Statement for the Record from
Federal Housing Finance Agency Inspector General Steve A. Linick
Hearing on "Oversight of the Federal Housing Finance Agency"
House Subcommittee on Oversight and Investigations
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Thank you, Chairman Neugebauer and Ranking Member Capuano, for inviting me to submit a statement for the Record. I appreciate the opportunity to summarize the work and findings of the Federal Housing Finance Agency Office of Inspector General (FHFA-OIG) to date.

As you know, I am the Agency's first Inspector General and my office began operations following my swearing in on October 12, 2010. Over the past fourteen months, we have made great strides in hiring a professional staff and getting the organization up and running. We have published 10 reports and have commenced 48 criminal or civil investigations. Just this week, we issued our second Semiannual Report to Congress.[1]

FHFA-OIG oversees FHFA's operations and programs. This oversight includes the Agency's regulation of the 12 Federal Home Loan Banks, Fannie Mae, and Freddie Mac and the GSEs' approximately 12,000 employees, as well as the conservatorships of Fannie Mae and Freddie Mac, which own or guarantee $5 trillion in mortgage assets and have received $183 billion in taxpayer money. In addition to promoting the economy, efficiency, and effectiveness of FHFA's operations, FHFA-OIG works to prevent and investigates fraud involving FHFA, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

In carrying out its mission, FHFA-OIG conducts, supervises, and coordinates audits, investigations, and other activities relating to the programs and operations of FHFA. An important facet of FHFA-OIG's mission is promoting transparency in FHFA's program administration and oversight of GSE operations, as well as public understanding of matters affecting FHFA, the GSEs, and housing policy.

Emerging Trends

Our reports have revealed a number of emerging trends. They credit FHFA's work in several areas, both as regulator of the GSEs and conservator of Fannie Mae and Freddie Mac (the Enterprises). For example, FHFA-OIG has found:

- FHFA has eliminated golden parachute compensation awards to terminated Fannie Mae and Freddie Mac executives;
- FHFA has taken steps to mitigate its shortage of qualified examiners;

[1] Available at http://www.fhfaoig.gov/Content/Files/second%20semiannual%20report.pdf.

- FHFA has taken steps that may improve Enterprise repurchase claims recoveries, thereby reducing Enterprise losses; and
- FHFA has positively responded to FHFA-OIG's recommendations to improve FHFA's effectiveness and efficiency and to reduce its vulnerability to fraud, waste, and abuse.

On the other hand, FHFA-OIG also has identified deficiencies in FHFA operations, and these deficiencies appear to reflect two significant and related trends. First, FHFA often relied on determinations of the Enterprises without independently testing and validating them, thereby giving undue deference to Enterprise decision-making. Second, FHFA's allocation of resources may have affected its ability to oversee the Enterprises and enforce its directives. As detailed below, both trends have emerged in a number of our reports.

I. FHFA Has Not Independently Tested and Validated Enterprise Decision-Making

In four reports, FHFA-OIG identified significant instances in which FHFA has displayed undue deference to Enterprise decision-making. Without adequately testing or validating data, FHFA has deferred to the Enterprises regarding: (1) Freddie Mac's assessment of mortgage repurchase claim issues involving Bank of America; (2) the Enterprises' participation in the Making Home Affordable programs (MHA); (3) the Enterprises' decisions regarding executive compensation; and (4) numerous transactions of the Enterprises.

The Agency's actions in each case reflect its approach as conservator to delegate most business decisions to the Enterprises. In each case, it relied upon review and corporate governance processes already in place at the Enterprises. However, FHFA-OIG concluded that some matters are sufficiently important to warrant greater involvement and scrutiny by the Agency.

a. FHFA Deferred to Freddie Mac's Analysis of Repurchase Claim Exposure

At the end of 2010, FHFA approved a $1.35 billion settlement of mortgage repurchase claims Freddie Mac asserted against Bank of America. In approving the settlement, FHFA relied on Freddie Mac's analysis of the settlement without testing the assumptions underlying the Enterprise's existing loan review process. An FHFA-OIG report found that FHFA did not act timely or test concerns raised by an FHFA senior examiner about limitations in Freddie Mac's existing loan review process for mortgage repurchase claims. The senior examiner was concerned that the loan review process Freddie Mac used for repurchase claims failed to account adequately for changes in foreclosure patterns among loans originated during the housing boom. According to the senior examiner, this could potentially cost the Enterprise a considerable amount of money.[2]

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[2] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-006.pdf.

b. FHFA Provided Limited Oversight of the Enterprises' Administration of the Home Affordable Modification Program

The Department of the Treasury (Treasury) initiated the MHA programs. A key initiative of MHA is the Home Affordable Modification Program (HAMP), which involves servicers agreeing to modify mortgages for borrowers facing default or foreclosure. In early 2009, the Enterprises began participating in HAMP. They started modifying mortgages in their portfolios and entered into five-year agreements with Treasury to manage the program and oversee participants' compliance with program requirements. An FHFA-OIG report found that FHFA largely removed itself from overseeing the negotiations of the five-year agreements. FHFA believed its appropriate role was to ensure the Enterprises were legally authorized to administer HAMP, not to participate actively in negotiations between the Enterprises and Treasury. Thus, FHFA did not engage in any formal substantive review to evaluate the agreements' feasibility, risks, or the suitability of the Enterprises to serve as Treasury's financial agents. This lack of engagement may have contributed to the agreements' omission of significant details concerning payments to the Enterprises, the scope of their responsibilities, and processes to resolve differences. As a consequence of the omissions, significant problems developed in these areas almost from the beginning, requiring FHFA and the Enterprises to devote substantial time and resources to resolve ambiguities.[3]

c. FHFA Did Not Fully Analyze Factors Related to Executive Compensation at Fannie Mae and Freddie Mac

For 2009 and 2010, the Enterprises awarded their top six officers over $35 million in compensation. FHFA reviewed and approved these compensation awards based on the Enterprises' determinations and recommendations. However, an FHFA-OIG report found that FHFA did not independently test or validate the means by which the Enterprises calculated their recommended compensation levels and did not consider factors that might have resulted in reduced executive compensation costs. These factors included the lower levels of compensation paid to senior officials at federal agencies supporting the housing market and whether compensation awards should be discounted to reflect the significant level of federal financial support provided to the Enterprises.[4]

d. FHFA Does Not Perform Sufficient Transaction Testing of Enterprise Activities

Transaction testing is the method employed by financial institution examiners to arrive at independent impressions about the financial and operational conditions of an institution, as well

[3] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-003.pdf.
[4] Available at
http://www.fhfaoig.gov/Content/Files/Exec%20Comp%20DrRpt%2003302011%20final,%20signed.pdf.

as its compliance with applicable laws and regulations. An example of transaction testing would be reviewing a regulated entity's loan files to test the veracity of statements concerning loan underwriting and performance. During an evaluation of FHFA's capacity to examine the GSEs, a senior FHFA manager acknowledged to FHFA-OIG that examiners too often accept assertions made by Enterprise managers rather than validate such assertions through appropriate transaction testing.[5]

II. FHFA's Resource Allocations May Have Affected Its Ability to Oversee the GSEs and Enforce Its Directives

In four reports, FHFA-OIG identified instances in which FHFA's resource allocations may have affected its ability to oversee the GSEs and enforce its directives. For example, FHFA may have too few examiners to meet its oversight responsibilities. In addition, FHFA may not have assigned sufficient priority and resources to handle consumer complaints or address new and emerging risks that may impact the GSEs. Additionally, FHFA-OIG found that FHFA (along with its predecessor agency, the Office of Federal Housing Enterprise Oversight (OFHEO)) has permitted five years of compliance delays by Fannie Mae, which has been under directives to implement an effective operational risk management program.

a. FHFA May Not Have Enough Examiners to Meet Its Regulatory and Conservatorship Oversight Responsibilities

FHFA has critical regulatory responsibilities with respect to the GSEs and conservator responsibilities regarding the Enterprises. To satisfy these responsibilities, Congress provided FHFA significant budget and hiring authority. Nonetheless, an FHFA-OIG report noted that FHFA-OIG had previously found shortfalls in the Agency's examination coverage, and this finding was corroborated by statements of senior FHFA officials. Internal Agency reviews also corroborated that FHFA has too few examiners to ensure the efficiency and effectiveness of its examination program. Additionally, only 34% of the Agency's line examiners are accredited federal financial examiners. FHFA has taken steps to mitigate its shortage of qualified examiners, but it needs to move quickly and aggressively in this area. Last winter, for example, the Acting Director announced and implemented a substantial restructuring of FHFA's supervision units and reassigned numerous staff. These steps, which also include plans to add examination staff and implement an examiner accreditation program, are designed to enhance FHFA's supervision program. Further, although FHFA's near-term plans include hiring up to 44 additional staff in the supervision divisions, FHFA-OIG concluded that there is substantial uncertainty as to whether this number of additional examiners will enable FHFA to overcome its

[5] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf.

examination capacity shortfalls and ensure the success of the Agency's 2011 reorganization of its examination structure.[6]

b. FHFA Did Not Allocate Sufficient Resources to Handle Consumer Complaints

Due in part to deteriorating financial conditions in the housing market, FHFA and OFHEO experienced a substantial increase in consumer complaints about the Enterprises. A number of these complaints contained important information about alleged foreclosure processing abuses and fraud. However, an FHFA-OIG report found that FHFA did not adequately process consumer complaints. This deficiency occurred because FHFA did not establish sound internal controls and did not assign sufficient priority and resources to complaint processing. For example, FHFA-OIG found that FHFA assigned only two employees – on a part-time basis – to handle consumer complaints.[7]

c. FHFA Did Not Identify and Address New and Emerging Risks Potentially Impacting the GSEs

FHFA did not begin to schedule comprehensive examination coverage of foreclosure issues, including allegations of abuse by its default-related legal services vendors, until after news stories about alleged abuses surfaced in mid-2010. FHFA had not previously considered risks associated with foreclosure processing to be significant. However, an FHFA-OIG report found that there were multiple indications of foreclosure issues prior to mid-2010 that could have led FHFA to foresee the heightened risk in foreclosure processing abuses. These indications included significant increases in the volume of foreclosures (which accompanied the collapse of the housing market), rising consumer complaints alleging improper foreclosures, contemporaneous media reports about foreclosure abuses by the Enterprises' law firms, and public court filings highlighting such abuses.[8]

d. FHFA Has Not Enforced Directives Regarding Fannie Mae's Operational Risk Program

Between 2006 and 2011, FHFA and OFHEO repeatedly found that Fannie Mae had failed to establish an acceptable and effective operational risk management program despite outstanding Agency requirements to do so. FHFA possesses broad authority to enforce its directives. However, an FHFA-OIG report found that FHFA did not take decisive action to compel Fannie Mae's compliance.[9]

[6] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-005.pdf.
[7] Available at http://www.fhfaoig.gov/Content/Files/AUD-2011-001.pdf.
[8] Available at http://www.fhfaoig.gov/Content/Files/AUD-2011-004.pdf.
[9] Available at http://www.fhfaoig.gov/Content/Files/EVL-2011-004.pdf.

OIG Operations

In addition to monitoring and reporting on FHFA's progress implementing report recommendations, FHFA-OIG will continue to release new audits and evaluations covering key areas. FHFA-OIG maintains a detailed Audit, Evaluation, and Survey Plan that focuses strategically on the areas of FHFA's operations posing the greatest risks and providing the greatest potential benefits to FHFA, Congress, and the public. Originally developed with input from an independent, third-party risk assessment, the Audit, Evaluation, and Survey Plan reflects continuous feedback from FHFA-OIG's reviews of current events and comments from FHFA officials, members of Congress, and others. Broadly, FHFA-OIG's audit and evaluation strategies include reviews of the following FHFA activities:

- Regulatory efforts and its management of the Enterprise conservatorships. This is a particularly high-risk area because Treasury has invested $183 billion of taxpayer funds in the Enterprises. As conservator, FHFA must regulate and oversee the Enterprises in an efficient, effective, and transparent manner so as to minimize taxpayer costs, conserve Enterprise resources, and meet all statutory mandates.

- Oversight of the Federal Home Loan Banks and their associated risks, including investment portfolio management and concentrations, credit underwriting, and administration.

- Internal operations, such as privacy and allegations of fraud, waste, or abuse.

The Audit, Evaluation, and Survey Plan identifies a number of other ongoing and planned reviews of specific FHFA programs.

As a further part of our mandate to combat fraud, waste, and abuse, FHFA-OIG operates an active Office of Investigations that has made significant contributions to a range of mortgage-related investigations. While many of them remain confidential, FHFA-OIG and its law enforcement partners, which include federal agencies, U.S. Attorneys' Offices, and state and local entities nationwide, have released details about several high-profile mortgage fraud investigations involving Colonial Bank and Taylor, Bean & Whitaker Mortgage Corporation, Marshall Home and Margaret Broderick, and Home Owners Protection Economics, Inc.

The Office of Investigations also operates the FHFA-OIG Hotline, which allows concerned parties to report information directly and in confidence regarding possible fraud, waste, or abuse related to FHFA or the GSEs. FHFA-OIG honors all applicable whistleblower protections. Should you or your constituents wish to report any allegations of fraud, waste, or abuse, the

Hotline can be reached at 1-800-793-7724, by fax at 202-408-2972, or through our website at www.fhfaoig.gov.

My staff and I look forward to continuing to work with you and the subcommittee to provide independent and objective assessments of the work of FHFA. The continuing fragility of the nation's housing market remains a significant source of ongoing concern. Further, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks continue to be key market participants, and FHFA continues to face significant challenges. We are hopeful that our findings and recommendations will be of assistance in meeting those challenges.