which also was noted in the inaugural Semiannual Report, has been completed and is discussed substantively herein.

their "incentive-based compensation arrangements," and barring any such arrangements that encourage inappropriate risk-taking.[h] FHFA-OIG commented that Section 956 of the Dodd-Frank Act specifies that all rules issued pursuant to it "shall be enforced under Section 505 of the Gramm-Leach-Bliley" Financial Services Modernization Act of 1999 (Gramm-Leach-Bliley), and no other enforcement authority is provided in Section 956. Section 505 of Gramm-Leach-Bliley references all of the regulators covered by the proposed rules except for FHFA because Gramm-Leach-Bliley was enacted approximately nine years before the establishment of FHFA.

FHFA-OIG recognized, however, that FHFA has authorities separate and apart from those set forth in the Dodd-Frank Act and Gramm-Leach-Bliley. Accordingly, FHFA-OIG recommended that FHFA: (1) amend the proposed rules to identify authority apart from Section 956 permitting it to regulate incentive-based compensation arrangements or (2) seek an amendment to Section 505 of Gramm-Leach-Bliley.

FHFA published the proposed rule on April 14, 2011. In doing so, FHFA asserted that it has enforcement authorities separate from Section 505 of Gramm-Leach-Bliley and amended the "Authority and Issuance" section of the proposed rule to reference Section 1319G of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act).

2. FHFA Draft Rule: Permissible Federal Home Loan Bank Investments (RIN 2590-AA32, FHFA-OIG Comments Submitted on April 5, 2011)

FHFA proposed a draft final regulation controlling the investments that FHLBanks may hold. Among other things, the regulation bases the permissibility of certain investments upon credit ratings. Specifically, the regulation would prohibit investments in "[d]ebt instruments that are not rated as investment grade" and in obligations of state, local, or tribal government units or agencies, unless they have "at least the second highest credit rating from [a Nationally Recognized Statistical Rating Organization (NRSRO)]." Additionally, the regulation would require certain FHLBanks to "hold retained earnings plus general allowances for losses as support for the credit risk of all investments that are not rated by an NRSRO." The regulation defines NRSRO as "a credit rating organization registered with the Securities and Exchange Commission."

Section 939A of the Dodd-Frank Act requires federal government agencies to review all their rules by July 21, 2011, identify those that require use of an assessment of credit-worthiness or credit ratings, and "remove any reference to or requirement of reliance on credit ratings and … substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for

[h] These regulators include FHFA, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Reserve, FDIC, the National Credit Union Administration, and the SEC. See Dodd-Frank Act § 956(e)(1).

such regulations." FHFA-OIG commented that FHFA's regulation as currently written would have to be substantially revised within a few months. It thus recommended, for the sake of efficiency and conformance to section 939A of the Dodd-Frank Act, that FHFA revise the proposed regulation accordingly.

FHFA published the final regulation on May 20, 2011, without making revisions recommended by FHFA-OIG.

3. **Revised Conservatorship Delegations/Operating Protocol for Delegations (FHFA-OIG Comments Submitted on May 10, 2011)**

FHFA proposed a revised Conservatorship Delegations/Operating Protocol for Delegations (the Delegations) that will replace delegations made to the Enterprises in November 2008. The 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. FHFA-OIG reviewed the proposal and commented, but FHFA has not issued the final Delegations. FHFA and FHFA-OIG, thus, have not completed their resolution of the comments. Due to ongoing discussions between FHFA and FHFA-OIG on this issue, the substance of the comments and their resolution will be published at a later date.

4. **Draft Final Rule: Practice and Procedure for Administrative Enforcement Proceedings (RIN 2590-AA14, FHFA-OIG Comments Submitted on May 11, 2011)**

Prior to the commencement of FHFA-OIG's operations, FHFA issued a proposed rule to govern civil administrative enforcement actions by FHFA under sections 1371-1379D of the Safety and Soundness Act. FHFA accepted and considered comments to the proposed rule and proposed a draft final rule on civil enforcement actions. FHFA-OIG reviewed the proposal and recommended revision of the rule to avoid confusion concerning FHFA-OIG's subpoena authority.

The Safety and Soundness Act, as amended, authorizes FHFA to issue subpoenas in connection with proceedings, examinations, and investigations conducted pursuant to its civil enforcement authority. FHFA may also "revoke, quash or modify" its subpoenas as necessary. Conversely, although FHFA-OIG is an office within FHFA, it derives its authority to issue subpoenas from the Inspector General Act.

FHFA-OIG commented that it was concerned about potential confusion arising from the dual subpoena authorities under the Safety and Soundness Act and the Inspector General Act. Specifically, FHFA-OIG was concerned that a future FHFA decision-maker could decide erroneously that FHFA-OIG's origin within FHFA constitutes a legally sufficient basis on which FHFA may interfere with a pending

FHFA-OIG subpoena. To avoid future confusion, and thereby to preclude potential FHFA interference with FHFA-OIG subpoenas, FHFA-OIG recommended clarifying language to the effect that FHFA cannot revoke, quash, or modify FHFA-OIG subpoenas.

FHFA published the final regulation on August 26, 2011, and the final regulation clarifies that FHFA is not authorized to revoke, quash, or modify subpoenas issued by FHFA-OIG.

5. **Draft Proposed Rule: Prudential Management and Operations Standards (RIN 2590-AA13, FHFA-OIG Comments Submitted on June 10, 2011)**

   FHFA is statutorily directed to establish prudential standards relating to the management and operations of Fannie Mae, Freddie Mac, and the FHLBanks.[39] FHFA forwarded to FHFA-OIG a draft proposed rule that would implement this direction through a series of guidelines and an appendix. In response to the draft proposed rule, FHFA-OIG acknowledged as positive FHFA's efforts thus far to establish prudential standards. However, FHFA-OIG believes that, in order to improve efficiency, effectiveness, and transparency, FHFA should consider adding more specificity to the proposed rule (i.e., details, directions, and benchmarks) to inform the GSEs how to comply with it and to enable FHFA-OIG to review effectively FHFA's administration of it.

   Without adding the recommended specificity, FHFA released the proposed rule on June 20, 2011.

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

   FHFA drafted a proposed rule to transfer its responsibilities for monitoring FHLBank member compliance with the Community Reinvestment Act and with first-time homebuyer standards from FHFA to the FHLBanks themselves. FHFA-OIG commented on the proposed rule, but FHFA and FHFA-OIG have not completed their resolution of the comments. The substance of the comments and their resolution will be published in a subsequent semiannual report.

FHFA-OIG COMMUNICATIONS AND OUTREACH EFFORTS

A key component of FHFA-OIG's mission is to communicate clearly with Congress, the GSEs and industry groups, the public, and colleagues at other federal agencies.

Hotline

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

*The FHFA-OIG **Hotline** can be reached at (800) 793-7724 or via e-mail at OIGHOTLINE@FHFA.GOV.*

Coordination with Other Oversight Bodies

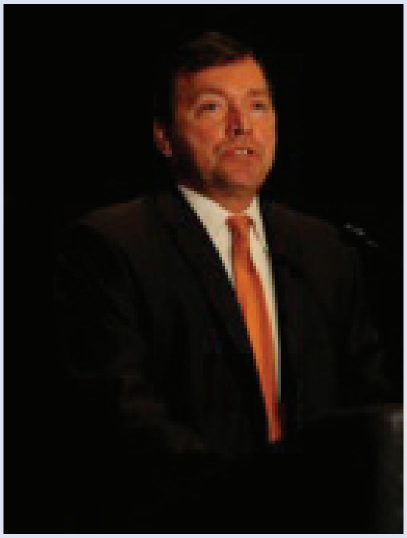
FHFA-OIG shares oversight of federal housing program administration with several other federal agencies (including HUD; the Department of Veterans Affairs (VA); the Department of Agriculture (USDA); Treasury's Office of Financial Stability (which manages the Troubled Asset Relief Program)); and their inspectors general, as well as other law enforcement organizations. To further its mission, FHFA-OIG participates in coordinating the efforts of these agencies and exchanging best practices, case information, and professional expertise. During the semiannual period ended September 30, 2011, representatives of FHFA-OIG participated in the following cooperative activities:

- CIGIE, which meets monthly, seeks to increase the professionalism and effectiveness of offices of inspectors general. The Inspector General and his Principal Deputy are active participants in CIGIE activities.
- The Dodd-Frank Act established the Council of Inspectors General on Financial Oversight (CIGFO) to facilitate the sharing of information among inspectors general at agencies responsible for financial oversight. The Inspector General is an active member of CIGFO and has attended all of its meetings. In addition, along with the eight other CIGFO member agencies, FHFA-OIG participated in the development of the inaugural CIGFO annual report, which was published on July 25, 2011.
- FHFA-OIG spearheaded the creation of a new interagency working group, the Federal Housing Inspectors General. In addition to FHFA-OIG, this group includes the Offices of Inspector General for other federal agencies with primary responsibility for federal housing programs and activities, including HUD, VA, and USDA. This group was formed to coordinate efforts and to work proactively in combating fraud, waste, abuse, and misconduct involving federal housing programs and activities. Further, the Federal Housing Inspectors General intend to combine their resources for maximum effectiveness and to achieve economies of scale in pursuing their statutory mandates, all in service of the federal government's varied efforts

to serve the American homebuyer and the primary and secondary mortgage markets. The Federal Housing Inspectors General have begun to collaborate on multiple joint initiatives, including criminal investigations and audits in areas of common interest. In addition, the Federal Housing Inspectors General are drafting a *Compendium of Federal Housing Programs and Activities*, which will serve as a quick reference guide concerning their agencies' single-family mortgage programs and related activities. It will be designed to enable the reader to identify various important facts about these programs quickly – including their statutory and regulatory authority and intended clientele – and to understand how the programs work. The Federal Housing Inspectors General anticipate producing additional materials for public benefit in subsequent semiannual periods.

- The Financial Fraud Enforcement Task Force (FFETF) is a broad coalition of state and federal law enforcement agencies, prosecutors, and other entities. President Obama 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. FHFA-OIG is an active member of FFETF and has begun to work with FFETF partners to combat financial crimes relevant to FHFA-OIG's mission. FHFA-OIG also participated in several FFETF working groups that, as described below, will enable FHFA-OIG to leverage other law enforcement entities' knowledge and assets in various areas relevant to FHFA-OIG's mission:
    - The FFETF MFWG combats mortgage fraud related to the financial crisis. Members of FFETF MFWG include FHFA-OIG, DOJ, HUD-OIG, the FBI, and the National Association of Attorneys General (NAAG).
    - The Recovery Act, Procurement, and Grant Fraud Working Group addresses procurement and grant fraud, including fraud arising in connection with the expenditure of funds provided by the American Recovery and Reinvestment Act of 2009. It also fights fraud committed in connection with federal procurement generally, and/or in connection with federal grants. Among FHFA-OIG's partners in this working group are DOJ, the Recovery Accountability and Transparency Board (RATB), and NAAG.
    - FFETF's Securities and Commodities Fraud Working Group works to eliminate fraud in America's financial markets. FHFA-OIG participates in this working group with, among others, DOJ, the SEC, and the Commodity Futures Trading Commission.

- FHFA-OIG has established partnerships with several federal agencies to share data, analyze internal complaints, and identify trends. These agencies include the FBI, HUD-OIG, FinCEN, the Secret Service, and SIGTARP. Each of FHFA-OIG's partnerships with these agencies is designed to enhance interagency cooperation. These partnerships focus the participating agencies' combined investigative resources, powers, experience, and expertise on the identification, investigation, and prosecution of individuals and entities involved in fraud schemes related to the entities regulated by the participants.
- FHFA-OIG also has carried out additional outreach and coordination efforts to a wide range of government agencies, including DOJ, the Office of the Comptroller of the Currency, the SEC, IRS-CI, U.S. Attorneys' Offices throughout the nation, and a number of state attorneys general.
- The FHFA Inspector General is vice chairman of the CIGIE Suspension and Debarment Working Group (the Working Group). The Working Group is a subcommittee of the CIGIE Investigations Committee, and its mission is to improve the effectiveness of suspension and debarment practices throughout the federal government:
    - o On May 6, 2011, the FHFA Inspector General sponsored a Working Group meeting at FHFA-OIG's offices. The purpose of the meeting was to discuss strategies to improve outreach efforts to executive agency debarment officials and to evaluate the results of a survey of executive agency use of debarment procedures.
    - o The Working Group has taken several substantial steps towards raising awareness of suspension and debarment as valuable tools for protecting federal agencies from ongoing misconduct from irresponsible parties. One such step was conducting a survey regarding actual suspension and debarment practices within the inspector general community. The Working Group's report of that survey's results – which CIGIE has endorsed unanimously – demonstrates that suspension and debarment could be used more frequently, debunks certain myths regarding their use, and offers suggested practices for inspectors general that seek to pursue them more effectively. In addition to its report on the survey, the Working Group published an article detailing the survey's results in the *Journal of Public Inquiry*, a semiannual CIGIE magazine containing articles of interest to the inspector general community.



The Deputy Inspector General for Investigations, Christopher Sharpley, speaks to the International Association of Financial Crimes Investigators in Charlotte, North Carolina, on August 30, 2011.

- During the most recent reporting period, the Deputy Inspector General for Investigations delivered several presentations on FHFA-OIG's achievements, available resources, and procedures for referring fraud allegations. These presentations have been made to a wide range of law enforcement and regulatory organizations with housing-related responsibilities, including:
    - the Illinois MFWG
    - the Annual National Fraud Advisory Council Conference
    - the Secret Service National Mortgage Fraud Conference
    - HUD-OIG Annual Conference
    - the State of California's Real Estate Fraud Conference
    - the 2011 "Race Against Fraud" Conference hosted by the International Association of Financial Crimes Investigators

Communications with Congress

To fulfill his responsibility to keep Congress fully apprised of developments concerning oversight of FHFA and the GSEs, the Inspector General meets regularly with members of Congress and their staffs. During the six-month period ended September 30, 2011, the Inspector General provided briefings on topics including FHFA-OIG's reports, organization, and strategy. Copies of the Inspector General's written testimony to Congress, hearing transcripts, and related materials are available at www.fhfaoig.gov.

SECTION 4

FHFA-OIG RECOMMENDATIONS

Section 4: FHFA-OIG Recommendations

In accordance with the provisions of the Inspector General Act, one of the key duties of FHFA-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 FHFA-OIG's formal recommendations to date and notes the status of their implementation.

Figure 8. Summary of FHFA-OIG Recommendations

No.	Recommendation	Report	Status
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 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.
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- to mid-term.	*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 FAAs, under which the Enterprises administer and enforce HAMP, by incorporating a specific dispute resolution process 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 MHA Program*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-002-1	To improve transparency, FHFA should post on its website information about executive compensation packages, the Enterprises' corporate performance goals and performance against those goals, related trend data, and provide 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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-002-2	FHFA should establish written criteria and procedures for reviewing annual performance and assessment data. FHFA should conduct independent testing and verification, perhaps on a randomized 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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-002-3	FHFA should establish an ongoing review and analysis process to include such issues as the level of federal support for the Enterprises and the compensation levels for 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*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
EVL-2011-002-4	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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-001-1	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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
EVL-2011-001-2	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*	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.
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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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 PII.	*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-2011-003-3	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 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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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 CPO 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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
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 POA&Ms.	*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-2011-002-5	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*	Recommendation agreed to by FHFA; implementation of recommendation pending.

No.	Recommendation	Report	Status
AUD-2011-001-1	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 FHFA-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-2011-001-2	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*	Recommendation agreed to by FHFA; implementation of recommendation pending.
AUD-2011-001-3	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*	Recommendation agreed to by FHFA; implementation of recommendation pending.

AN OVERVIEW OF THE HOME FORECLOSURE PROCESS

An Overview of the Home Foreclosure Process

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

Among the most prominent features of the current housing crisis has been an unprecedented jump in the incidence of mortgage delinquencies and **foreclosures**. Public policy and financial market observers have attributed delinquency and foreclosure increases to a wide range of causes and have offered varying policy prescriptions for what remains a continuing problem. Allegations of improper or deficient practices on the part of mortgage originators and servicers have also been a major source of controversy over the past few years. By identifying and describing the procedures and requirements that characterize an appropriately executed foreclosure process, FHFA-OIG seeks to provide useful context and understanding for policymakers and members of the public.

Most home purchases in the United States are financed through loans provided by banks or other lenders. Lenders, as part of the legal process that provides cash financing to borrowers, typically require a secured interest or mortgage on the property financed. Borrowers agree to accept the secured interest on their properties and to repay the loans provided over time. The foreclosure process typically commences only after a borrower has stopped repaying the loan (meaning that the loan has gone into default); the lender therefore uses the foreclosure process to recover the proceeds of the loan through the sale of the property. Foreclosure involves specific rights and obligations with respect to both the homeowner/borrower and the lender (or its representatives) through each step of the process.

Before turning to default and the foreclosure process, however, this overview reviews the legal process supporting mortgage loans. It next turns to default, the gateway to foreclosure, before discussing the foreclosure process and loss mitigation options. This discussion will also identify sources of information regarding federal programs designed to assist homeowners who may be involved in, or at risk of, foreclosure proceedings.

FUNDAMENTALS OF THE MORTGAGE

A mortgage is a loan secured by real estate collateral, specifically the borrower's house or apartment.[i] While the term "mortgage" is used colloquially to refer to both the loan and the security, there are actually two separate legal documents: a note and a security instrument.

The Note

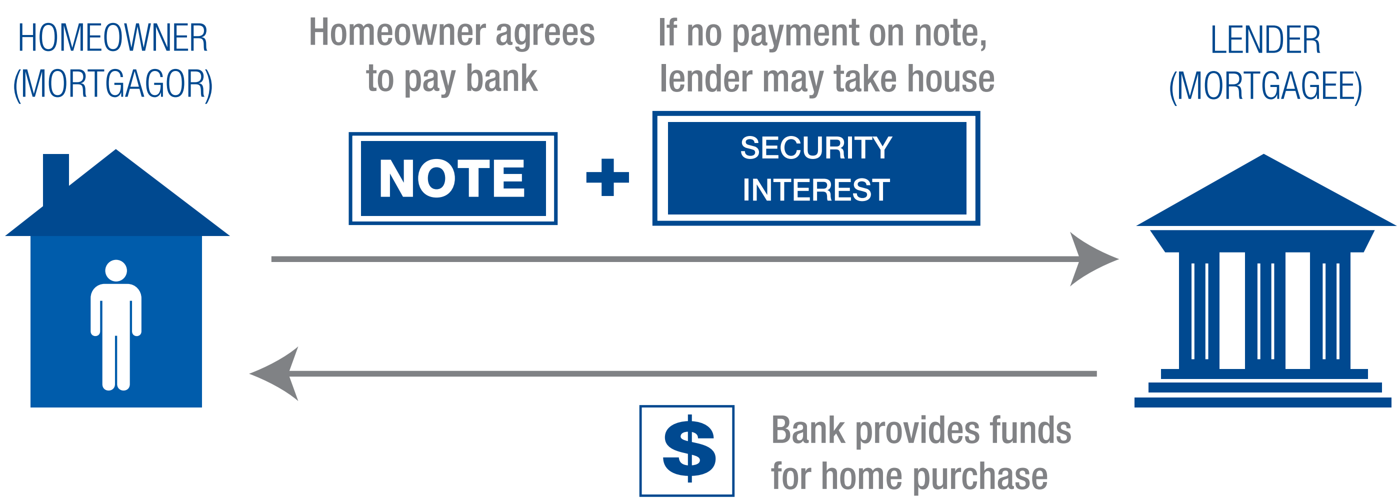
The note represents the promise or agreement of the homeowner (mortgagor) to repay the loan to the lender or noteholder and specifies the terms of repayment, such as the interest rate and schedule of payments. Most mortgage notes are freely transferable from the original lender to others. Lenders, in fact,

[i] Although real estate investors may also finance their purchases of commercial properties, such as office buildings and rental apartment complexes, through mortgage debt, this discussion will center specifically on residential mortgages.

sell most loans to third parties, either directly or through the **securitization** process in which groups of mortgages are pooled together and sold as a security to investors. The Enterprises are the most prominent participants in the purchases and sale of mortgages; they accounted for approximately 70% of the nation's issuances of MBS in 2010. Rather than lend directly to homeowners, they purchase mortgages from the original lenders and other buyers. The mortgage note specifies that the borrower must repay the noteholder, which may differ from the original lender if the loan is sold.

Securitization:
A process whereby a financial institution assembles pools of income-producing assets (such as loans) and then sells an interest in the cash flows as securities to investors. See page 20, Figure 1.

Figure 9. Mortgage



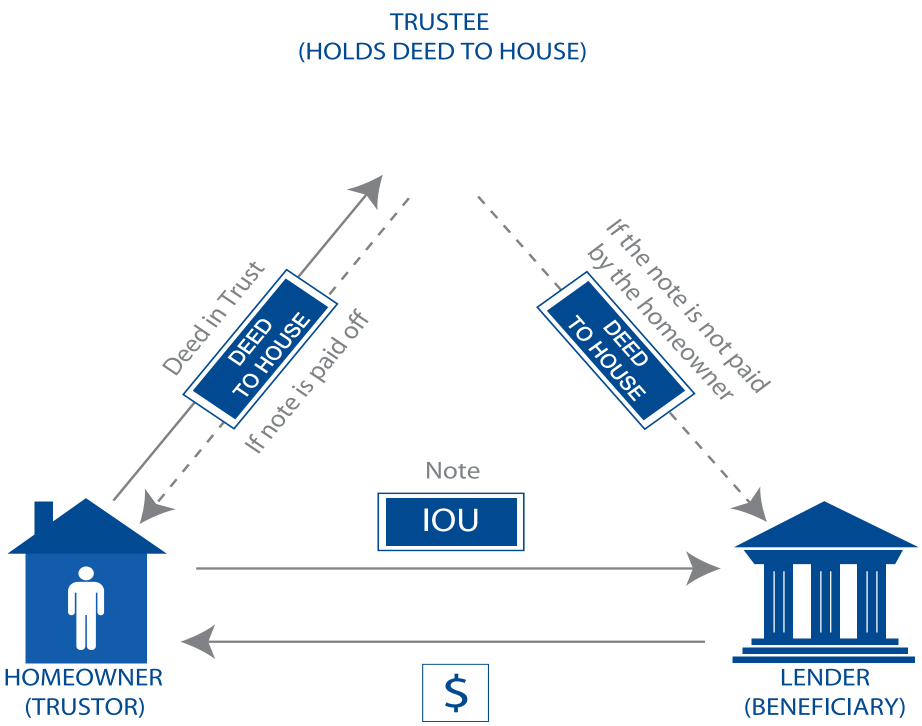
The Security Instrument

The security instrument is the separate legal document or agreement that pledges the house as collateral for repayment of the note. The security instrument goes by various names, such as the "mortgage," the "deed of trust" (DOT), or the "trust deed," depending on its form and the state in which the house is located. In many states, it is typically recorded in the county recorder of deeds offices in order to establish the mortgagee's interest in the property as a matter of public record. This is important because it establishes the mortgagee's rights in the property relative to other parties, including other mortgagees. The majority of mortgages are recorded using a private recordation company known as the Mortgage Electronic Registration System (MERS). When MERS is used, it is listed in county property records as the mortgagee, while the real mortgagee is tracked in MERS' private registry. The validity of MERS' various processes has been the subject of significant and on-going legal controversy.

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.

The form of the security instrument affects the foreclosure process. Legally speaking, a mortgage is the granting of a **lien**. The homeowner, as mortgagor, retains title to the property and grants a contingent interest to the lender as mortgagee. Alternatively, a DOT is more akin to a sale and repurchase: the homeowner, as trustor, gives title to the property to the DOT trustee, who holds it on behalf of the lender as beneficiary. The DOT trustee is typically a title company or a local attorney. The DOT trustee is charged with releasing the deed to the trustor if the loan is paid off or with foreclosing if the trustor defaults. In the standard DOT arrangement, if the homeowner defaults, the beneficiary noteholder will appoint a substitute trustee, often an affiliate, to handle foreclosure. The precise duties of DOT trustees may be a potential issue in foreclosures.[j]

Figure 10. Deed of Trust



j DOT trustees should not be confused with securitization trustees. Many securitizations involve a trust that holds legal title to the mortgages and notes. These trusts have a trustee – a major financial institution – that acts as an agent for the trust, carrying out functions such as remitting payments to investors in the securities issued by the trust and reporting to investors on the performance of the trust's mortgages. The actual management of the mortgages, though, is carried out by another entity, known as the servicer.

The Servicer

All mortgage loans are "serviced," meaning the payments are collected and the loan otherwise is administered, including the release of liens upon payoff or the management of defaults. The servicer may be an arm of the original lender, or it may be an unrelated third party, in which case it is acting on behalf of the current owner of the loan, typically under a detailed contract known as a "pooling and servicing agreement" or "loan servicing agreement." As the majority of mortgage loans are sold by their original lender (sometimes referred to as the loan's "originator"), most loans have servicers that are unaffiliated with the original lender. For example, the Enterprises do not service any of the loans they own themselves; instead, they use third-party servicers, typically affiliates of the parties that sold the loans to them.

For more information on the servicer, see pages 26-27 of this report, Selected FHFA Programs and Activities.

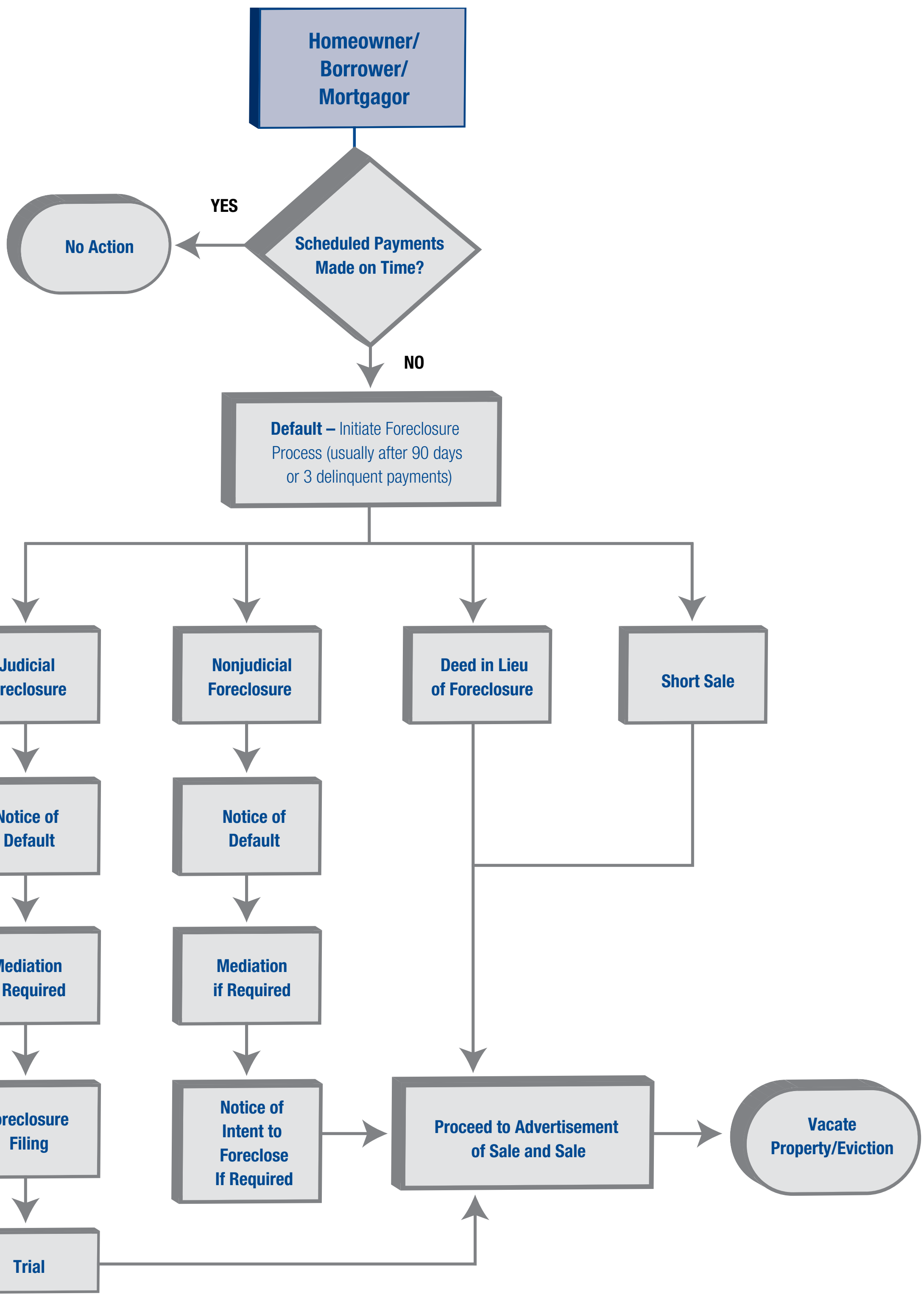
Subcontracting arrangements are common in servicing, so a borrower's contact may in fact be with a subservicer, a vendor, or an attorney engaged by one of these parties. Both servicing and subservicing contracts frequently impose limitations on the servicer's ability to manage the loan, including when and how the servicer may modify or otherwise restructure a loan.

DEFAULT

Default is the prelude to foreclosure. Although various technical defaults are possible, the typical default is a failure to make payments as required on the mortgage. Most mortgages require defined payments each month (though the amount due may vary if the mortgage has an adjustable rate), and mortgage servicers will often refuse to accept partial payments. Figure 11 illustrates the remediation process for a defaulted loan. The outcomes following a default depend on factors such as the amount and degree of delinquency, the borrower's overall financial situation, the value of the property and amount of indebtedness, the servicer's economic interests (as distinct from the mortgagee's), and constraints placed on the servicer by contract and applicable laws. Thus, a defaulted residential mortgage may return to good standing or be modified, or the property may be sold or repossessed by the mortgagee via foreclosure or a voluntary surrender.

Generally, servicers will not commence a foreclosure until a mortgage is 90 days delinquent – that is, until the borrower has missed three consecutive payments. Thus, a homeowner can conceivably fall behind on a mortgage for a month or two and catch up without the servicer commencing a foreclosure. However, it is important to note that a servicer may legally begin foreclosure proceedings before a mortgage is 90 days late. Ninety days is a common practice, not a legal requirement.

Figure 11. Foreclosure Process Flowchart



Loss Mitigation

In some cases, the default may be cured and the loan reinstated. In addition, depending on individual circumstances, alternatives may exist that permit defaulted borrowers to remain in their homes while addressing their payment delinquency. It is important to note that most of these options are voluntary, but state law and contractual arrangements, including the acceptance of MHA program funds from Treasury, may trigger particular loss mitigation duties on the part of the servicer.

Mediation. Many states offer or require pre-foreclosure mediation between homeowners and servicers. In some states servicers are required to mediate in good faith in order to proceed with foreclosure. This may include presenting the homeowner with all appropriate paperwork for a foreclosure and having authority to accept settlement offers.

Mediation:
Mediation is a process by which a neutral third party (mediator) assists the homeowner and lender in reaching a fair, voluntary, negotiated agreement. The mediator does not decide who is right or wrong.

Modification. Common modifications include extending the mortgage's maturity date, adding past-due payments to the end of the mortgage, and making both permanent and temporary interest rate reductions. In most cases, when appropriately applied, these measures will lower the borrower's re-amortized monthly mortgage payment to a more affordable level.

Reductions in the borrower's unpaid principal balance are uncommon. Although HAMP permits principal reductions at participants' option, the Enterprises do not provide for principal reductions in their implementation of HAMP. Homeowners should be aware that under certain circumstances the forgiven debt may be deemed income for tax purposes.[40]

Figure 12, at the end of this overview, lists those states that offer or require mediation as part of the mortgage loan default remediation process.

Forbearance. Lenders may always exercise forbearance on defaulted loans, meaning that the lender may simply decline to proceed with foreclosure. Homeowners have no right to forbearance, unless they are active duty military servicemembers covered by the Servicemembers Civil Relief Act or have been so within the previous 90 days. Note that some types of modifications, such as ones that tack past-due balances onto the end of loans as balloon payments, are sometimes referred to as forbearance.

A detailed listing of borrower eligibility criteria for HAMP and other MHA assistance programs is available at www.makinghomeaffordable.gov.

By contrast to payment reductions, payment forbearance involves temporarily suspending the need to make mortgage payments. In their guidance to loan servicers, Fannie Mae and Freddie Mac permit payment forbearance for up to six months in the cases of unemployed borrowers. Servicers must consider unemployed borrowers for such forbearance before consideration for a HAMP loan modification. Borrowers who are not offered any such forbearance must be evaluated for HAMP.

The websites of Fannie Mae (www.fanniemae.com) and Freddie Mac (www.freddiemac.com) incorporate utilities that permit borrowers to learn whether those organizations guarantee or own specific home loans.

Common Misperceptions About Enterprise Policies for HAMP Participants

Published reports indicate that mistaken or outdated understandings may persist among participants (both servicers and borrowers) in HAMP for loans owned or guaranteed by the Enterprises. Three common misperceptions are discussed below:

- **HAMP Participants Must Be Delinquent**. HAMP does not require homeowners to be actually delinquent in their payments before participating. Despite reported cases of mortgage servicers indicating that homeowners must be delinquent, and in some cases actually encouraging them to fall behind in their payments, program guidance and the Enterprises' servicer directives explicitly permit participation by homeowners who remain current, but for whom default is "reasonably foreseeable."
- **HAMP Requires a Very Long Trial Period**. The Enterprises' published guidance states that the initial trial period for HAMP participants "must be three months long for mortgage loans already in default and four months long for mortgage loans where the servicer has determined that default is imminent but has not yet occurred," contrary to reported instances of borrowers making trial payments for much longer.
- **The Foreclosure Process Can Proceed While Loss Mitigation Efforts Are Underway.** As a result of FHFA's Servicing Alignment Initiative, current Enterprise guidance states that servicers may not commence the foreclosure process as long as they are engaged in a good faith effort with the borrower to resolve the delinquency. "Dual tracking" a single loan for both foreclosure and modification is prohibited. Additionally, before a loan is referred for foreclosure, the servicer must also perform a formal review of the case to ensure that appropriate alternatives were considered.

Refinancing. Another option for handling a defaulted loan is to replace it with a new loan via a refinancing. The terms of the new loan can be whatever the borrower and new lender negotiate; the proceeds of the new loan are used to pay off the balance on the old loan. When the old lender is paid off, the old lender releases its lien on the property.

The difference between refinancing and modification is that refinancing entails a new loan, whereas modification is simply a change to the terms of an existing loan. A refinancing can involve the substitution of a new lender for the existing lender or a new loan from the existing lender, whereas a modification involves the same lender. Because a refinancing involves a new loan, there are generally closing costs associated with a refinancing, whereas modification may or may not involve fees to the borrower.

Traditionally, refinancing requires the payment in full of the existing loan. Most mortgage loans have "due on sale" clauses that require payment of the full balance of the loan upon the sale of the property and further define a refinancing as a sale. Unless the existing mortgage is paid off, the existing mortgagee continues to hold a lien on the property that is senior to the new lender's. Payment in full via a refinancing thus requires the homeowner to have **equity** in the property, as today lenders will almost never extend credit beyond the value of the property (above a 100% loan-to-value ratio). Accordingly, refinancing has not been an option, generally, for borrowers who are **underwater**, even if they are current on their mortgage. However, the Enterprises will refinance qualifying underwater mortgages they own or guarantee under the federal government's Home Affordable Refinancing Program (HARP). Loans that are held on banks' balance sheets or in private-label securitizations are not eligible for HARP.

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 it, such as home equity loans).

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).

On October 24, 2011, FHFA announced revisions to HARP to expand the number of eligible homeowners. FHFA-OIG will discuss these revisions in greater detail in the next Semiannual Report.

In addition, some lenders will accept a "short refinancing" in which they receive less than the full unpaid principal balance, may forgive the remaining balance, and release the lien. They may choose to do so if they believe that they will make more in a partial payment via a refinancing than they will in a foreclosure sale. FHA, for example, offers a short-refinancing program: for qualifying borrowers who do not currently have FHA-insured loans, FHA will insure a new first lien mortgage loan at up to 97.75% loan-to-value ratio based on a fresh appraisal. This means that the existing lender must agree to a write-down of the balance as part of the refinancing. FHA requires that the existing lender reduce the existing balance by at least 10% and that the combined loan-to-value ratio of all mortgages on the property be no more than 115%. While short refinancing may be a valuable solution for underwater borrowers, refinancing with a new lender is often very difficult for borrowers with impaired credit scores (which includes any borrower who has defaulted), or even for those with relatively good credit scores.

FORECLOSURE AND ITS EFFECTS

If loss mitigation efforts do not succeed, the defaulted loan will proceed to foreclosure. There are two basic types of foreclosure. Judicial foreclosures proceed through the court system, while nonjudicial foreclosures take place outside it. The type of foreclosure process and other specific features are governed by state law, which varies considerably among the states, and by the terms of the mortgage itself. Some mortgages permit only one type of foreclosure. Some states permit only one type of foreclosure, while others provide for the possibility of either. State law can also vary depending on the type of property involved (its size and use) and by whether the mortgage was a purchase money mortgage or a refinancing of a previous mortgage. This overview is designed to present a general description of the foreclosure process. Actual state law may vary from the process described herein, and this overview should not be relied upon as a legal guide.

Judicial Foreclosure

A judicial foreclosure is a litigation process with a specific remedy. Generally, the loan servicer, on the noteholder's behalf, commences the foreclosure by filing a suit against the homeowner. If those bringing the suit cannot prove that they are acting on behalf of the party entitled to repayment under the terms of the note, they may lack legal standing to do so. Similarly, a foreclosure may be invalid if the foreclosing party or its representative files suit before becoming the holder of the note and the mortgagee.

To begin a foreclosure action, the noteholder's representative files various documents with the court in the form of a "complaint." It also must serve the complaint to the homeowner, notifying him or her of the litigation. Additionally, notice must typically be sent to all **junior lienholders**, such as

Junior Lienholder:
The security interest that can be availed only after the senior lien is satisfied, is called a junior lien. The holder of this security interest is the junior lienholder. Depending on the relative priority of the junior lien, the junior lienholder may be the second mortgagee, third mortgagee, etc. For example, a bank holding a home equity mortgage on a home is the junior lienholder to the bank holding the primary mortgage.

home equity lenders. The specific requirements vary by state, but state law typically requires the foreclosing party to assert for the record that:

- the homeowner is indebted to the foreclosing party;
- the homeowner has defaulted on the loan;
- the loan is secured by a mortgage, and the foreclosing party is or represents the mortgagee; and
- service of process has been made on the homeowner.

These are typically made via affidavits – sworn written statements submitted to the court. For example, the fact and amount of the indebtedness are typically established via an affidavit of indebtedness. State law requires that affidavits be sworn out by affiants who have personal knowledge of the facts to which they attest. Such affidavits are typically notarized.

Robo-signing. In mid-2010, certain leading mortgage servicers were found to be routinely submitting flawed affidavits to courts in foreclosure cases. Affidavits are supposed to be sworn out by affiants with personal knowledge of the facts, which are attested to in the affidavit, such as the fact and amount of the homeowner's indebtedness and that the homeowner had defaulted on the loan. In the course of depositions in foreclosure cases, servicers were found to have employees whose sole job was to sign foreclosure affidavits, as many as 10,000 affidavits in a single month by some employees (roughly one per minute). These employees had no personal knowledge of any of the facts to which they attested.

As robo-signing began to garner media attention, several major servicers imposed voluntary moratoria on their foreclosure activities. All have subsequently resumed foreclosures, although some foreclosure filings have been withdrawn and resubmitted and, in Maryland, a state judge threw out over 10,000 foreclosures filed by Ally Financial Inc. (formerly known as GMAC, LLC) because of robo-signing. Federal banking regulators commenced an investigation of robo-signing practices that resulted in consent orders between leading servicers and the federal regulators, in which the servicers agreed to improved internal controls. State attorneys general are still investigating robo-signing and related issues.

While media attention was focused on the lack of personal knowledge of the affiants and the sheer volume of signatures made by individual robo-signers, more serious issues lurk in the robo-signing scandal. In particular, the backdating of mortgage transfer documents was the focus of the depositions in which robo-signing was uncovered. The date of the transfer of a mortgage is critical for three reasons:

- First, it may affect whether a servicer has legal standing to foreclose; only the mortgagee has such standing. In *Ibanez v. U.S. Bank*, the Massachusetts Supreme Judicial Court upheld the reversal of a foreclosure in which the servicer could not prove that the loan had been transferred to the securitization trust before the foreclosure was commenced.
- Second, it may affect whether the servicer is a "holder-in-due-course," a special legal status that prevents the homeowner from raising certain defenses (including that the homeowner was fraudulently induced into the mortgage) and counterclaims. A party that receives a loan that is in default cannot be a holder-in-due-course, so determining the date of transfer is critical to ensure that the homeowner is not wrongfully deprived of his or her legal rights to raise defenses and counterclaims.
- Third, for securitized loans, tax and trust law rules depend on the date of the transfer. If the loan was transferred too late, there may be adverse tax consequences for the investors in the mortgage-backed securities and the transfer may itself be void under trust law.

Thus, issues related to the timing of transfers of mortgages (often referred to as "chain of title") have profound legal implications.

Generally, state law requires that a copy of the mortgage note accompany the complaint. The foreclosing party may be required to produce the original "wet ink" or "blue ink" note. Often state law requires the filing of the mortgage itself as part of the complaint, but because recorded mortgages (unlike notes) are public records, a reference to the mortgage may be sufficient. Some states also require certification of mandatory loss mitigation efforts, such as mediation, prior to foreclosure.

Most judicial foreclosures are not contested and result in default judgments against the homeowner. In such cases, it is rare for courts to undertake more than a cursory examination of the sufficiency of the foreclosing party's filings.

If a homeowner contests a foreclosure, either because of procedural deficiencies or on the basis of substantive defenses and counterclaims, then the case is litigated like a regular civil action. A homeowner's ability to raise defenses and counterclaims depends on whether the foreclosing party is a "holder-in-due-course" of the defaulted note. To be a holder-in-due-course, the foreclosing party must: (1) possess the actual note; (2) have given value for the note and taken it in good faith; and (3) have no notice of any defect in the note, including that the note is in default. This means that if the note were transferred to the foreclosing party subsequent to the default, the foreclosing party is not a holder-in-due-course, so the homeowner may raise a full battery of defenses and counterclaims in the foreclosure action.

If the court awards judgment to the foreclosing party, the property is then scheduled for sale, typically by the county sheriff. Sale scheduling is determined in part by requirements for advertisement of the sale for a minimum time period. The homeowner may, of course, appeal the foreclosure judgment.

Show Me The Note. Foreclosure defense litigation has begun to feature variations of the "show-me-the-note" defense, in which the homeowner challenges the foreclosing party to prove that it has the right to foreclose. In its most basic form, this defense is a demand that the foreclosing party produce the original mortgage note, but the term refers to a range of challenges relating to the foreclosing party's standing.

Critically, the show-me-the-note defense does not involve a claim that the homeowner is not in default. Instead, it focuses on whether the foreclosing party is the party that is legally entitled to foreclose and has made the required evidentiary showings. Determining the proper party is important for issues of legal standing, holder-in-due-course status, and the homeowner's ability to raise various defenses and counterclaims, and because it affects settlement abilities and incentives. A portfolio lender, for example, may have very different settlement abilities and incentives than a third-party mortgage servicer.

Kemp v. Countrywide Home Loans, Inc., 449 Bankr. 624 (Bankr. D.N.J. 2010) provides an illustration of a successful "show-me-the-note" defense. In *Kemp*, the homeowner had taken out a loan from Countrywide Home Loans, Inc. Countrywide subsequently securitized the loan, selling it to a trust named CWABS Asset-Backed Certificates, Series 2006-8. The Bank of New York served as trustee for the trust and Countrywide as servicer for the trust.

The homeowner filed for bankruptcy, having previously defaulted on his mortgage. Countrywide, as servicer, filed a claim in the bankruptcy on behalf of the trust. The homeowner challenged that claim based on the fact that the mortgage note had not been properly endorsed to the Bank of New York as trustee for the securitization trust and was never placed in the Bank of New York's possession. Accordingly, the homeowner argued, the trust was not a party entitled to enforce the note, as only a physical holder of the note, a non-holder in possession, or someone who has lost a note may enforce a note.

During the trial, Countrywide produced an "allonge" — a separate sheet of paper to be affixed to a note to allow room for additional endorsements. This allonge contained the endorsement that was missing on the note itself (albeit with an error in the name of the trust). Countrywide's official witness, however, testified that the allonge had been created in anticipation of the litigation. The official witness further testified that the original note had never left Countrywide's possession and that the new allonge had never actually been affixed to the note — it was simply a piece of paper with an endorsement, but no indication of what had been endorsed.

The bankruptcy court denied the claim Countrywide had filed on behalf of the trust because the trust could not show that it was a party entitled to enforce the note. The trust was neither a holder of the note (an owner of the note in physical possession of the note), nor a non-holder (someone who lacks ownership of the note) in possession of the note, nor had it lost the note. Because the Bank of New York, as trustee, and Countrywide, as its agent, were not entitled to enforce the note, the bankruptcy claim against Kemp was disallowed.

Nonjudicial Foreclosure

Nonjudicial foreclosures proceed rather differently. There are no court filings or showings of proof required. Instead, in a nonjudicial foreclosure, the foreclosing party must notify the homeowner of the default and the scheduled sale. Sometimes this requires a formal "notice of intent to foreclose." It is also required to advertise the sale. Advertisement requirements vary significantly by jurisdiction, but generally the sale must be advertised in a newspaper of record for the community for a few weeks prior to the sale. The assumption in a nonjudicial foreclosure proceeding is that the foreclosing party has the right to foreclose, provided that it appropriately provides notice and advertises the sale.

A nonjudicial foreclosure may effectively be transformed into a judicial foreclosure if the homeowner brings a quiet title action or the equivalent, which has the effect of contesting the foreclosure sale's transfer of title to the foreclosure sale purchaser. Conversely, foreclosure sale purchasers will sometimes bring subsequent judicial actions to ensure quiet title, particularly if there are any questions about the procedural propriety of the sale.

The Foreclosure Sale

The rules governing the actual foreclosure sale vary by jurisdiction. Sales are conducted by auction, but there are usually few if any rules governing the actual sale in nonjudicial foreclosures. The timing and the bidding in judicial foreclosure sales is frequently specified in detail by statute, including minimum bids, appraisal requirements, deposits, and completion of payment. Some jurisdictions, however, leave details of the bidding up to the local government official, typically the sheriff, who conducts the auctions.

Two constant rules for all foreclosure sales are the order of payment and the effect on liens. The proceeds of a foreclosure sale are used first to cover the expenses of the sale. They are then paid to the foreclosing party, and, if there are surplus funds, to junior lienholders in their order of seniority. Rules of lien priority generally follow a first-in-time, first-in-right pattern, with the first lienholder to **perfect** its lien (by making the necessary legal filings or automatically in some cases) having seniority over subsequently perfected (or unperfected) liens. There are many exceptions to this pattern, however. Notably, state tax liens frequently have priority over other previously perfected liens. If any surplus remains, it is paid to the (former) homeowner.

Perfection:
The legal recording of evidence for a creditor's lien on a particular item of property.

There is no right for prospective buyers (or the foreclosing party) to inspect the property before the foreclosure sale. Prior to the completion of the sale, the property still belongs to the mortgagor/homeowner. Accordingly, third parties tend to discount foreclosure sale purchase bids heavily. Although they can ascertain the external condition of the property, they cannot discern the layout or condition of the property internally, and many foreclosed properties have been damaged prior to sale.

The inability to inspect the property pre-sale, as well as the foreclosing party's ability to "credit bid," means that there are relatively few bidders in most foreclosure sales other than the foreclosing party. Most foreclosure sale properties are purchased by the foreclosing party via a "credit bid." This means that the foreclosing party bids the amount it is owed on the loan rather than bidding with cash. In other words, a credit bidding party merely credits itself rather than writing itself a check. A credit bidding party typically bids in the full amount of the debt owed, which means that a third-party bidder must be willing to pay a higher cash price to win the auction. By credit bidding, the foreclosing party can obtain clear title to the property, inspect the property, fix it as necessary, and then resell it subsequently.

It is important to note that foreclosure sales are frequently cancelled or rescheduled. This may occur for a variety of reasons, including ongoing negotiations between the borrower and the lender; intervening bankruptcy filings; and inability to complete procedural steps, including accumulation of necessary documentation.

Cures

Acceleration:
The declaring of a debt due and payable immediately. Lenders may possess this right under certain conditions, according to the terms of the obligation or applicable law.

Until the completion of the foreclosure sale, the homeowner may cure the default and stop the foreclosure. Typically this requires payment of the entire mortgage debt, as the lender will have **accelerated** the debt. The lender may be willing, but is under no obligation, to stop the sale if only past due payments are tendered.

If the homeowner files for bankruptcy, the foreclosure sale is automatically stayed, and federal bankruptcy law permits homeowners to unwind the acceleration of a mortgage and cure by paying only the past due payments and associated costs.

Deficiency Judgments

The foreclosure sale may not provide proceeds sufficient to satisfy the mortgage debt. In such cases, the noteholder's representative (and any junior lienholders) may seek a deficiency judgment – a legal judgment for the remaining amount of the debt. A deficiency judgment is an unsecured debt, like credit card debt, and collection follows the procedure for other unsecured debt. This means that deficiency judgments are often difficult for lenders to collect, as many states place restrictions on wage garnishment and unsecured debts are generally dischargeable in bankruptcy. Accordingly, noteholders often sell deficiency judgments to third-party debt collectors at substantial discounts from face value. Attempts to collect these debts are typically subject to the provisions of the Fair Debt Collection Practices Act as well as to state debt collection law.

The availability and procedure for a deficiency judgment varies by state and foreclosure process. Generally, deficiency judgments are not available when nonjudicial foreclosure is used because of concerns that private sales might be manipulated to suppress foreclosure sales prices in order to produce a larger deficiency judgment. In some states, deficiency judgments are available automatically following a judicial foreclosure. In others, the foreclosing party must file a motion or a complaint for a deficiency judgment. Even then, there is variation as to whether a deficiency judgment (if allowed) is awarded as a matter of right or by judicial discretion.

Right of Redemption

Figure 12, at the end of this overview, summarizes provisions for right of redemption by state.

In some states, homeowners have a statutory post-foreclosure sale "right of redemption." This means that the homeowner can redeem – reclaim title to – the house by tendering the amount of the unpaid debt and foreclosure sale costs. The length of the statutory redemption period varies considerably, from as short as 10 days in New Jersey to 2 years in Tennessee. The existence of rights of redemption is a factor foreclosure sale purchasers are likely to consider, as they run the risk of being deprived of their foreclosure sale purchase (even though the purchase price is returned). While it is uncommon for foreclosed homeowners to come up with the cash to redeem their properties during the redemption period, the right is exercised at times.

Eviction

If the former homeowner does not voluntarily surrender the property following the foreclosure sale, the foreclosure sale purchaser can have the former homeowner evicted. Eviction is also a state law procedure; the precise process varies by state law, but it is not always automatic. Because foreclosure sale purchasers are often concerned about former homeowners damaging the property before they leave, they are often willing to negotiate with homeowners regarding relocation timetables and costs. They are, however, under no obligation to do so.

Renters Living in Foreclosed Property

Sometimes a foreclosed property is occupied by renters. Renters' rights in a foreclosure involving their landlord vary by state. Since 2009, however, the Helping Families Save Their Homes Act has included minimum protections for renters in the foreclosure of most mortgages, including all mortgages owned by the Enterprises. If the renter has a *bona fide* lease entered into prior to the notice of foreclosure, then the renter may occupy the property until the end of the remaining term on the lease unless the renter is given notice of termination by the foreclosure sale purchaser, in which case the renter has 90 days of occupancy rights. If the renter is not renting under a lease or the lease is terminable at will, then the renter also has 90 days of occupancy rights from notice of termination. Some states give renters additional occupancy rights; others merely give renters the right to notice of the foreclosure.

Liability for Insurance, Taxes, and Homeowners' Fees

Until title passes to the foreclosure sale purchaser, the homeowner typically remains liable for taxes, homeowners' association dues, nuisances, and accidents on the property. Noteholders or their representatives typically have the right to force-place insurance on the property if the homeowner has failed to maintain insurance payments. Force-placement of insurance involves the noteholder's purchasing insurance on the property with itself as the loss-payee. Force-placed insurance can be expensive relative to regular insurance, and some servicers force-place insurance with their affiliates.

Post-sale, the liability falls on the property's new owner. In some communities, however, a phenomenon known as "bank walkaway" has occurred in which a servicer will commence a foreclosure, but not complete it. Frequently, bank walkaway occurs when the property's value is so low that it is not worth the expense of foreclosure. In bank walkaway cases, the homeowner remains the owner of the property, although in many cases he or she will have moved out because of the anticipated foreclosure. Because the homeowner remains the title owner of the property, he or she remains liable for property taxes and upkeep. Thus, the homeowner could be subject to fines and other penalties if the property becomes a nuisance, or the homeowner could be liable for accidents that occur. Similarly, the noteholder's representative may complete the foreclosure and purchase the property itself in the foreclosure sale, but fail to record the deed in its own name. In such cases, the homeowner remains liable for property taxes.

Impact on Credit Score

Mortgage defaults, foreclosures, deeds in lieu of foreclosure, and short sales can have adverse impacts on consumers' credit scores. A default, foreclosure, deed in lieu, or short sale may remain on a consumer's credit report for up to seven years. A bankruptcy may remain on a consumer's credit report for up to 10 years. The presence of adverse events on credit reports is likely to lower a consumer's credit score, which can make it more difficult or expensive for a consumer to obtain credit in the future. Credit reports are also used by insurers and employers, so adverse credit events can affect the cost of insurance and/or employment opportunities.

FORECLOSURE ALTERNATIVES

More information on HAFA is available at www.makinghomeaffordable.gov/programs/exit-gracefully/Pages/hafa.aspx.

Depending on individual circumstances, alternatives may exist to foreclosure proceedings that reduce expenses or legal liability for troubled homeowners. However, like foreclosure, these options will typically result in the homeowner's loss of his or her house. These alternatives may include short sales, deeds in lieu, and bankruptcy. The Enterprises participate in the federal government's HAFA program, which is designed to encourage alternatives to the foreclosure process for troubled home mortgage loans. Participating HAFA servicers may not seek deficiency judgments and may provide relocation incentives of up to $3,000 for eligible homeowners who tender deeds in lieu of foreclosure or do short sales.

Short Sale

Lenders may agree to a "short sale," in which the homeowner conducts a private sale of the house, and the lender releases its lien in exchange for the sale proceeds, even though the sale proceeds are insufficient to pay off the debt. A short sale does not necessarily discharge the homeowner's debt; it merely results in a release of the lien, so the homeowner may still be liable for the deficiency. If the lender forgives the deficiency, it may be imputed as taxable income for the homeowner, particularly if the mortgage had a cash-out component.

There are certain barriers to a short sale. Servicers are frequently wary of short sale offers because of concerns that they are settling the debt at too low a price and that the bidder may have colluded with the homeowner. In addition, the high rate of denials for short sale offers has made realtors reluctant to handle them because realtors are only paid upon consummation of a sale and put in more effort in short sales than for regular sales.

Deed in Lieu of Foreclosure

Lenders will sometimes accept a deed in lieu of foreclosure. This means that the homeowner will surrender title and possession of the property voluntarily, rather than requiring the lender to go through the full foreclosure process. For the lender, a deed in lieu spares the time and expense of the foreclosure process. For the homeowner, a deed in lieu may be attractive because the terms under which the homeowner surrenders the property may be negotiated — the lender may be willing to provide the homeowner with some relocation funds or a more generous timetable for moving out.

Critically, a deed in lieu does not extinguish junior liens, so the lender will acquire the property with junior liens still attached. Thus, if neither the homeowner nor the lender who has taken the deed in lieu pays off the junior lienholder(s), the latter may foreclose on the property. Accordingly, lenders may be reluctant to accept deeds in lieu when there is a junior lien on a property.

Bankruptcy

A homeowner may file for bankruptcy at any point before, during, or after the foreclosure process. Bankruptcy is a federal judicial proceeding. A bankruptcy filing automatically stops the foreclosure process. If a lender wishes to proceed with a foreclosure against a bankrupt homeowner, the lender must get permission from the bankruptcy court to do so.

If the homeowner files for Chapter 7 bankruptcy and has defaulted, the homeowner will not be able to retain the property after the bankruptcy absent the lender's consent. If the homeowner files for Chapter 13 bankruptcy and has defaulted, the homeowner may de-accelerate the note and cure the default simply by making up missed payments rather than the full amount of the note. The homeowner may not, absent the lender's consent, modify the terms of the mortgage in bankruptcy if the property is a single-family residence. For multi-family residences, the homeowner may be able to restructure the mortgage in bankruptcy.

For further information on homeowner assistance programs, borrowers should visit www.makinghomeaffordable.gov or call 888-995-HOPE.

Figure 12. Summary of Foreclosure Process by State

State	Foreclosure Process[41]	Right of Redemption[42]	Mediation Programs
Alabama	Primarily nonjudicial	1 year	None
Alaska	Primarily nonjudicial	No	None
Arizona	Primarily nonjudicial	No	None
Arkansas	Primarily nonjudicial	No	None
California	Primarily nonjudicial	2 years if court grants deficiency judgment	Yes[43]
Colorado	Primarily nonjudicial	Redemption by lienholders allowed only within specified periods	Yes[44]
Connecticut	Primarily judicial	Yes, after judgment and before sale	Yes[45]
Delaware	Primarily judicial	No	Yes[46]
District of Columbia	Primarily nonjudicial	In optional judicial procedure there is a provision for redemption before judgment	Yes[47]
Florida	Primarily judicial	Yes, up to date clerk files certificate of sale	Yes[48]
Georgia	Primarily nonjudicial	No	None
Hawaii	Primarily nonjudicial	No	Yes[49]
Idaho	Primarily nonjudicial	No	None
Illinois	Primarily judicial	Yes, later of 7 months after service of complaint or 3 months after judgment	Yes[50]
Indiana	Primarily judicial	No	Yes[51]
Iowa	Primarily judicial	1 year	None
Kansas	Primarily judicial	3 to 12 months depending on percentage of debt that has been paid	None
Kentucky	Primarily judicial	1 year	Yes[52]
Louisiana	Primarily judicial	No	None
Maine	Primarily judicial	Mortgages after 10/1/75, 90 days. Mortgages prior to 10/1/75, 1 year	Yes[53]
Maryland	Primarily nonjudicial	No	Yes[54]
Massachusetts	Primarily nonjudicial	No	Yes[55]
Michigan	Primarily nonjudicial	1 month to 1 year depending on size of parcel, number of units, percentage of original loan outstanding, and whether property is abandoned	Yes[56]
Minnesota	Primarily nonjudicial	6 or 12 months depending on date of mortgage, size of property, and whether use is agricultural	Yes[57]
Mississippi	Primarily nonjudicial	No	None
Missouri	Primarily nonjudicial	1 year	None
Montana	Primarily nonjudicial	Generally 1 year; for small tracts no	None
Nebraska	Primarily nonjudicial	No	None

State	Foreclosure Process[41]	Right of Redemption[42]	Mediation Programs
Nevada	Primarily nonjudicial	No	Yes[58]
New Hampshire	Primarily nonjudicial	No	Yes[59]
New Jersey	Primarily judicial	6 months	Yes[60]
New Mexico	Primarily nonjudicial	9 months	Yes[61]
New York	Primarily judicial	No	Yes[62]
North Carolina	Primarily nonjudicial	10 days	None
North Dakota	Primarily judicial	60 days or 1 year for agricultural land	None
Ohio	Primarily judicial	Before confirmation of sale with the amount of judgment and associated costs paid	Yes[63]
Oklahoma	Primarily nonjudicial	Up to confirmation of sale	None
Oregon	Primarily nonjudicial	No	Yes[64]
Pennsylvania	Primarily judicial	No	Yes[65]
Puerto Rico	Primarily judicial	No	None
Rhode Island	Primarily nonjudicial	No, except if foreclosure by process of law or by open entry then 3 years	Yes[66]
South Carolina	Primarily judicial	No redemption after sale. Redemption possible for 5 days after sheriff takes possession	None
South Dakota	Primarily nonjudicial	1 year	None
Tennessee	Primarily nonjudicial	Generally no, could be 2 years but right to redemption is routinely waived	None
Texas	Primarily nonjudicial	No	None
Utah	Primarily nonjudicial	6 months for judicial foreclosure	None
Vermont	Primarily judicial	In judicial strict foreclosure with no sale, 6 months. In judicial foreclosure with sale may redeem until sale	Yes[67]
Virginia	Primarily nonjudicial	No	None
Washington	Primarily nonjudicial	8 months	Yes[68]
West Virginia	Primarily nonjudicial	No	None
Wisconsin	Primarily judicial	Up to time of sale; 12 months after judgment unless creditor waives right, if waived 6 months	Yes[69]
Wyoming	Primarily nonjudicial	3 months	None

APPENDICES

Appendix A: Glossary and Acronyms

GLOSSARY OF TERMS

Acceleration: The declaring of a debt due and payable immediately. Lenders may possess this right under certain conditions, according to the terms of the obligation or applicable law.

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 dealing with 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.

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, FHFA placed the Enterprises into conservatorships. 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 board of directors, officers, and shareholders; however, the day-to-day operations of the company are still with the Enterprises' existing management.

Conventional Conforming Mortgage Loans: Conventional mortgage loans are 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 2011, 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.

Credit Rating Agency: Credit rating agencies provide their opinions on the creditworthiness of institutional borrowers and their financial obligations. While the Securities and Exchange Commission recognizes 10 credit rating agencies as Nationally Recognized Statistical Rating Organizations, 3 (S&P, Moody's, and Fitch) are considered the most prominent.

Debarment: Disqualification of a firm or 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.

Deed in Lieu: A deed in lieu of foreclosure is a disposition option in which a mortgagor voluntarily deeds collateral property in exchange for a release from all obligations under the mortgage.

Default: Default is failure to comply with the terms of an obligation.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act): 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 (EESA): 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 it, such as home equity loans).

Fair Debt Collection Practices Act: Legislation that prohibits deceptive, unfair, and abusive practices by third-party collectors, but the Act permits reasonable collection efforts that promote repayment of legitimate debts. For the most part, creditors are exempt when they are collecting their own debts.

Federal Home Loan Banks (FHLBanks): 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 (Freddie Mac): 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 (FHA): Part of HUD, FHA provides mortgage insurance on loans made by approved lenders throughout the United States and insures residential mortgages against payment losses. It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934.

Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act): Legislation that modernized the regulatory oversight of Fannie Mae and Freddie Mac. It created OFHEO as a new regulatory office within HUD with the responsibility to "ensure that Fannie Mae and Freddie Mac are adequately capitalized and operating safely." The Safety and Soundness Act established risk-based and minimum capital standards for the Enterprises and established HUD-imposed housing goals for financing of affordable housing, housing in central cities, and other rural areas. OFHEO was eliminated by HERA.

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

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

Golden Parachute: A term used to describe special compensation arrangements, such as cash, special bonuses, stock options, or vesting of previously awarded compensation, between a company and its senior executives in case the company is acquired or if an individual is fired or involuntarily separated.

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

Government-Sponsored Enterprises (GSEs): Business organizations chartered and sponsored by the federal government that include Fannie Mae, Freddie Mac, and the FHLBanks.

Guarantee: A pledge to investors that the guarantor will bear the default risk on the collateral pool of loans, thereby ensuring the timely payment of principal and interest owed to investors.

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

Implied Guarantee: The assumption, prevalent in the financial markets, that the federal government will cover GSE 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 a 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 would be required to step in and cover that debt.

Junior Lienholder: The security interest that can be availed only after the senior lien is satisfied, is called a junior lien. The holder of this security interest is the junior lienholder. Depending on the relative priority of the junior lien, the junior lienholder may be the second mortgagee, third mortgagee, etc. For example, a bank holding a home equity mortgage on a home is the junior lienholder to the bank holding the primary mortgage.

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.

Mediation: Mediation is a process by which a neutral third party (mediator) assists the homeowner and lender in reaching a fair, voluntary, negotiated agreement. The mediator does not decide who is right or wrong.

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.

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

Perfection: The legal recording of evidence for a creditor's lien on a particular item of property.

Personally Identifiable Information (PII): 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.

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

Real Estate Owned (REO): 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.

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.

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

Senior Lienholder: The security interest that has priority over all other interests in a property, is called a senior lien. The holder of this security interest is the senior lienholder or first mortgagee. For example, the bank holding the first mortgage on a home is the senior lienholder.

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 a preferred stock investment facility for each Enterprise. Under the PSPAs, the Enterprises agree to consult Treasury concerning a variety of significant business activities, capital stock issuance and dividend payments, ending the conservatorships, transferring assets, and awarding executive compensation.

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 Refinancing: A refinancing option offered by FHA to homeowners who owe more on their mortgages than their homes are worth.

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

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).

Underwriter: In the context of the securities markets, an underwriter is an entity that purchases newly issued bonds from the issuer and resells them to investors. In their role as marketing and sales agents, underwriters have specific obligations to disclose accurate and pertinent information about such bond offerings, many of which are stated in the Securities Act of 1933.

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ACRONYMS AND ABBREVIATIONS

Agency- Federal Housing Finance Agency

Blue Book- Quality Standards for Inspection and Evaluation

CIGFO- Council of Inspectors General on Financial Oversight

CIGIE- Council of the Inspectors General on Integrity and Efficiency

CPO- Chief Privacy Officer

Delegations- Conservatorship Delegations/Operating Protocol for Delegations

Dodd-Frank Act- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

DOJ- United States Department of Justice

DOT- Deed of Trust

EESA- Emergency Economic Stabilization Act

Enterprises- Fannie Mae and Freddie Mac

EO- Executive Office

FAAs- Financial Agency Agreements

Fannie Mae- Federal National Mortgage Association

FBI- Federal Bureau of Investigation

FDIC- Federal Deposit Insurance Corporation

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

FHFA-OIG- Federal Housing Finance Agency Office of Inspector General

FHFB- Federal Housing Finance Board

FHLBank System- Federal Home Loan Bank System

FHLBanks- Federal Home Loan Banks

FinCEN- Financial Crimes Enforcement Network

FISMA- Federal Information System Management Act of 2002

Fitch- Fitch Ratings

Freddie Mac- Federal Home Loan Mortgage Corporation

GAO- United States Government Accountability Office

Ginnie Mae- Government National Mortgage Association

Gramm-Leach-Bliley- Financial Services Modernization Act of 1999

GSEs- Government-Sponsored Enterprises

HAFA- Home Affordable Foreclosure Alternatives

HAMP- Home Affordable Modification Program

HARP- Home Affordable Refinancing Program

HERA- Housing and Economic Recovery Act of 2008

HOPE- Home Owners Protection Economics, Inc.

HUD- United States Department of Housing and Urban Development

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

IRS-CI- Internal Revenue Service-Criminal Investigation

MBS- Mortgage-Backed Securities

MERS- Mortgage Electronic Registration System

MFWG- Mortgage Fraud Working Group

MHA- Making Home Affordable Programs

Moody's- Moody's Investors Service

NAAG- National Association of Attorneys General

NIST- National Institute of Standards and Technology

NRSRO- Nationally Recognized Statistical Rating Organization

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

OMB- Office of Management and Budget

OPOR- Office of Policy, Oversight, and Review

PII- Personally Identifiable Information

POA&Ms- Plans of Action and Milestones

PSPAs- Senior Preferred Stock Purchase Agreements

QRMs- Qualified Residential Mortgages

RAN- Retained Attorney Network

RATB- Recovery Accountability and Transparency Board

RefCorp- Resolution Funding Corporation

REO- Real Estate Owned

RFI- Request for Information

S&P- Standard & Poor's Rating Services

Safety and Soundness Act- Federal Housing Enterprises Financial Safety and Soundness Act of 1992

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

UBS- UBS Americas, Inc.

USDA- United States Department of Agriculture

VA- United States Department of Veterans Affairs

Working Group- Council of the Inspectors General on Integrity and Efficiency Suspension and Debarment Working Group

Yellow Book- Government Auditing Standards

Appendix B: Information Required by the Inspector General Act

Section 5(a) of the Inspector General Act provides that FHFA-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 FHFA-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, FHFA-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.	5-8 36-48
Section 5(a)(2)- A description of the recommendations for corrective action made by FHFA-OIG with respect to significant problems, abuses, or deficiencies.	36-48
Section 5(a)(3)- An identification of each significant recommendation described in previous semiannual reports on which corrective action has not been completed.	65-66
Section 5(a)(4)- A summary of matters referred to prosecutive authorities and the prosecutions and convictions that have resulted.	49-53
Section 5(a)(5)- A summary of each report made to the Director of FHFA.	36-48
Section 5(a)(6)- A listing, subdivided according to subject matter, of each audit and evaluation report issued by FHFA-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.	36-48
Section 5(a)(7)- A summary of each particularly significant report.	36-48
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.	106
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.	107
Section 5(a)(10)- A summary of each audit and evaluation report issued before the commencement of the reporting period for which no management decision has been made by the end of the reporting period.	107
Section 5(a)(11)- A description and explanation of the reasons for any significant revised management decision made during the reporting period.	107

Source/Requirement	Pages
Section 5(a)(12)- Information concerning any significant management decision with which the Inspector General is in disagreement.	107
Section 5(a)(13)- The information described under section 05(b) of the Federal Financial Management Improvement Act of 1996.	107-108

The paragraphs below address the status of FHFA-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, FHFA-OIG has released eight reports:

- Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America (EVL-2011-006, September 27, 2011)
- Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs (EVL-2011-005, September 23, 2011)
- Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk (EVL-2011-004, September 23, 2011)
- Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program (EVL-2011-003, August 12, 2011)
- FHFA's Oversight of Fannie Mae's Default-Related Legal Services (AUD-2011-004, September 30, 2011)
- Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation – 2011 (AUD-2011-003, September 30, 2011)
- Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Information Security Program – 2011 (AUD-2011-002, September 29, 2011)
- Audit of the Federal Housing Finance Agency's Consumer Complaints Process (AUD-2011-001, June 21, 2011)

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-OIG's audit and evaluation reports listed above do not include recommendations with dollar values for funds to be put to better use by management.

AUDIT AND EVALUATION REPORTS WITH NO MANAGEMENT DECISION

Section 5(a)(10) of the Inspector General Act, as amended, requires that FHFA-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 FHFA-OIG report information concerning the reasons for any significant revised management decision made during the reporting period. During the six-month reporting period ended September 30, 2011, there were no significant revised management decisions on FHFA-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 FHFA-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 2010, 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. As part of its audit, GAO assessed FHFA's compliance with the applicable provisions of HERA.

Several FHFA-OIG reports published during the semiannual period identified specific opportunities to strengthen FHFA's internal controls. These reports are summarized on pages 36 through 48.

Appendix C: FHFA-OIG Reports

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

EVALUATION REPORTS

Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America (EVL-2011-006, September 27, 2011).

Evaluation of Whether FHFA Has Sufficient Capacity to Examine the GSEs (EVL-2011-005, September 23, 2011).

Evaluation of FHFA's Oversight of Fannie Mae's Management of Operational Risk (EVL-2011-004, September 23, 2011).

Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in Treasury's Making Home Affordable Program (EVL-2011-003, August 12, 2011).

AUDIT REPORTS

FHFA's Oversight of Fannie Mae's Default-Related Legal Services (AUD-2011-004, September 30, 2011).

Clifton Gunderson LLP's Independent Audit of the Federal Housing Finance Agency's Privacy Program and Implementation - 2011 (AUD-2011-003, September 30, 2011).

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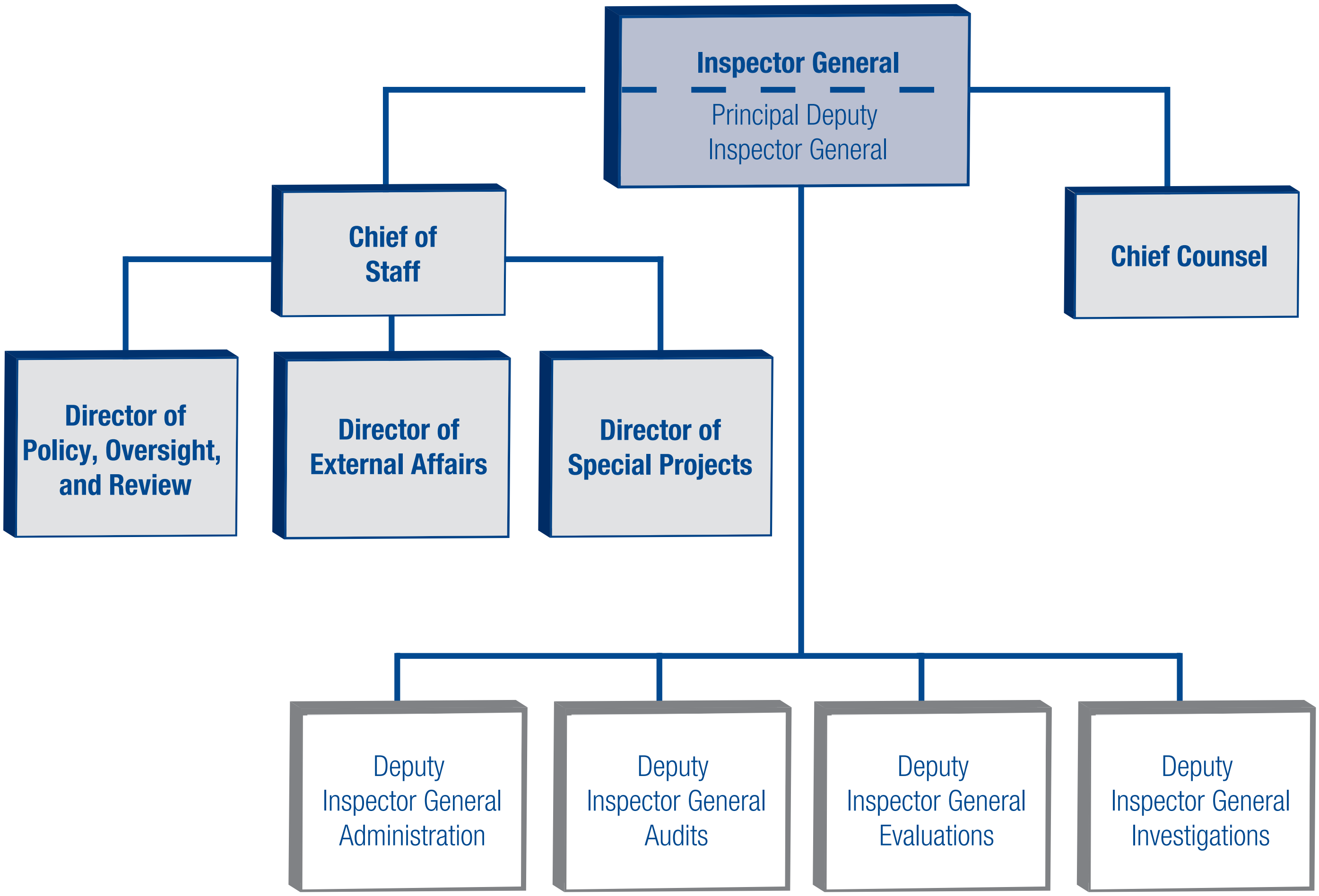
Appendix D: FHFA-OIG Organizational Chart



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Federal Housing Finance Agency
Office of Inspector General

Semiannual Report to the Congress

April 1, 2011, through September 30, 2011

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