Federal Housing Finance Agency
Office of Inspector General

DBR's Unwritten Procedures and Practices for Oversight of Efforts by Federal Home Loan Banks to Correct Deficiencies Underlying the Most Serious Supervisory Matters Are Inconsistent with the Written Oversight Requirements Promulgated by FHFA

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Executive Summary

As the regulator of Fannie Mae and Freddie Mac (collectively, the Enterprises) and of the Federal Home Loan Banks (FHLBanks), the Federal Housing Finance Agency (FHFA) is tasked by statute to ensure that these entities operate safely and soundly, and serve as a reliable source of liquidity and funding for housing finance and community investment. Examinations of its regulated entities are a fundamental aspect of FHFA's supervisory mission. FHFA has adopted a unified supervisory framework for its supervision of the FHLBanks and the Enterprises. Its supervision of the FHLBanks is carried out by its Division of Federal Home Loan Bank Regulation (DBR) and its supervision of the Enterprises is carried out by its Division of Enterprise Regulation (DER).

In the FHFA Office of Inspector General's (OIG) 2016 Audit and Evaluation Plan, we explained our intent to focus our resources on those aspects of FHFA's programs and operations that pose the greatest financial, governance, and reputational risk to it, the Enterprises, and the FHLBanks. One such aspect we identified was the rigor with which FHFA supervises the Enterprises and the FHLBanks. This special project report is one in a series of OIG reports in which we assess the robustness of FHFA's policies, procedures, and practices governing its oversight of a regulated entity's remediation of deficiencies identified during a supervisory activity.

FHFA's Advisory Bulletin 2012-01 (AB 2012-01) prescribes the process that must be followed by DBR and DER examiners to oversee a regulated entity's efforts to correct deficiencies. When an Agency examiner identifies a deficiency during a supervisory activity, he or she will classify that deficiency as a Matter Requiring Attention (MRA), a violation, or a recommendation, depending on the severity of the deficiency (MRAs being the most severe).

In a recent evaluation report, we assessed DER's oversight of the Enterprises' remediation of MRAs. We found that the systems DER uses to track open MRAs have substantial weaknesses that limit DER's ability to monitor the Enterprises' remediation efforts. We also examined a sample of open and closed MRAs issued to each Enterprise and found that examiners did not consistently follow the requirements set forth in AB 2012-01 or the internal guidance issued by DER to supplement these requirements.

In this special project, we assessed DBR's oversight of the FHLBanks by reviewing a sample of nine MRAs issued by DBR from January 2014 through September 2015. We compared documentation prepared by DBR examiners and information gained during interviews of DBR managers and examiners with the requirements set forth in AB 2012-01. For the nine MRAs in

our sample, we found that DBR's unwritten procedures and practices are inconsistent with the specific requirements of AB 2012-01 for examiner oversight of remediation of MRAs by regulated entities in the following areas:

- **Preparation by the regulated entity of a written remedial plan for FHFA approval.** According to AB 2012-01, MRAs are the "most serious supervisory matters" and it directs that the remediation process begins with "written remediation plans, prepared by the regulated entity" that set forth corrective action(s) that are acceptable to FHFA. DBR, however, prepares a findings memorandum that prescribes corrective action(s) and establishes the completion date for all such action(s). DBR officials, including the Deputy Director, have stated that this findings memorandum is, in fact, the remediation "plan" referenced in AB 2012-01.

- **Establishment of a timeline with specific milestones within each remedial plan.** FHFA requires that MRAs demand "prompt remediation by the regulated entity." AB 2012-01 contemplates that each remediation plan will include "specific milestones" that "reflect the seriousness of the MRA, taking into consideration the complexity of the issue, and the urgency regarding correction." In our sample of nine MRAs, none of the remediation plans prepared by DBR contained interim milestones.

- **Follow-up, including testing, by examiners throughout the remediation period to determine progress against the plan and documentation of that testing.** Due to the seriousness of MRAs, AB 2012-01 instructs examiners to "check and document progress at an interval determined by the Examiner in Charge (EIC) and guided by the remediation plan," including "an assessment of materials provided by the regulated entity, discussions with the responsible parties at the regulated entity, and testing, if appropriate, to determine progress against a remediation plan." In our sample of nine MRAs, we identified no instance in which a DBR examiner "check[ed] and document[ed] progress" by the FHLBank to remediate any portion of any MRA between annual examinations. DBR contends, however, that the nature, organization, and staffing of its supervision program is unsuited to conducting such follow-up testing between annual examinations and, in any case, such testing is not warranted, as the FHLBanks have generally met remediation deadlines.

- **Consideration of other supervisory action if progress toward remediation is not made or milestones are missed.** AB 2012-01 directs that "[i]f progress toward remediation is not being made and/or milestones are missed, other supervisory action should be considered." It contemplates the possibility that lack of sufficient progress in

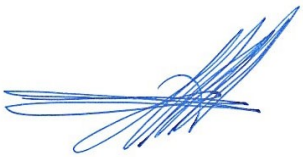
> implementing the specified remedial action could warrant an enforcement action and commands that "[e]xaminers will document all follow-up activities, to inform internal FHFA management reports." For four of the nine MRAs in our sample, we found that DBR examiners determined at the subsequent annual examination that each of the FHLBanks had inadequately implemented their specified remedial actions and insufficiently remediated the MRA. However, the examiners closed each of these four MRAs and reissued them in whole or in part and extended the remediation timetable for at least one year from the date of reissuance, notwithstanding the directive in AB 2012-01 that MRAs must be remediated promptly.

For two of these four MRAs, DBR examiners determined that the affected FHLBank made no progress in remediating the underlying deficiencies and reissued MRAs with substantially the same terms, and for the remaining two, issued revised MRAs that were limited to those deficiencies in the original MRAs that had not been adequately remediated. We found no evidence to show that DBR examiners considered whether to take other supervisory or enforcement actions against management of the affected FHLBank to hold it accountable for the lack of remedial progress or ineffective remediation of the MRA. Despite AB 2012-01's requirement that all examiners "document all follow-up activities . . . to inform internal FHFA reports," we found no documentation in the materials provided to us by DBR that explained the rationale for closing and reissuing an MRA, in whole or in part, and extending the remediation period without considering other supervisory or enforcement actions.

In written comments, DBR agreed that their practices and guidance could be better aligned and stated that they will work to make them conform to one another.

This special project was led by Karen E. Berry, Senior Investigative Counsel, with assistance from Wesley M. Phillips, Senior Policy Advisor; Patrice Wilson, Senior Investigative Evaluator; and Jon Anders, Program Analyst. We appreciate the cooperation we received from FHFA in completing this special project.

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.



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ABBREVIATIONS

AB 2012-01	Advisory Bulletin 2012-01, *Categories for Examination Findings*
DBR	Division of Federal Home Loan Bank Regulation
DER	Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac, collectively
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General

BACKGROUND

Created by Congress in 2008, FHFA is charged by the Housing and Economic Recovery Act of 2008 with, among other things, the supervision of the Enterprises and the FHLBanks. Its mission as a federal financial regulator includes ensuring the safety and soundness of its regulated entities so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA maintains that it uses a risk-based approach to plan and execute its supervisory activities. Supervision by risk requires a comprehensive, risk-focused view of each regulated entity so that supervisory activities can be tailored to the risks with the highest supervisory concerns. FHFA has adopted a unified supervisory framework for its supervision of the FHLBanks and the Enterprises. Its supervision of the FHLBanks is carried out by DBR and its supervision of the Enterprises is carried out by DER.

When conducting their supervisory activities at a regulated entity, FHFA examiners may identify deficiencies that result in findings. When they do so, FHFA's AB 2012-01, *Categories for Examination Findings*,[1] requires that the examiners classify their finding as: (1) a recommendation; (2) a violation; or an (3) MRA. According to AB 2012-01, only "the most serious supervisory matters" are categorized as MRAs. FHFA examiners will issue an MRA for matters such as "non-compliance with laws or regulations that result, or may result, in significant risk of financial loss or damage," "repeat deficiencies that have escalated due to insufficient action or attention," "unsafe or unsound practices," "matters that have resulted, or are likely to result, in a regulated entity being in an unsafe or unsound condition," and "breakdowns in risk management, significant control weaknesses, or inappropriate risk-taking."

As supervisor of the 11 regional FHLBanks and the Office of Finance,[2] DBR assesses their safety and soundness primarily through annual, on-site examinations.[3] DBR examination teams, led by an EIC, spend five to six weeks on-site at the FHLBank reviewing its risk

[1] FHFA, Advisory Bulletin 2012-01, *Categories for Examination Findings*, at 2 (Apr. 2, 2012) (online at www.fhfa.gov/SupervisionRegulation/AdvisoryBulletins/Pages/AB-2012-01-CATEGORIES-FOR-EXAMINATION-FINDINGS.aspx (accessed July 1, 2016).

[2] Each FHLBank is cooperatively owned by its respective member financial institutions, including banks, thrifts, and insurance companies. The primary business activity of each FHLBank is to provide loans, known as advances, to their members to support housing finance and for other purposes. FHLBanks may also invest in United States Treasury securities, certain mortgage assets, and other types of assets as permitted by law and FHFA regulations.

[3] DBR also conducts periodic visits, special reviews, and off-site monitoring of FHLBank financial data.

management and operations.[4] After completing on-site fieldwork, DBR examiners review the examination work papers and prepare an annual report of examination for each FHLBank, which summarizes the results of the prior year's supervisory activities, and issues that report of examination to the Board of Directors of the FHLBank.

FHFA's Written Requirements for Examiner Oversight of MRA Remediation by a Regulated Entity

In AB 2012-01, FHFA identifies the actions that FHFA examiners must take to ensure that a regulated entity has timely and adequately corrected the deficiencies underlying an MRA.[5] Subsequent to issuance of AB 2012-01, FHFA promulgated its *Examination Manual*, which discusses, without the granularity of AB 2012-01, several aspects of MRA issuance and examiner oversight of MRA remediation. While DER has issued supplemental internal written guidance, DBR has not.

The specific instructions in AB 2012-01 direct examiners to:

1. Require the affected regulated entity to prepare a written remediation plan that articulates the planned corrective action(s) and is "acceptable to the FHFA";

2. Require a timeline with "specific milestones" in each remediation plan that "reflect the seriousness of the MRA, taking into consideration the complexity of the issue, and the urgency regarding correction."

3. "Check and document progress" by the regulated entity to correct the deficiencies underlying the MRA throughout the remediation period because of the "seriousness of MRAs," at intervals to be "determined by the EIC and guided by the remediation plan." This examiner follow-up of the entity's remedial progress should include the following three elements and must be documented:

    a. "[A]ssessment of materials provided by the regulated entity";

    b. "[D]iscussions with the responsible parties at the regulated entity"; and

    c. "[T]esting, if appropriate, to determine progress against a remediation plan."[6]

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[4] According to a DBR official, a typical DBR examiner participates in four annual FHLBank examinations per year and spends approximately five months on travel doing so.

[5] The Deputy Directors of DER and DBR approved the content of AB 2012-01 before it was issued by FHFA.

[6] *See* FHFA, *Categories for Examination Findings, supra* note 1.

4. Consider other supervisory action if progress toward remediation is not made or milestones are missed, and document that consideration.

DBR's Unwritten Procedures and Practices for Oversight of MRA Remediation Are Inconsistent with the Directives in AB 2012-01

Unlike DER, DBR has not issued internal written guidance to its examiners on oversight of MRA remediation to supplement AB 2012-01.[7] The Deputy Director of DBR reported to us that the directives in AB 2012-01 apply to DBR. However, he acknowledged that DBR examiners follow unwritten DBR procedures and practices that are inconsistent with AB 2012-01. In his view, DBR's unwritten procedures and practices are tailored to its views of its responsibility for FHLBank oversight and the nature of its on-site annual examination program.

DBR Establishes the Remediation Plan for Each MRA with a Completion Date for Corrective Actions

Although AB 2012-01 directs that the regulated entity "must" prepare the written remediation plan setting forth the corrective action(s) to be taken, DBR does not follow this requirement and instead prepares a findings memorandum, which constitutes the remediation plan. DBR managers and EICs explained to us that DBR issues findings memoranda at the completion of its annual examination of an FHLBank in which DBR identifies deficiencies, including MRAs, sets forth the corrective actions the FHLBank must take to remediate them, and sets completion dates for the remediation. According to the Deputy Director of DBR, examiners establish the remediation plan and final remediation dates in consultation with the affected FHLBank.[8]

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[7] As we have explained, DER has issued internal guidance applicable to its examiners to supplement FHFA's *Examination Manual* and AB 2012-01 and assisted them in oversight of Enterprise remediation of MRAs and to close MRAs. *See* OIG, *FHFA's Examiners Did Not Meet Requirements and Guidance for Oversight of an Enterprise's Remediation of Serious Deficiencies* (Mar. 29, 2016) (EVL-2016-004) (online at www.fhfaoig.gov/Content/Files/EVL-2016-004.pdf); OIG, *FHFA's Inconsistent Practices in Assessing Enterprise Remediation of Serious Deficiencies and Weaknesses in its Tracking Systems Limit the Effectiveness of FHFA's Supervision of the Enterprises* (July 14, 2016) (EVL-2016-007) (online at www.fhfaoig.gov/Content/Files/EVL-2016-007.pdf).

[8] Most FHLBanks establish internal remediation plans containing interim milestones by which they expect certain corrective actions to be taken. Since these interim milestones are contained in the affected FHLBanks' internal plans, DBR examiners do not follow up on the FHLBanks' compliance with them.

DBR's Timetable in Each MRA Remediation Plan Provides a Final Completion Date for Corrective Actions That Typically Precedes the Next Annual On-Site Examination but DBR Typically Does Not Include Interim Milestones in its Timetable

According to the Deputy Director of DBR, the only date provided by DBR in its remediation plan is the date by which the specified actions must be completed. He explained that this date is a "final" date. In general, a final date is set prior to the next annual examination. Consequently, DBR's remediation plans typically do not contain interim milestones by which to measure an FHLBank's progress in remediating specific remedial actions. The Deputy Director said that DBR has not needed to use interim milestones because, generally, completion of all specified remedial actions by FHLBanks has been timely. While he remarked that DBR could include interim milestones in a remedial plan, he was not aware of any instances in which it had done so.

DBR Examiners Do Not "Check and Document" Remedial Progress during the Remediation Period Between Annual On-Site Examinations

In interviews with a number of DBR officials, they advised that DBR examiners are not required by DBR to periodically review an FHLBank's implementation of the corrective actions detailed in a remedial plan prepared by DBR between the date of issuance of an MRA and DBR's next scheduled annual on-site examination of the FHLBank. According to the Deputy Director, DBR expects its examiners to assess the adequacy and timeliness of an FHLBank's remediation of an MRA during the next scheduled annual examination. In the view of the Deputy Director of DBR, interim testing of the FHLBanks' progress in completing the assigned corrective actions of an FHLBank would be atypical for several reasons: the nature, organization, and staffing of DBR's supervision program is unsuited to it; and DBR has not experienced problems with the timeliness and adequacy of remediation by the FHLBanks. While the Deputy Director remarked that DBR could undertake interim testing of an FHLBank's remediation of an especially egregious MRA, he acknowledged that this possibility is hypothetical.

DBR officials reported to us that EICs speak with FHLBank officials between annual examinations and that these conversations may include the progress of MRA remediation. Additionally, associate directors and EICs conduct mid-point, on-site visits at each FHLBank; in roughly two days, DBR and FHLBank officials discuss a range of issues, including the status of MRA remediation. DBR officials advised us that DBR did not consider these telephonic discussions with FHLBank officials between annual examinations and mid-point on-site visits to constitute examiner assessments of the adequacy or timeliness of ongoing remediation in satisfaction of the requirements of AB 2012-01.

DBR Examiners Will Close an Existing MRA and Either Reissue It or Issue the Portions that Have Not Been Remediated, Without Consideration of Other Supervisory or Enforcement Actions

FHFA has not issued guidance that sets forth the process to be followed in determining whether examiners should close an MRA, and DBR has not issued internal written guidance on this subject.[9] We learned from the Deputy Director of DBR and DBR managers that it is not uncommon for DBR examiners to conclude, during a subsequent annual on-site examination, that the FHLBank has not completed the corrective actions specified in the remedial plan or that the actions taken are not adequate to address the deficiency. In those instances, DBR permits its examiners to close the existing MRA, reissue it in whole or in part, and extend the timetable for completion until the next annual on-site examination.

AB 2012-01 requires all examiners to "document all follow-up activities . . . to inform internal FHFA reports." We found no documentation in the materials provided to us by DBR to show that examiners consider other supervisory or enforcement actions when an FHLBank has not successfully completed all MRA remediation as of the subsequent annual on-site examination. A DBR official with whom we spoke reported that DBR did not require examination teams to document, in writing, the reasons for any decision to reissue an MRA without considering other supervisory or enforcement action.

REVIEW OF DBR'S OVERSIGHT OF THE FHLBANKS' REMEDIATION OF NINE MRAS

We assessed DBR's oversight of MRA remediation by comparing a random sample of the documentation for nine MRAs issued to FHLBanks during the period January 2014 through September 2015 with the requirements in AB 2012-01. For these nine MRAs, we found that DBR examiners followed unwritten procedures and practices that were inconsistent with AB 2012-01, which confirmed the views of the Deputy Director of DBR.

Based on this analysis, we found that DBR's deviation from the requirements set forth in AB 2012-01 constrains its ability to ensure that MRAs—"the most serious of supervisory matters"—are remediated promptly. As we discuss below, DBR did not "check and document" remedial progress for any of the nine MRAs in our sample during the remediation period and first reviewed the adequacy and timeliness of MRA remediation at the subsequent

[9] DBR officials reported to us that DBR will permit an EIC and examination team to rely on any testing performed by the internal audit function of an FHLBank as part of an assessment whether the corrective actions are adequate and timely. DBR asserts, however, that it would only permit such reliance if the EIC and examination team deemed the work of the FHLBank's internal audit function adequate.

annual on-site examination. For four of the nine MRAs in our sample, DBR concluded that the FHLBank had not completed the remedial actions in whole or in part, one year or more after they were issued. If DBR examiners had engaged in follow-up of MRA remediation during the remediation period as required by AB 2012-01, then the FHLBanks' inadequate remediation could have been identified earlier and actions taken to jump-start the necessary corrections.

Instead, DBR's examiners determined to close each of the four MRAs and reissue them, in whole or in part, with new completion dates, and disregarded the directive in AB 2012-01 to document their consideration of supervisory or enforcement actions when milestones in a remediation plan were missed or progress was not made. In effect, DBR's decision to reissue four new MRAs with new completion dates nearly two years after the MRAs first issued serves to reward, and not hold accountable, the management of the affected FHLBanks for their failure to correct the deficiencies for which the MRAs were issued.

DBR, Not the Affected FHLBank, Prepared the Written Remediation Plan for Each of the Nine MRAs in our Sample

As we discussed earlier, AB 2012-01 requires that "[c]orrective action for MRAs must be articulated in written remediation plans, prepared by the regulated entity, acceptable to the FHFA." We were advised by DBR officials that DBR prepares findings memoranda, which contain the remediation plan and completion date for the remediation, and that the FHLBanks do not prepare written remediation plans for DBR to review. For each of the nine MRAs in our sample, DBR examiners, instead of the FHLBanks, prepared a findings memorandum that identified the deficiency giving rise to the MRA, the remedial actions to be taken to correct it, and the completion date for the remediation.

AB 2012-01 directs that "specific milestones within remediation plans should reflect the seriousness of the MRA, taking into consideration the complexity of the issue, and the urgency regarding correction." DBR reported to us that it affords its examiners considerable discretion to set MRA final completion dates. One associate director advised that he would typically establish a remediation period of 60-120 days for an FHLBank to draft a new policy or procedure; another associate director reported that his general rule was to set the remediation period to end at some point during the quarter before the next scheduled examination so as to provide the affected FHLBank with sufficient time to complete the remedial action. The remediation plan for each of the nine MRAs in our sample required the FHLBanks to establish a new policy or procedure or to amend an existing policy or procedure. Two of the remediation dates fell within the quarter in which the affected FHLBank's next annual on-site examination was scheduled to begin, three fell within the quarter before the next annual on-site examination, and the remainder fell within the first two quarters after the MRA issued.

Even with the lengthy remediation periods provided for five of the nine MRAs, four of the nine were not adequately corrected by the time of the subsequent annual on-site examination so the affected FHLBanks were provided with a second year in which to attempt to remediate the deficiency.

None of the Remedial Plans for the Nine MRAs in our Sample Contained Specific Interim Milestones

Because FHFA directs that MRAs should only issue for "the most serious supervisory matters," AB 2012-01 contemplates that each remediation plan will include "specific milestones" that "reflect the seriousness of the MRA, taking into consideration the complexity of the issue, and the urgency regarding correction." DBR officials reported to us that DBR only identifies the completion date for the specified remediation in the remedial plans.[10] According to the Deputy Director of DBR and the relevant EICs, the nine written remediation plans in our sample contained only "final" dates by which the affected FHLBanks were expected to have completed their assigned remedial actions. According to the Deputy Director of DBR, DBR has not needed to use interim milestones because, in general, the FHLBanks have timely and adequately corrected the deficiencies underlying the MRAs issued to them. None of the remediation plans for the nine MRAs in our sample contained interim milestones.

DBR Examiners Did Not "Check and Document Progress" during the Remediation Period for the Nine MRAs in our Sample

As we reported earlier, DBR officials advised us that DBR examiners typically do not independently assess remediation progress between examinations. For three of the nine MRAs in our sample, documents provided to us by DBR showed that a mid-point meeting was conducted for each of the affected FHLBanks but that DBR examiners did not "check and document" progress of the FHLBank's remediation efforts at that meeting. Apart from the DBR memoranda memorializing that a mid-point meeting occurred, we found no documentation to reflect that DBR examiners independently assessed or documented the FHLBank's progress in remediating the MRA.

As discussed earlier, the Deputy Director of DBR explained to us that DBR has not needed to check and document the affected FHLBanks' progress in its remediation activities for two reasons: the nature, organization, and staffing of DBR's supervision program is unsuited to it; and DBR has not experienced problems with the timeliness and adequacy of remediation by

[10] DBR officials said that the FHLBanks may establish their own internal plans and interim milestones for implementing the requirements in the findings memoranda. DBR does not generally assess the FHLBanks' internal plans and milestones.

the FHLBanks. In our small sample of nine MRAs, DBR did not "check and document" remedial progress by any of the affected FHLBanks during the period between annual examinations. Of these nine MRAs, DBR itself determined at the subsequent annual on-site examination that the FHLBanks failed to timely and adequately remediate four of the nine (44%) MRAs in our sample. DBR's decision not to "check and document" remedial progress during the period rendered DBR unable to identify the lack of compliance with the MRA remediation plans for these four MRAs at an earlier juncture.

DBR Examiners Did Not Appear to Consider "Other Supervisory Actions" when They Found that an FHLBank Had Not Made Progress Toward Remediating the Deficiencies Underlying the MRA

When DBR imposes an MRA during an annual on-site examination, it seeks to determine during the following annual on-site examination whether the completion deadline in the remediation plan has been met and whether the remediation adequately corrects the underlying deficiency. For each of the nine MRAs in our sample, we found that DBR examiners obtained documents from the affected FHLBank and spoke with FHLBank officials during the on-site portion of the examination and tested, as appropriate. In our view, the DBR examiners made independent assessments of the adequacy and timeliness of the FHLBanks' remediation actions in each of the nine MRAs in our sample. For five of the nine MRAs, DBR examiners concluded that the remediation was timely and corrected the underlying deficiencies, and closed each of them.

For the remaining four MRAs, DBR examiners independently determined that the FHLBanks had not successfully completed all or some portion of the required remedial action. AB 2012-01 counsels that where "progress toward remediation is not being made and/or milestones are missed, other supervisory action should be considered." Here, DBR examiners closed each of the four MRAs and either reissued new MRAs or reissued the portion of the MRA that had not been remediated, with remediation completion dates, on average, being 22 months from the date of the original MRA. DBR reissued two of the four MRAs because the examiners determined that the affected FHLBanks largely failed to correct the deficiencies underlying each MRA. DBR reissued a portion of the remaining two MRAs because the examiners found that the affected FHLBanks had not fully implemented the remedial actions specified in the findings memoranda.

AB 2012-01 requires all examiners to "document all follow-up activities … to inform internal FHFA management reports." Documents provided to us by DBR explain the examiners' reasons for determining that the deficiencies underlying the four MRAs had not been corrected by the final dates specified in the remediation plans. However, none of these documents contained a discussion of the examiners' reasons for electing to close the existing

MRAs, reissue them in whole or in part, and extend the deadlines for completing them instead of considering alternative supervisory or enforcement actions.

CONCLUSION

FHFA's AB 2012-01 sets forth activities that its examiners are expected to undertake to oversee efforts by a regulated entity to remediate an MRA. Based on our assessment of DBR's oversight of remedial efforts for the nine MRAs in our sample, we found that the unwritten procedures and practices of DBR examiners are inconsistent with the requirements of this AB.

- For each of the nine MRAs, DBR, not the affected FHLBank, prepared the written remediation plan in which DBR identifies the corrective action(s) that the FHLBank must take;
- Because DBR determined that FHLBanks generally meet DBR's established completion dates for MRA remediation with adequate corrective action, DBR typically does not include interim milestones in its remedial plans; none of the remediation plans for the nine MRAs in our sample contained interim milestones. However, four of the nine MRAs in our sample were not timely and adequately remediated;
- DBR does not expect its examiners to "check and document" the progress of MRA remediation during the remedial period and no interim follow-up was conducted for any of the nine MRAs in our sample;
- When DBR issues an MRA to an FHLBank, its examiners assess, during the subsequent annual on-site examination of an FHLBank, whether the MRA has been adequately and timely remediated. Such independent assessments were performed for each of the nine MRAs in our sample. DBR examiners determined that four of these MRAs had not been adequately or timely remediated. Notwithstanding the directive in AB 2012-01 that MRAs must be remediated promptly, DBR's examiners elected to close and reissue each of the four MRAs in whole or in part and established completion dates that were on average 22 months from the date of the original MRAs. The examiners did not document their bases for closing and reissuing these MRAs in whole or in part rather than considering alternative supervisory or enforcement actions.

OBJECTIVE, SCOPE, AND METHODOLOGY .....

The objective of this special project was to assess DBR's oversight of the FHLBanks' efforts to remediate MRAs and other findings.

To meet our objective, we first compared DBR's findings on remediation oversight processes and practices to AB 2012-01 and DER's internal policies and practices. We reviewed relevant Agency guidance and met with senior DBR officials and EICs.

Next, we assessed DBR's implementation of its stated policies and practices for overseeing the FHLBanks' findings for remediation efforts. To do so, we obtained from FHFA the population of 178 findings issued during the completed annual examinations of each of the FHLBanks from January 1, 2014, through September 30, 2015. We selected a random—but statistically non-representative—sample of 36 findings from the population.[11] We excluded from the sample 16 findings that were classified as open, since DBR examiners had not yet determined whether the FHLBank appropriately remediated these findings. Accordingly, our final sample was comprised of 20 closed findings of which nine were MRAs.

We requested from DBR the underlying work paper documentation supporting each of the 20 closed findings in our sample. We focused our analysis and work paper review on the nine MRAs in the sample since AB 2012-01 identifies MRAs as the most serious supervisory deficiencies that may be identified at FHFA's regulated entities. We reviewed the documentary record for the nine MRAs to determine if DBR complied with its stated policies and practices and AB 2012-01.

We conducted our special project during the period April 2016 to September 2016 under the authority of the Inspector General Act of 1978, as amended and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council for the Inspectors General on Integrity and Efficiency.

We also provided a draft of this report to FHFA for its review and comment. FHFA provided technical comments on the draft report which were incorporated as appropriate. FHFA's response to this report is reproduced in its entirety in Appendix A.

[11] The population of 178 records is statistically small. A statistically representative sample would require almost all 178 records to be tested. Although our test results cannot be projected to the population, the randomness of the sampling allows for the collection of unbiased, evidential material that may be used to assess the controls for the population.

APPENDIX A .....

FHFA's Management Response

Federal Housing Finance Agency

MEMORANDUM

TO: Richard Parker, Deputy Inspector General for Compliance and Special Projects

FROM: Fred Graham, Deputy Director, Division of FHLBank Regulation

SUBJECT: Compliance Report: DBR's Unwritten Procedures and Practices for Oversight of Efforts by Federal Home Loan Banks to Correct Deficiencies Underlying the Most Serious Supervisory Matters Are Inconsistent with the Written Oversight Requirements Promulgated by FHFA

DATE: September 28, 2016

We thank the OIG for its review of DBR's process for establishing necessary actions by the FHLBanks to remediate MRAs. We agree that our practices and guidance could be better aligned and will work to make them conform to one another.

In providing guidance to FHLBanks to correct deficiencies cited in MRAs, DBR examination staff establish remediation requirements to address the root causes of the deficiencies and an expected completion date for those requirements. The Banks in turn develop internal plans to implement remediation prior to the agreed upon completion date. Those plans will generally have interim milestones that serve as a guide to management in executing the necessary actions. DBR expects the FHLBanks to make progress during the remediation period and to inform examination staff if they (the FHLBanks) miss significant milestones. We believe this approach to be in keeping with the spirit of our guidance.

The OIG also raises concerns about DBR's practice of closing and reissuing MRAs that a Bank has not completely resolved. In addition to aligning our methods and guidance, we will review our practices related to closing and reissuing MRAs.

We appreciate OIG's careful review of our processes.

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