REDACTED

Federal Housing Finance Agency
Office of Inspector General

For Nine Years, FHFA Has Failed to Take Timely and Decisive Supervisory Action to Bring Fannie Mae into Compliance with its Prudential Standard to Ensure Business Resiliency

This report contains redactions of information that is privileged or otherwise protected from disclosure under applicable law.

Evaluation Report • EVL-2021-002 • March 22, 2021

EVL-2021-002

March 22, 2021

Executive Summary

The Housing and Economic Recovery Act of 2008 (HERA) created and charged the Federal Housing Finance Agency (FHFA or the Agency) with, among other things, the supervision of Fannie Mae and Freddie Mac (together, the Enterprises), the Federal Home Loan Banks, and the Federal Home Loan Banks' fiscal agent, the Office of Finance. For the Enterprises, FHFA fulfills this statutory obligation through its Division of Enterprise Regulation (DER), which conducts targeted examinations and ongoing monitoring of the Enterprises. DER relies on these activities to conclude on the adequacy of the Enterprises' risk management policies, procedures, compliance, and internal controls.

FHFA recognizes that "[u]ncontrolled events, such as natural disasters, pandemics, and cyberattacks, can threaten the regulated entities' ability to perform mission critical operations, such as providing liquidity and access to credit in the mortgage market." To ensure the continuity of safe and sound operations, FHFA expects that each will establish and maintain business resiliency programs "to minimize the impact of disruptions and maintain business operations at predefined levels."

Pursuant to HERA, FHFA issued its prudential management and operations standards (PMOS) in 2012. PMOS 8, Principle 11 applies to the Enterprises' business resiliency and disaster recovery: it directs that a "regulated entity should have adequate and well-tested disaster recovery and business resumption plans for all major systems and have remote facilitates [sic] to limit the effect of disruptive events." FHFA's then-General Counsel testified before Congress that FHFA carries "forward prudential standards set forth in regulation to meet [its] responsibilities relating to safety and soundness and compliance with laws and regulations."

Beginning in 2012, FHFA consistently found critical deficiencies in Fannie Mae's [redacted] practices and lack of [redacted]. Based on a 2011 targeted examination, DER examiners found a number of shortcomings in Fannie Mae's [redacted] program, including the [redacted]. They highlighted that "[redacted]" and FHFA imposed a Matter Requiring Attention (MRA). However, Fannie Mae omitted a proposal to put into place [redacted] from its proposed remediation plan; nevertheless, DER accepted this plan. DER closed this MRA in 2016, despite its explicit acknowledgement that Fannie

This report contains redactions of information that is privileged or otherwise protected from disclosure under applicable law.

EVL-2021-002

March 22, 2021

Mae never conducted such [redacted]. Now, more than four years later, Fannie Mae has not successfully completed such [redacted]; FHFA, its supervisor, has taken no adverse supervisory action.

Beginning in 2016, DER has highlighted deficiencies in Fannie Mae's [redacted] in each subsequent examination cycle in its annual risk assessments, ongoing monitoring activities, and annual Reports of Examination (ROEs). Our review of DER workpapers found that Fannie Mae has conducted some [redacted], and has promised that other [redacted] will be undertaken. However, the workpapers make clear that Fannie Mae has never completed [redacted].

DER workpapers contain no assessment of Fannie Mae's business resiliency capabilities against PMOS 8, Principle 11, and the DER examination managers responsible for overseeing the business resiliency portions of DER's examination activities since 2016 confirmed that no formal assessment has been undertaken. No explanation is provided in the workpapers for DER's failure to assess an Enterprise's actions against FHFA's prudential standard adopted in 2012.

These examination managers separately reported to us that Fannie Mae has failed to [redacted] the standard set forth in PMOS 8, Principle 11. Based on our review of DER workpapers over this period, we share that conclusion. Nevertheless, DER has neither issued an MRA nor directed Fannie Mae to submit a corrective plan to bring Fannie Mae's business resiliency program and testing into compliance with PMOS 8, Principle 11. Instead, it has allowed Fannie Mae to proceed at its own leisurely pace: Fannie Mae now projects it will complete [redacted] during 2021, nearly nine years after adoption of PMOS 8, Principle 11.

We made two recommendations to address the shortcomings our evaluation identified. We proposed that FHFA conduct additional examination work in 2021 using PMOS 8, Principle 11, and FHFA responded with an alternative, offering to conduct examination work during 2022 using its Advisory Bulletin (AB) 2019-01. Because nine years have passed since FHFA first recognized that Fannie Mae lacked an [redacted] program that was [redacted] and because FHFA has repeatedly deferred to Fannie Mae during this period, we do not agree that a further delay in examining Fannie Mae's compliance is a reasonable alternative.

For the second recommendation, we proposed that FHFA develop examination guidance that establishes criteria and expectations for determining, on an annual basis, whether a regulated entity meets or fails to meet PMOS 8, Principle 11. FHFA maintained that AB 2019-01 provided sufficient criteria for examinations and communicated FHFA's supervisory expectations on business resiliency to the Enterprises and rejected our recommendation. Assessing an Enterprise's practices against an unenforceable supervisory policy guidance, AB 2019-01, is not an acceptable alternative to assessing those practices against the Agency's PMOS, which are enforceable and are required by Congress.

For those reasons, we disagree with FHFA's management decisions and consider our recommendations to be closed as rejected.

This report was prepared by Jacob Kennedy, Senior Investigative Evaluator, with assistance from Michael Kubik, Attorney Advisor, and Jason Ramserran, Program Analyst. 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.fhfaoig.gov, and www.oversight.gov.

/s/

Kyle D. Roberts
Deputy Inspector General for Evaluations

TABLE OF CONTENTS ....

ABBREVIATIONS

AB	Advisory Bulletin
DER	Division of Enterprise Regulation
Enterprises	Fannie Mae and Freddie Mac
FHFA	Federal Housing Finance Agency
HERA	Housing and Economic Recovery Act of 2008
MRA	Matter Requiring Attention
[redacted]	[redacted]
PMOS	Prudential Management and Operations Standards
ROE	Report of Examination

BACKGROUND

Importance of Business Resiliency

Fannie Mae and Freddie Mac (collectively, the Enterprises) perform an important role in the nation's housing finance system by providing liquidity, stability, and affordability to the mortgage market. FHFA recognizes that "[u]ncontrolled events, such as natural disasters, pandemics, and cyberattacks, can threaten the regulated entities' ability to perform mission critical operations, such as providing liquidity and access to credit in the mortgage market." As FHFA officials have explained, should the Enterprises be unable to play their role, there could be a huge immediate impact on the mortgage finance industry and mortgage liquidity gridlock, with disruptions having widespread impacts on the financial services industry, homeowners, and investors.

In its 2020 annual 10-K filing with the Securities and Exchange Commission, Fannie Mae disclosed the risks associated with the failure of its operational systems and infrastructure. Fannie Mae stated that "[s]hortcomings or failures in our internal process, people, data management or systems could disrupt our business or have a material adverse effect on our risk management, liquidity, financial statement reliability, financial condition and results of operations." Fannie Mae explained that as a result of the concentration of employees and operations in two metropolitan areas, "a major disruptive event . . . could impact our ability to operate notwithstanding the business continuity plans and facilities . . . including our out-of-region data center for disaster recovery."

To help prepare the Enterprises to respond to such events and ensure the continuity of safe and sound operations, FHFA expects that each will have established and will continue to maintain a business resiliency program. FHFA defines business resiliency management to include the Enterprises' "ability to minimize the impact of disruptions and maintain business operations at predefined levels."

FHFA Prudential Management and Operations Standards for Business Resiliency

The Housing and Economic Recovery Act of 2008 (HERA) amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 to require FHFA to establish prudential standards that address 10 specific areas relating to the management and operations of the regulated entities.[1] Pursuant to Section 1108 of HERA, FHFA issued its prudential

[1] 12 U.S.C. § 4513b(a)(1)-(10); the 10 areas are: (1) adequacy of internal controls and information systems; (2) independence and adequacy of internal audit systems; (3) management of interest rate risk exposure; (4) management of market risk; (5) adequacy and maintenance of liquidity and reserves; (6) management of

management and operations standards (PMOS) in June 2012, effective August 7, 2012. These standards were adopted by regulation, after notice and comment.[2]

The PMOS communicate FHFA's expectations for minimum risk management practices by the regulated entities, including managing risk from disasters and other disruptions to their operations. FHFA's PMOS 8, Principle 11 is applicable to business resiliency and disaster recovery.[3] That PMOS Principle directs that a "regulated entity should have adequate and well-tested disaster recovery and business resumption plans for all major systems and have remote facilitates [sic] to limit the effect of disruptive events."[4]

Potential Consequences for Failure to Meet an FHFA Prudential Management and Operations Standard

Shortly after FHFA adopted its prudential standards, its then-General Counsel testified before Congress that FHFA had "explicit authority to impose and enforce prudential standards…"[5] He explained that FHFA carries "forward prudential standards set forth in regulation to meet [its] responsibilities relating to safety and soundness and compliance with laws and regulations."

FHFA, in its implementing regulation for its PMOS and advisory bulletin on examination findings, identifies the tools available for it to impose consequences on a regulated entity that

---

asset and investment portfolio growth; (7) investments and acquisitions of assets; (8) overall risk management processes; (9) management of credit and counterparty risk; and (10) maintenance of adequate records.

[2] *See* 12 C.F.R. Part 1236, Appendix to Part 1236. FHFA issued the PMOS as guidelines.

[3] In May 2019, FHFA issued Advisory Bulletin (AB) 2019-01, *Business Resiliency Management*, which provides guidance on, among other things, business resiliency testing. The AB points to several PMOS standards—including Standard 8, Principle 11—and states that business resiliency programs in alignment with the AB "will meet FHFA's supervisory expectations on the points that the AB addresses, with respect to those standards."

[4] At the time FHFA adopted its PMOS, the importance of business resiliency, out-of-region centers (geographically dispersed resources), and testing of back-up sites was well-established. The Securities and Exchange Commission, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency issued a 2003 Interagency Paper (Interagency Paper) to advise financial institutions on necessary steps to protect the financial system. The Interagency Paper identified four key practices built upon long-standing principles of business continuity planning to strengthen the overall resilience of the financial system: (1) Identifying critical activities that support its critical financial markets; (2) Determining appropriate recovery and resumption objectives; (3) Maintaining sufficient geographically dispersed resources; and (4) Routinely using or testing recovery and resumption arrangements.

[5] U.S. Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Alfred M. Pollard, General Counsel, FHFA, "Housing Finance Reform: Powers and Structure of a Strong Regulator" (Nov. 21, 2013).

fails to meet any of the PMOS.[6] One tool is required remediation: the FHFA Director may, by written notice, require the regulated entity to submit a corrective plan acceptable to FHFA, and implement that plan to bring itself into compliance with the PMOS.[7] Another tool is issuance of an MRA, the mechanism used by FHFA to notify a regulated entity of significant deficiencies related to risk management, risk exposure, or violations of laws, regulations, or orders affecting its performance or condition, which requires remediation. A third tool is a finding of an "unsafe and unsound practice": that finding triggers FHFA's enforcement authorities.[8]

FHFA's Supervision of the Enterprises and Examination Guidance on Business Resiliency

By statute, FHFA must conduct annual onsite examinations of its regulated entities. According to FHFA's Examination Manual, DER examines risk management practices and each Enterprise's financial condition and safety and soundness relative to applicable laws, regulations, supervisory guidance, and prudent business practice.

FHFA's Examination Guidance on Business Resiliency

The FHFA Examination Manual provides examination instructions and work programs organized by risk category or line of business or activity. According to FHFA's Business Continuity exam module, released in August 2013:

> The board of directors . . . is responsible for designing and adopting a business continuity plan at the institutional level. From there, the board will likely charge executive management to establish appropriate business continuity programs . . . to identify and control risk at the department and often business unit level. The board-approved plan is the framework upon and around which the entity's overall programs are built.

---

[6] *See* 12 C.F.R. § 1236.4(b); FHFA, AB 2017-01, *Classifications of Adverse Examinations Findings*, at 1-2 (Mar. 13, 2017), which superseded and rescinded AB 2012-01, *Categories of Examination Findings*, at 2-3 (Apr. 2, 2012).

[7] *See* 12 C.F.R. § 1236.4(b). The consequences of a failure to meet a standard may be severe. If the regulated entity, after receiving written notice from FHFA, fails to submit a corrective plan acceptable to FHFA, or fails in any material respect to implement or otherwise comply with a corrective plan, "FHFA *shall* order the regulated entity to correct the deficiency …" (Emphasis added) FHFA may also require the regulated entity to take any other action that the Director determines will better carry out the purposes of the statute by bringing the regulated entity into conformance with the Standards. 12 C.F.R. § 1236.5(a)(6) (Remedies for failure to submit a corrective plan; noncompliance).

[8] 12 C.F.R. § 1236.3(d) (citing 12 U.S.C. Chapter 46, subchapter III). Those authorities include, without limitation, cease-and-desist orders. 12 U.S.C. § 4631(a).

The guidance explains that "[e]ach program will consist of a set of policies and procedures designed to transform the institution's high-level articulation of principles . . . into operational-level practices and protocols." In addition, "[t]hese policies and procedures facilitate the operation of critical business functions on a day-to-day basis as well as recovery in a timely and orderly fashion from any unexpected disruption."

The exam module clearly identifies Standard 8, Principle 11 as one of the primary PMOS Principles that "should be considered when evaluating business continuity planning." It also directs that the Enterprise:

> must test its [business continuity] programs at least annually. Management should consider developing multi-year test strategies that progressively challenge recovery assumptions and making test exercises more complex and robust over time. . . . Successful test strategies identify gaps or inadequacies in recovery facilities, personnel, and assumptions so that management can take corrective measures.

FHFA Examination Activities Identified Critical Deficiencies in Fannie Mae's [redacted] Practices from 2012 Through 2016

Beginning in 2012, FHFA consistently found critical deficiencies in Fannie Mae's [redacted] practices and lack of [redacted].

2011 Targeted Examination of Information Technology: FHFA Imposed an MRA Requiring Corrective Action to Address Deficiencies in Fannie Mae's [redacted] Practices

Based on a targeted examination conducted during the 2011 examination cycle of the management of risks in business continuity planning and disaster recovery at Fannie Mae, examiners found a number of shortcomings. Those deficiencies included:

- [redacted]
- [redacted]

- [redacted]

In its February 2012 conclusion letter to Fannie Mae, FHFA issued an MRA requiring it to address the deficiencies in its [redacted]"[9]

MRA Remediation from 2012 to December 2016

Management submitted its remediation plan to FHFA in March 2012. This plan proposed complete remediation by September 2014 of four proposed corrective items. The need for [redacted], which was a focus of that 2012 MRA, was omitted from the Enterprise's remediation plan; nevertheless, DER accepted this plan.[10]

Eighteen months after submitting its initial remediation plan, Fannie Mae management submitted a revised remediation plan in September 2013 with an additional corrective action, [redacted]. According to FHFA examination documents, Fannie Mae management completed the five corrective actions in its remediation plan in September 2014, which were verified by Fannie Mae Internal Audit.

DER Closed the MRA in 2016 but Examination Staff Recorded That Management Had Not Corrected a Critical Underlying Deficiency; Nevertheless, DER Opted Not to Issue a New MRA

DER issued its remediation letter closing the MRA on December 27, 2016. The letter stated that Fannie Mae "satisfactorily completed the steps outlined in the remediation action plan submitted to DER for non-objection" and reported that the MRA had been closed. In this letter, DER advised that, in light of the stated remaining risks associated with Fannie Mae's [redacted], it would "conduct further supervisory work, which could potentially result in additional findings." DER did not opine on whether the Enterprise's practices met PMOS 8, Principle 11, FHFA's prudential standard for testing disaster recovery and business resumption plans and establishing remote facilities.

---

[9] It also issued an MRA relating to deficiencies in Fannie Mae's [redacted], which was closed in 2017. That MRA is not relevant to this evaluation.

[10] The examiner's analysis memo for closing the MRA, dated September 29, 2016, recognized that "[redacted] [which was part of the MRA] was not included in the remediation plan to which FHFA did not object."

The acting Operational Risk examination manager responsible for examination activities of Fannie Mae's business resiliency practices acknowledged to us that Fannie Mae's [redacted] practices [redacted] PMOS 8, Principle 11 at that time. While FHFA's exam module clearly states that PMOS 8, Principle 11 "should be considered" when examining the efficacy of business continuity planning, the acting examination manager had no recollection of discussing whether Fannie Mae's practices met PMOS 8, Principle 11 with the then-examiner-in-charge or the examination team at the time the MRA was closed.[11] We found no reference to PMOS 8, Principle 11 in the examination workpapers.

While the remediation letter stated that Fannie Mae "satisfactorily completed the steps outlined in the remediation action plan submitted to DER for non-objection," the examination record contains a starkly different conclusion. According to this record, DER examiners discussed with Fannie Mae management that DER planned to issue new MRAs, including one focused on [redacted]"[12] The examination record reflects that, in the months prior to closing the MRA, DER examiners proposed a new MRA based on their views that [redacted]" (Emphasis added) The proposed MRA was intended to address the fact that Fannie Mae's "[redacted]"

No MRA was forthcoming. Although the examination record makes clear that a critical shortcoming underlying the 2012 MRA – lack of in-depth [redacted] – had not been corrected when it was closed in 2016, that record provides no explanation of the reasons that a new MRA was not issued. The acting Operational Risk examination manager at the time of the MRA's closure contended that he and the then-examiner-in-charge determined that the 2016 examination workpapers did not contain sufficient objective criteria on which to base a new MRA. His assertion stands at odds with his acknowledgement that Fannie Mae's [redacted] remained deficient, a conclusion that is found in the 2016 workpapers, and his recognition that Fannie Mae [redacted] PMOS 8, Principle 11. We were unable to find an explanation in the workpapers for the reasons that no MRA issued in 2016.[13]

---

[11] As discussed earlier, an Enterprise's failure to meet a PMOS may constitute an unsafe and unsound practice for purposes of the Agency's enforcement provisions. *See* 12 C.F.R. § 1236.3(d).

[12] Subsequently, Fannie Mae's Chief Compliance Officer reported to the Board of Directors Audit Committee in January 2017 that management anticipated an MRA from FHFA that would require the Enterprise to "[redacted]."

[13] In its technical comments to a draft of this report, FHFA asserted that it does not require examiners to document why an adverse examination finding was not issued. The applicable guidance issued by FHFA

DER Labeled Fannie Mae's [redacted] Practices Deficient in the 2016 Report of Examination, Issued Roughly 60 Days After It Closed the MRA

Notwithstanding DER's decision to refrain from issuing a new MRA in late 2016, it notified Fannie Mae's Board of Directors roughly 60 days later that Fannie Mae's [redacted] were deficient. The 2016 Report of Examination (ROE), which was transmitted to Fannie Mae's Board in March 2017, stated that "[redacted]." It further observed:

- "Fannie Mae's [redacted]."
- Fannie Mae "still lacks a [redacted]."
- "… Fannie Mae is still building its [redacted]. The Enterprise's [redacted]."

DER did not opine in that ROE whether Fannie Mae's business resiliency practices met PMOS 8, Principle 11.

FACTS AND ANALYSIS……………………………………………………

The acting Operational Risk examination manager for Fannie Mae reported to us that, as of March 2017, Fannie Mae [redacted] PMOS 8, Principle 11. However, FHFA used none of

---

and DER is to the contrary. FHFA's 2013 Examination Manual states that "workpapers must be prepared in sufficient detail to provide a clear understanding of the examination work performed." Similarly, DER's 2014 Operating Procedures Bulletin (OPB), which was in effect until December 11, 2018, directed that examiners should prepare workpapers "in a manner that provides a third-party with a clear understanding of the examination work performed, the examination findings, conclusions, and ratings reached…" DER's 2020 OPB on Monitoring states that "examiners should ensure that examination documentation reflects the ultimate disposition of preliminary matters (i.e.,…matter should be categorized as a critical supervisory matter, deficiency, or violation, or the matter is not an adverse examination finding)." Given that the examination record reflects that examiners clearly considered issuing a new MRA to address the lack of [redacted] by Fannie Mae and shared that view with Fannie Mae, the rationale for DER's contrary conclusion should have also been reflected in the examination record, according to applicable examination guidance. In our view, DER's technical comment cannot be reconciled with the plain language of this guidance.

the tools available to it to impose consequences on Fannie Mae for its failure to [redacted] this PMOS.

DER's Internal Risk Assessments for 2016 Through 2019 Found Continued Issues Relating to Incomplete [redacted] and Insufficient [redacted] for Fannie Mae's [redacted] Program

DER's internal risk assessments, issued for 2016 through 2019, flagged continuing issues with the adequacy of Fannie Mae's [redacted].

- 2016 Risk Assessment: Fannie Mae's risk management rating for [redacted]"
- 2017 Risk Assessment: "Fannie Mae still has gaps in [redacted]"
- 2018 Risk Assessment: The residual [redacted] risk "[redacted].
- 2019 Risk Assessment: Fannie Mae's quality of [redacted] risk management was rated as "[redacted]"

In 2020, eight years after DER issued an MRA to Fannie Mae for its failure to complete [redacted] for its business resiliency program, DER observed in its risk assessment that Fannie Mae completed "[redacted]." To support this observation, DER cited a presentation from Fannie Mae management, which had promised [redacted] since 2013. The current Operational Risk examination manager, who assumed that position in May 2018 and has been responsible for examination activities of Fannie Mae's business resiliency practices, reported to us that he believed Fannie Mae conducted a significant amount of [redacted] in 2018 and 2019 but such [redacted].

Over the Course of Multiple Examination Cycles, DER Never Concluded That Fannie Mae's [redacted] Activities Met PMOS 8, Principle 11

Annually from 2017 through 2020, DER conducted ongoing monitoring activities with the stated objective of "[redacted]."[14] Each of these activities assessed Fannie Mae's [redacted], and the 2019 and 2020 activities expressly included [redacted] in their stated scope.

Notwithstanding these ongoing monitoring examination activities during this period, and DER's awareness that the deficient [redacted] practices first identified in the 2012 MRA had not been corrected, DER never concluded that Fannie Mae's business resiliency capabilities and testing met PMOS 8, Principle 11. We found no reference to PMOS 8, Principle 11 in the examination workpapers.

- 2017 ongoing monitoring activity: DER concluded that "Fannie Mae's current [redacted]. The procedures document for this activity lists "[redacted]" as an inherent [redacted] risk warranting supervision.[15] Nevertheless, and in apparent disregard of PMOS 8, Principle 11, DER commented that Fannie Mae's plan to [redacted] Fannie Mae's [redacted] Fannie Mae's [redacted]—by the end of 2018 was [redacted].

- 2018 ongoing monitoring activity: DER examiners documented that they were "[redacted]," [redacted] in November

---

[14] The 2017 and 2018 ongoing monitoring activities used this language, while the 2019 and 2020 each varied immaterially in their stated objective. DER also conducted three targeted examinations during the review period of this evaluation that were relevant to the [redacted] but they did not address the outstanding [redacted] issue.

[15] In its list of inherent risks warranting supervisory activity, the workpaper stated: "[redacted]." (Emphasis added).

2018 of "[redacted]. While Fannie Mae projected it would "[redacted] by December 2018," the examiner's year-end analysis memo did not conclude whether Fannie Mae met its projection.[16] Workpapers for this supervisory activity do not reflect whether Fannie Mae's [redacted].

- 2019 ongoing monitoring activity: DER noted that "[redacted]" As it related to [redacted], Fannie Mae [redacted] in March 2019, and "FHFA found that Fannie Mae successfully demonstrated its successful March 2019 [redacted]." During the course of this ongoing monitoring activity, Fannie Mae informed DER that it "[redacted]]." (Emphasis added) DER projected that [redacted] would "[redacted]" as Fannie Mae performed additional [redacted] through 2020. The current examination manager confirmed that the [redacted] conducted by Fannie Mae in 2019 did not constitute [redacted].

- 2020 ongoing monitoring activity: DER concluded that "[redacted]" Regarding [redacted], the examination workpapers note that the Enterprise walked DER through its "[redacted] in December 2019 and [redacted]." While Fannie Mae experienced [redacted] **by Q2 of 2021**." (Emphasis added)

The examination record for DER's examination activities since 2012 show that, over an eight-year period, DER concluded that Fannie Mae had not successfully completed [redacted]. Indeed, Fannie Mae projected that such [redacted]" by Q2 2021. Again and again, that record reflects that Fannie Mae made commitments to DER to complete [redacted] by some point in the future, but those commitments were not met.

---

[16] DER had the opportunity to make this determination, as the year-end memo for this activity is dated March 2019.

Subsequent to the 2016 ROE, DER Continued to Highlight Deficiencies in Fannie Mae's [redacted] Practices and [redacted] Deficiencies in Annual ROEs

In ROEs for the 2017, 2018, and 2019 annual examination cycles, DER repeated the same substantive concerns about the inadequacy of Fannie Mae's [redacted] practices.

- 2017 ROE: [redacted]."
- 2018 ROE: While Fannie Mae [redacted]"
- 2019 ROE: Although Fannie Mae continued to [redacted] in 2019."[17]

Notwithstanding Acknowledgement by DER's Examination Managers That Fannie Mae Failed to [redacted] PMOS 8, Principle 11 from 2016 Through 2020, FHFA Imposed No Consequences on Fannie Mae for its Failure to [redacted] this PMOS

FHFA's PMOS 8, Principle 11, which was adopted in 2012, requires the Enterprise to have "adequate and well-tested disaster recovery and business resumption plans for all major systems and have remote facilitates [sic] to limit the effect of disruptive events." As we have shown, FHFA has a number of tools it can use to impose possible consequences on a regulated entity that fails to meet any of the PMOS.

The acting Operational Risk examination manager for the examination at the time DER closed the MRA (December 2016) confirmed with us that Fannie Mae [redacted] PMOS 8, Principle 11 at that time. That manager continued in that position for the 2017 examination cycle and one-half of the 2018 examination cycle. He acknowledged to us that during his tenure as examination manager, Fannie Mae [redacted] PMOS 8, Principle 11 due to the known deficiencies with [redacted].

His successor, the current Operational Risk examination manager, confirmed to us that Fannie Mae [redacted] PMOS 8, Principle 11 since he assumed his position during the 2018 examination cycle. According to this examination manager, Fannie Mae established clear plans for its [redacted] program in 2017 and its implementation of those plans has

[17] The ROE for 2020 had not been issued when we completed the fieldwork for this evaluation.

generally remained on track, including a significant amount of [redacted]. He acknowledged, however, that Fannie Mae [redacted] PMOS 8, Principle 11 from 2018 through 2020, since Fannie Mae did not have a [redacted] program in place.

Even though the examination managers from 2016 through 2020 stated, without qualification, that Fannie Mae's [redacted] PMOS 8, Principle 11 during this four-year period, we found no discussion in the examination record of any formal assessment of Fannie Mae's capabilities against the standard. We found, and the examination managers confirmed, that FHFA has not imposed any consequence on Fannie Mae for its failure to meet the PMOS standard since 2016:

- It has not required Fannie Mae to submit a corrective plan acceptable to FHFA and implement that plan within a specific timetable;
- It has not issued an MRA; and
- It has not found an "unsafe and unsound practice" triggering its enforcement authorities.

Instead, it has allowed Fannie Mae to proceed at its own leisurely pace. Fannie Mae currently projects that its [redacted] will be completed during 2021.

Nine years after DER issued an MRA to Fannie Mae for lack of [redacted], which was closed in 2016 without completion of such [redacted], Fannie Mae has not remediated that deficiency and fails to meet PMOS 8, Principle 11.

FINDINGS

1. FHFA and Fannie Mae have long recognized the vital importance of business resiliency.

2. FHFA's prudential management and operations standards issued in 2012, which set FHFA's *minimum* expectations for the Enterprises' risk management practices, include Standard 8, Principle 11: "A regulated entity should have adequate and well-tested disaster recovery and business resumption plans for all major systems and have remote facilitates [sic] to limit the effect of disruptive events." FHFA's Examination Manual states that DER examines risk management practices and each Enterprise's financial condition and safety and soundness relative to applicable laws, regulations, supervisory guidance, and prudent business practice.

3. In the subsequent eight years, DER officials acknowledge that DER has never formally assessed whether Fannie Mae's business resiliency program meets PMOS 8, Principle 11.

4. The MRA issued in 2012 identified the [redacted] of Fannie Mae's business resiliency capabilities. DER closed the MRA in 2016; the examination record reflects that the deficiency had not been corrected. After closing the MRA, DER continued to highlight deficiencies in Fannie Mae's [redacted] practices and [redacted] through its comments in the annual ROEs, but has not taken meaningful supervisory action. Instead, it has allowed Fannie Mae to proceed at its own leisurely pace, with Fannie Mae currently projecting its [redacted] to be completed during 2021.

5. Although DER has not formally assessed Fannie Mae's capabilities against PMOS 8, Principle 11, the examination managers from 2016 through 2020 stated, without qualification, that Fannie Mae's [redacted] that standard.

6. Nine years after DER issued an MRA to Fannie Mae for its lack of [redacted] of its business resiliency program, which was closed in 2016 without completion of such [redacted], Fannie Mae has not remediated that deficiency and fails to meet PMOS 8, Principle 11.

CONCLUSION

PMOS 8, Principle 11 directs that a "regulated entity should have adequate and well-tested disaster recovery and business resumption plans for all major systems and have remote facilitates [sic] to limit the effect of disruptive events." FHFA is equipped with a number of tools to enforce the Enterprises' compliance with PMOS and ensure remediation of deficiencies. In 2012, DER identified a deficiency with Fannie Mae's [redacted] program and issued an MRA. However, DER accepted a remediation plan that did not include [redacted]. While it closed the MRA in 2016, it advised Fannie Mae that the deficiency had not been addressed. It consistently highlighted this deficiency year after year without issuing other MRAs and allowed Fannie Mae to gradually progress in building its [redacted] program.

Despite its awareness that Fannie Mae's deficient [redacted] practices had not been corrected, DER never made a formal assessment of Fannie Mae's business resiliency capabilities and testing against PMOS 8, Principle 11. Rather than take timely and decisive supervisory action, DER has allowed the Enterprise to proceed at its own leisurely pace, with Fannie Mae currently projecting its [redacted] to be completed during 2021, nearly nine years after adoption of PMOS 8, Principle 11.

RECOMMENDATIONS

To address the findings identified in this evaluation, we recommend that FHFA:

1. In the current examination cycle, assess Fannie Mae's business resiliency practices and capabilities and formally determine whether they meet or fail to meet PMOS 8, Principle 11; and

2. Develop examination guidance that establishes criteria and expectations for determining, on an annual basis, whether a regulated entity meets or fails to meet PMOS 8, Principle 11.

FHFA COMMENTS AND OIG RESPONSE................................

We provided FHFA an opportunity to respond to a draft report of this evaluation. FHFA provided technical comments on the draft report, which we incorporated as appropriate. In its management response to this report, which is reprinted in its entirety in the Appendix, FHFA stated that it "agrees to take an alternative management action" to address our recommendation that FHFA assess Fannie Mae's business resiliency practices and capabilities in the current examination cycle and formally determine whether those practices meet or fail to meet PMOS 8, Principle 11. DER committed to complete a targeted examination in the area of business resiliency and capabilities during the 2022 examination cycle—but not during the current examination cycle—using "relevant criteria in AB 2019-01."

In our view, that alternative management action is not acceptable. Because nine years have passed since FHFA first recognized that Fannie Mae lacked an [redacted] program that was [redacted] and because FHFA has repeatedly deferred to Fannie Mae during this period, we do not agree that a further delay in examining Fannie Mae's compliance is reasonable.

For the second recommendation, we proposed that FHFA develop examination guidance that establishes criteria and expectations for determining, on an annual basis, whether a regulated entity meets or fails to meet PMOS 8, Principle 11. FHFA rejected that recommendation, claiming that AB 2019-01 provided sufficient criteria for examinations and communicated FHFA's supervisory expectations on business resiliency to the Enterprises. Assessing an Enterprise's practices against an unenforceable supervisory policy guidance, AB 2019-01, is not an acceptable alternative to assessing those practices against the Agency's PMOS, which are enforceable and are required by Congress.

FHFA, in its response, asserts: "It is our supervisory determination that examining to specific criteria, such as Advisory Bulletins (AB), is more effective than the general standards in PMOS" and that AB 2019-01 "goes well beyond the general standards outlined in the PMOS." While AB 2019-01 provides more detailed guidance with respect to FHFA's supervisory expectations for business resiliency, that guidance is no substitute for law, regulation, or, in this case, FHFA's PMOS 8. FHFA has long held the position that its supervisory guidance is not enforceable.

In our view, FHFA is obligated to adhere to the PMOS framework required by Congress and its rejection of our recommendation is inconsistent with its statutory obligation. Should FHFA hold the view that its current PMOS 8 is too general to provide an effective standard for supervision, then it is incumbent on FHFA to amend that standard.

For those reasons, we disagree with FHFA's management decisions.

We consider both our recommendations to be closed as rejected.

OBJECTIVE, SCOPE, AND METHODOLOGY ....

The objective of this evaluation was to assess DER's supervision of Fannie Mae's testing of its business resiliency program and compliance with PMOS 8, Principle 11. To achieve this objective, we sought to determine if DER concluded whether Fannie Mae's disaster recovery testing for its business resiliency program met PMOS 8, Principle 11 since FHFA issued the PMOS in 2012. The Review Period of this evaluation was September 2016 through December 2020.

We reviewed four principal categories of documents: (1) applicable FHFA guidance and standards in effect during our Review Period; (2) examination records pertaining to business resiliency and disaster recovery testing; (3) DER risk assessments; and (4) ROEs. In particular, our review of the applicable guidance and standards included PMOS 8, Principle 11, the 2013 Business Continuity Planning exam module, and AB 2019-01 Business Resiliency Management. We reviewed the examination record for ongoing monitoring of remediation of a 2012 MRA and ongoing monitoring activities and targeted examinations related to business resiliency and Fannie Mae's out-of-region data center that were conducted after closure of that MRA in 2016.

We also interviewed DER's Examination Managers for the Fannie Mae Operational Risk Branch who were responsible for the examination activities of Fannie Mae's business resiliency practices from the time the MRA closed in 2016 to the present.

The fieldwork for this report was completed between October 2020 and February 2021.

This evaluation was conducted under the authority of the Inspector General Act and in accordance with the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluation (January 2012). These standards require us to plan and perform an evaluation based upon evidence sufficient to provide a reasonable basis to support its findings and recommendations. We believe that the findings and recommendations discussed in this report meet those standards.

APPENDIX: FHFA MANAGEMENT RESPONSE..........................

Federal Housing Finance Agency

MEMORANDUM

TO: Kyle D. Roberts, Deputy Inspector General for Evaluations, Office of Inspector General

FROM: Paul J. Miller, Deputy Director, Division of Enterprise Regulation PJM

SUBJECT: Draft Evaluation Report: *For Nine Years FHFA has Failed to Take Timely Action to Bring Fannie Mae Into Compliance with its Prudential Standard to Ensure Business Resiliency*

DATE: March 16, 2021

Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft report referenced above (Report). While we have regularly reviewed Fannie Mae's business resiliency practices and capabilities through ongoing monitoring, FHFA acknowledges that Fannie Mae's actions to fully implement business resiliency capabilities have been ongoing for an extended period of time, and that nine years is too long since the last targeted examination. There are a couple of points that we would like to make to clarify our responses to the recommendations:

1) FHFA's Prudential Management and Operations Standards (PMOS), Appendix to 12 CFR Part 1236, set forth FHFA's general standards for safe and sound operations. While PMOS offer a specific method for enforcement to address the failure of a regulated entity to meet the standards, FHFA has other methods, both formal and informal, to ensure the Enterprises improve their risk management practices. It is our supervisory determination that examining to specific criteria, such as Advisory Bulletins (AB), is more effective than the general standards in PMOS.

2) On May 7, 2019, FHFA issued AB 2019-01: *Business Resiliency Management* to provide principles-based guidance for all regulated entities on disaster recovery and business resumption capacity that goes well beyond the general standards outlined in the PMOS. This AB also communicates to the regulated entities the Agency's supervisory expectations for safe and sound operations in the area of business resiliency and references PMOS 8, Principle 11 on business resiliency and disaster recovery.

The draft Report makes two recommendations:

Recommendation 1: *OIG recommends that FHFA in the current examination cycle, assess Fannie Mae's business resiliency practices and capabilities and formally determine whether they meet or fail to meet PMOS 8, Principle 11.*

Management Response: FHFA agrees to take an alternative management action to address the OIG's recommendation. During the 2021 supervisory cycle, DER is monitoring Fannie Mae's business resiliency practices and capabilities. DER will complete a targeted examination in this area during the 2022 examination cycle using relevant criteria in AB 2019-01. Based on these supervisory activities, we may issue adverse examination findings, and/or take additional supervisory actions, if warranted.

Recommendation 2: *OIG recommends that FHFA develop examination guidance that establishes criteria and expectations for determining, on an annual basis, whether a regulated entity meets or fails to meet PMOS 8, Principle 11.*

Management Response: FHFA disagrees with this recommendation. FHFA has already developed examination guidance in the form of AB 2019-01 to provide criteria for examinations and to communicate FHFA's supervisory expectations on business resiliency to the Enterprises. As DER utilizes a continuous supervision model through which onsite examination teams conduct risk-based examinations to assess the condition and risk management practices of the Enterprises, DER will continue to follow a risk-based approach in determining the appropriate supervisory activities to conduct during the examination cycle.

We would like to thank the OIG staff that worked with the Agency during this evaluation. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Chris Bosland
Kate Fulton
Scott Valentin
Eric Wilson
John Major

ADDITIONAL INFORMATION AND COPIES..............................

For additional copies of this report:

- Call: 202-730-0880
- Fax: 202-318-0239
- Visit: www.fhfaoig.gov

To report potential fraud, waste, abuse, mismanagement, or any other kind of criminal or noncriminal misconduct relative to FHFA's programs or operations:

- Call: 1-800-793-7724
- Fax: 202-318-0358
- Visit: www.fhfaoig.gov/ReportFraud
- Write:

    FHFA Office of Inspector General
    Attn: Office of Investigations – Hotline
    400 Seventh Street SW
    Washington, DC 20219