

Federal Housing Finance Agency
Office of Inspector General



DBR Provided Sufficient Oversight of the Office of Finance's Debt Issuance and Debt Servicing Functions

Audit Report • AUD-2024-008 • September 11, 2024

..... EXECUTIVE SUMMARY

PURPOSE

The Federal Home Loan Banks' Office of Finance (Office of Finance) functions as the fiscal agent for each Federal Home Loan Bank (FHLBank). It facilitates the issuance and servicing of all FHLBanks' consolidated obligations, which they use to make advances and to purchase mortgage loans and investments. As part of our ongoing oversight of the Federal Housing Finance Agency's (FHFA or Agency) supervision of the Federal Home Loan Bank System (FHLBank System), we performed an audit to assess whether the Division of Federal Home Loan Bank Regulation (DBR) provided sufficient oversight of the Office of Finance's debt issuance and debt servicing functions.

RESULTS

We determined that DBR provided sufficient oversight of the FHLBanks' Office of Finance's debt issuance and servicing functions. Specifically, we found that DBR's examination guidance provided examiners with worksteps needed to review and evaluate the debt issuance and debt servicing functions. DBR's supervisory activities during the audit scope met minimum frequency requirements and provided coverage of the Office of Finance's significant debt issuance and debt servicing risk management processes. DBR's supervisory conclusions were supported by the results of examination work documented in examination workpapers that had been subjected to DBR quality control processes. Furthermore, DBR assessed the remediation of adverse examination findings related to the Office of Finance's issuance and servicing of debt. Our review of certain DBR and Office of Finance debt issuance and servicing monitoring reports found no indications of unaddressed supervisory concerns.

We made no recommendations in this report.

This report was prepared by Jim Lisle, Audit Director; April Ellison, Audit Manager; Marco Uribe, Auditor-in-Charge; and Kobe Wilson, Auditor; with assistance from Abdil Salah, Assistant Inspector General for Audits. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report. This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaog.gov, and www.oversight.gov.

James Hodge
Deputy Inspector General for Audits /s/

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ABBREVIATIONS

DBR	Division of Federal Home Loan Bank Regulation
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
FHLBank System	Federal Home Loan Bank System
MRA	Matter Requiring Attention
OIG	FHFA Office of Inspector General
OPB	Operating Procedures Bulletin
QCB	Quality Control Branch
ROE	Report of Examination

BACKGROUND

The FHLBank System consists of 11 FHLBanks and the FHLBanks' Office of Finance (Office of Finance), which functions as the FHLBanks' fiscal agent. The Office of Finance Regulation (12 C.F.R. Part 1273) establishes the authorities, functions, and duties of the Office of Finance and the structure of its Board of Directors.

The Office of Finance's primary functions include the issuance and servicing of all FHLBanks' consolidated obligations,¹ which are used by the FHLBanks to make advances and to purchase mortgage loans and investments. The Office of Finance issues a variety of consolidated obligation types, including discount notes with maturities of less than one year, callable bonds, bullet bonds, and floating-rate bonds.² Whether issued through the FHLBanks' discount window or regularly scheduled auctions, nearly all consolidated obligations are issued through dealers authorized by the Office of Finance. The servicing of consolidated obligations includes the payment of interest, the payment of principal, bond calls, adjustment of the rate on floating rate bonds, and the adjustment of the coupon payments on more complex bond structures. Consolidated obligations are held on the balance sheets of the regional FHLBanks and were approximately \$1.19 trillion and \$1.16 trillion, as of December 31, 2023 and 2022, respectively. Consolidated obligations represented 98 percent of the FHLBanks' total liabilities as of these dates.

FHFA's DBR Oversight of the Office of Finance

FHFA regulates and supervises the FHLBank System, including the Office of Finance. The FHFA Director delegated supervision of the FHLBank System to the Deputy Director, DBR. DBR conducts risk-based supervisory activities of the Office of Finance, including an annual examination and offsite monitoring.

¹ The Office of Finance also prepares the quarterly and annual combined financial reports of the FHLBanks and administers the Resolution Funding Corporation, a tax-exempt government corporation created during the savings and loan crisis of the 1980s. Since our audit objective was focused on DBR's oversight of debt issuance and servicing, the oversight of these other functions was not included in the scope of this audit.

² Callable bonds can be redeemed by the issuer before the listed maturity date. Bullet bonds are non-callable bonds in which the entire principal value is paid in one lump sum on its maturity date. Floating-rate bonds have a variable interest rate.

DBR's Annual Examination of the Office of Finance

DBR's annual examination focuses on the Office of Finance's management and operational risk. This includes the activities of the board of directors, audit committee, and senior management and the assessment of key operational areas that may impact the safety and soundness of the FHLBanks, such as debt issuance and servicing. At the conclusion of an examination, DBR issues a Report of Examination (ROE) to the Office of Finance's board of directors. The ROE communicates substantive examination conclusions, principal findings—including all matters requiring attention (MRAs),³ and the composite and component CAMELSO ratings.⁴ Due to the nature of its activities, the Office of Finance is only rated on the Management and Operational Risk components.

DBR's Monitoring of the Office of Finance

DBR's Capital Markets Branch also performs offsite monitoring of the Office of Finance's debt issuance activities. DBR's Capital Markets Branch prepares daily, twice-weekly, weekly, monthly, and annual debt issuance reports using information from a combination of external and internal datasets, including debt issuance data obtained directly from Office of Finance systems. DBR also receives periodic Office of Finance reports on operational issues including debt servicing errors. DBR examiners noted they engage in a weekly call (or more frequently when necessary) with Office of Finance officials at which they discuss monitoring results.

DBR's Guidance for Oversight of the Office of Finance's Debt Issuance and Debt Servicing Functions

FHFA's Examination Manual, Office of Finance module, provides direction to examiners for developing the examination scope and selecting procedures related to the Office of Finance.

³ Per DBR OPB, Federal Home Loan Bank Adverse Examination Finding Processes, there are three broad classifications of findings: MRAs, which are the most serious; recommendations; and violations. This OPB also communicates various processes and provides examiners with guidelines to follow when issuing, following up, and closing adverse examination findings.

⁴ CAMELSO is a risk-focused rating system under which each FHLBank and the Office of Finance is assigned a composite rating based on an evaluation of various aspects of its operations. For the FHLBanks, the components evaluated are Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk, and Operational Risk.

This module provides examination guidance on significant processes, including debt issuance, debt servicing, funding contingency planning,⁵ and dealer compliance.^{6,7}

DBR's Operating Procedures Bulletins (OPBs) set forth expectations for FHLBank System examinations as follows:

- 2012-DBR-OPB-03, Workprogram Minimum Frequency Guidelines, establishes minimum frequency for the various workprograms performed in FHLBank System examinations. The Office of Finance workprogram has been assigned an annual minimum frequency.⁸
- 2016-DBR-OPB-01, Federal Home Loan Bank Examination Workpaper Standards, sets guidelines regarding the standards and quality of DBR examination workpapers.
- 2017-DBR-OPB-01, Federal Home Loan Bank Adverse Examination Findings Processes, establishes various processes related to adverse examination findings at examinations of the FHLBanks and Office of Finance. It complements Advisory Bulletin 2017-01, Classifications of Adverse Examination Findings.⁹
- 2018-DBR-OPB-03, Quality Control Program, sets forth DBR's guidance for implementing quality control reviews of examination workpapers.

⁵ The ability to issue debt into the marketplace through the Office of Finance is essential to maintain the FHLBank System's liquidity. A funding contingency plan outlines an agreed upon System-wide approach to debt allocation under stressed conditions.

⁶ When consolidated obligations are sold by dealers, as is the case with most consolidated obligations issued through the Office of Finance, it is the dealer's responsibility to sell them to suitable customers; that is, customers sufficiently sophisticated to fully understand the risks associated with the security purchased. The Office of Finance's selling group agreement contractually obligates dealers to sell consolidated obligations only to suitable investors and provides the Office of Finance access to dealer records to review sales for suitability.

⁷ DBR guidance states that individual workprograms (i.e., sub-workprograms) be prepared for debt issuance, debt servicing, dealer compliance, and funding contingency planning to facilitate an effective examination process.

⁸ Workprograms can be assigned an annual, biennial, triennial, or quadrennial minimum frequency.

⁹ Advisory Bulletin 2017-01 defines three broad classifications of findings: MRAs, Recommendations, and Violations. MRAs consist of either "critical supervisory matters (the highest priority), which pose substantial risk to the safety and soundness of the regulated entity [or the Office of Finance]," or "deficiencies," which if not corrected could "escalate and potentially negatively affect" the regulated entity. Recommendations are advisory in nature and suggest changes to a policy, procedure, practice, or control that supervision staff believes would improve, or prevent deterioration in, condition, operations, or performance. Violations are matters in which an examination discloses noncompliance with laws, regulations, or orders.

OBJECTIVE AND SCOPE

The objective of our audit was to assess whether DBR provided sufficient oversight of the FHLBanks’ Office of Finance’s debt issuance and debt servicing functions. The scope of our work covered DBR’s supervision of the Office of Finance’s debt issuance and debt servicing activities during the calendar years 2022 and 2023 examination cycles.

For details on methodology, see Appendix I.

RESULTS

DBR conducted two annual examinations of the Office of Finance during our audit scope that we found provided sufficient oversight of the FHLBanks’ Office of Finance’s debt issuance and debt servicing functions. Specifically, we determined that:

- FHFA’s Examination Manual, Office of Finance module and workprogram, provided examiners with worksteps needed to review and evaluate the debt issuance and debt servicing functions consistent with the Office of Finance Regulation (12 C.F.R. Part 1273).
- DBR’s supervisory activities related to the Office of Finance’s debt issuance and debt servicing functions were performed in accordance with the annual minimum frequency guideline. Specifically, DBR performed examination work for all four sub-workprograms (i.e., debt issuance, debt servicing, dealer compliance, and funding contingency planning) that made up the Office of Finance’s workprogram during both the 2022 and 2023 examination cycles.
- DBR’s supervisory activities included coverage of governance and risk management processes provided in the Office of Finance Regulation and DBR’s Office of Finance’s debt issuance and debt servicing examination guidance. In addition to debt issuance, debt servicing, dealer compliance, and funding contingency planning practices, the examination procedures addressed general risk management topics such as board reporting, organizational structure, internal audit, and information technology.
- DBR’s examination workpapers support supervisory conclusions that the Office of Finance’s debt issuance and servicing functions were satisfactory. These results were documented in accordance with DBR’s examination workpaper standards.
- DBR performed quality control reviews of the Office of Finance’s four sub-workprograms (i.e., debt issuance, debt servicing, dealer compliance, and funding

contingency planning) in accordance with DBR’s quality control guidance. The quality control reviews identified three substantive documentation issues that examiners addressed.

- DBR assessed the Office of Finance’s remediation of three recommendations in accordance with DBR’s adverse examination findings guidance.¹⁰ Specifically, DBR examiners monitored progress of corrective actions against the Office of Finance’s remediation plan, assessed Office of Finance Internal Audit’s validation of corrective actions, and assessed sufficiency of corrective actions. There were no open MRAs related to the Office of Finance’s debt issuance and servicing functions during our audit scope.
- DBR’s Capital Market Branch conducted monitoring of capital markets and debt issuance activities of the Office of Finance. DBR officials told us that they considered debt issuance costs (i.e., all-in borrowing costs) and servicing errors as two key measures of the Office of Finance’s performance. We reviewed debt issuance cost information contained in all 24 of DBR’s Monthly Debt Issuance Reports and its Flash Report – 2023 Debt Issuance, which were prepared during the audit scope. These reports showed that debt issuance costs increased significantly, but these increases were consistent with the overall trend in U.S. Treasury rates that were impacted by the Federal Reserve rate hikes at the time. We also reviewed debt servicing error information in all 24 of the Office of Finance’s Risk Dashboards, which were reviewed by DBR examiners. The dashboard identified one debt servicing error, a daylight overdraft¹¹ in April 2023 that DBR addressed with Office of Finance management. We determined that neither the increase in debt issuance costs nor the debt servicing error represented supervisory concerns.

Based on our results, we made no recommendations in this report.

FHFA COMMENTS AND OIG EVALUATION.....

We provided FHFA an opportunity to comment on a draft of this audit report. FHFA management did not have any technical comments on the report and chose not to provide a formal written management response because there were no recommendations.

¹⁰ The three adverse finding recommendations resulted from the 2021 and 2022 annual examinations.

¹¹ A daylight overdraft occurs when an FHLBank withdraws more money than it has in its Federal Reserve account in order to make a payment; the overdraft must be settled by the end of the business day.

APPENDIX I: METHODOLOGY.....

To accomplish our objective, we performed the following procedures:

- Reviewed Government Accountability Office’s *Standards for Internal Control in the Federal Government* (GAO-14-704G; September 2014) and determined that the control activities and information and communication components of internal control were significant to this objective. We focused on the underlying principles that management should: (1) design control activities to achieve objectives and respond to risks; (2) implement control activities through policies; and (3) use quality information to achieve the entity’s objectives.
- Assessed the DBR Office of Finance examination module to determine the extent to which it was consistent with the Office of Finance regulation (12 C.F.R. Part 1273).
- Reviewed the following FHFA and DBR guidance to identify requirements for DBR’s supervision of the Office of Finance debt issuance and debt servicing risks:
 - FHFA, FHFA Examination Manual (December 2013)
 - 2012-DBR-OPB-03, Workprogram Minimum Frequency Guidelines (December 19, 2012; last updated October 1, 2020)
 - 2016-DBR-OPB-01, Federal Home Loan Bank Examination Workpaper Standards (July 29, 2016; last updated September 9, 2020)
 - 2017-DBR-OPB-01, Federal Home Loan Bank Adverse Examination Findings Processes (April 19, 2017; updated August 27, 2020; and January 31, 2022)
 - 2018-DBR-OPB-03, Quality Control Program (December 26, 2018; last updated December 21, 2021)
- Reviewed prior OIG reports to identify findings and recommendations related to the Office of Finance’s debt issuance and debt servicing functions and determined there was no impact on our audit:
 - FHFA-OIG, [*DBR Generally Followed its Guidance to Assess the Remediation of Adverse Examination Findings Issued to the FHLBanks and the Office of Finance*](#) (September 2, 2021) (AUD-2021-012)
 - FHFA-OIG, [*FHFA Conducted BSA/AML Program Examinations of 10 of 11 Federal Home Loan Banks During 2016-2018 in Accordance with its Guidelines, But Failed*](#)

- [to Support a Conclusion in the Report of Examination for the Other Bank](#) (July 10, 2019) (AUD-2019-008)
- FHFA-OIG, [Compliance Review of DBR's Quality Control for Examination Work Performed by Examiners-in-Charge](#) (August 25, 2021) (COM-2021-007)
 - FHFA-OIG, [An Overview of the Federal Home Loan Bank System](#) (March 31, 2023) (WPR-2023-002)
- Interviewed DBR personnel to gain an understanding of DBR's oversight of the Office of Finance's debt issuance and debt servicing functions. Obtained written responses from DBR personnel to address questions and observations related to our audit testing procedures. DBR personnel included the Senior Associate Director, Associate Directors, Supervisory Examiners, Principal Examiners, a Supervisory Financial Database Specialist as well as a Supervisory Examination Specialist responsible for conducting independent quality control reviews of DBR examination workpapers.
 - Reviewed the Office of Finance's calendar years 2022 and 2023 examination scope memoranda to determine: (a) the population of Office of Finance examinations conducted by DBR and (b) whether DBR complied with 2012-DBR-OPB-03, Workprogram Minimum Frequency Guidelines. We found that DBR completed all four sub-workprograms (debt issuance, debt servicing, dealer compliance, and funding contingency planning) that make up the Office of Finance workprogram in each of the two annual Office of Finance examinations conducted during our audit scope.
 - Analyzed all four sub-workprograms completed during each of the annual Office of Finance examinations conducted during our audit scope to determine whether DBR's examination procedures, taken as a whole, addressed aspects of governance and risk management processes in the Office of Finance Regulation and examination guidance related to the Office of Finance's debt issuance and debt servicing functions.
 - Selected one of the two annual examinations (50 percent) of the Office of Finance performed by DBR during our audit scope to assess whether DBR's debt issuance and servicing examination workpapers complied with 2016-DBR-OPB-01, Federal Home Loan Bank Examination Workpaper Standards (updated September 9, 2020), including whether examiners' supervisory conclusions were supported by the results of examination work documented in the examination workpapers. We selected our sample judgmentally to capture the most recent examination (i.e., 2023 examination cycle) and cannot project the results across the universe of Office of Finance examinations.
 - Reviewed all nine DBR quality control reviews on debt issuance and servicing examination work completed during our audit scope. The nine quality control reviews

consisted of: (1) two Quality Control Branch (QCB) General Reviews (one for each of the Office of Finance examinations performed during our audit scope); (2) one QCB Sectional Review (2023 debt issuance sub-workprogram); (3) one Examiner-in-Charge review (2022 funding contingency planning sub-workprogram); and (4) five peer reviews (2022 dealer compliance and debt issuance sub-workprograms and the 2023 dealer compliance, debt servicing, and funding contingency planning sub-workprograms). QCB General Reviews are independent quality control reviews of an entire examination focused on assessing the accuracy, consistency, and sufficiency of examination planning, summary results, and the ROE. A QCB Sectional Review is an independent review of compliance with workpaper standards focused on a specific workprogram within the examination. Examiner-in-Charge and peer reviews are similar in scope to a Sectional Review, i.e., they assess compliance with workpaper standards for a workprogram (or sub-workprogram), but are typically performed by the Examiner-in-Charge or a member of the examination team who did not perform the examination work rather than QCB personnel. We assessed whether the reviews were performed in accordance with 2018-DBR-OPB-03, Quality Control Program (updated December 21, 2021) and whether all substantive issues identified in the quality control review were resolved prior to the issuance of the ROE.

- Assessed whether DBR examiners ensured remediation of adverse examination findings and supervisory concerns related to debt issuance and debt servicing in accordance with 2017-DBR-OPB-01, Federal Home Loan Bank Adverse Examination Findings Processes (updated January 31, 2022). We determined that there were no MRAs related to the Office of Finance's debt issuance and debt servicing functions during our audit scope. Therefore, we reviewed all three of the recommendations open during our audit scope related to the Office of Finance's debt issuance and debt servicing functions. There was one recommendation from the 2021 annual examination still open at the beginning of our scope, and DBR issued two more recommendations related to the 2022 annual examination. DBR closed all three within the audit scope. We confirmed the population of Office of Finance recommendations and the absence of MRAs with DBR officials.
- Determined that debt issuance costs (i.e., effective rate of borrowings) and debt servicing errors are two key performance measures for the Office of Finance debt issuance and debt servicing functions through discussion with DBR officials. We reviewed debt issuance cost information contained in all 24 of DBR's Monthly Debt Issuance Reports and its Flash Report – 2023 Debt Issuance, prepared during the audit scope. We also reviewed debt servicing error information in all 24 of the Office of Finance's Risk Dashboards reviewed by DBR as part of the examinations. We assessed whether these monitoring results indicated the existence of any supervisory concerns that DBR had not addressed. We made inquiries about the data sources, data reliability, and report preparation methods

for the debt issuance and debt servicing error monitoring reports that we reviewed and found them to be reliable for our purposes.

We conducted this performance audit from February 2024 to September 2024, at our headquarters in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Federal Housing Finance Agency Office of Inspector General

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