

Federal Housing Finance Agency
Office of Inspector General



DER Satisfied Procedural Requirements When Planning Its Supervision of CSS for the 2023 Examination Cycle

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Executive Summary

Fannie Mae and Freddie Mac (collectively, the Enterprises) promote liquidity in the housing finance system by purchasing mortgages from lenders and packaging them into mortgage-backed securities (MBS) that are sold to investors or held in the Enterprises' portfolios. Common Securitization Solutions, LLC (CSS), the Enterprises' jointly and equally owned affiliate, was chartered to create, operate, update, and maintain the technology and business activities necessary to facilitate the Enterprises' issuance, sale, and administration of single-family MBS. The Federal Housing Finance Agency's (FHFA or Agency) Division of Enterprise Regulation (DER) has primary safety and soundness oversight responsibility for the Enterprises and CSS.

In a 2019 audit, we reported that DER's CSS supervisory framework was outdated because it was established in 2016, prior to when CSS began issuing, on the Enterprises' behalf, a single MBS referred to by FHFA as the Uniform Mortgage-Backed Security (UMBS). DER agreed with our recommendation that it reassess and revise its CSS supervisory framework. In February 2020, DER adopted a framework under which it would supervise CSS using the same procedures and standards it applied to the Enterprises, subject to limited exceptions. We closed our recommendation in March 2020 based on this corrective action.

In November 2022, in keeping with the new framework, DER adopted a supervisory planning procedure intended to apply to CSS and the Enterprises. The procedure requires DER to issue or at least update annually six planning documents, including those identifying key risks facing CSS and the Enterprises. The procedure also requires consultation among stakeholders in producing these planning documents and that DER's Deputy Director approve them.

We initiated this compliance review to determine whether DER followed its procedure when planning its supervision of CSS for the 2023 examination cycle. We determined that DER complied with the procedure during our review period: it prepared the mandatory planning documents; it ensured that the required consultation among stakeholders took place; and the DER Deputy Director approved all of the mandatory planning documents.

This report was prepared by Karen Van Horn, Senior Investigative Counsel, and Wesley Phillips, Senior Policy Advisor. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.



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This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaig.gov.

/s/

Brian W. Baker
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ABBREVIATIONS

CSS	Common Securitization Solutions, LLC
DER	FHFA Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac, collectively
FHFA or Agency	Federal Housing Finance Agency
MBS	Mortgage-Backed Securities
OIG	FHFA Office of Inspector General
OPB	Operating Procedures Bulletin
Planning OPB	DER OPB entitled <i>Supervisory Planning</i> , dated November 18, 2022
Review Period	2023 CSS examination cycle
ROE	Report of Examination
UMBS	Uniform Mortgage-Backed Security

BACKGROUND

CSS Supports the Enterprises' Mortgage Finance Operations

In 2013, the Enterprises established CSS as their jointly and equally owned affiliate to create, operate, update, and maintain the technology and business activities necessary to facilitate the Enterprises' issuance, sale, and administration of single-family MBS. CSS began issuing the UMBS for both Enterprises in June 2019.

CSS' administration of the Enterprises' single-family MBS and mortgage portfolios includes registering MBS, distributing payments to MBS investors, and making disclosures to investors. The Enterprises' total mortgage assets were valued at more than \$7.5 trillion as of June 2023.

As of 2019, DER Had Not Updated Its Supervisory Framework to Reflect CSS' Changed Circumstances

Pursuant to the Housing and Economic Recovery Act of 2008, FHFA serves as both the Enterprises' regulator and as their conservator. The Agency's regulatory mission includes ensuring the Enterprises' safety and soundness so that they continue to serve as reliable sources of liquidity and funding for housing finance and community investment. Because CSS is the Enterprises' affiliate, FHFA's supervisory authority over the Enterprises extends to CSS.

DER is the Agency division responsible for safety and soundness supervision of the Enterprises and CSS. DER's supervisory framework is the methodology under which its supervisory examinations and other oversight activities are designed, and which FHFA maintains is based on risks to the Enterprises' or CSS' safe and sound operation, or to their compliance with applicable laws and regulations.

Prior to 2019, DER did not have a dedicated Examiner-in-Charge (EIC) or examination team to issue CSS-specific reports of examination (ROEs); rather, DER communicated adverse examination findings to CSS through conclusion letters following completion of examination activities. Indeed, in 2019, DER produced a one-page "Annual Supervisory Letter" pertaining to CSS, noting that its "supervisory work at [CSS] was limited in scope and covered evaluations of management and operational risks."

In a 2019 audit, we reported that, according to DER’s own standards, its CSS supervisory framework had become outdated.¹ DER’s November 23, 2016 memorandum, entitled “CSS Supervision Framework-Close out memo,” summarizes its supervisory framework for CSS, including details as to planning, performance, and documentation of examination activity. The memorandum states that the framework “was crafted for CSS in 2016, but is designed to serve as the foundation for ongoing supervisory work as CSS operations expand. This framework is expected to be adjusted in 2017 and subsequent years to reflect changes in CSS activities, operations, and organization.”

However, our 2019 audit found that DER had not adjusted its CSS supervisory framework since its original adoption in November 2016, even after CSS began issuing the Enterprises’ UMBS. According to a DER official, CSS’ issuance of the UMBS required a reassessment of DER’s CSS supervisory framework. We recommended that FHFA “[r]eassess the supervision framework for CSS and update that framework as appropriate to meet FHFA’s supervisory responsibility for this affiliated entity now that it was issuing a single MBS for both Enterprises.” FHFA agreed with the recommendation.

DER Created a Consistent Supervisory Framework for the Enterprises and CSS

Upon reassessing its CSS supervisory framework, DER stated in a February 2020 procedure document that it would hold CSS to the same supervision standards to which it holds the Enterprises, subject to limited exceptions.² Accordingly, we closed the recommendation from our 2019 audit on March 19, 2020.

DER subsequently took other actions to align its CSS supervisory framework with the Enterprises. In particular, DER officials stated that, in 2022, DER assigned an EIC with staff to conduct CSS oversight. The EIC told us the CSS exam team conducted examinations in 2022 and 2023 similar to those conducted by DER’s Fannie Mae and Freddie Mac examination teams and issued ROEs directly to CSS.

Moreover, DER established an annual planning process to be applied consistently to its safety and soundness oversight of both the Enterprises and CSS. As set forth in an Operating Procedures Bulletin on supervisory planning (Planning OPB) dated November 18, 2022, the

¹ OIG, *FHFA’s Completion of Planned Targeted Examinations of Fannie Mae Improved from 2016 through 2018, But Timeliness Remained an Issue; With the June 2019 Issuance of the Single Security, FHFA Should Reassess its Supervision Framework for CSS* (AUD-2019-012) (Sept. 17, 2019).

² On February 25, 2020, DER issued Operating Procedures Bulletin (OPB) *Enterprise Supervision Program*, which stated: “Since CSS conducts significant activities on behalf of the Enterprises, DER will apply the standards outlined in this and other DER OPBs, where relevant, to the supervision of CSS. Accordingly, unless otherwise noted, supervisory program standards for the ‘Enterprises’ appearing hereinafter in this and other DER OPBs should be interpreted as applying to the supervision of Fannie Mae, Freddie Mac, and CSS.”

annual planning process requires DER to complete six key documents for its examinations of CSS and the Enterprises.³

The Planning OPB also requires DER to ensure consultation among stakeholders in developing these mandatory documents and to secure the Deputy Director’s approval of them. For example, the OPB states that the individual tasked with updating the “Supervisory Priorities” document “will collaborate with the EICs and other DER Executives/Office Heads to develop Supervisory Priorities” to guide examination activity.

FINDINGS

We initiated this compliance review to assess whether DER complied with the Planning OPB’s requirements when planning its supervision of CSS for the 2023 examination cycle (review period).⁴ To do so, we reviewed DER’s relevant planning documentation for the review period and interviewed Agency officials.

DER Followed the Planning OPB’s Required Elements for CSS

We determined that DER followed the Planning OPB for its oversight of CSS by preparing the key required documents during the review period. All of the documents were prepared as required. We also found that DER followed the other requirements we tested from the Planning OPB. Specifically, we found that DER had updated its examination plans and approved changes to planning documents, as required.⁵

³ The Planning OPB rescinded and replaced the *Supervisory Planning-Pilot Program for 2021* OPB issued on September 3, 2021, for which we conducted a compliance review entitled *FHFA Completed All Planned Ongoing Monitoring Activities for Fannie Mae and CSS During the 2022 Examination Cycle* (COM-2024-002) (Jan. 10, 2024). The six documents are described as: (1) Supervisory Taxonomy (a comprehensive categorization of key risks and processes of supervisory interest); (2) Risk Assessments (documenting DER’s view of the Enterprises’ and CSS’ risk exposure and providing conclusions on the quantity and direction of risk, and the quality and direction of risk management); (3) Supervisory Priorities (highlighting emerging or known supervisory issues requiring attention); (4) Supervisory Strategy (supporting the supervision program’s risk-based approach by demonstrating the assignment of supervision activities based on each activity’s relation to the Enterprises’ and CSS’ risk profile); (5) Supervision Plans (showing calendar year examination activities planned by each of the examination teams); and (6) Supervisory Calendar (establishing the Deputy Director’s expectations for finalizing each of the elements of the planning process and including due dates for specific deliverables).

⁴ Our compliance review’s scope did not include one of the six planning documents identified in the Planning OPB: CSS – Risk Assessments. Prior OIG work – in particular, *FHFA’s Failure to Include the Financial Crimes and Model Components in its CSS Risk Assessment Is Inconsistent with a Risk-Based Approach to Supervision* (AUD-2021-005) (Mar. 23, 2021) – addressed this topic.

⁵ Specifically, DER conducted the required annual update of the Supervisory Priorities document and documented changes to the Supervisory Taxonomy document.

We also verified from email communications and electronic approval workflows that in updating each of the key planning documents that were tested as part of this compliance review, DER’s planning official consulted other stakeholders, including DER supervisory examiners, an EIC, and associate directors of the Office of Financial Analysis. Finally, we confirmed that the Deputy Director reviewed and approved each of the planning documents and updates, as required.

CONCLUSIONS

DER followed the tested Planning OPB requirements with respect to CSS during the review period. By doing so, DER has effectively implemented the corrective action upon which we closed our 2019 recommendation.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this compliance review to assess whether DER followed the Planning OPB’s requirements with respect to CSS for the 2023 examination cycle (review period). Our work’s scope did not include DER risk assessments or assessing the substance of DER planning documentation. To conduct our work, we requested and reviewed DER supervision planning materials. We also interviewed DER officials.

We conducted the fieldwork for this compliance review from February 2024 through April 2024 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (December 2020), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment.

ADDITIONAL INFORMATION AND COPIES.....

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