



Audit and Evaluation Plan

Office of Inspector General
Federal Housing Finance Agency

February 2015

OVERVIEW

Federal Housing Finance Agency

On July 30, 2008, the Federal Housing Finance Agency (FHFA or Agency) was established by the Housing and Economic Recovery Act of 2008 (HERA).¹ Specifically, HERA abolished two existing Federal agencies, the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board, and in their place created FHFA to regulate the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) (together, the Enterprises), the Federal Home Loan Banks (FHLBanks), and the FHLBanks' fiscal agent, the Office of Finance (collectively, the Government Sponsored Enterprises or GSEs).

FHFA's mission is to: provide effective supervision, regulation, and oversight of the GSEs; promote their safety and soundness; support housing finance, affordable housing, and community development goals; and facilitate a stable and liquid mortgage market.² Since September 2008, FHFA also has been the conservator of the Enterprises. FHFA placed the Enterprises into conservatorships out of concern that their deteriorating financial conditions would destabilize the financial markets. At that time, the U.S. Department of the Treasury (Treasury) agreed to provide them with substantial financial support. As of December 31, 2014, the Enterprises under their conservatorships have received \$187.5 billion in Treasury support pursuant to senior preferred stock purchase agreements with each of them.

FHFA Office of Inspector General

The FHFA Office of Inspector General (FHFA-OIG) was established by section 1105 of HERA, which amended the Inspector General Act of 1978.³ The mission of FHFA-OIG is to: promote the economy, efficiency, and effectiveness of FHFA's programs; prevent and detect fraud, waste, and abuse in FHFA's programs; and seek sanctions against, and civil and criminal prosecutions of, those responsible for such fraud, waste, and abuse. FHFA-OIG provides independent and objective reporting to FHFA's Director, Congress, and the American people through audits, evaluations, and investigations.

¹ Public Law No. 110-289.

² The Enterprises purchase mortgages from lenders and either package them into mortgage-backed securities that are sold to investors or hold them in their portfolios. By doing so, the Enterprises' actions promote liquidity in the housing finance system. The FHLBank System issues debt and each of the FHLBanks makes secured loans known as advances to their members, such as banks or thrifts. Their members can use the advance proceeds to originate mortgages or support affordable housing or community development.

³ Public Law No. 95-452.

FHFA-OIG Office of Audits

The Office of Audits provides audit and related services covering the programs and operations of FHFA. Through its performance audits and attestation engagements, the Office of Audits seeks to promote economy, efficiency, and effectiveness in the administration of FHFA's programs; detect and deter fraud, waste, and abuse in FHFA's activities and operations; and ensure compliance with applicable laws and regulations.

Under the Inspector General Act, inspectors general are required to comply with standards established by the Comptroller General of the United States for audits of federal establishments, organizations, programs, activities, and functions. These standards, referred to as Generally Accepted Government Auditing Standards, are prescribed in the *Government Auditing Standards*, commonly referred to as the "Yellow Book." The Office of Audits performs its audits and attestation engagements in accordance with the Yellow Book.

FHFA-OIG Office of Evaluations

The Office of Evaluations reviews, studies, and analyzes FHFA's programmatic and operational activities and provides independent and objective analyses to FHFA. It also assists FHFA by developing recommendations designed to resolve significant deficiencies in the effectiveness or efficiency of FHFA's programs and operations, and by preventing fraud, waste, and abuse.

The Inspector General Reform Act of 2008⁴ requires inspectors general to adhere to professional standards developed by the Council of the Inspectors General on Integrity and Efficiency. Evaluation standards are prescribed in its *Quality Standards for Inspection and Evaluation*, commonly referred to as the "Blue Book." The Office of Evaluations performs its evaluations in accordance with the Blue Book.

PLANNING

FHFA-OIG Audit and Evaluation Planning Processes

In order to meet the requirements of the Inspector General Act, the Yellow Book, and the Blue Book, FHFA-OIG has established an ongoing and dynamic planning process⁵ focusing on the areas of greatest risk to FHFA and the GSEs.⁶ FHFA-OIG's Audit and Evaluation Plan⁷ enables

⁴ Public Law No. 110-409.

⁵ The *Quality Standards for Federal Offices of Inspector General* (August 2012), adopted by the Council of the Inspectors General on Integrity and Efficiency, addresses the importance of conducting an annual evaluation planning process to identify and prioritize potential work.

⁶ To guide FHFA-OIG, the Inspector General has prioritized the development of this comprehensive Audit and Evaluation Plan. FHFA-OIG does not publicly disclose its investigative plan due to the sensitive nature of its investigations.

⁷ This plan is dynamic. It is neither final nor all-inclusive. It does not include, for example, audits or evaluations that

it to address these risks and ensure transparency and accountability in the Agency's programs and operations, including the Agency's regulation of the GSEs. FHFA-OIG identifies subjects that should be audited or evaluated through a variety of means, including discussions with FHFA and GSE executives, the public, Congress, and other government officials; reviews of relevant reports and documents prepared by FHFA and external parties; risk assessments performed in key areas related to FHFA's mission; and matters referred to FHFA-OIG through its Hotline.

Key Areas of FHFA-OIG Audit and Evaluation Focus

In November and December of 2014, FHFA-OIG reassessed its Audit and Evaluation Plan (April 2014 revision); engaged in discussions with FHFA, the GSEs, and stakeholders; and reviewed reports and risk assessments. FHFA-OIG identified four areas that it believes present high levels of financial, governance, and reputational risk: conservatorship operations, Enterprise supervision, nonbank sellers, and information technology security.

Conservatorship Operations

Since 2008, FHFA has administered two conservatorships of unprecedented scope and undeterminable duration, and simultaneously served as the regulator for two large, complex companies that dominate the secondary mortgage market and the mortgage securitization sector of the U.S. housing finance industry. Balancing the dual role of conservator and regulator presents obvious challenges for FHFA.

As Conservator of the Enterprises, FHFA has expansive authority over trillions of dollars in assets and billions of dollars in revenue. FHFA also makes business and policy decisions that influence and impact the entire mortgage finance industry. Further, the Conservator's actions are not subject to judicial review or intervention, and are not subject to procedural safeguards that are ordinarily applicable to regulatory activities such as rulemaking. In light of this, FHFA has developed and adjusted its governance practices for the conservatorships in order to address procedural issues and substantive matters that arise in the course of business and require the Conservator's attention and/or approval. The Conservator has acted on more than 2,600 requests or other matters that cover a wide variety of topics, including Conservator-led initiatives and significant policies pertaining to foreclosure prevention, loss mitigation, credit standards, and mortgage insurers.

FHFA-OIG may undertake pursuant to requests from FHFA, Congress, and other stakeholders, or situations to which FHFA-OIG's attention may be drawn as a result of its ongoing activities. FHFA-OIG will work closely with the Government Accountability Office and other inspectors general to ensure that its planning process continues to include risk-based coverage of government-wide programs. It also does not include several statutorily required inquiries—such as the annual Federal Information Security Management Act security assessment (see 44 U.S.C. §§ 3535, 3545) and the improper payments audit (see 31 U.S.C. § 3321 note)—that FHFA-OIG will conduct.

Given this environment, FHFA-OIG's 2015 work will:

- Review the Conservator's decisions;
- Assess the Conservator's governance practices, internal controls, decision-making process, and follow-up/compliance activities; and
- Evaluate Conservator initiatives.

These efforts will determine whether FHFA is fulfilling its statutory duties and responsibilities and safeguarding taxpayers.

Enterprise Supervision

The Division of Enterprise Regulation (DER)—the division within FHFA primarily responsible for regulating the Enterprises, i.e., ensuring their safe and sound operations—consists of staff located at FHFA headquarters and two core teams of examiners—one at each Enterprise. DER's regulatory activities include: (1) examination planning, (2) examination execution, and (3) remediation of examination findings.

Examination Planning. At the start of the examination planning process, DER's core teams review risk assessments that highlight the strengths and weaknesses of each Enterprise. The risk assessments inform a comprehensive supervisory strategy for each Enterprise. Next, DER drafts a supervisory plan that establishes a schedule of supervisory activities for examiners on both core teams. Finally, prior to the start of their examination work, DER examiners prepare a procedures document that reflects the specific objectives for the scheduled activity and identifies the level of transaction testing to be completed.

Examination Execution. The supervisory plan identifies the risk areas that will be the subject of ongoing monitoring or targeted examinations. Ongoing monitoring activities allow examiners to analyze current information and use those analyses to identify changes in an Enterprise's risk profile that may warrant further supervisory attention. Typically, examiners conduct such monitoring through meetings with Enterprise management and review of management and board reports. Targeted examinations—DER's most comprehensive assessment tool—involve in-depth assessments of specific risks or risk management systems. The conclusions drawn from both ongoing monitoring activities and targeted examinations are derived from testing and independent analysis of Enterprise information, data, and documents.

Remediation. During the course of the examination activities described above—particularly the targeted examinations—FHFA identifies deficiencies that result in examination findings that require Enterprise remediation. To correct a deficiency, DER may make a recommendation, cite a violation, issue a matter requiring attention, write a supervisory letter, or utilize certain enforcement actions to ensure the safety and soundness of the Enterprises. DER awaits

verification of management's remediation activities by the Enterprises' internal audit groups and verifies remediation through ongoing monitoring.

Consistent with DER's examination structure, FHFA-OIG's 2015 work will:

- Consider DER's processes for identifying risks and allocating resources,
- Review its targeted examinations and ongoing monitoring, and
- Evaluate its remediation of examination findings.

These efforts will determine whether DER's overall performance during the 2013 and 2014 examination cycles fulfilled its statutory duties and responsibilities and safeguarded taxpayers.

Nonbank Sellers

Fannie Mae's Form 10-K for the fiscal year ended December 31, 2013, disclosed that: (1) the Enterprise is acquiring an increasing portion of its business volume directly from smaller or non-depository financial institutions (nonbank sellers), which may not have the same financial strength, liquidity, or operational capacity as its larger depository financial institution counterparties; and (2) this potentially lower financial strength, liquidity, and operational capacity of nonbank sellers may negatively affect their ability to satisfy their repurchase or compensatory fee obligations to the Enterprise. The decrease in the concentration of the Enterprise's business with large depository financial institutions could increase both institutional counterparty credit risk and mortgage credit risk, and could have a material, adverse effect on the Enterprise's business, results of operations, financial condition, liquidity, and net worth.

Accordingly, FHFA-OIG's 2015 work will:

- Analyze the risk posed by the increased business volume of nonbank sellers,
- Assess the adequacy of FHFA's oversight of the Enterprises' controls for nonbank sellers, and
- Study the Enterprises' controls for nonbank sellers.

These efforts will determine whether FHFA and the Enterprises have sufficiently mitigated the increased risk that Fannie Mae reported.

Information Technology Security

As of December 12, 2014, the number of reported software vulnerabilities worldwide for the preceding 90 days was 3,373. These vulnerabilities are tracked by the Department of Homeland Security and its respective cybersecurity partners and are defined as bugs, flaws, weaknesses, or exposures of an application, system, device, or service that could lead to a failure of

confidentiality, integrity, or availability. Further, there have been many recent large-scale breaches of credit card data, including millions of customer accounts breached at Home Depot, Target, and T.J.Maxx. In this environment, the vulnerabilities of the GSEs' systems are particularly acute because much of their information technology is outdated. In many cases, the systems were developed and implemented before the current state of cybercrime existed.

As a consequence, FHFA-OIG will work to assess the:

- Adequacy of FHFA's oversight of the GSEs' information technology security, and
- GSEs' controls for information technology security.

FHFA-OIG AUDIT AND EVALUATION PLAN

Within the four areas of concentration mentioned above, FHFA-OIG's 2015 audits and evaluations will include:

Conservatorship Operations

- Identification of trends in Conservator decisions and requests for Conservator action.
- Assessment of the efficiency and effectiveness of FHFA's governance of Conservator decisions and the monitoring of compliance with those decisions.
- Evaluation of the efficiency and effectiveness of FHFA's process for identifying, developing, and implementing Conservator-sponsored initiatives, and for monitoring the success of those initiatives.

Enterprise Supervision

- Assessment of whether DER complied with its established standards for developing risk assessments for the 2013 and 2014 examination cycles, and whether its supervisory strategies and examination schedules were consistent with the findings of its risk assessments.
- Analysis of the methodology DER used to ensure that there would be sufficient examiner resources to conduct proportionately weighted targeted examinations and ongoing monitoring activities of the Enterprises' high risk areas.
- Evaluation of the efficiency and effectiveness of the steps DER took to require the Enterprises to remediate deficiencies or violations identified during the 2013 and 2014 examination cycles.

Nonbank Sellers

- Analysis of FHFA's oversight of the Enterprises' exposure to nonbank sellers.
- Evaluation of whether FHFA and the Enterprises have taken adequate steps to understand and address the risks posed by nonbank sellers.
- Assessment of how FHFA has overseen the Enterprises' implementation of Advisory Bulletin 2013-01, Contingency Planning for High-Risk or High-Volume Counterparties, and Advisory Bulletin 2014-07, Oversight of Single-Family Seller/Service Relationships, as they relate to nonbank sellers.
- Analysis of the Enterprise's standard eligibility requirements for nonbank sellers.

Information Technology Security

- Evaluation of FHFA's oversight of whether the GSEs have programs in place to ensure the identification and protection of Protected Personal Information.
- Assessment of FHFA's and the GSEs' controls for information technology security.

FEDERAL HOUSING FINANCE AGENCY
OFFICE OF INSPECTOR GENERAL

HOTLINE

To Report Suspected
FRAUD, WASTE, OR ABUSE

in FHFA Programs or Operations
(including mortgage fraud referrals involving FHFA,
Fannie Mae, Freddie Mac, and Federal Home Loan Banks)



CALL

the OIG Hotline at
1-800-793-7724

ONLINE

www.fhfoig.gov

FAX

202-318-0358

WRITE

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