



# **AUDIT, EVALUATION, AND COMPLIANCE PLAN**

April 2019

## OVERVIEW

The Federal Housing Finance Agency (FHFA or Agency) Office of Inspector General (OIG) is pleased to present this Audit, Evaluation, and Compliance Plan for calendar year 2019. The plan describes FHFA's and OIG's roles and missions, explains our risk-based methodology for developing this plan, provides insight into risks within five areas, and generally discusses where we will focus our audit, evaluation, and compliance resources during calendar year 2019.

## BACKGROUND

### Federal Housing Finance Agency

On July 30, 2008, Congress established FHFA with the Housing and Economic Recovery Act of 2008 (HERA)<sup>1</sup> to regulate Fannie Mae, Freddie Mac (together, the Enterprises), the Federal Home Loan Banks (FHLBanks) (collectively, the regulated entities), and the FHLBanks' fiscal agent, the Office of Finance.<sup>2</sup> FHFA's mission is to "[e]nsure the regulated entities operate in a safe and sound manner so that they serve as a reliable source of liquidity and funding for housing finance and community investment."<sup>3</sup>

Since September 2008, FHFA also has been the conservator of the Enterprises. FHFA placed the Enterprises into conservatorships "in response to a substantial deterioration in the housing markets that severely damaged each Enterprise's financial condition and left both of them unable to fulfill their mission without government intervention."<sup>4</sup> When then-Secretary of the Treasury Henry Paulson announced the conservatorships in September 2008, he explained that they were meant to be a "time out" during which the Enterprises would be stabilized, enabling the "new Congress and the next Administration [to] decide what role government in general, and these entities in particular, should play in the housing market."<sup>5</sup> However, putting the Enterprises into conservatorships has proven to be far easier than taking them out, and the "time out" period for the conservatorships is now in its 11<sup>th</sup> year.

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<sup>1</sup> Public Law No. 110-289.

<sup>2</sup> The Enterprises purchase mortgages from lenders and either package them into mortgage-backed securities that are sold to investors or hold them in their portfolios. By doing so, the Enterprises' actions promote liquidity in the housing finance system. Among other activities, the FHLBanks make secured loans known as advances to their members, such as banks or thrifts. Their members can use the advance proceeds to originate mortgages or support affordable housing or community development.

<sup>3</sup> FHFA, *FHFA Strategic Plan: Fiscal Years 2018–2022* (Jan. 29, 2018).

<sup>4</sup> FHFA, History of Fannie Mae & Freddie Mac Conservatorships (online at [www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx](http://www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx)).

<sup>5</sup> Statement by Treasury Secretary Henry M. Paulson, Jr., on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008).

FHFA's two conservatorships are of unprecedented scope and undetermined duration. The two entities dominate the secondary mortgage market and the mortgage securitization sector in the United States and thus affect the entire mortgage finance industry. While in conservatorship, the Enterprises have required almost \$191.5 billion in financial investment from the Treasury to avert their insolvency and, through December 2018, the Enterprises have paid to the Treasury more than \$292 billion in dividends on its investment. Despite their high leverage, diminished capital, conservatorship status, and uncertain future, the Enterprises have grown in size during conservatorship and, according to FHFA, their combined market share of newly issued mortgage backed securities is more than 60%. The Enterprises' combined total assets are more than \$5.4 trillion and their combined debt exceeds \$5 trillion.

Although market conditions have improved and the Enterprises have paid dividends on Treasury's investments, the Enterprises' future profitability cannot be assured for these reasons: the wind down of their retained investment portfolios and associated reduction in net interest income; the level of guarantee fees they will be able to charge and keep; the future performance of their business segments; and the significant uncertainties involving key market drivers, such as mortgage rates, home prices, credit standards, and unemployment.

### **FHFA Office of Inspector General**

Congress also established OIG with a mission to promote economy, efficiency, and effectiveness in the administration of FHFA's programs and operations, and to prevent and detect fraud, waste, and abuse in those programs and operations.<sup>6</sup> The FHFA Inspector General is Presidentially appointed and Senate confirmed.

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<sup>6</sup> Section 1105 of HERA amended the Inspector General Act of 1978, Public Law No. 95-452, to establish OIG.

## Our Vision

We seek to be an organization that promotes excellence and trust through exceptional service to FHFA, Congress, and the American people. OIG achieves this vision by being a first-rate independent oversight organization in the federal government that acts as a catalyst for effective management, accountability, and positive change in FHFA. In addition, we are committed to holding accountable those, whether inside or outside of the federal government, who waste, steal, or abuse funds in connection with the Agency, the Enterprises, or the FHLBanks.

## Our Mission

OIG promotes economy, efficiency, and effectiveness and protects FHFA and the entities it regulates against fraud, waste, and abuse, contributing to the liquidity and stability of the nation's housing finance system. We accomplish this mission by providing independent, relevant, timely, and transparent oversight of the Agency to promote accountability, integrity, economy, and efficiency. We also advance our mission by advising the Director of the Agency and Congress, informing the public, and engaging in robust law enforcement efforts to protect the interests of the American taxpayers.

## Our Organization

OIG consists of the Inspector General, her senior staff, and operational and support offices within OIG. The operational offices are: the Office of Audits, the Office of Evaluations, the Office of Investigations, and the Office of Compliance and Special Projects. This Audit, Evaluation, and Compliance Plan most directly impacts OIG's Offices of Audits, Evaluations, and Compliance and Special Projects.

### *OIG Office of Audits*

The Office of Audits conducts independent performance audits with respect to the Agency's programs and operations. It also undertakes projects to address statutory requirements and stakeholder requests.

As required by the Inspector General Act of 1978 (IG Act),<sup>7</sup> the Office of Audits performs its audits in accordance with the standards promulgated by the Comptroller General of the United States, which are known as Generally Accepted Government Auditing Standards or GAGAS (Yellow Book).

The Office of Audits may also conduct administrative inquiries of hotline complaints alleging non-criminal waste or abuse.

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<sup>7</sup> Public Law No. 95-452.

### *OIG Office of Evaluations*

The Office of Evaluations conducts independent and objective reviews, assessments, studies, and analyses of FHFA's programs and operations. Under the Inspector General Reform Act of 2008,<sup>8</sup> inspectors general are required to adhere to the professional standards designated by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). The Office of Evaluations performs its evaluations in accordance with the standards CIGIE established for inspections and evaluations, which are known as the *Quality Standards for Inspection and Evaluation* (Blue Book).

### *OIG Office of Compliance and Special Projects*

The Office of Compliance and Special Projects is charged with several critical responsibilities. First, it consults with each office in the development of recommendations to ensure that such recommendations, if accepted and implemented, will be susceptible to follow-up and verification testing. Second, it tracks the status of all OIG recommendations, from issuance to closure to subsequent follow-up and testing. Third, it consults with each office prior to closure of a recommendation to facilitate application of a single standard across the office for closing recommendations. Last, it conducts testing on closed recommendations to verify independently whether FHFA has implemented in full the corrective actions it represented to OIG that it intended to take. The results of that testing are published as compliance reviews.

The Office of Compliance and Special Projects also undertakes special projects, which include reviews and administrative inquiries of hotline complaints alleging non-criminal misconduct. It performs its compliance reviews and special projects in accordance with the Blue Book.

## **RISK ASSESSMENTS**

OIG's broad oversight mission encompasses the full scope of the Agency's programs and operations, including its conservatorship of the Enterprises. To best leverage our resources to strengthen OIG's oversight, we determined to focus our resources on programs and operations that pose the greatest financial, governance, and/or reputational risk to the Agency, the Enterprises, and the FHLBanks. We have established an ongoing and dynamic planning process to identify the most significant risks, which includes two types of periodic deliverables. The first deliverable is composed of strategic plans that seek to further FHFA's strategic goals for its programs (i.e., ensure safe and sound regulated entities; ensure liquidity, stability, and access in housing finance, and manage the Enterprises' ongoing conservatorships); the second is composed of tactical audit, evaluation, and compliance plans that flow from the strategic plans and focus on particular areas of greatest risk to FHFA and the entities it regulates.

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<sup>8</sup> Public Law No. 110-409.

## Strategic Plan

In February 2018, OIG issued *Strategic Plan: Fiscal Years 2018–2022*. The plan sets forth four high-level goals, of which three serve as a blueprint for our oversight of FHFA.<sup>9</sup> These three goals are:

- Strategic Goal 1—Promote FHFA’s effective supervision of the Enterprises and the FHLBanks to ensure their safety and soundness.
- Strategic Goal 2—Promote FHFA’s effectiveness as conservator of the Enterprises.
- Strategic Goal 3—Prevent and detect fraud, waste, and abuse in the programs and operations of the Agency.

The Strategic Plan is available at [www.fhfa.ig.gov/reports/strategicplan](http://www.fhfa.ig.gov/reports/strategicplan). OIG will continue to monitor events potentially impacting FHFA and housing finance and make changes to the plan as circumstances warrant.

## Audit, Evaluation, and Compliance Plan

OIG’s Audit, Evaluation, and Compliance Plan<sup>10</sup> focuses on and implements these three high-level goals in the Strategic Plan for the upcoming year. We have identified four areas of significant risk facing FHFA and one area of management concern, based on ongoing OIG work, OIG published reports, other publicly available information, and OIG’s general knowledge of FHFA’s operations and the external environment; discussions with FHFA and officials of the regulated entities, the public, Congress, and other government officials; reviews of relevant reports and documents prepared by FHFA and external parties; risk assessments performed in key areas related to FHFA’s mission; and matters referred to OIG through its Hotline. For calendar year 2019, OIG will continue to focus on the four areas of significant risk, in addition to one area of management concern:

- Conservatorship operations,
- Supervision of the regulated entities,
- Cybersecurity at the regulated entities and information security at FHFA,

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<sup>9</sup> The plan also includes a fourth goal of promoting excellence and effectiveness in OIG internal operations.

<sup>10</sup> These plans are fluid; they are neither final nor all-inclusive. They do not include, for example, audits, evaluations, compliance reviews, or special projects that OIG may undertake pursuant to requests from FHFA, Congress, and other stakeholders, or situations to which OIG’s attention may be drawn as a result of our ongoing activities. They also do not include several statutorily required reviews—such as the annual independent evaluation pursuant to the Federal Information Security Modernization Act of 2014 of FHFA’s information security program and practices (see 44 U.S.C. § 3555) and the improper payments audit (see 31 U.S.C. § 3321 note)—that OIG will conduct.

- Counterparties and third parties, and
- Internal controls over Agency and Enterprise operations (management concern).

Both FHFA and OIG have previously acknowledged the difficulties resulting from the ongoing uncertainty regarding the future role of the Enterprises in the housing finance system. In identifying and assessing these four significant risks facing FHFA, OIG remains mindful of this uncertainty and recognizes that such ongoing uncertainty adds additional difficulties for FHFA as it seeks to address these risks.

### Conservatorship Operations

As conservator of the Enterprises since September 2008, FHFA has expansive authority to oversee and direct operations of two large, complex companies that dominate the secondary mortgage market and the mortgage securitization sector of the U.S. housing finance industry. Under HERA, FHFA possesses all rights and powers of any stockholder, officer, or director of the Enterprises, and is vested with express authority to operate them, conduct their business activities, and take those actions necessary to put them in a sound and solvent condition and preserve and conserve their assets and property.

As conservator of the Enterprises, FHFA exercises control over trillions of dollars in assets and billions of dollars in revenue and makes business and policy decisions that impact the entire mortgage finance industry. For reasons of efficiency, concordant goals with the Enterprises, and operational savings, FHFA has determined to delegate revocable authority for general corporate governance and day-to-day matters to the Enterprises' boards of directors and executive management. The Enterprises recognize that FHFA, as conservator, has succeeded to all rights, titles, powers, and privileges of the Enterprises and of any shareholder, officer, or director of the Enterprises, and that the directors of the Enterprises owe fiduciary duties only to FHFA. Under HERA, the Agency's actions as conservator are not subject to judicial review or intervention, nor are they subject to procedural safeguards that are ordinarily applicable to regulatory activities such as rulemaking.

As of this writing, the duration of the conservatorships is still unknown. In January 2018, Treasury Secretary Mnuchin stated that:

...the current situation of indefinite conservatorship for Fannie Mae and Freddie Mac is neither sustainable nor a lasting solution. The Administration looks forward to working with Congress to reform America's housing finance system in a manner that helps consumers obtain the housing best suited to their own personal and financial situations while, at the same time, protecting taxpayers.<sup>11</sup>

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<sup>11</sup> Statement of Secretary Steven T. Mnuchin Before the U.S. Senate Committee on Banking, Housing, & Urban Affairs (Jan. 30, 2018).

In his nomination testimony, Director Calabria expressed frustration with the current state of the mortgage system and the need for reform.<sup>12</sup> OIG has determined that FHFA’s administration of the conservatorships continues to be a critical risk given the taxpayers’ enormous investment in the Enterprises, their critical role in the secondary mortgage market, unknown ability to sustain future profitability, and the unreviewability of FHFA’s decisions by a court of law.

### *Oversight of Delegated Matters*

As conservator of the Enterprises, FHFA has a responsibility to U.S. taxpayers, the largest shareholders in the Enterprises, and is charged with ensuring that the Enterprises achieve their statutory purpose. FHFA has delegated revocable authority for many matters, both large and small, to the Enterprises pursuant to its powers under HERA to take actions “necessary to put [Fannie Mae and Freddie Mac] in a sound and solvent condition” and “appropriate to carry on the business of [Fannie Mae and Freddie Mac]” and “preserve and conserve” their assets.<sup>13</sup> Since 2008, FHFA has issued more than 300 conservatorship directives in which it instructs the Enterprises to take certain actions, most of which relate to delegated responsibilities.

Historically, FHFA’s oversight of delegated matters, in its role as conservator, has largely been limited to attendance at Enterprise internal management and board meetings as an observer and discussions with Enterprise managers and directors. For the most part, FHFA, as conservator, has not assessed the reasonableness of Enterprise actions pursuant to delegated authority, including actions taken by the Enterprises to implement conservatorship directives, or the adequacy of director oversight of management actions. In the coming year, we intend to continue to look at governance issues relating to FHFA’s delegation of matters to the Enterprises.

### *Management of Non-Delegated Matters*

FHFA has retained authority to decide specific issues and can, at any time, revoke previously delegated authority. Generally, FHFA has retained authority (or has revoked previously delegated authority) to resolve issues of significant monetary and/or reputational value. FHFA has established written internal review and approval processes for non-delegated matters in an attempt to ensure that FHFA follows a consistent approach for analyzing and resolving such matters and that the decision-makers are apprised of all relevant facts and considerations. FHFA faces challenges in ensuring that its established processes are followed. In the next year, we intend to continue to review, as warranted, the Agency’s decision-making for non-delegated matters.

Our efforts should assist FHFA in improving the effective management of the conservatorships.

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<sup>12</sup> Testimony of Mark A. Calabria, Ph.D., nominee for Director, Federal Housing Finance Agency Before the United States Senate Committee on Banking, Housing and Urban Affairs (Feb. 14, 2019).

<sup>13</sup> 12 U.S.C. § 4617(b)(2)(D).



## Supervision

As FHFA has recognized, effective supervision of the entities it regulates is fundamental to ensuring their safety and soundness. Within FHFA, the Division of Federal Home Loan Bank Regulation is responsible for supervision of the FHLBanks and the Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises. FHFA's supervisory activities include designing a comprehensive, risk-based supervisory strategy (examination planning), conducting on-site examinations (examination execution), and monitoring remediation of deficiencies identified during examinations (oversight). FHFA has repeatedly stated that effective supervision of the FHLBanks and the Enterprises is critical to ensuring their safety and soundness, and we have determined that FHFA's administration of its supervision responsibilities continues to be a critical risk.

According to FHFA, "Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime" for the Enterprises and FHLBanks. FHFA must conduct annual examinations of the financial condition of the regulated entities; and the FHFA Director has substantially the same authority as the bank regulators.

Like the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC), FHFA conducts safety and soundness examinations of its regulated entities, reports on the findings and conclusions of those examinations in annual reports of examinations, and, when necessary, issues findings identifying deficiencies. FHFA's governing statute, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended, also grants the FHFA Director authority to use examiners from the OCC, FRB, or FDIC to conduct FHFA's examinations and requires the Director to set compensation levels for FHFA staff that are comparable with other federal financial regulators.<sup>14</sup>

Based on our assessments of different elements of DER's supervision program, we identified four recurring themes and reported them in a December 2016 roll-up report: (1) FHFA lacks adequate assurance that DER's supervisory resources are devoted to examining the highest risks of the Enterprises; (2) many supervisory standards and guidance issued by FHFA and DER lack the rigor of those issued by other federal financial regulators; (3) the flexible and less prescriptive nature of many requirements and guidance promulgated by FHFA and DER has resulted in inconsistent supervisory practices; and (4) where clear requirements and guidance for specific elements of DER's supervisory program exist, DER examiners-in-charge and examiners have not consistently followed them.<sup>15</sup> Without prompt and robust Agency attention to address

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<sup>14</sup> 12 U.S.C. §§ 4515(b), 4517(c).

<sup>15</sup> See *OIG, Safe and Sound Operation of the Enterprises Cannot Be Assumed Because of Significant Shortcomings in FHFA's Supervision Program for the Enterprises* (OIG-2017-003) (Dec. 15, 2016) (online at [www.fhfa.ig.gov/Content/Files/OIG-2017-003.pdf](http://www.fhfa.ig.gov/Content/Files/OIG-2017-003.pdf)).

the shortcomings, we have cautioned that safe and sound operation of the Enterprises cannot be assumed from FHFA's current supervisory program.

This year, we will reassess the rigor of some of the elements of FHFA's supervisory programs, to include assessments of its execution of planned supervisory activities addressing (1) the Enterprises' highest risks as identified by FHFA and (2) the FHLBanks' implementation of anti-money laundering/terrorist financing programs. We will also continue to review whether FHFA has implemented prior recommendations to strengthen its supervisory programs and assess the adequacy of those remedial measures.

Our efforts are intended to assist FHFA in improving the effectiveness of its supervision of the Enterprises and the FHLBanks.

### Cybersecurity at the Regulated Entities and Information Security at FHFA

Cybersecurity, as defined by the National Institute of Standards and Technology (NIST), is "the process of protecting information by preventing, detecting, and responding to attacks." In May 2017, President Trump issued an executive order to strengthen the cybersecurity of federal networks and critical infrastructure. The Financial Stability Oversight Council, of which FHFA is a member, has identified cybersecurity oversight as an emerging threat for increased regulatory attention. The Council reported that "cybersecurity-related incidents create significant operational risk, impacting critical services in the financial system, and ultimately affecting financial stability and economic health."<sup>16</sup> Treasury Secretary Mnuchin has testified that cybersecurity is one of our biggest risks.

Systems security continues to be a preeminent issue for businesses and individuals alike. The regulated entities, like most modern institutions, rely on numerous, complex information technology (IT) systems to conduct almost every aspect of their work. These systems manage processes to guarantee and purchase loans, supporting more than \$5 trillion in Fannie Mae and Freddie Mac mortgage assets. Both Enterprises and the FHLBanks have been the targets of cyberattacks. All of the entities regulated by FHFA acknowledge that the substantial precautions put into place to protect their information systems may be vulnerable and penetration of their systems poses a material risk to their business operations. Further, the Enterprises are increasingly relying on third-party service providers, requiring the sharing of sensitive information between Enterprise and third-party systems. Consequently, the Enterprises face an increased risk in that an operational failure by a third party will adversely affect them.

As cyberthreats and attacks at financial institutions increase in number and sophistication, FHFA faces challenges in designing and implementing its examination activities for the entities it supervises. As the use of technology continues to become more sophisticated, hiring and training

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<sup>16</sup> Financial Stability Oversight Council, *2016 Annual Report* at 7 (online at <https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf>).

a sufficient number of employees with the expertise needed to conduct detailed examinations of information security systems presents a challenge. Our oversight activities this year are intended to assess FHFA's IT security posture. We will also continue to review whether FHFA has implemented prior recommendations to address gaps in its supervisory guidance to ensure that it adequately maps to the NIST *Framework for Improving Critical Infrastructure Cybersecurity*.

Our oversight is intended to assist FHFA in strengthening protections over its network operations and its supervision of cybersecurity risk management by the entities it regulates.

### Counterparties and Third Parties

The Enterprises rely heavily on counterparties and third parties for a wide array of professional services, including mortgage origination and servicing.

Counterparty relationships with the Enterprises carries risk. One of the most significant counterparty risks is the risk posed by loan originators and servicers that are not depository institutions (also called non-banks). As participants in the mortgage market change, counterparties can affect the risks to be managed by Fannie Mae and Freddie Mac. In recent years, the Enterprises' businesses have changed dramatically in terms of the types of institutions originating and selling mortgages to them.

In light of the financial, governance, and reputational risks arising from the Enterprises' relationships with counterparties and third parties, our efforts are intended to enhance FHFA's oversight of the Enterprises' management of risks related to their counterparties.

### Sustain and Strengthen Internal Controls Over Agency and Enterprise Operations

FHFA's programs and operations are subject to legal and policy requirements common to federal agencies. Satisfying such requirements necessitates the development and implementation of, and compliance with, effective internal controls within the Agency.

In January 2019, there was a leadership change upon the expiration of the prior Director's term. Last year, two senior agency officials were found to have violated FHFA's policies regarding leave and work schedules. We also found that FHFA needed to strengthen controls over its employee transportation benefits program. Recently, we found that FHFA's offboarding controls over access cards, sensitive information technology assets, and records were not always documented or followed during 2016 and 2017. Our work demonstrates that FHFA is challenged to ensure that its existing controls, including its written policies and procedures, are sufficiently robust, and its personnel are adequately trained on these internal controls and comply fully with them.

Both Enterprises have also recently made or announced leadership changes. Fannie Mae's Chief Executive Officer (CEO) left in late 2018, and Freddie Mac has stated that its CEO will depart in June 2019. In addition, the terms of a number of Enterprise directors have also recently expired.

Among other things, changes in leadership can lead to lack of attention to, and deterioration of, internal controls.

Our oversight will continue to include reviews of FHFA's internal operations that are important to achieving its mission.

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OFFICE OF INSPECTOR GENERAL

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