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FHFA's Oversight of the Enterprises' Implementation of and Compliance with Conservatorship Directives during an 18-Month Period

United States: Federal Housing Finance Agency (FHFA)

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Federal Housing Finance Agency
Office of Inspector General



**FHFA's Oversight of the
Enterprises' Implementation of and
Compliance with Conservatorship
Directives during an 18-Month
Period**



OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency

400 7th Street SW, Washington, DC 20219

March 28, 2016

TO: Robert C. Ryan, Deputy Director, Division of Conservatorship

FROM: Kyle D. Roberts, Deputy Inspector General for Evaluations

A handwritten signature in blue ink, appearing to read "KDRoberts".

SUBJECT: FHFA's Oversight of the Enterprises' Implementation of and Compliance with Conservatorship Directives during an 18-Month Period (ESR-2016-002)

Summary

This memorandum closes our evaluation of oversight by the Federal Housing Finance Agency (FHFA or Agency) of Fannie Mae's and Freddie Mac's (collectively, the Enterprises) implementation of and compliance with conservatorship directives in 2013 and the first half of 2014. This closing memorandum is intended to advise the Agency of prior gaps in its oversight of its directives in order to promote efficiency in its administration of the conservatorships.

According to FHFA, conservatorship directives set forth significant policy determinations and initiatives and provide specific directions to the Enterprises for which compliance is required. In December 2011 and in April 2013, then-FHFA Inspector General testified before Congress that FHFA had not proactively overseen Enterprise compliance with its conservatorship directives to ensure that their purposes were achieved.¹ In this evaluation, we examined whether FHFA, as conservator, had significantly enhanced its oversight of the Enterprises' implementation of and compliance with conservatorship directives for an 18-month period, from January 1, 2013, through June 30, 2014 (the review period), and learned that little had changed. We found that,

¹ See Senate Committee on Banking, Housing, and Urban Affairs, Testimony of FHFA Inspector General Steve A. Linick (Dec. 13, 2011) ("...FHFA was not proactive in oversight and enforcement, and accordingly, resource allocations may have affected its ability to oversee the GSEs and enforce its directives. Both trends have emerged in a number of our reports.") (online at www.fhfaog.gov/Content/Files/Senate-12-13-2011.pdf); see also Senate Committee on Banking, Housing, and Urban Affairs, Testimony of FHFA Inspector General Steve A. Linick (Apr. 18, 2013) ("Even when FHFA has identified risks and taken steps to manage those risks, the Agency has not consistently enforced its directives to ensure that identified risks are adequately addressed.") (online at [www.fhfaog.gov/Content/Files/Linick testimony Senate Banking.pdf](http://www.fhfaog.gov/Content/Files/Linick%20testimony%20Senate%20Banking.pdf)).

during 2013, one Enterprise submitted no reports to FHFA on its compliance with conservatorship directives and the other Enterprise, which began submitting quarterly reports to FHFA on its compliance with conservatorship directives, provided erroneous information in its reports.²

Beginning in 2014, Enterprise reporting on their implementation of and compliance with conservatorship directives changed, and the scope of that reporting evolved. We intend to monitor FHFA's oversight of Enterprise implementation of and compliance with conservatorship directives, and will subsequently test whether more robust reporting from the Enterprises has enhanced FHFA's oversight of conservatorship directives.

Facts and Analysis

In September 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorships pursuant to its authority under the Housing and Economic Recovery Act of 2008 (HERA).³ HERA vested FHFA, as the Enterprises' conservator, with sweeping powers. The Agency is empowered to operate the Enterprises "with all the powers of the shareholders, the directors, and the officers" and possesses broad authority to take any action appropriate to preserve and conserve Enterprise assets.⁴ As long as the Enterprises remain in conservatorships, FHFA is authorized by statute to operate them.

FHFA administers the conservatorships through, among other things: the delegation of responsibility for general corporate governance and day-to-day matters to the Enterprises' boards of directors (boards) and executive management,⁵ issuance of conservatorship directives, regular

² In an audit report published today, we report on FHFA's tracking and rating of the scorecard objective for a conservatorship directive effective during this period—the directive to launch a new representation and warranty framework—and found that Agency records designed to track and rate Enterprise performance of the directive contained inconsistencies and were unclear. See *OIG, Review of FHFA's Tracking and Rating of the 2013 Scorecard Objective for the New Representation and Warranty Framework Reveals Opportunities to Strengthen the Process*.

³ Pub. L. No. 110-289, 122 Stat. 2654 (2008). HERA extensively amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, 12 U.S.C. §§ 4501 *et seq.*

⁴ 12 U.S.C. § 4617(b)(2)(B)(i), (D)(ii).

⁵ The boundaries of this delegation are governed by Letters of Instruction to the Enterprises, which were most recently revised in November 2012. Specifically, the Revised Letters of Instruction require the Enterprises to seek FHFA approval for certain significant activities, and to provide notice to FHFA prior to engaging in a separate list of activities. All matters not enumerated in the Revised Letters of Instruction are delegated to the Enterprises. In 2012, an OIG audit report found that once FHFA made a decision on a non-delegated matter, the Agency lacked a formalized process to ensure that the Enterprises adhered to its decision. Among other things, OIG recommended that FHFA require the Enterprises to notify the Agency if it deviates from a conservatorship decision. Additionally, OIG recommended that FHFA implement a risk-based compliance testing program to review the Enterprises' adherence to FHFA's decisions. FHFA has since addressed both recommendations, which we now classify as

communications with the Enterprises' respective boards and management, a multi-year strategic plan for the conservatorships that defines general goals and initiatives, annual conservatorship scorecards that focus the Enterprises on short-term objectives to further the conservator's strategic goals, and governance practices and organizational infrastructure supporting these activities.⁶ FHFA may revoke any delegation of authority to the Enterprises at any time.

FHFA achieves its conservatorship objectives, in part, by issuing significant policies and initiatives in conservatorship directives, and by delegating to the Enterprises the responsibility to implement and comply with the directives. Conservatorship directives, which can only be issued after approval by the FHFA Director, contain specific implementation instructions and must be followed by the Enterprises.⁷ As of October 2015, FHFA has issued 231 conservatorship directives of differing scope and purpose.⁸ For purposes of this memorandum, we grouped conservatorship directives into three categories:

- Direction to one or both Enterprises to take a specified action;
- Direction to the Enterprises to collaborate with each other, under FHFA supervision, on the development of specific initiatives; and
- Direction to the Enterprises to implement specific programs or policies announced by FHFA.

The first category of conservatorship directives generally involves a single action to achieve compliance, such as a 2011 directive to the Enterprises requiring them to participate in settlement discussions with a counterparty and a 2014 directive to Fannie Mae requiring it to appoint a specific person as chairman of its board. Of the 231 conservatorship directives issued by FHFA, 46 can be grouped into this category.

Fifty-nine of the 231 conservatorship directives can be grouped into the second category of directives in which FHFA directs the Enterprises to collaborate with each other, under the supervision of FHFA, to develop a specified initiative. Examples of directives in this category include a 2013 conservatorship directive requiring the Enterprises to work together to resolve certain issues related to the development of a common securitization platform and a 2015

closed. See *OIG, FHFA's Conservator Approval Process for Fannie Mae and Freddie Mac Business Decisions*, (Sept. 27, 2012) (AUD-2012-008) (online at www.fhfa.gov/Content/Files/AUD-2012-008_2.pdf).

⁶ For a discussion of how FHFA manages the conservatorships, see *OIG, FHFA's Conservatorships of Fannie Mae and Freddie Mac: A Long and Complicated Journey*, at 8-14 (Mar. 25, 2015) (WPR-2015-002) (online at www.fhfa.gov/Content/Files/WPR-2015-002_0.pdf).

⁷ Conservatorship directives may contain proprietary, supervisory, and/or privileged nonpublic information and such directives are not publicly released by the Enterprises or FHFA.

⁸ The FHFA Division of Conservatorship maintains a list of all conservatorship directives issued by the Agency.

directive requiring the Enterprises to collaborate and explore the feasibility of alternate credit score and credit history loan decision models.

In the third category of FHFA directives are directives to the Enterprises to implement specific programs or policies that FHFA has developed either independently or in collaboration with the Enterprises or other regulators. Of the 231 conservatorship directives, 126 can be grouped into this category. These directives vary in complexity but generally require program development and implementation to achieve compliance. Implementation may take several years. Examples of directives grouped into this category include:

- Direction to the Enterprises to participate in Treasury’s Making Home Affordable program, including foreclosure prevention programs such as the Home Affordable Refinance Program and the Home Affordable Modification Program; and
- Direction to the Enterprises, as part of the Servicing Alignment Initiative (SAI), to implement a streamlined loan modification program and align their foreclosure timelines.

In November 2012, FHFA issued the *Conservatorship Decision Protocols* (the Protocols) to set forth the respective roles of the Enterprises and the Agency with respect to conservatorship decisions, defined in the Protocols to include conservatorship directives. The Protocols explain that FHFA, as conservator, will issue conservatorship directives and will delegate to the Enterprises the responsibility to implement and comply with them. The delegation of compliance responsibilities requires the Enterprises to “[d]evelop their own system to ensure that they are in compliance with all [conservatorship] decisions,” which include directives.⁹

As conservator, FHFA exercised very limited oversight of Enterprise implementation of and compliance with conservatorship directives during the review period. Officials from FHFA’s Division of Conservatorship (DOC), the division responsible for assisting the Director in carrying out his responsibilities as conservator, reported to us that DOC did not actively oversee the Enterprises’ efforts to implement or comply with directives.¹⁰ They informed us that DOC would be notified of an issue only if it were designated the lead office for a directive (i.e., if DOC had developed the directive), or if the problem rose to the level of warranting a change to a directive’s terms.¹¹ Officials in FHFA’s Division of Housing Mission and Goals (DHMG), the division responsible for developing major policy initiatives, reported to us that DHMG did not test directive compliance after a directive had issued. Both DOC and DHMG officials advised us

⁹ FHFA, *Conservatorship Decision Protocols*, at 8 (Nov. 15, 2012).

¹⁰ The FHFA Director established DOC to assist in carrying out his responsibilities by managing conservatorship operations; coordinating with the Enterprises on FHFA’s strategic goals, conservatorship scorecards, and performance assessments; and taking the lead on matters requiring conservator approval.

¹¹ A DOC official reported to us that DOC is the lead office for 34 of the 231 conservatorship directives.

that FHFA expected an Enterprise to report any issues encountered in implementing a directive to the FHFA division that issued the directive or had been designated the lead for the directive. Because DOC and DHMG employees were in frequent contact with the Enterprises, officials in both divisions stated to us that their employees could have learned, on an ad hoc basis, of compliance issues during those conversations.

According to the Protocols, FHFA's Division of Enterprise Regulation (DER) is responsible for conducting examinations to test compliance with conservatorship directives, rather than the FHFA division or office that developed the directives. DER selects which directives to test, consults with FHFA officials responsible for developing the directives, and reviews Enterprise work papers.¹² During the review period, DER performed compliance testing on five directives in the third category described above (i.e., program or policy directives requiring longer-term implementation beyond collaboration or discussion).

Fannie Mae Efforts to Report on its Compliance with Conservatorship Directives

Fannie Mae's Compliance section, the office responsible for issuing internal compliance policies and testing compliance with directives, began generating a quarterly management "dashboard" (dashboard report) in early 2009 summarizing the previous quarter's compliance, anti-fraud, and privacy testing results. Beginning with the dashboard report for the first quarter of 2012, generated in May 2012, the Compliance section included a list of conservatorship directives,¹³ grouped by subject matter¹⁴ and ranked by risk.¹⁵ The list also identified the status of directives as "New," "In-Process," "Implemented," or "Closed."¹⁶ A later section of the dashboard report summarized the Compliance section's targeted reviews and testing results from the previous quarter, including any findings and recommendations. In November 2012, shortly after FHFA issued the Protocols, Fannie Mae finalized an internal policy outlining the steps to intake, assess, monitor, and test compliance with conservatorship directives. In August 2013, Fannie Mae

¹² FHFA may also review any periodic directive implementation updates generated by the Enterprises at FHFA's request.

¹³ Beginning with the dashboard report for the first quarter of 2014, issued in May 2014, the quarterly dashboard reports no longer included this list. Thus, only the first five quarterly dashboard reports issued during the review period contain this list of directives.

¹⁴ For example, the dashboard organized all directives related to the Contract Harmonization Project together and all directives related to the Servicing Alignment Initiative together.

¹⁵ The directives were risk-ranked as low, medium, or high based upon the directive's relationship to conservatorship scorecard criteria, Enterprise alignment, degree of regulatory oversight, and potential for reputational harm.

¹⁶ According to Fannie Mae's internal policy, the dashboard reports label a directive "In Process" if implementation had begun, but would require a period of time before compliance with the directive would be complete. The dashboard reports labeled a directive "Implemented" when Fannie Mae believed it had completed all of the necessary steps or activities to comply with the directive.

began providing its quarterly dashboard report to a DER examiner on a regular basis.¹⁷ During the review period, Fannie Mae generated six dashboard reports, all of which were eventually shared with a DER examiner.¹⁸

Beginning in April 2014, the Fannie Mae Chief Compliance Officer's (CCO) regulatory and supervisory report to the board was enlarged to include an appendix with information about conservatorship directives. That appendix lists open conservatorship directives, labels them as "New," "Pending Guidance," or "In Process," and provides a brief status update for each one. Because this report was submitted to the board every other month, only two reports with this appendix were presented to the board during the review period. These reports were also provided to FHFA.

For a number of years, Fannie Mae's CCO has submitted an Integrated Issue Assessment report and corresponding narrative to a joint board committee three times per year. From January 2013 through June 2014, the joint board committee received four of these reports, all of which were also provided to FHFA. Although the report format did not contain a dedicated section on compliance with specific directives nor describe the issues identified in the quarterly dashboard report,¹⁹ it did flag a possible timeliness issue associated with the implementation of a conservatorship directive during the review period.²⁰ Additionally, a report by the CCO to the Audit Committee four times per year previously contained an Appendix titled "Compliance, Anti-Fraud, and Privacy Action Items." That Appendix tracked issues with directive compliance that were flagged in the quarterly dashboard reports.²¹ That Appendix stopped appearing in this report in November 2014.

¹⁷ At the time, the DER examiner was responsible for testing Fannie Mae's compliance with the Contract Harmonization Project. Prior to that, Fannie Mae shared its dashboard reports with DER on an ad hoc basis.

¹⁸ In 2013, Fannie Mae's Compliance section prepared an additional quarterly management report on compliance with conservatorship directives, which it also shared with FHFA. This shorter quarterly report contained much of the same information found in the dashboard reports, but provided a more thorough description of each directive's status. This report was discontinued at the end of 2013.

¹⁹ None of the four reports issued during the review period identified any issues with Fannie Mae's compliance with the directives on the salary freeze and loan modification remedies, which are discussed in detail below.

²⁰ The March 2013 report explained that management attention "is needed to improve project management of the rep and warrant workstreams to ensure required activities are completed on time" to implement the conservatorship directive. The concern about timely implementation of the directive was not noted in the corresponding dashboard report.

²¹ For example, the report provided to the Audit Committee in March 2013 identified the same compliance issues with the salary freeze directive as the dashboard report issued in the same month, as discussed below.

Freddie Mac Efforts to Report on its Compliance with Conservatorship Directives

In connection with an examination of Freddie Mac's compliance with two directives, DER identified in June 2013 that Freddie Mac had not established a formal oversight process to ensure compliance with conservatorship directives, as required by the Protocols, and directed the Enterprise to establish a process to address this, categorizing it as a most serious supervisory matter.

In January 2014, Freddie Mac adopted a policy requiring internal monitoring and testing of compliance with conservatorship directives, as well as an evaluation of the adequacy of its business units' controls and documentation. This policy directed Freddie Mac's Compliance section to produce an annual report to the Freddie Mac board summarizing its assessment of Freddie Mac's compliance with conservatorship directives. After adoption of this policy, the Freddie Mac CCO began incorporating directive compliance information in the semiannual report to Freddie Mac's Audit Committee, also provided to FHFA. During the review period, Freddie Mac's CCO submitted one such report, subsequent to issuing the directive compliance policy, to the Audit Committee. This report advised that Freddie Mac's Compliance section was still in the process of building a compliance program, "testing activities are incomplete," and that the CCO was "not yet able to conclude on compliance with Conservator directives."²²

During the Review Period, DER Testing of Enterprise Compliance with Conservatorship Directives Identified Compliance Problems Not Previously Reported by the Enterprises

During the review period, DER tested Enterprise compliance with five conservatorship directives in the third category, namely directives to the Enterprises to implement specific programs or policies.²³ As a result of this supervisory work, DER identified compliance or other supervisory issues with several of the directives which had not been reported previously to FHFA by either Enterprise.

Enterprise Salary Freeze Directives: FHFA issued two directives to the Enterprises, one in 2010 and one in 2011, instructing them to freeze employee salaries in calendar years 2011 and 2012. Both FHFA directives allowed modest pay raises for promotions or significant changes in duties.

In its dashboard report for the first quarter of 2012, issued in May 2012, Fannie Mae's Compliance section reported that the 2011 salary freeze directive was "Closed." That same

²² Each Enterprise provides self-assessments to FHFA of its progress in meeting annual conservatorship scorecard goals, and some of these assessments report on the progress of initiatives that may be related to conservatorship directives. Neither Enterprise reported that it used the scorecard self-assessments to document their implementation of and compliance with conservatorship directives.

²³ FHFA issued a total of 188 conservatorship directives from the inception of conservatorship through June 2014. We classified 104 of those directives into the third category (i.e., program or policy directives).

conclusion appeared in the dashboard report for the second quarter of 2012, issued in August 2012.

In late 2012, Fannie Mae's Compliance section tested Fannie Mae's compliance with both salary freeze directives and found that a lack of criteria created variability in the rationale for salary increase requests. The Compliance section recommended that, by April 2013, Fannie Mae's Human Resources office develop basic criteria for requesting salary adjustments and ensure that documentation is sufficient to support such requests. The results of the compliance review were included in Fannie Mae's fourth quarter 2012 dashboard report, issued in March 2013. That quarterly dashboard report documented the Compliance section's finding that Human Resources had limited documentation to ensure compliance with the salary freeze directives and recommended that it develop criteria and revise its process for salary increases. The dashboard report for the first quarter of 2013, issued in May 2013, labeled the second salary freeze directive "Implemented"²⁴ and provided no further information regarding required remediation. That same quarter, Fannie Mae's Compliance section produced a report stating that its Human Resources office enhanced the controls around salary increases. Similarly, its dashboard report for the second quarter of 2013, issued in August 2013, also labeled the second salary freeze directive "Implemented."

In 2013, DER examiners conducted examinations to assess Fannie Mae's and Freddie Mac's compliance with the 2010 and 2011 salary freeze directives. Despite Fannie Mae's prior dashboard reports stating that the second salary freeze directive was implemented, DER found [REDACTED] deficiencies in the Enterprises' compliance with the directives [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED]²⁵ DER instructed the Enterprises to remediate the deficiencies.

²⁴ Fannie Mae asserted to us that it may mark a conservatorship directive as "implemented" on a dashboard based on information provided by the responsible business unit, even if its Compliance section has not assessed the effectiveness of initial compliance activities or tested controls to ensure compliance.

²⁵ OIG has previously assessed FHFA's oversight of the Enterprises' executive and non-executive compensation through a series of reports. In March 2011, we found that FHFA lacked key controls necessary to monitor the Enterprises' ongoing executive compensation decisions. See OIG, *Evaluation of Federal Housing Finance Agency's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs*, at 13 (Mar. 31, 2011) (EVL-2011-002) (online at www.fhfa.gov/Content/Files/Exec_Comp_DrRpt_03302011_final%2C_signed.pdf). In December 2012, we found that FHFA enhanced its oversight of the approximately 90 executives at the Enterprises, but also found that FHFA's oversight of the compensation for the more than 2,000 senior professionals at the Enterprises was comparatively limited. Specifically, we noted that FHFA has not examined the implementation of the salary freeze directive to determine whether the Enterprises may be using promotions and changes in responsibility to offset the impact of the salary freeze. See OIG, *FHFA's Oversight of the Enterprises' Compensation of Their Executives and Senior Professionals*, at 20 (Dec. 10, 2012) (EVL-2013-001) (online at www.fhfa.gov/Content/Files/EVL-2013-001.pdf). At that time, we recommended that FHFA develop a plan to

[REDACTED] FHFA directed Fannie Mae to address the identified deficiencies and [REDACTED]

[REDACTED]
[REDACTED]
FHFA underscored the importance of satisfactorily addressing the identified deficiencies “in a timely manner.” Fannie Mae submitted a proposed remedial plan on December 20, 2013, and committed to complete remediation by March 31, 2014.

While Fannie Mae [REDACTED], it missed its own deadline for completing that work by 18 months. Fannie Mae management reported to the board in October 2015 that it had completed all remedial actions in September 2015.

DER examiners tested Freddie Mac’s compliance with the salary freeze directives in 2013. They found that Freddie Mac had no formal oversight process in place to ensure compliance with conservatorship directives, as required by the Protocols, and that this lack of process undermined Freddie Mac’s ability to demonstrate compliance with the salary freeze directives. [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] DER identified [REDACTED] areas [REDACTED] that needed improvements and issued [REDACTED] recommendations [REDACTED].

FHFA also notified Freddie Mac that it lacked a formal oversight program required by the Protocols to ensure compliance with conservatorship directives and instructed Freddie Mac to remediate the issue. Freddie Mac first adopted a formal oversight policy in January 2014. The CCO’s June 2014 semiannual report to Freddie Mac’s Audit Committee—the first and only CCO report issued subsequent to the new policy and during our review period—stated that internal testing of compliance with conservatorship directives was incomplete. According to Freddie Mac, it provided no written updates to FHFA during the review period of its efforts to comply with the salary directive.²⁶

strengthen its oversight of the Enterprises’ compensation of their senior professionals through reviews or examinations, to which FHFA agreed. In a February 2014 memorandum to the FHFA Director, we closed out our previous evaluation after documenting that DER completed examination work at both Enterprises and that FHFA had begun a limited oversight regimen based upon the quarterly reporting of senior professional salaries by the Enterprises. See *OIG, Update on FHFA’s Oversight of the Enterprises’ Non-Executive Compensation Practices*, at 8 (Feb. 25, 2014) (EVL-2014-004) (online at www.fhfa.gov/Content/Files/EVL-2014-004.pdf).

²⁶ The December 2014 CCO report to the Freddie Mac Audit Committee stated that “Compliance completed testing of Directives (issued Sept 2008-Aug 2014), Decisions (issued September 2008-April 2013) and the High and Moderate risk provisions of the Revised Letter of Instruction. No significant issues have been identified in testing.”

Servicing Alignment Initiative (SAI) Directive: In 2011, FHFA issued a conservatorship directive to both Enterprises to align their mortgage servicing policies to better address delinquent borrowers and limit foreclosures.²⁷ Fannie Mae reported in its dashboard reports for the fourth quarter of 2012 and in 2013 that the directive was “Implemented.” DER conducted a targeted examination at each Enterprise starting in 2012 to assess their implementation of SAI. At the conclusion of these examinations in July and August 2013, DER issued examination findings to each Enterprise.

[REDACTED]

Fannie Mae Provided Inconsistent and Inaccurate Information on Compliance with Contract Harmonization Project Directives

In 2012, FHFA issued two directives related to the Contract Harmonization Project (CHP), an FHFA initiative to improve consistency in the Enterprises’ contracts with mortgage seller-servicers. The first directive, issued in June 2012, instructed the Enterprises to implement an agreed-upon representation and warranty framework in their seller-servicer contracts. Fannie Mae’s March 2013 Integrated Issue Assessment report, presented to a joint board committee, stated that “management attention is needed to improve project management of the [directive’s] workstreams to ensure required activities are completed on time.” Fannie Mae labeled the first CHP directive as “Implemented” in its March, May, and November 2013 quarterly dashboard reports. The August 2013 dashboard report labeled the directive as “In Process.”

DER reviewed Fannie Mae’s compliance with the first CHP directive in the second and third quarters of 2013 through ongoing monitoring, [REDACTED]

²⁷ OIG previously assessed the extent of FHFA’s monitoring of servicer compliance with the Enterprises’ SAI guidelines. We found that FHFA was not in a position to determine whether SAI was achieving its intended goals because the Agency did not require the Enterprises to submit critical internal reports. See OIG, *FHFA’s Oversight of the Servicing Alignment Initiative*, at 14 (Feb. 12, 2014) (EVL-2014-003) (online at www.fhfaog.gov/Content/Files/EVL-2014-003.pdf). The 2014 OIG report assessed FHFA’s oversight of servicers’ compliance with specific Enterprise guidelines, while this report assesses FHFA’s oversight of the Enterprises’ compliance with conservatorship directives.

[REDACTED]

The second CHP directive, issued by FHFA in August 2012, required both Enterprises to pursue a set of uniform remedies for certain servicing deficiencies, including non-compliance with loan modification guidelines. The directive included a number of different instructions. One instruction specified two types of remedies available for loan modification defects: repurchase, or requiring the servicer to buy back the loan from the Enterprise; and indemnification, or requiring the servicer to reimburse the Enterprise for monetary losses attributable to the loan modification defect, pursuant to a formula to be developed by each Enterprise to estimate its future financial loss.

After FHFA issued the second CHP conservatorship directive, Fannie Mae began efforts to develop an indemnification formula. By July 2013, 11 months later, we found that Fannie Mae had not settled on a formula. In the three quarterly dashboard reports during this period, Fannie Mae labeled both CHP directives as high risk. Fannie Mae's dashboard reports for the fourth quarter of 2012, issued in March 2013, and the first quarter of 2013, issued in May 2013, stated that implementation of the second CHP directive was "Implemented," even though Fannie Mae had not developed an indemnification formula nor sought indemnification from any servicer for loan modification defects.²⁸ In July 2013, Fannie Mae alerted FHFA that it had not settled on an indemnification formula.²⁹

Fannie Mae officials advised us that, between August 2012 and July 2013, Fannie Mae prioritized implementation of the instructions in the second CHP directive that it determined to be most important, but failed to settle on an indemnification formula. However, none of the three dashboard reports during this period flagged any compliance issues with the second CHP directive, or otherwise suggested that Fannie Mae was having difficulty in developing an

²⁸ Fannie Mae informed us that it reports the overall status of directives at a group or portfolio level (e.g., instead of reporting the status of the second CHP directive separately, Fannie Mae assigned an overall status to the group of CHP directives). As mentioned earlier, Fannie Mae's Compliance section also may rely on information provided by management and mark directives as "implemented" before assessing the effectiveness of compliance activities or testing controls to ensure compliance. With respect to the CHP directives listed as "implemented" in the March 2013 dashboard report, Fannie Mae's Compliance section stated that it relied on Fannie Mae's CHP scorecard submission to Fannie Mae, Fannie Mae's servicing guide announcement, and a close-out letter from DHMG's Office of Housing and Regulatory Policy. DHMG officials informed us that they do not check on directive compliance. Once the Enterprise issues the servicing guideline, DHMG "hands off" the directive to DER, which conducts examinations to test compliance with conservatorship directives.

²⁹ From August 2012 through May 2013, Freddie Mac worked to develop an indemnification formula so it could implement the second conservatorship directive, and generally kept FHFA apprised of its progress throughout the period. Effective June 2013, Freddie Mac began seeking loan modification remedies pursuant to an indemnification formula it had developed. In the first month, the Enterprise requested approximately \$5.8 million in remedies for loan modification defects from its servicers. After problems arose with implementation of the formula, Freddie Mac halted its efforts to seek remedies, and Freddie Mac and FHFA, along with Fannie Mae, began discussions to reconsider modification remedies.

indemnification formula. We found no documentary evidence to show that FHFA was aware that Fannie Mae was not in compliance with this aspect of the second CHP directive during that period, and, in our interviews, FHFA officials did not recall Fannie Mae having any implementation issues with the formula. In March 2014, FHFA informed both Enterprises that it was suspending the loan modification remedy component of the directive.

Conclusion

In December 2011 and in April 2013, then-FHFA Inspector General testified before Congress that FHFA had not been proactive in its oversight of Enterprise compliance with its conservatorship directives to ensure that their purposes were achieved. In this survey, we sought to assess whether FHFA strengthened its oversight of the Enterprises' compliance with conservatorship directives for the period January 1, 2013, through June 30, 2014, and found that little had changed since 2011. We determined that, in large measure, FHFA, as conservator, exercised little oversight of the Enterprises' compliance with conservatorship directives and relied on the Enterprises to self-report concerns, questions, and operational issues with implementation and compliance. During the review period, we found that one Enterprise shared compliance reports for each quarter with FHFA on the status of directives, but those reports were of very limited value because of their inaccuracies and incomplete information. The other Enterprise provided no written directive compliance reports to FHFA; at the end of the review period, it was still building a formal directive compliance program and had yet to complete directive testing. FHFA's heavy reliance on the Enterprises to self-report compliance issues during this period significantly limited FHFA's ability, as conservator, to determine whether the policies and initiatives announced in its conservatorship directives had been fully implemented. In a separate audit, OIG assessed FHFA's tracking and rating of the scorecard objective for a portion of CHP, one of the conservatorship directives addressed in this report, and found that Agency records were internally inconsistent and unclear about what work had been done to assess the effectiveness of actions required in connection with the directive.

We recognize that, beginning in April 2014, one Enterprise developed additional, regular written reports on its efforts to comply with conservatorship directives, and, beginning in December 2014, the other Enterprise began providing a report to FHFA on its internal compliance testing of conservatorship directives. At this time, we have not reviewed the information in these reports for accuracy and completeness. We intend to monitor FHFA's oversight of Enterprise implementation of and compliance with conservatorship directives and will subsequently test whether additional reporting from the Enterprises has enhanced FHFA's oversight of Enterprise implementation of and compliance with conservatorship directives.

This memorandum closes OIG's survey of FHFA's oversight of Enterprise efforts to implement and comply with conservatorship directives for the period January 1, 2013, through June 30, 2014.

Scope and Methodology

This review was conducted under the authority of the Inspector General Act in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which was promulgated by the Council of the Inspectors General on Integrity and Efficiency. These standards require OIG to plan and perform an evaluation that obtains evidence sufficient to provide a reasonable basis to support its conclusions. OIG believes that this review meets these standards.

This review was led by Brian Harris, Investigative Counsel. The performance period for this review was June 2014 to October 2015. A draft of this memorandum was sent to FHFA.

We appreciate the cooperation of FHFA, as well as the assistance of all those who contributed to the preparation of this report. It has been distributed to Congress, the Office of Management and Budget, and others and will be posted on OIG's website, www.fhfa.ig.gov.

cc: The Honorable Melvin L. Watt, FHFA Director

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