

Annual Report of the Council of Inspectors General on Financial Oversight



AUGUST 2015

Message from the Chair

Five years after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Financial Stability Oversight Council (FSOC) is implementing and administering it to ensure U.S. financial system stability. At the same time, the Council of Inspectors General on Financial Oversight (CIGFO) is sharing information on financial oversight, monitoring FSOC activities and conducting audits.

In keeping with its mission, during the course of the past year, CIGFO members continued to share information about regulatory and supervisory activities impacting the broader financial system. As a result of these discussions CIGFO members were able to draw on expertise that provided them with more knowledge and insight about specific issues that could impact their current or future work. For example, the Inspectors General discussed the status of the Federal Deposit Insurance Corporation's implementation of the Dodd-Frank Act resolution authorities, the Office of Financial Research's collection and dissemination of data for FSOC financial system monitoring purposes, mortgage fraud, and other important issues.

In addition to the CIGFO's oversight and monitoring activities, it has, since 2011, established working groups that are comprised of auditors from each of the various CIGFO member Inspector General offices to conduct audits of FSOC operations--CIGFO relies on these volunteers to fulfill its mission. To date, it has issued four audits.

In 2014, the CIGFO unanimously approved a working group proposal, developed and offered by the Federal Housing Finance Agency Inspector General, to audit FSOC's oversight of Interest Rate Risk. Since mid-2013, the FSOC has voiced concerns about financial institutions' response to a long period of low interest rates by pointing out the impact sharp increases in rates could have on current leveraged lending practices, as well as continued reach for higher yields. As a result, in both its 2013 and 2014 Annual Report, FSOC recommended that regulators and the private sector continue to monitor and assess interest rate risk. The CIGFO Audit Working Group determined that FSOC monitors interest rate risk on an ongoing basis by facilitating the sharing of financial expertise and information among FSOC members and member agencies and by making annual report recommendations. Furthermore, it recommends that FSOC publicly document its rationale for removing prior year recommendations related to interest rate risk in its annual reports to Congress.

In the coming year, CIGFO members will continue, through their individual and joint work, to help strengthen oversight of the financial system by the FSOC and its Federal member agencies.

/s/

Eric M. Thorson
Chair, Council of Inspectors General on Financial Oversight
Inspector General, Department of the Treasury

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The Council of Inspectors General on Financial Oversight

The Council of Inspectors General on Financial Oversight (CIGFO) was established by the Dodd-Frank Act, and meets on a quarterly basis to facilitate the sharing of information among Inspectors General. The CIGFO members discuss the ongoing work of each Inspector General who is a member of the Council, with a focus on concerns that may apply to the broader financial sector, and talk about ways to improve financial oversight. The CIGFO publishes an annual report that includes separate sections within the exclusive editorial control of each Inspector General. Those sections describe the concerns and recommendations of each Inspector General and a discussion of ongoing and completed work.

During the course of the year, the CIGFO continued to monitor coordination efforts among and between Financial Stability Oversight Council (FSOC) members. Specifically, CIGFO members discussed the following:

- FSOC's implementation of CIGFO audit recommendations
- The Federal Deposit Insurance Corporation's (FDIC) implementation of the Dodd-Frank Act resolution authorities
- FSOC's implementation of its transparency policy
- FSOC's modifications to its procedures for designation of nonbank financial companies

The general belief of the CIGFO is that the FSOC's implementation of the Dodd-Frank Act continues to progress. The CIGFO continues to believe that more should be done to institutionalize the FSOC processes and procedures to ensure the law is applied in a fair, transparent, and consistent manner.

Joint Inspector General Oversight Projects

In addition to conducting CIGFO working group audits, CIGFO members work together on joint projects, which are an effective means of leveraging various Office of Inspector General (OIG) resources. During the past year, Inspectors General collaborated on one review. That work is discussed below.

Enforcement Actions Against Institution-Affiliated Parties and Professional Liability Claims Against Individuals and Entities Associated with Failed Institutions

The federal banking regulators have strong enforcement powers under section 8 of the Federal Deposit Insurance Act to address violations of law, breaches of fiduciary duty, or unsafe and unsound practices. The financial crisis had a profound and lasting impact on the banking industry and broader economy, resulting in the failure of 465 insured depository institutions (or institutions) over the 5-year period from 2008-2012 and losses totaling \$86.6 billion to the Deposit Insurance Fund. In the wake of the crisis, members of the Congress, the media, and the general public have questioned whether the regulators sufficiently used these powers to hold accountable those individuals whose actions harmed institutions.

The OIGs of the FDIC, U.S. Department of the Treasury, and the Board of Governors of the Federal Reserve System (FRB)/Consumer Financial Protection Bureau conducted a joint evaluation of (1) the regulators' efforts to investigate, pursue, and impose enforcement actions (EAs) against institution-affiliated parties (IAPs) and (2) the FDIC's efforts to pursue professional liability claims (PLCs) against individuals and entities whose actions harmed institutions that ultimately failed. The evaluation focused on the 465 institution failures that occurred during the 5 year period from 2008-2012. These institutions were regulated by the FDIC, FRB, the Office of the Comptroller of the Currency (OCC), and the former Office of Thrift Supervision.

EAs against IAPs include removal/prohibition orders, civil money penalties, administrative restitution, and personal cease and desist orders. Removal/prohibition orders are the most severe actions and prohibit an IAP from participating in the affairs of any insured depository institution for life. Accordingly, the statutory criteria for sustaining a removal/prohibition order are rigorous and the regulators must prove three grounds: misconduct, effect of the misconduct, and culpability for the misconduct. To prove culpability, the regulators must show that the IAP exhibited personal dishonesty or a willful or continuing disregard for the safety or soundness of an institution. Proving willful or continuing disregard is particularly difficult, according to the regulators.

The regulators each have similar, formal processes to investigate and impose EAs on IAPs whose actions harmed institutions. These processes generally include an investigative period, agency review, an opportunity for the IAP to consent to the action, and a Notice of Charges if the IAP does not consent. A Notice of Charges triggers a review by an Administrative Law Judge, followed by an agency decision, and potentially an IAP appeals process.

The regulators issued a total of 275 EAs against individuals associated with 87 failed institutions, or 19 percent of the 465 institutions that failed. The majority of these EAs were imposed against institution directors and officers. As of September 30, 2013, potential EAs against IAPs were in-process related to an additional 59 failed institutions. These EAs will ultimately be closed-out or imposed. Of the total 275 EAs imposed, 128

were removal/prohibition orders against IAPs associated with 75 institutions (16 percent of the 465 failed institutions). The joint report notes that this is an increase over the banking crisis of the 1980s and early 1990s where the regulators imposed removal/prohibition orders against IAPs associated with about 6 percent of the institutions that failed from 1985 through 1995.

The Inspectors General determined that several factors appeared to impact the regulators' ability to pursue EAs against IAPs. Those factors included the rigorous statutory criteria for sustaining removal/prohibition orders; the extent to which each regulator was willing to use certain EA tools, such as personal cease and desist orders; the regulators' risk appetite for bringing EAs; EA statutes of limitation; and staff resources, among other things. In connection with these factors, the Inspectors General made recommendations related to evaluating approaches and developing methodologies to support issuing EAs against IAPs where the regulators can show that IAPs exhibited a willful or continuing disregard for safety or soundness and, also, increasing the use of personal cease and desist orders.

As for PLCs, the purpose of the professional liability program is to hold accountable directors, officers, and other professionals who caused losses to failed institutions. When an institution fails, the FDIC, as Receiver, acquires legal rights, powers, titles, and privileges, which include PLCs. The FDIC's Professional Liability Unit investigates 11 claim areas for each institution failure, regardless of the primary federal regulator, and pursues claims that are both meritorious and expected to be cost-effective. For a PLC to have merit, the FDIC must meet the burden of proof required by the federal or state law that applies to the claim. For a typical tort claim, the FDIC generally must show that the subject individual or entity owed a duty to the institution, breached that duty, and the breach caused a loss to the institution. According to FDIC officials, the threshold for misconduct to sustain a PLC can be lower than that for a removal/prohibition order. To collect on these claims, the FDIC as Receiver typically must sue the individuals or entities for losses resulting from their breaches of duty to the failed institution. Recovery sources include liability insurance policies, fidelity bond insurance policies, and the assets of the individuals or entities pursued.

The FDIC has a formal process for investigating and pursuing PLCs. In that regard, the FDIC completed¹ 430 PLCs and had an additional 305 pending a final result based on litigation or negotiation as of September 30, 2013. In total, the 735 completed and pending PLCs were associated with 193 of the 465 failed institutions (42 percent). Of these 735 completed and pending PLCs, 162 pertained to directors and officers associated with 154 of the 465 failed institutions (33 percent). During the banking crisis of the 1980s and early 1990s, the FDIC brought claims against directors and officers in 24 percent of the failed institutions.

A key factor impacting the pursuit of PLCs was an increasing number of insurance policy exclusions that became prevalent in this financial crisis, which excluded or attempted to exclude coverage for claims made by the FDIC. Other factors include applicable federal or state law standards in support of meritorious claims, limited recovery resources, and a court decision pertaining to another agency that resulted in the FDIC limiting its use of tolling agreements to extend the statutes of limitation on PLCs. The Inspectors General recommended that the FDIC research ways to compensate for lost revenues as a result of insurance policy exclusions. The Inspectors General also recommended that the OCC and FRB inform their regulated institutions about the risks related to insurance policy exclusions. Finally, the joint report included a

¹ Completed PLCs comprised settlements and court judgments to pay the FDIC and cases dismissed by the courts. Of the 430 completed PLCs, 379 resulted from settlements, 32 resulted from court judgments, and 19 were dismissed.

recommendation that with respect to tracking and reporting PLC expense and recovery information, the FDIC should take steps to provide more institution-specific information to members of its Board of Directors.

The joint report was issued to the Chairman of the FDIC, Chair of the Board of Governors of the Federal Reserve System, and Comptroller of the Currency. In their responses, these officials agreed with all recommendations and committed to take responsive actions to address OIG findings.

Council of Inspectors General on Financial Oversight Audits

The Dodd-Frank Act authorizes the CIGFO to convene a working group, by a majority vote, for the purpose of evaluating the effectiveness and internal operations of the FSOC.

To date, CIGFO has conducted four audits—

- 2012- Audit of the Financial Stability Oversight Council’s Controls over Non-public Information
- 2013- Audit of the Financial Stability Oversight Council’s Designation of Financial Market Utilities
- 2014- Audit of the Financial Stability Oversight Council’s Compliance with Its Transparency Policy
- 2015- Audit of the Financial Stability Oversight Council’s Monitoring of Interest Rate Risk to the Financial System

The corrective actions described by FSOC met the intent of our recommendations, and may be subject to verification in future CIGFO working group reviews.



Office of Inspector General

Board of Governors of the Federal Reserve System and Consumer Financial Protection Bureau

The Office of Inspector General provides independent oversight by conducting audits, investigations, and other reviews of the programs and operations of the Board of Governors of the Federal Reserve System and the Consumer Financial Protection Bureau and demonstrates leadership by making recommendations to improve economy, efficiency, and effectiveness, and by preventing and detecting fraud, waste, and abuse.

Background

Congress established the Office of Inspector General (OIG) as an independent oversight authority for the Board of Governors of the Federal Reserve System (Board), the government agency component of the broader Federal Reserve System, and the Consumer Financial Protection Bureau (CFPB).

Under the authority of the Inspector General Act of 1978, as amended (IG Act), the OIG conducts independent and objective audits, inspections, evaluations, investigations, and other reviews related to the programs and operations of the Board and the CFPB.

- We make recommendations to improve economy, efficiency, and effectiveness and prevent and detect fraud, waste, and abuse.
- We share our findings and made corrective action recommendations to the Board and the CFPB, but we do not have the authority to manage agency programs or implement changes.
- We keep the Board's Chair, the CFPB's Director, and Congress fully informed of our findings and corrective action recommendations, as well as the agencies' progress in implementing corrective action.

In addition to the duties set forth in the IG Act, Congress has mandated additional responsibilities for the OIG. Section 38(k) of the Federal Deposit Insurance Act (FDI Act) requires that the OIG review failed financial institutions supervised by the Board that result in a material loss to the Deposit Insurance Fund (DIF) and produce a report within six months. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended section 38(k) of the FDI Act by raising the materiality threshold and requiring the OIG to report on the results of any nonmaterial losses to the DIF that exhibit unusual circumstances warranting an in-depth review.

Section 211(f) of the Dodd-Frank Act also requires the OIG to review the Board's supervision of any covered financial company that is placed into receivership under title II of the act and produce a report that evaluates

the effectiveness of the Board's supervision, identifies any acts or omissions by the Board that contributed to or could have prevented the company's receivership status, and recommends appropriate administrative or legislative action.

The Federal Information Security Management Act of 2002 (FISMA), as amended by the Federal Information Security Modernization Act of 2014, established a legislative mandate for ensuring the effectiveness of information security controls over resources that support federal operations and assets. In a manner consistent with FISMA requirements, we perform annual independent reviews of the Board's and the CFPB's information security programs and practices, including the effectiveness of security controls and techniques for selected information systems.

OIG Reports and Other Products Related to the Broader Financial Sector

In accordance with section 989E(A)(2)(B) of the Dodd-Frank Act, the following highlights the completed and ongoing work of our office, with a focus on issues that may apply to the broader financial sector.

Completed Work

The Board Should Enhance Its Supervisory Processes as a Result of Lessons Learned From the Federal Reserve's Supervision of JPMorgan Chase & Company's Chief Investment Office, OIG Report No. 2014-SR-B-017, October 17, 2014

We completed our evaluation of the Federal Reserve's supervisory activities related to the loss at JPMorgan Chase & Company's Chief Investment Office. We found that there was a missed opportunity for the Federal Reserve Bank of New York (FRB New York) and the OCC to discuss risks related to the Chief Investment Office and consider how to deploy the agencies' collective resources most effectively. We also found that (1) Federal Reserve and OCC staff lacked a common understanding of the Federal Reserve's approach for examining Edge Act corporations, (2) FRB New York staff were not clear about the expected deliverables resulting from continuous monitoring activities, and (3) FRB New York's JPMorgan Chase & Company supervisory teams appeared to exhibit key-person dependencies. We made recommendations that encourage the Board's Division of Banking Supervision and Regulation to enhance its supervisory processes and approach to consolidated supervision for large, complex banking organizations. We released the summary version of our report in October 2014 and a redacted version of our full report in January 2015.

Opportunities Exist to Enhance the Board's Oversight of Future Complex Enforcement Actions, OIG Report No. 2014-SR-B-015, September 30, 2014

In February 2013, the Board and the Office of the Comptroller of the Currency issued amended consent orders that require mortgage servicers to provide about \$3.67 billion in payments to nearly 4.2 million borrowers based on possible harm and to provide other foreclosure prevention assistance. Our objectives for this evaluation were to (1) evaluate the Board's overall approach to oversight of the amended consent orders, (2) determine the effectiveness of the Board's oversight of the borrower slotting process, and (3) determine the effectiveness of the Board's oversight of the servicers' paying agent, Rust Consulting, Inc.

We found that the Board's advance preparation and planning efforts for the payment agreement with the 13 servicers that joined the agreement in January 2013 were not commensurate with the complexity associated with this unprecedented interagency effort. In addition, project management resources were not available to the Board's oversight team for this initiative. Further, we found that data integrity issues at two mortgage servicers impacted the reliability and consistency of the slotting results. The payment agreement required servicers to slot borrowers into categories of possible harm—with payment amounts set for each category—that were defined by Board and Office of the Comptroller of the Currency staff. The approach to resolving these data integrity issues may have resulted in borrowers who experienced similar harm receiving different payment amounts. We also determined that an approach has not been selected to end the payment agreement. Despite these challenges and limitations, as of August 15, 2014, borrowers had cashed or deposited checks representing about \$3.15 billion, or approximately 86 percent, of the total \$3.67 billion.

We made recommendations to improve the Board's oversight of future complex enforcement strategies. The Board generally agreed with our recommendations and noted the corrective actions that it has implemented or intends to implement.

The CFPB Complies With Section 1100G of the Dodd-Frank Act, but Opportunities Exist for the CFPB to Enhance Its Process, OIG Report No. 2014-SR-C-013, September 29, 2014

We conducted this evaluation to assess the CFPB's compliance with section 1100G of the Dodd-Frank Act. The Regulatory Flexibility Act, as amended, requires federal agencies to analyze the impact of their regulatory actions on small entities. Section 1100G of the Dodd-Frank Act amended some of the provisions of the Regulatory Flexibility Act, requiring the CFPB to assess the impact of any proposed rule on the cost of credit for small business entities and convene panels to seek direct input from small business entities prior to issuing certain rules. The CFPB created two interim policy and procedures documents that outline the agency's process to comply with these requirements.

Overall, we found that the CFPB complied with the provisions of section 1100G of the Dodd-Frank Act as well as the agency's two interim policies and procedures. We found, however, that the interim policies and procedures have been in use for approximately two years without being updated or finalized. We also found that the interim policies and procedures afforded teams significant discretion in their 1100G rulemaking approach to regulatory analysis, which contributed to a variance in documentation and inconsistent knowledge transfer practices. Finally, we found that the CFPB's Division of Research, Markets, and Regulation uses an inconsistent approach to storing supporting documentation related to 1100G rulemakings. After the close of our fieldwork, we were informed by CFPB officials that the division had finalized and reissued the two policy and procedures documents.

Our recommendations include that the CFPB establish a standard approach to manage electronic 1100G rulemaking supporting documents and ensure that the standard approach complies with CFPB and other applicable provisions. The CFPB concurred with our recommendations and outlined actions that have been or will be taken to address them.

Opportunities Exist to Enhance the Onsite Reviews of the Reserve Banks' Wholesale Financial Services, OIG Report No. 2014-FMIC-B-014, September 30, 2014

The Reserve Banks provide wholesale financial services to depository institutions, the U.S. government, and foreign institutions, and the Board's Division of Reserve Bank Operations and Payment Systems (RBOPS) oversees the Reserve Banks. As such, our audit assessed the extent and effectiveness of RBOPS's oversight of the Reserve Banks' wholesale financial services.

The Dodd-Frank Act broadened the Board's supervisory authority over private payment, clearing, and settlement systems designated as systemically important financial market utilities. Since the enactment of the act, RBOPS's Financial Market Infrastructure Oversight group has worked to closely align its Reserve Banks' wholesale financial services oversight processes with those applied in the supervision of designated financial market utilities.

We did not note any deficiencies regarding the efficiency and effectiveness of the Financial Market Infrastructure Oversight group's onsite review activities for wholesale financial services. We found, however, that the Financial Market Infrastructure Oversight group does not have comprehensive formal policies and procedures that guide the execution and documentation of its onsite review of wholesale financial services. In addition, we noted that a small percentage of onsite review documentation was incomplete, and we noted a few instances in which the reviewer indicated a lack of understanding of a review step. We generally did not see indications of a second-level review of this documentation.

We made a recommendation to enhance RBOPS's oversight of the Reserve Banks' wholesale financial services. RBOPS generally concurred with our recommendation and noted it has initiated efforts to augment existing procedures and, if necessary, develop new procedures that guide its onsite reviews of wholesale financial services.

The CFPB Can Enhance Its Diversity and Inclusion Efforts, OIG Report No. 2015-MO-C-002, March 4, 2015

We completed our review of the CFPB's diversity and inclusion efforts, which was conducted in response to a congressional request. Overall, our audit determined that the CFPB has taken steps to foster a diverse and inclusive workforce since it began operations in July 2011. Recent activities include elevating the Office of Minority and Women Inclusion and the Office of Equal Employment Opportunity to the Office of the Director; conducting listening sessions with employees to identify and respond to perceptions of fairness, equality, and inclusion; and creating an internal advisory council and working groups to focus on diversity and inclusion issues.

We identified four areas of the CFPB's diversity and inclusion efforts that can be enhanced. First, diversity and inclusion training is not mandatory for CFPB employees, supervisors, and senior managers. Second, data quality issues exist in the CFPB's tracking spreadsheets for equal employment opportunity (EEO) complaints and negotiated grievances, and certain data related to performance management are not analyzed for trends that could indicate potential diversity and inclusion issues. Third, the CFPB's diversity and inclusion strategic plan has not been finalized, and opportunities exist for the CFPB to strengthen supervisors' and senior managers' accountability for implementing diversity and inclusion initiatives and human resources-related policies. Finally, the CFPB would benefit from a formal succession planning process to help ensure that it

will have a sufficient and diverse pool of candidates for its senior management positions. We acknowledge that initiatives and activities that are beyond the scope of our review also contribute to enhancing diversity and inclusion. Therefore, the CFPB's ability to attract, develop, and retain a diverse and inclusive workforce is affected by other factors not specifically identified in our report.

Our report contains recommendations designed to improve the monitoring and the promotion of diversity and inclusion at the CFPB, as well as to strengthen related controls. The CFPB concurred with our recommendations and outlined planned, ongoing, and completed activities related to analyzing performance management data, performance management training, and tracking of EEO and non-EEO complaints. In addition, the CFPB developed and approved standard operating procedures to address several recommendations and has worked with its union to develop a new performance management system.

The Board Can Enhance Its Diversity and Inclusion Efforts, OIG Report No. 2015-MO-B-006, March 31, 2015

We completed our review of the Board's diversity and inclusion efforts, which was conducted in response to a congressional request. The Board has established diversity and inclusion practices that are embedded in its longstanding EEO programs. Recent activities include adopting a more standardized process for recruiting officers, developing a formal agency-wide succession planning program to help identify a diverse pool of candidates for senior management positions, and conducting an agency-wide employee survey.

We identified areas of the Board's diversity and inclusion efforts that can be enhanced. First, the Board can enhance its efforts to track and analyze certain types of workforce data that can be used to identify diversity and inclusion trends. Second, the Office of Diversity and Inclusion can increase its interaction with all Board divisions and provide diversity and inclusion and EEO training on a regular basis. Third, the Board should formalize standards for equal employment opportunity and the racial, ethnic, and gender diversity of the workforce to fully comply with section 342 of the Dodd-Frank Act. Fourth, the Board can further enhance its diversity and inclusion goals and objectives by finalizing and implementing its diversity strategic plan.

We acknowledge that initiatives and activities that are beyond the scope of our review also contribute to enhancing diversity and inclusion. Therefore, the Board's ability to attract, develop, and retain a diverse and inclusive workforce is affected by other factors not specifically identified in our report. Our report contains recommendations designed to enhance and promote diversity and inclusion at the Board. The Board concurred with our recommendations and outlined planned, ongoing, and completed activities. The Board has taken steps to improve the collection of applicant demographic data, provide non-EEO statistics, and finalize the diversity and inclusion strategic plan. In addition, the Board plans to enhance certain functions within the Office of Diversity and Inclusion.

Review of the Failure of Waccamaw Bank, OIG Report No. 2015-SR-B-005, March 26, 2015

Waccamaw Bank was supervised both by the Federal Reserve Bank of Richmond under delegated authority from the Board and by the North Carolina Office of the Commissioner of Banks. On June 8, 2012, the North Carolina Office of the Commissioner of Banks closed Waccamaw Bank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. The FDIC estimated that the failure of Waccamaw Bank would result in a \$51.1 million loss to the DIF, which was beneath the material loss threshold. Consistent with Dodd-

Frank Act requirements, we concluded that Waccamaw Bank's failure presented unusual circumstances that warranted an in-depth review.

Based on the in-depth review, we determined that Waccamaw Bank failed because its board of directors and senior management did not control the risks associated with its rapid growth strategy. As a result, the bank sustained significant losses during a downturn in its local real estate market. In addition, we learned that (1) supervisory activity records were not retained in accordance with Board policy, (2) Waccamaw Bank's written agreement did not contain a provision that required regulatory approval of material transactions, and (3) Board and Federal Reserve Bank of Richmond appeals policies were silent on procedural aspects for second-level and third-level appeals. We made recommendations related to the Board's records retention and appeals policies and procedures. The Director of the Division of Banking Supervision and Regulation agreed with our recommendations and outlined planned corrective actions to address them.

Ongoing Work

Evaluation of the Federal Reserve System's Practices for Addressing Divergent Views and Making Supervisory Decisions for Large Banking Holding Companies

In response to a request from the Board dated November 17, 2014, the OIG is conducting an evaluation of the Federal Reserve System's practices for addressing divergent views and making supervisory decisions regarding large bank holding companies. The Board requested that we initiate a review related to the manner in which the Federal Reserve System conducts examinations of bank holding companies with total assets in excess of \$50 billion, known as Large Institution Supervision Coordinating Committee (LISCC) firms and large banking organizations (LBOs). As part of our project, we also plan to evaluate the effectiveness of continuous monitoring as a supervisory tool for LISCC firms and LBOs.

Our objectives are to (1) assess the methods for Federal Reserve System decisionmakers to obtain material information necessary to ensure that decisions and conclusions resulting from supervisory activities at LISCC firms and LBOs are appropriate, supported by the record, and consistent with applicable policies; (2) determine whether there are adequate channels for Federal Reserve System decisionmakers to be aware of supervision staff's divergent views about material issues regarding LISCC firms and LBOs; and (3) assess the effectiveness of continuous monitoring as a supervisory tool for LISCC firms and LBOs. Our work will include reviewing applicable Board and Federal Reserve Bank policies and procedures, meeting with staff from the Board and the Federal Reserve Banks, and reviewing documentation associated with supervisory activities. We plan to visit a sample of Federal Reserve Banks that have responsibility for supervising LISCC firms and LBOs.

This project is an evaluation conducted pursuant to the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation* and is not a criminal, civil, or administrative investigation. Unlike investigations conducted by law enforcement officials that may assess the actions of individual employees, auditors conduct evaluations that assess the effectiveness and efficiency of agency programs and operations. Our evaluations typically result in reports issued to Board officials that often include recommendations designed to improve the efficiency and effectiveness of the agency's operations, programs, and policies.

Evaluation of the Board Division of Banking Supervision and Regulation's (BS&R) Model Risk-Management Practices for Models Used in Support of the Annual Comprehensive Capital Analysis and Review (CCAR)

CCAR is the largest initiative of the Operating Committee of the Large Institution Supervision Coordinating Committee. CCAR is a supervisory assessment of the capital planning processes and capital adequacy of the largest, most complex bank holding companies. We are reviewing BS&R's model risk-management practices, including model validation activities, for the supervisory models used in support of the CCAR stress testing.

Audit of the CFPB's Public Consumer Complaint Database

In June 2012, the CFPB became the first federal regulator to publicly share individual-level consumer financial complaint data. While the Consumer Complaint Database initially contained only credit card complaints, the CFPB has extended the database to other consumer financial products and services covered by the CFPB. Our audit objective is to assess the effectiveness of the CFPB's controls over the accuracy and completeness of the public complaint database.

Audit of the Board's Public Release of Economic Information

The Board produces several economic publications and statistical releases on a periodic schedule. Many of these releases have the potential to influence market trading; therefore, the Board needs to have sufficient controls over the release of this sensitive information to the public. We are auditing the Board's processes to ensure that these data are properly safeguarded on the day of issuance.

Audit of the CFPB's Distribution of Funds From the Civil Penalty Fund

The Dodd-Frank Act established the Civil Penalty Fund. The CFPB must deposit any civil penalty it obtains in any judicial or administrative action under federal consumer financial law into the fund. The CFPB is to use the funds collected to compensate consumers who were harmed by activities for which civil penalties have been imposed. To the extent that victims cannot be located or payment is not practicable, the CFPB may use the funds for consumer education and financial literacy programs. Our audit is focused on internal controls related to the administration of the Civil Penalty Fund. Specifically, our audit will assess the efficiency and effectiveness of the process for identifying victims.

Evaluation of the Federal Reserve System's Examination Approach Used to Assess Office of Foreign Assets Control (OFAC) Compliance

In the past few years, there have been high-profile instances of foreign banking organizations (FBOs) operating in the United States that were facilitating payments to prohibited entities on OFAC's list of specially designated nationals. The Federal Financial Institutions Examination Council's *Bank Secrecy Act/Anti-Money Laundering Examination Manual* contains specific examination procedures for assessing OFAC compliance programs. This evaluation seeks to assess the effectiveness of the Board's and the Federal Reserve Banks' approach to examining the OFAC compliance programs for FBOs operating in the United States. This evaluation will assess the extent to which the current examination approach to OFAC compliance should be updated based on (1) lessons learned from these incidents or (2) evolving expectations for OFAC compliance programs based on recent updates to the sanctions list.

Evaluation of the Effectiveness of the CFPB's Examination Workpaper Documentation

The CFPB's *Supervision and Examination Manual* (version 2.0) summarizes the agency's expectations for workpaper documentation to support the results of its examination activity. The manual describes the following three principal purposes for workpaper documentation: (1) providing a record of the work performed that supports examination results, (2) maintaining the evidence necessary to support supervisory agreements or formal enforcement actions, and (3) facilitating internal quality control reviews. This evaluation will assess the CFPB's policies and procedures for documenting examination results, the training programs and materials used to implement workpaper documentation expectations, and the extent to which each of the CFPB's regions meets those expectations.

Audit of the Board's STAR Modernization Project

STAR is the central computer application used by the statistics function at the Federal Reserve Banks and the Board to collect and edit over 75 periodic statistical reports from financial institutions. These data reports are subsequently delivered to end users at the Board, the Federal Reserve Bank of New York's Trading Desk, and the Federal Reserve Banks' Economic Research and Banking Supervision Divisions for use in performing their duties regarding monetary policy and supervision and regulation of financial institutions. STAR is also used by the Federal Reserve System's Reserve Administration function to calculate reserve requirements, monitor reserve balances, and perform other activities. In addition, STAR produces reserve account information that can be used by depository institutions to manage their accounts effectively. The current technology is being updated to better support business needs and to include a server-based environment and support by the Federal Reserve System's National IT. The Board began decommissioning the legacy STAR system in 2014. Our audit focus includes the adequacy and internal controls of the development process for the new system, including the cost and schedule. In addition, we are determining how security controls are being built into the system.

Security Control Review of the Board's C-SCAPE System

The Federal Information Security Management Act of 2002 requires that each agency Inspector General evaluate a representative subset of the agency's information systems. As part of meeting this requirement, we are conducting a security control review of the Board's Consolidated Supervision Comparative Analysis, Planning and Execution (C-SCAPE) system. C-SCAPE is a data input and reporting tool used to support the supervisory program. C-SCAPE is intended to support the Large Institution Supervision Coordinating Committee's reengineered supervisory processes for large banking organizations, foreign banking organizations, and financial market utilities. Our specific audit objective is to evaluate the adequacy of certain control techniques designed to protect data in the system from unauthorized access, modification, destruction, or disclosure.



Office of Inspector General Commodity Futures Trading Commission

The CFTC OIG acts as an independent Office within the CFTC that conducts audits, investigations, reviews, inspections, and other activities designed to identify fraud, waste, and abuse in connection with CFTC programs and operations, and makes recommendations and referrals as appropriate.

Background

The CFTC OIG was created in 1989 in accordance with the 1988 amendments to the Inspector General Act of 1978 (P.L. 95-452). OIG was established as an independent unit to:

- Promote economy, efficiency and effectiveness in the administration of CFTC programs and operations and detect and prevent fraud, waste and abuse in such programs and operations;
- Conduct and supervise audits and, where necessary, investigations relating to the administration of CFTC programs and operations;
- Review existing and proposed legislation, regulations and exchange rules and make recommendations concerning their impact on the economy and efficiency of CFTC programs and operations or the prevention and detection of fraud and abuse;
- Recommend policies for, and conduct, supervise, or coordinate other activities carried out or financed by such establishment for the purpose of promoting economy and efficiency in the administration of, or preventing and detecting fraud and abuse in, its programs and operations; and
- Keep the Commission and Congress fully informed about any problems or deficiencies in the administration of CFTC programs and operations and provide recommendations for correction of these problems or deficiencies.

CFTC OIG operates independently of the Agency and has not experienced any interference from the CFTC Chairman in connection with the conduct of any investigation, inspection, evaluation, review, or audit, and our investigations have been pursued regardless of the rank or party affiliation of the target.² The CFTC OIG consists of the Inspector General, the Acting Assistant Inspector General for Auditing, a Senior Auditor, two attorneys, and one support staff. The CFTC OIG obtains additional audit and administrative assistance through contracts.

² The Inspector General Act of 1978, as amended, states: "Neither the head of the establishment nor the officer next in rank below such head shall prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation..." 5 U.S.C. App. 3 sec. 3(a).

Role in Financial Oversight

The CFTC OIG has no direct statutory duties related to oversight of the futures, swaps and derivatives markets; rather, the CFTC OIG acts as an independent Office within the CFTC that conducts audits, investigations, reviews, inspections, and other activities designed to identify fraud, waste, and abuse in connection with CFTC programs and operations, and makes recommendations and referrals as appropriate. The CFTC's yearly financial statement and Customer Protection Fund audits are conducted by an independent public accounting firm, with OIG oversight.

Recent, Current or Ongoing Work in Financial Oversight

In addition to our work on CIGFO projects described elsewhere in this report, CFTC OIG worked on the following projects during the past year:

Compliance Audit of Futures Commission Merchants and Retail Foreign Exchange Dealers Compliance with CFTC Reporting Requirements

In May 2013, CFTC OIG issued its Review of CFTC's Oversight and Regulation of MF Global, Inc. Among other concerns, we noted that the examination processes for Futures Commission Merchants (FCM) at the time had no manuals, were not performed in accordance with generally accepted audit standards, and that the teams assigned to perform FCM reviews had no peer review or other internal review requirement. In addition, we voiced concern with staff documentation of requests for information designed to assure the safety of customer funds. The objective of this audit was to assess the process CFTC examination staff, in the Division of Swap Dealer and Intermediary Oversight, undertake in their review of financial information submitted by FCM and RFED in compliance with CFTC regulatory requirements, including CEA section 1.16 and 1.17. CFTC OIG contracted with an independent public accounting firm and monitored their conduct of the audit.

CFTC OIG issued the audit report on July 17, 2014. The audit found that CFTC had management controls to help achieve its regulatory oversight of FCMs' and RFEDs' compliance with CFTC financial reporting requirements during FY 2012 and FY 2013. The audit identified and separately communicated to management certain matters about CFTC's control deficiencies for which CFTC could take measures to strengthen its controls. The full report is available here: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_auditreportp05.pdf

Performance Audit of CFTC's Rule Enforcement Reviews of Designated Contract Markets – FY2011 through FY2014

As stated in its current strategic plan, "CFTC conducts regular Rule Enforcement Reviews (RERs) and System Safeguard Examinations (SSEs) to assess ongoing compliance by the exchanges with core principles through the self-regulatory programs operated by exchanges. This function represents a significant part of the regulatory oversight structure and serves to assess the soundness of the self-regulation program of the derivatives industry."³ The objective of this audit is to review DMO Market Compliance Section's performance

3 CFTC, *Strategic Plan FY 2014-2018* (Oct. 16, 2014) (<http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2018strategicplan.pdf>).

in conducting RERs during the period FY2011 through FY2014. This is the first audit performed by OIG in this program area.

CFTC OIG contracted an independent public accounting firm to conduct the audit. Work on this audit was ongoing at the close of the reporting period.



Office of Inspector General Federal Deposit Insurance Corporation

The Office of Inspector General (OIG) promotes the economy, efficiency, and effectiveness of FDIC programs and operations, and protects against fraud, waste, and abuse. In doing so, the OIG assists and augments the FDIC's contribution to stability and public confidence in the nation's financial system.

Background

The Federal Deposit Insurance Corporation (FDIC) was created by the Congress in 1933 as an independent agency to maintain stability and public confidence in the nation's banking system by insuring deposits and independently regulating state-chartered, non-member banks. Federal deposit insurance protects depositors from losses due to failures of insured commercial banks and thrifts. According to most recent data, the FDIC insures approximately \$6.2 trillion in deposits at 6,509 banks and savings associations, and promotes the safety and soundness of these institutions by identifying, monitoring, and addressing risks to which they are exposed. The FDIC is the primary federal regulator for 4,138 of the insured institutions. An equally important role for the FDIC, especially in light of the financial crisis, is as receiver for failed institutions—that is, upon closure of an institution by its chartering authority—the state for state-chartered institutions, and the Office of the Comptroller of the Currency for national banks and federal savings associations—the FDIC is responsible for resolving the institution and managing and disposing of its remaining assets.

The FDIC Office of Inspector General (OIG) is an independent and objective unit established under the Inspector General (IG) Act of 1978, as amended. The FDIC OIG mission is to promote the economy, efficiency, and effectiveness of FDIC programs and operations, and protect against fraud, waste, and abuse. In doing so, we can assist and augment the FDIC's contribution to stability and public confidence in the nation's financial system. We have continued to undertake work in support of that mission since issuance of the last CIGFO annual report in July 2014, as discussed in more detail below. This discussion highlights OIG efforts that contribute broadly to stability in the financial sector, in line with CIGFO's mission.

Since issuance of last year's annual report, we completed a comprehensive review of the FDIC's efforts to ensure that financial institutions and technology service providers are prepared to prevent, detect, respond to, and recover from cyberattacks; provide sufficient and qualified resources to examine and monitor information technology risk management practices of financial institutions and technology service providers; and promote information sharing about cybersecurity incidents to appropriate authorities. We also conducted work related to the FDIC's response to Bank Secrecy Act and anti-money laundering concerns at FDIC-supervised institutions. With respect to failed bank work, we conduct material loss reviews in cases where losses to the Deposit Insurance Fund meet the threshold outlined in Section 38(k) of the Federal Deposit Insurance Act, as amended, and we perform failed bank reviews of all failures of FDIC-supervised

institutions to determine whether unusual circumstances exist that would warrant an in-depth review of the failure. Since July 2014, we have issued one material loss review and one in-depth review, focusing in each on the causes for the institution's failure and the FDIC's supervisory activities involving each institution. We have also continued an on-going risk assessment and monitoring of the FDIC's activities related to implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

We continued to coordinate with our financial IG counterparts on issues of mutual interest. Of special note, we collaborated in the conduct of a review of enforcement actions and professional liability claims taken by the regulators against institution-affiliated parties or individuals and issued our joint report on July 25, 2014. At the end of the CIGFO reporting period, we were also coordinating with OIG colleagues to finalize our review of coordination efforts among the Consumer Financial Protection Bureau and prudential regulators. As a member of CIGFO, the FDIC OIG also participated in the joint project related to the Financial Stability Oversight Council's oversight of interest rate risk, as presented later in this report.

In addition to audit and evaluation work, we sustained strong investigative efforts to combat financial institution fraud at both open and closed institutions. Further discussion of selected FDIC OIG audit, evaluation, and investigative efforts since July 2014 follows.

The FDIC's Supervisory Approach to Cyberattack Risks

Information is one of a financial institution's (FI) most important assets. Protection of information is critical to establishing and maintaining trust between the FI and its customers, complying with laws and regulations, and protecting the FI's reputation. Most FIs rely heavily on information technology (IT) systems, external technology service providers (TSP), and Internet-connected applications to provide or enable key banking functions. The importance of ensuring information security has grown and has become a vital component of operations as FIs and TSPs face growing challenges from cyberattacks—that is, deliberate exploitations of computer systems or networks resulting in disruptive consequences that can compromise data and lead to cybercrimes, such as information and identity theft. We conducted a review to examine key aspects of the FDIC's supervisory activities to protect against cyberattacks.

By way of background, the FDIC conducts IT examinations of FDIC-supervised FIs and TSPs for compliance with sections 39 of the Federal Deposit Insurance Act and the 1999 Gramm-Leach-Bliley Act. The federal banking agencies issued implementing *Interagency Guidelines Establishing Information Security Standards* (Interagency Guidelines) in 2001. In 2005, the FDIC developed the Information Technology—Risk Management Program, based largely on the Interagency Guidelines, as a risk-based approach for conducting IT examinations at FDIC-supervised FIs. The FDIC generally conducts IT examinations of FIs in conjunction with risk management examinations. The FDIC also uses work programs developed by the Federal Financial Institutions Examination Council (FFIEC) to conduct IT examinations of TSPs.

In February 2013, President Obama released Executive Order 13636, *Improving Critical Infrastructure Cybersecurity*, which established policy to enhance the security and resilience of the Nation's critical infrastructure and called for the development of a risk-based cybersecurity framework and a program for its voluntary adoption. The National Institute of Standards and Technology released the *Framework for Improving Critical Infrastructure Cybersecurity* in February 2014 to provide a blueprint that firms of all sizes can use to evaluate, maintain, and improve the resiliency of their computer systems.

As a result of our review, we determined that IT examination work programs needed to be updated and should focus more specifically on cyberattack risks. We found that these work programs focus on security controls at a broad program level and did not explicitly address cyberattack risk. The programs could be updated and expanded to align with other security frameworks. They could also include specific information about key program-level control characteristics.

Additionally, we determined that the FDIC should revisit the extent of reliance placed on institution management attestations when determining the IT examination scope. The IT Officer's Questionnaire relies on FI management's self-assessment that IT risks are managed and controlled, and the Questionnaire mirrors the work program and consists of "yes/no" questions. Examiners we interviewed also raised concerns about the value of the Questionnaire in scoping the examination.

We further reported that examiners could better document conclusions and procedures performed related to IT control areas. Examiners routinely addressed compliance with the Interagency Standards, and they generally concluded on some, but not all, of the broad control areas (e.g., intrusion detection and incident response). Because of the examiners' approach to documentation, we could not always tell what procedures they performed to reach their conclusions.

Institutions that we reviewed in conducting our work had weaknesses in key IT control areas. For example, we noted variation in the quality and depth of risk assessments and other IT security program elements. We observed that vendors frequently obtained third-party reviews that provided lower levels of assurance. That is, these reviews focused on internal control over financial reporting as opposed to reviews that address controls relevant to security, availability, processing integrity, confidentiality, and privacy.

As for FDIC resources in the IT examination area, the FDIC faces challenges in determining permanent resource needs. The number of IT examination staff has increased, but mostly in non-commissioned, term IT examination analyst positions. The FDIC's future resource needs and competencies will depend largely on how the FDIC/FFIEC changes its IT examination approach.

With respect to training, we reported that opportunities exist to increase regional management IT training. The FDIC has training programs for developing IT examination staff which include mandatory and discretionary courses and on-the-job (OJT) training experiences. While most IT examination staff have received IT training, many regional supervisors such as Assistant Regional Directors and Case Managers have received limited IT examination training.

We also pointed out that the FDIC could better ensure that examination teams possess necessary qualifications to review complex institutions. For example, non-commissioned IT examination analysts sometimes examined complex FIs under the supervision of a commissioned examiner who was not an IT specialist.

Further, IT subject matter experts sometimes served as the examiner-in-charge on complex IT examinations before they had completed required IT-OJT courses.

With respect to information sharing, the FDIC has processes for receiving cyber incident information and various initiatives to help promote information sharing about cyberattack incidents to FIs, the financial sector, and other regulators and authorities. The FDIC receives cybersecurity information through FI security incident reports and Suspicious Activity Reports filed with the Financial Crimes Enforcement Network. The

FDIC participates in a number of interagency and financial sector councils and committees and will soon be approved to begin receiving classified intelligence information on cybersecurity incidents.

The FDIC periodically issues information security-related guidance to FIs on areas such as new regulations and policies. The frequency of FDIC-issued IT guidance increased markedly in 2014, and the FDIC's practice of issuing notices about specific industry cyber threats has evolved. The FDIC has also held webinars, issued technical assistance videos, and discussed cybersecurity issues with banking industry representatives.

In our view, the FDIC could enhance its information sharing activities by improving the categorization of specific types of cyberattacks in security incident reports and reaching agreements with other regulators to share security incident information.

The FDIC and the FFIEC have ongoing initiatives to update programs for examining FIs and TSPs. Accordingly, we framed our recommendations to complement the Division of Risk Management Supervision's (RMS) efforts associated with updating examination and institution guidance, addressing resource and training challenges, and enhancing information collection and sharing initiatives.

In responding to our report, the Director of RMS concurred with the report's nine recommendations and noted that RMS had started project plans for several of the recommendations. The response outlined corrective actions that were responsive to the recommendations. RMS established planned completion dates for corrective actions throughout 2015 and 2016 and expects to have all actions completed by the end of 2016.

Importantly, during our evaluation, several questions arose that were outside of the scope of our review. Given their varied nature, we may pursue some in more depth in separate reviews or in discussions with FDIC management. These questions include the consideration of how IT examination results could be further emphasized in safety and soundness ratings, challenges presented by differing IT examination cycles for FIs and TSPs, the sufficiency of contracts between FIs and TSPs, and the legal framework associated with addressing TSP weaknesses.

The FDIC's Response to Bank Secrecy Act and Anti-Money Laundering Concerns Identified at FDIC-Supervised Institutions

FDIC-supervised financial institutions are responsible for developing and administering a program to assure and monitor compliance with the Bank Secrecy Act (BSA) and related regulations (referred to as a BSA Compliance Program). The FDIC is responsible for regularly reviewing BSA Compliance Programs, communicating identified deficiencies and apparent violations to the institution's management and Board of Directors (and other regulatory authorities, as appropriate), and taking supervisory action to address the associated risks.

Within the FDIC, RMS has primary responsibility for examining financial institutions for compliance with the BSA and related regulations. Because RMS considers BSA compliance to be a matter of safety and soundness, each on-site risk management examination includes an assessment of the institution's BSA Compliance Program. Any deficiencies in BSA Compliance Programs or apparent violations of BSA-related regulations identified by examiners are documented in reports of examination and visitation reports that are provided to the institution's management and Board of Directors. The FDIC's primary system of record for recording

information about BSA examinations and related supervisory activities is the Virtual Supervisory Information on the Net.

We conducted an audit to determine how the FDIC has responded to BSA and anti-money laundering (AML) concerns identified in reports of examination. In doing so, we determined the extent and types of supervisory actions that the FDIC has taken to address BSA/AML concerns. We also assessed the extent to which supervisory actions, including referrals of apparent violations to other federal agencies, comply with applicable statutes; interagency policy and guidance; and FDIC policies, procedures, and guidelines. Finally, we evaluated the consistency of the FDIC's Regional Offices in applying BSA/AML-related policies, procedures, and guidelines.

By way of background, in response to BSA/AML concerns identified in reports of examination, RMS implements supervisory actions ranging from examiner recommendations that address isolated BSA/AML deficiencies to formal enforcement actions (EA) that address systemic weaknesses in BSA Compliance Programs. Serious BSA concerns can also result in referrals to the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) for the issuance of civil money penalties.

We reported that during the 4-year period October 1, 2009, through September 30, 2013, the FDIC and/or applicable state regulator cited FDIC-supervised institutions for 3,294 apparent violations of BSA-related regulations, agreed to or issued 175 BSA-related informal and formal EAs, and made 22 referrals to FinCEN for civil money penalties. In addition, the reports of examination and visitation reports that we reviewed identified the specific BSA regulations that were violated, the nature and causes of the violations, the recommended corrective actions, and the institutions' management responses. Further, follow-up examinations and visitations were generally conducted in a timely manner.

Our review of the FDIC's supervisory actions to address BSA/AML concerns at 51 non-statistically sampled financial institutions found that the actions were generally consistent with applicable statutory requirements, interagency policy and guidance, and FDIC policies, procedures, and guidelines. However, in 4 of 15 cases involving BSA Compliance Program failures and/or repeat apparent violations of BSA program requirements, stronger or earlier supervisory action in the form of a formal enforcement action may have been warranted. Based on the results of subsequent examinations, two of the four institutions took action to improve their BSA Compliance Programs. Although FDIC management provided a rationale for the supervisory approach applied in these cases, promptly issuing formal EAs would have established a supervisory tenor of expectations consistent with interagency policy.

Our review also identified a potential control improvement with respect to recording in the Virtual Supervisory Information on the Net the status and disposition of civil money penalties referrals to FinCEN.

The FDIC has established a number of controls to promote consistency among its Regional Offices in applying BSA/AML-related policies, procedures, and guidelines. Such controls include, for example, bimonthly meetings between the Regional Offices and RMS headquarters' Anti-Money Laundering and Risk Analysis Branch to discuss BSA/AML problem institutions, the examination report review process, and periodic internal reviews by RMS' Internal Control and Review Section. In addition, the FDIC's Regional Offices generally appeared to apply BSA/AML-related policies, procedures, and guidelines in a consistent manner for the institutions that we reviewed. However, Regional Office procedures for monitoring institutions with

significant BSA/AML problems were not always current, and we noted differences among these Regional Office procedures.

We made three recommendations to improve internal controls for addressing BSA/AML concerns identified during examinations of FDIC supervised institutions. Management concurred with the recommendations and described planned corrective actions to address them.

Reviews of Failed Banks

Although the number of institution failures has decreased dramatically since the height of the financial crisis, we continue work related to failed banks, as required by Section 38(k) of the FDI Act, as amended. Our findings in these periodic reviews are generally consistent with those in our many prior reviews of this type, as noted below.

Our material loss review of the Bank of Union, El Reno, Oklahoma, determined that the bank failed primarily because its Board and management did not effectively manage the risks associated with the bank's aggressive growth and concentrations in commercial and industrial, and agricultural loans, particularly in the livestock and trucking industries. In retrospect, it would have been prudent for the FDIC to have followed up with the bank to ensure that certain repeat concerns were promptly corrected. Also, a more comprehensive assessment of the bank's largest borrowing relationship—primarily involving livestock loans—may have uncovered the bank's practice of using account overdrafts to keep the debt of certain borrowers in the relationship current. The reports of examination were also not critical of the bank's inadequate collateral inspections related to livestock loans.

In the case of Vantage Point Bank, our in-depth review pointed out that the bank engaged in material changes to its business plan during its de novo period without regulatory approval. It failed because its Board and management did not effectively manage the risks associated with the bank's rapid expansion of its mortgage banking operation. The FDIC's approach to monitoring the bank for compliance with its original business plan was consistent with supervisory guidance for the first 3 years of the bank's operation. However, monitoring in subsequent years was generally not adequate.

More effective monitoring and stronger supervisory action would have been consistent with supervisory guidance for newly insured banks and may have prompted the bank to better control the expansion of its mortgage banking operation, mitigating the losses incurred by the bank and, to some extent, the Deposit Insurance Fund. We made three recommendations in the in depth review intended to improve the effectiveness of the FDIC's supervision of newly insured institutions such as Vantage Point Bank.

FDIC OIG's Ongoing Dodd-Frank Act Risk Assessment and Monitoring

The Dodd-Frank Act created a comprehensive new regulatory and resolution framework designed to avoid the severe consequences of financial instability. Title I of the Dodd-Frank Act provides tools for regulators to impose enhanced supervision and prudential standards on systemically important financial institutions (SIFI). Title II provides the FDIC with a new orderly liquidation authority for SIFIs, subject to a systemic risk determination by statutorily-designated regulators. The FDIC faces challenges in fulfilling its insurance, supervisory, receivership management, and resolution responsibilities as it meets the requirements of

the Dodd-Frank Act. These responsibilities are cross-cutting and are carried out by staff throughout the Corporation's headquarters and regional divisions and offices.

Our office continues its ongoing initiative to keep current with the FDIC's efforts associated with implementation of the Dodd-Frank Act provisions. Our purpose in doing so is to understand and analyze operational and political issues and emerging risks impacting the FDIC, the financial community, and internal OIG operations and plans. This continuous and focused risk assessment and monitoring enhances our more traditional, periodic OIG risk assessment and planning efforts and assists with the OIG's internal preparation efforts in the event a systemically important financial institution should fail. The assessment and monitoring is intended to provide an informal, efficient means of making management aware of issues and risks warranting attention—it is not being conducted as an audit or evaluation.

We briefed FDIC senior management regarding our efforts and shared our approach with colleagues on the Council of Inspectors General on Financial Oversight. Going forward, we will communicate to FDIC management periodic summaries of issues and risks for management consideration. We have identified areas for further review and will be commencing additional work in the near future.

FDIC OIG Investigations Target Financial Institution Fraud

FDIC OIG investigative work at both open and closed banks over the past months continued to complement our audit and evaluation work. Our criminal investigations provide additional insights into the control weaknesses that allowed perpetrators of fraud to commit illegal acts. We are particularly concerned when individuals inside the bank—officers, directors, and others—conspire to circumvent controls and commit crimes that harm their banks and cause losses to the DIF, thus undermining the integrity of the banking system as a whole.

Our office is committed to partnerships with other OIGs, the Department of Justice, the Federal Bureau of Investigation, and other state and local law enforcement agencies in pursuing criminal acts in open and closed banks and helping to deter fraud, waste, and abuse. The OIG also actively participates on numerous mortgage fraud and other financial fraud working groups nationwide to keep current with new threats and fraudulent schemes that can undermine the integrity of the FDIC's operations and the financial services industry as a whole. These include the Bank Fraud Working Group, Mortgage Fraud Working Group, and Financial Fraud Enforcement Task Force, all spearheaded by the Department of Justice. The OIG is also a member of the National Cyber Investigative Joint Task Force, the focal point for all government agencies to coordinate, integrate, and share information related to all domestic cyber-threat investigations, and is an active participant in the Federal Bureau of Investigation's Washington Field Office Cyber Task Force.

Our caseload as of March 31, 2015 included 260 active investigations. Of these, 145 relate to open bank matters and 96 to closed bank matters. These cases involve fraud and other misconduct on the part of senior bank officials, and include mortgage and commercial loan fraud exposed by turmoil in the housing, commercial real estate, and lending industries. The perpetrators of such crimes can be those very individuals entrusted with governance responsibilities at the institutions—directors and bank officers. In other cases, parties providing professional services to the banks and customers, others working inside the bank, and customers themselves are principals in fraudulent schemes. Other investigations include cases involving misrepresentations of FDIC insurance or affiliation, concealment of assets, and computer crimes. We are

coordinating closely with the FDIC to ensure the continued safety and soundness, and integrity of the nation's banks and to preserve public confidence in the banking system.

A priority initiative for our office continues to involve enhanced coordination with the FDIC Legal Division, Division of Risk Management Supervision, and Division of Resolutions and Receiverships on matters related to enforcement actions. Specifically, we have established an on-going program to share information to ensure that the OIG's investigative results are available to FDIC management in its consideration of civil and administrative enforcement activities, and that information developed by the FDIC is effectively communicated to OIG criminal investigators, when warranted.

FDIC OIG investigative results over the 6 months ending March 31, 2015 include the following: 67 indictments; 34 arrests; 57 convictions; potential monetary recoveries (fines, restitution, and asset forfeitures) of more than \$98 million; and 38 referrals to the Department of Justice.

Additional information on the work of the FDIC OIG may be found at www.fdicig.gov



Office of Inspector General Federal Housing Finance Agency

The Federal Housing Finance Agency Office of Inspector General (FHFA-OIG) conducts, supervises, and coordinates audits, evaluations, investigations, and other activities relating to the programs and operations of the Federal Housing Finance Agency (FHFA or the Agency), which regulates and supervises the housing-related government-sponsored enterprises (GSEs): the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBanks). Since September 2008, FHFA has also served as conservator for Fannie Mae and Freddie Mac (collectively, the Enterprises).

Introduction

FHFA-OIG's oversight mission is to provide independent, relevant, timely, and transparent oversight of FHFA that:

- promotes accountability, integrity, economy, and efficiency;
- advises the Director of the Agency and Congress;
- informs the public; and
- protects the interests of the American taxpayers.

To accomplish this mission, FHFA-OIG delivers expert analyses through independent and objective audits, evaluations, investigations, surveys, and risk assessments, and alerts FHFA's Director, Congress, and the American people to problems. Additionally, FHFA-OIG special agents support federal, state, and local law enforcement efforts related to housing finance. FHFA-OIG also teams with FHFA staff and program participants to ensure effectiveness, efficiency, and integrity.

Background

Since beginning operation in 2010, FHFA-OIG has prioritized robust oversight geared toward ensuring the integrity, transparency, effectiveness, and soundness of both FHFA's operations and the organizations it oversees. The need for such financial oversight is made clear by the government's \$187.5 billion Enterprise bailout, their uncertain future, and a housing market that continues to be fragile.

On September 18, 2014, the Senate confirmed a new Inspector General for FHFA, and she took the oath of office shortly thereafter. Since taking the oath of office, the new Inspector General has focused on assessing FHFA-OIG's strengths, weaknesses, challenges, and opportunities to best position FHFA-OIG to fulfill its critical mission.

To best leverage FHFA-OIG's resources and strengthen its oversight, it determined to focus its resources on programs and operations that pose the greatest financial, governance, and/or reputational risk to the Agency, the Enterprises, and the FHLBanks. After discussions with FHFA, the Enterprises, and different stakeholders to seek input on the largest risks; and reviews of reports prepared by FHFA and third parties, and risk assessments performed in key areas related to FHFA's mission, and hotline complaints, FHFA-OIG identified the areas of greatest risk:

- FHFA's ongoing work as conservator;
- FHFA's rigor in conducting examinations in its role as regulator of the Enterprises;
- FHFA's oversight of the Enterprises' controls for smaller or nondepository financial institution mortgage sellers (nonbank sellers); and
- FHFA's oversight of the information technology (IT) security at the Enterprises and the FHLBanks.

Thereafter, FHFA-OIG revised its Audit and Evaluation Plan and work plans to focus on these areas.

FHFA-OIG also took steps to improve internal efficiencies by encouraging greater collaboration across its offices because nothing is more powerful and productive than when people work collaboratively. Additionally, FHFA-OIG established two new offices—the Office of Risk Analysis (ORA) and the Office of Compliance and Special Projects (OCo)—to strengthen its oversight.

To exercise rigorous oversight of the Agency and the entities that it regulates (or serves as conservator of), FHFA-OIG must identify emerging risks and be sufficiently nimble to revise its work plans as new risks emerge and existing risks are better controlled. FHFA-OIG established ORA to use data mining, and analysis of data and relevant information to identify and monitor emerging and ongoing areas of risk. The identification, analysis, and prioritization of risk areas will allow FHFA-OIG to utilize resources strategically and realign its Audit and Evaluation Plan, in real time, to address those risks.

FHFA-OIG also created OCo to carry out two missions. First, it will be responsible for assessing the status of recommendations made to FHFA in all FHFA-OIG audits, evaluations, and systemic implication reports and reviewing actions taken by FHFA to address such recommendations. Additionally, OCo will undertake special projects, such as congressional requests, to examine emerging issues and deliver prompt, actionable reports to the Congress.

Furthermore, during this reporting period, FHFA-OIG has continued to record significant oversight achievements, many of which are summarized here and discussed more fully in our eighth and ninth semiannual reports to Congress (available at www.fhfaog.gov/Reports/Semiannual).

Examples of FHFA-OIG's Oversight Accomplishments: White Papers, Audits, Evaluations, Investigations, and Collaborations

White Papers

Report No. WPR-2015-002: FHFA's Conservatorships of Fannie Mae and Freddie Mac: A Long and Complicated Journey (March 25, 2015)

In 2008, FHFA placed Fannie Mae and Freddie Mac in conservatorship. Since that time, the Enterprises have required \$187.5 billion in financial support from Treasury in order to avert insolvency and receivership. These conservatorships are now in their seventh year. The FHFA Director has asserted that conservatorship “cannot and should not be a permanent state” for the Enterprises and, under his stewardship, FHFA will continue the conservatorships until a new housing finance system is put into place by Congress. At present, the conservatorships are of unknown duration and the Enterprises, as necessary, will rely on Treasury for financial support if they are not able to sustain profitability in the future. Given the taxpayers’ enormous investment in the Enterprises and the Enterprises’ critical role in the secondary housing finance market, FHFA-OIG determined that FHFA’s administration of the conservatorships constituted a critical risk.

In this white paper, FHFA-OIG outlined the history of the conservatorships and FHFA’s evolving management of them. FHFA-OIG then summarized findings of prior FHFA-OIG reports that reviewed conservatorship decisions and practices. Last, FHFA-OIG outlined its planned work in the coming year to assess the conservator’s governance practices, internal controls, decision-making process, and follow-up/compliance activities.

Report No. WPR-2015-001: The Continued Profitability of Fannie Mae and Freddie Mac Is Not Assured (March 18, 2015)

The Enterprises’ financial conditions have stabilized and market conditions have improved since 2008. They returned to profitability in 2012; however, the level of earnings they experienced in 2013 and 2014 is not sustainable over the long term. The lack of consensus in Congress about what the nation’s mortgage finance system should look like and what role, if any, the Enterprises should play in it means the Enterprises will continue to operate under FHFA’s conservatorship until these issues are resolved. The outsized financial results reported by the Enterprises in 2012 and 2013 led some to conclude that the Enterprises would remain profitable for the foreseeable future. FHFA-OIG recognized the many challenges faced by the Enterprises that affect their profitability and understood that, if these challenges caused losses that resulted in a negative net worth for an Enterprise, then that Enterprise would be obligated to obtain an injection of additional taxpayer monies. FHFA-OIG prepared this white paper to explain the challenges faced by the Enterprises affecting their profitability and to caution that future profitability is not assured.

In the white paper, FHFA-OIG explained that nonrecurring events were a significant driver of earnings in 2013 and 2014 and are unlikely to drive future earnings. Core earnings from the Enterprises’ business segments—single-family guarantee, multifamily, and investments—comprised only 40% of net income in 2013 and 55% in 2014.

Going forward, the Enterprises will have to rely on their guarantee fee business segments and mortgage-related investment portfolios for earnings, and those sources are subject to uncertainty. The Enterprises must

reduce the size of their retained investment portfolios over the next few years pursuant to the terms of their agreements with Treasury and additional limits from FHFA. Declines in the size of these portfolios will reduce portfolio earnings over the long term. These portfolios have been the Enterprises' largest source of earnings in the past. Additionally, legislation from Congress and directives by FHFA, as the Enterprises' conservator, have raised the Enterprises' guarantee fees, the primary source of revenue for their single-family guarantee business segments. However, the Enterprises have cautioned that any income growth from guarantee fees may not completely offset the loss in income from the retained portfolios. Further, as policy perspectives change, the Enterprises' fees could be reduced in the future.

The housing finance system is in the midst of a period of significant uncertainty, and those uncertainties relate to key market drivers such as home mortgage rates, home prices, credit standards, and other rates (e.g., short-term and long-term swap rates) that impact the Enterprises' financial performance. Future profitability will be determined by how these drivers change and to what degree. For instance, fluctuations in interest rates introduce volatility into the Enterprises' derivatives portfolios. The Enterprises report changes in the value of their derivatives portfolios as fair value gains or losses, and those changes impact financial performance. For example, Fannie Mae reported fair value gains on derivatives of \$3.3 billion in 2013 and fair value derivative losses of \$5.8 billion in 2014, a swing of more than \$9 billion.

While FHFA-OIG cannot predict whether additional Treasury investments in either Enterprise are a reasonable possibility in the near future, it recognizes that significant uncertainties concerning the level of guarantee fees the Enterprises will be able to charge, when combined with the winding down of their investment portfolios and loss of interest income and possible losses on the derivatives portfolios, mean that the Enterprises' future profitability is far from assured.

Audits

Report No. AUD-2014-014: FHFA Actions to Manage Enterprise Risks from Nonbank Servicers Specializing in Troubled Mortgages (July 1, 2014)

Banks that traditionally service mortgage loans backed by the Enterprises have been selling the rights to service troubled loans in bulk to new companies specialized to handle them. In July 2014, nonbank specialty servicers held approximately \$1.4 trillion in mortgage servicing rights out of a nearly \$10 trillion market. These new servicers have less stringent regulatory and financial requirements than banks, which poses additional risk to the Enterprises.

As part of a review of problems FHFA identified with a nonbank specialty servicer, FHFA-OIG initiated this audit to assess the Agency's controls to ensure the Enterprises monitor nonbank specialty servicer performance and mitigate related risks.

Overall, FHFA-OIG concluded that while the Agency and the Enterprises have responded well to specific problems at nonbank specialty servicers, FHFA has not established a risk management process or oversight framework to handle some general risks posed by nonbank specialty servicers. FHFA-OIG recommended that the Agency issue guidance on a risk management process for nonbank specialty servicers and develop an oversight framework to mitigate the risks these nonbank specialty servicers pose. The Agency generally agreed with FHFA-OIG's recommendations.

Report No. AUD-2014-015: FHFA Oversight of Fannie Mae's Collection of Funds from Servicers that Closed Short Sales Below the Authorized Prices (August 7, 2014)

Short sales are part of Fannie Mae's loss mitigation strategy to help minimize the severity of losses it incurs due to loan defaults. Fannie Mae and its servicers closed over 210,000 short sales in a recent 3-year period. Fannie Mae determined that 4,883 short sale transactions were potentially closed in violation of servicer delegations of authority between August 2010 and December 2013, but, through a series of determinations and exclusions, the Enterprise reduced the number of transactions warranting an indemnification demand to 453 with a total minimum net reserve shortfall of approximately \$11 million. FHFA-OIG initiated this audit to look at the effectiveness of the Agency's oversight and Fannie Mae's controls over delegated servicers to ensure that net proceeds from short sales met the minimum amount authorized by the Enterprise.

FHFA-OIG found that Fannie Mae went to considerable lengths to demonstrate why it should not pursue servicer noncompliance rather than emphasize the importance of established controls. Additionally, Fannie Mae did not fully address this lack of servicer compliance through consideration of penalties, including interest on shortfalls collected and recoupment of incentive fees for completing short sale transactions. FHFA-OIG made three recommendations that generally asked the Agency to take a stronger supervisory role, including communicating written supervisory expectations for reviewing non-delegated short sale transactions and collecting funds for delegated and non-delegated short sale transactions when the net proceeds received were less than the amounts authorized by Fannie Mae. The Agency agreed with FHFA-OIG's recommendations.

Report No. AUD-2014-016: FHFA's Representation and Warranty Framework (September 17, 2014)

In June 2011, FHFA initiated the Contract Harmonization Project to improve the Enterprises' contracting with seller/servicers to maximize their performance and, thus, economic return on the Enterprises' loan portfolios. A new representation and warranty framework is a component of the project. The framework's objective is to clarify seller repurchase exposure and liability on future loans sold to the Enterprises. The framework relieves sellers from certain representations and warranties, such as those relating to credit underwriting and borrower eligibility, that were formerly effective for the life of the loan. Given the potential elevated risk from the new framework and the financial magnitude of loans involved, FHFA-OIG audited the Agency's oversight of the Enterprises' implementation of the new representation and warranty framework.

FHFA-OIG identified several weaknesses in the framework. First, FHFA mandated the framework despite significant unresolved operational risks to the Enterprises; neither Enterprise had implemented the processes, procedures, and systems needed to operate within the new framework before it went into effect in 2013. Second, FHFA's analysis was not robust enough to consider additional risks of moving to the new framework. For example, the Agency mandated a 36-month sunset period for representation and warranty relief without validating the Enterprises' analyses or performing sufficient additional analysis needed to appropriately balance financial risk between the Enterprises and sellers. Finally, FHFA did not analyze the costs and benefits to determine whether the 36-month period would result in an economic return to the Enterprises.

FHFA-OIG recommended that the Agency assess whether: (1) the Enterprises' current operational capabilities minimize financial risk that may result from the new framework; and (2) the financial risks associated with the framework, including the sunset periods, are balanced between the Enterprises and the sellers. The Agency

partially agreed with the first recommendation and disagreed with the second. On March 23, 2015, FHFA-OIG announced an audit survey to, among other things, analyze the costs and benefits of the framework changes.

Report No. AUD-2014-018: FHFA's Oversight of Risks Associated with the Enterprises Relying on Counterparties to Comply with Selling and Servicing Guidelines (September 26, 2014)

The Enterprises use a delegated business model to buy and service mortgage loans. They contract with third-party mortgage loan sellers and/or servicers (such as banks) and rely on them to comply with requirements for: (1) originating loans that the Enterprises buy; (2) servicing the purchased loans (e.g., collecting payments); and (3) reporting data about the loans. The Enterprises rely on the counterparties for compliance and reporting, and thus run the risk of counterparties failing to meet selling and servicing guidelines. Assurance regarding compliance with selling requirements is particularly important in light of the new representation and warranty framework. As such, increased reliance is being placed on controls at the sellers. To better assess the operational and financial risks posed by these counterparties, FHFA-OIG reviewed the Agency's oversight of how the Enterprises ensure their counterparties comply with their requirements.

FHFA-OIG concluded that the Enterprises may benefit from independent assurance that counterparties are complying with their selling and servicing requirements. FHFA-OIG recommended that the Agency direct the Enterprises to assess a risk-based approach to having their counterparties obtain independent, third-party attestations of their compliance with origination and servicing requirements in order to increase assurance that the approximately \$5 trillion in Enterprise-owned and -guaranteed mortgages are appropriately originated and serviced. The Agency did not agree with the recommendation.

Evaluations

Report No. EVL-2014-006: Recent Trends in Federal Home Loan Bank Advances to JPMorgan Chase and Other Large Banks (April 16, 2014)

FHLBanks make loans called "advances" to their members, but, from 2008 to March 2012, the FHLBanks' advance business declined 62%. Since then, advances began a steep climb, largely due to the four largest members of the FHLBank system. In light of potential risks and benefits associated with the growth in—and concentration of—advances, FHFA-OIG reviewed the causes of the surging advances.

FHFA-OIG determined that the rising advances were due, in part, to new bank liquidity standards. Some banks have taken FHLBank advances to purchase more liquid securities, such as Treasury securities, in order to meet the new standards. In other words, the purposes of the advances did not further the mission of the FHLBanks. FHFA-OIG recommended that the Agency publicly report on the advances, including their consistency with the safety and soundness of the FHLBank system and with the FHLBank housing mission. FHFA agreed with the recommendation.

Report No. EVL-2014-008: Status of the Development of the Common Securitization Platform (May 21, 2014)

In 2012, FHFA concluded that the back-office systems by which Fannie Mae and Freddie Mac securitize mortgages were outmoded and in need of being immediately upgraded. Subsequently, FHFA, as conservator, directed the Enterprises to build a Common Securitization Platform (CSP) to replace parts of

these systems. FHFA assumed, but did not verify, that developing the CSP would be more cost-effective than requiring each Enterprise to upgrade its own systems. In addition, FHFA envisioned the CSP outliving the Enterprises' current structures and supporting policymakers' efforts to reform the nation's housing finance system. As of December 31, 2013, the Enterprises had spent approximately \$65 million developing the CSP. Given the importance of the CSP to the Enterprises' current and future operations, FHFA-OIG evaluated the Agency's oversight of its development.

FHFA-OIG found that the Agency did not fully deploy essential project management tools when developing the CSP. Specifically, FHFA did not develop a comprehensive timeline and a total cost estimate for the project. FHFA-OIG recommended that the Agency: (1) establish schedules and timeframes for completing key components of the project and an overall completion date; and (2) establish cost estimates for varying stages of the initiative and an overall cost estimate. FHFA agreed with these recommendations.

Report No. EVL-2014-009: FHFA's Oversight of the Enterprises' Lender-Placed Insurance Costs (June 25, 2014)

The Enterprises require borrowers to have hazard insurance for their homes; this insurance safeguards home value if there is a covered incident, such as fire, and so preserves the Enterprises' security interests. When a loan servicer- with which an Enterprise has contracted- identifies a lapse in hazard insurance, it initiates new coverage known as lender-placed insurance (LPI). Borrowers are responsible for paying LPI premiums but do not always do so. When borrowers fail to make LPI payments, the servicers make the payments and attempt to recoup the costs. When borrowers default, the cost of unpaid LPI premiums is generally borne by the Enterprises. In 2012, the Enterprises paid approximately \$360 million in LPI premiums. Accordingly, FHFA-OIG evaluated the financial impact of LPI on the Enterprises and the Agency's measures to conserve the Enterprises' assets in this regard.

FHFA-OIG found that several state regulators determined that LPI rates were excessive and they concluded that rates may have been driven up by profit-sharing arrangements between servicers and LPI providers. FHFA-OIG determined that the Enterprises may have been harmed by the excessive LPI rates. FHFA-OIG found that the Agency had taken some steps to prevent the profit-sharing arrangements, but that it had not sought redress for any potential financial harm sustained by the Enterprises for excessive LPI premiums. Accordingly, FHFA-OIG recommended that the Agency consider the feasibility of initiating litigation against servicers to remedy the potential damages arising from abuses in the LPI market. FHFA agreed with this recommendation.

Report No. EVL-2014-010: Recent Trends in the Enterprises' Purchases of Mortgages from Smaller Lenders and Nonbank Mortgage Companies (July 17, 2014)

In recent years, the Enterprises have seen a shift in the composition of their mortgage sellers, with relatively fewer sales from large depository institutions and more sales from smaller lenders and nonbank mortgage companies. FHFA-OIG conducted this evaluation to document the rise in sales from smaller financial institutions and nonbank mortgage companies, discuss the reasons behind this trend, and assess the Agency's oversight of the Enterprises' risk management controls.

FHFA-OIG determined that, during 2013, the Agency conducted high-level examinations of the Enterprises' counterparty risk management and reviewed the risks associated with certain nonbanks' servicing operations. FHFA also began to develop guidance intended to strengthen the Enterprises' counterparty

risk management. However, FHFA-OIG found that, due to other examination priorities, the Agency did not test and validate the effectiveness of the controls the Enterprises put in place to address the potential risks stemming from the increase in mortgage sales from smaller and nonbank lenders. FHFA-OIG will continue monitoring the effectiveness of the Agency's efforts to oversee this issue.

Report No. EVL-2014-011: Freddie Mac Could Further Reduce Reimbursement Errors by Reviewing More Servicer Claims (August 27, 2014)

Freddie Mac relies on servicers to make payments on behalf of delinquent borrowers. When a borrower becomes delinquent, a servicer may be required to maintain the property, pay taxes and insurance, and liquidate the loan. After the loan is liquidated, the servicer seeks reimbursement of its expenses from Freddie Mac. Before it reimburses servicers, Freddie Mac selects a random, statistically representative sample of claims for detailed review. FHFA-OIG evaluated Freddie Mac's process for reimbursing servicers and reviewed the controls it had in place to minimize payment errors.

FHFA-OIG found that Freddie Mac's multi-layer prepayment review resulted in the Enterprise identifying and denying approximately \$126 million in erroneous claims in 2013. This process appears to be generally effective in reducing erroneous servicer reimbursement expenses. However, FHFA-OIG estimated that in 2013 Freddie Mac paid out about \$70 million to settle erroneous reimbursement claims that were not subject to prepayment review. Specifically, FHFA-OIG noted that the third layer of Freddie Mac's prepayment review involves a relatively small sample of claims, and a larger sample size would likely identify more erroneous claims. FHFA-OIG recommended that the Agency require Freddie Mac to: (1) determine, through cost-benefit analysis, whether to increase the sample size of reimbursement claims for prepayments review, and (2) increase the sample size if warranted by the analysis. FHFA agreed with the recommendations.

Report No. EVL-2015-004: FHFA's Oversight of Governance Risks Associated with Fannie Mae's Selection and Appointment of a New Chief Audit Executive (March 11, 2015)

In October 2013, Fannie Mae appointed a new Chief Audit Executive (CAE) to direct Fannie Mae's Internal Audit Department, a critical element of Fannie Mae's risk management controls. Pursuant to the Sarbanes-Oxley Act of 2002 and Fannie Mae's governance documents, its Internal Audit function provides independent, objective assurance of the Enterprise's governance, risk management, and controls. Given the CAE's critical role in Fannie Mae's risk management framework, FHFA-OIG reviewed the Enterprise's selection process.

FHFA-OIG determined that the process used by Fannie Mae's Audit Committee to select a candidate to fill this critical executive position was haphazard. The committee did not adequately plan how to identify qualified candidates, and Fannie Mae had no record of meetings reflecting the committee's deliberations before selecting the new CAE. Further, the new CAE's audit experience did not meet the qualifications deemed "preferable" in the position's description. The CAE's prior management responsibilities in Fannie Mae also created significant conflicts of interest with the new role. In addition, FHFA-OIG concluded that the Agency's oversight of the selection process was ineffective. Nothing in the record shows that FHFA officials elevated their own concerns about the selection process and conflicts of interest to the Agency's then-Acting Director. Accordingly, FHFA-OIG recommended that, among other corrective actions, the Agency: ensure its Director is informed of significant concerns; evaluate the Audit Committee's effectiveness; and assess how Fannie Mae's Board of Directors fills its committees. FHFA agreed with these recommendations.

Investigations

Computer Intrusion at Fannie Mae, Virginia

On October 3, 2014, in U.S. District Court for the Eastern District of Virginia, Satmish Kumar Chandhun Rajendran was sentenced to 36 months of probation, 50 hours of community service, forfeiture of his laptop computer, and over \$69,000 in restitution. Rajendran was further ordered to write and publish an online article detailing his offense, its seriousness, the effect on himself and his family, and why others should not engage in similar behavior. As part of his plea agreement, Rajendran has agreed not to seek employment in any sensitive positions or those of trust.

From August 2010 until August 2013, Rajendran worked at Fannie Mae as an information technology term employee and was assigned to the development of the CheckMyNPV.com website. Operated by Fannie Mae under the auspices of the Making Home Affordable Programs, an online tool on this website allowed users to determine the net present value of their homes and check their eligibility to participate in the Home Affordable Modification Program (HAMP), a federal program designed to avoid mass foreclosures. After being terminated from employment at Fannie Mae in August 2013, Rajendran repeatedly used administrator credentials to log into servers and make unauthorized changes to CheckMyNPV.com, including disabling the website's online tool for checking HAMP eligibility. As a result of these actions, Rajendran caused damage and loss to Fannie Mae in the amount of approximately \$69,000.

This was a joint investigation with the Office of the Special Inspector General for the Troubled Asset Relief Program; Fannie Mae's Investigations Unit provided exceptional assistance as well.

Multifamily Scheme, Illinois

On October 8, 2014, in U.S. District Court for the Southern District of Illinois, Maximus Yaney, Jamie Bray, and James Russell were indicted on one count of conspiracy to commit bank fraud and wire fraud, bank fraud, and wire fraud. On February 11, 2015, in the same venue, Russell pled guilty to extortion.

From April 2007 through February 2010, Yaney, Bray, and Russell allegedly conspired to devise and engage in a scheme to defraud Washington Mutual Bank and Greystone Bank. As part of the alleged scheme, Yaney flipped Marshal Reed Apartments by using a straw company he controlled called HG Capital, LLC, to sell the property to another company he owned called Titan, LLC. The flip involved the conspirators inflating the sale price and using false rent rolls and leases to obtain an \$8.4 million loan to fund Titan's purchase. Conspirators further used the false rent rolls and leases to obtain long-term financing with a Fannie Mae multifamily loan. False information was submitted to Greystone Servicing Corporation, Inc., a Fannie Mae delegated underwriting service, to obtain an \$8.1 million refinance loan, along with false financials submitted to Greystone Bank to obtain an additional \$300,000 gap loan. In furtherance of the fraud scheme, Russell admitted to extorting over \$200,000 in money and other benefits in return for concealing the fraud from both law enforcement and victim lenders. The scheme caused over \$6.8 million in losses to Fannie Mae and over \$1.1 million in losses to Greystone Servicing.

A forfeiture allegation was also charged against \$6.1 million that Yaney allegedly received in proceeds from the scheme.

This was a joint investigation with the FBI.

Large Condo Case, Florida

From October 2014 through February 2015, in U.S. District Court for the Southern District of Florida, several defendants pled guilty to or were convicted of crimes related to bank and wire fraud. These included: Leidy Masvidal, who was sentenced to 33 months in prison, 60 months of probation, and ordered to pay over \$5.7 million in restitution; Tania Masvidal, who was sentenced to 35 months in prison, 60 months of probation, and ordered to pay over \$5.6 million in restitution; Douglas Ponce, who was sentenced to 15 months in prison, 60 months of probation, and ordered to pay over \$1.6 million in restitution; Luis Michael Mendez, who was sentenced to 51 months in prison, 36 months of probation, and ordered to pay over \$2.8 million in restitution; and Wilkie Perez, who was sentenced to 36 months in prison, 36 months of probation, and ordered to pay over \$4.9 million in restitution.

Between mid-2006 and December 2010, several co-conspirators owned or controlled various real estate properties in the Miami area. They enlisted mortgage brokers and other individuals to recruit straw buyers to act as qualifying mortgage applicants to fraudulently purchase condominiums at various properties. They prepared and caused to be prepared loan documents containing false statements and representations relating to the buyers' income, assets, and other information necessary to enable lenders to assess the buyers' qualifications, which induced the lenders to make loans to finance the condominiums. After the loans were funded, the defendants allegedly caused fraudulent payments to be made from the loan proceeds to pay kickbacks through shell companies to the brokers, recruiters, and straw buyers, as well as to pay the mortgages to conceal the conspiracy. Eventually, the conspirators were unable to make mortgage payments, causing many of the condominium units to go into foreclosure and leading to losses by the lenders. In total, the scheme caused losses of over \$20 million, including loss exposure to Fannie Mae of approximately \$5.2 million and to Freddie Mac of approximately \$5.6 million.

This was a joint investigation with the Department of Housing and Urban Development OIG.

Two Sentenced in Identity Theft Involving Fannie Mae Insider, Texas

On November 12, 2014, in U.S. District Court for the Northern District of Texas, Tilisha Morrison was sentenced to 48 months in prison and 24 months of probation. On November 17, 2014, in the same venue, Katrina Thomas was sentenced to 48 months in prison and 24 months of probation.

Between October 2009 and July 2013, Thomas and others conspired to steal the personally identifiable information (PII) of over 1,000 Fannie Mae customers and others, and caused monetary damages to the involved financial institutions, including JPMorgan Chase and Bank of America. As part of the conspiracy, Morrison and others purchased PII that former Fannie Mae employee Thomas illegally obtained in the course of her employment. Conspirators then utilized other co-conspirators to misuse this PII to commit bank fraud.

This was a joint investigation with the Secret Service and the Dallas County District Attorney's Office.

Deed Theft Scheme, California

On November 13, 2014, in U.S. District Court for the Southern District of California, Mazen Alzoubi, Daniel Deaibes, and Mohamad Daoud were indicted by a grand jury for mail fraud.

From May 2012, the three allegedly operated a scheme to steal Fannie Mae and Freddie Mac properties by filing forged grant deeds. Because the properties did not have liens, a forged grant deed effectively

transferred ownership. They allegedly transferred the properties to shell companies they created and then sold the stolen properties to unwitting investors. The proceeds from the sales were deposited into bank accounts controlled by the subjects and then disbursed to various sources, including a large amount of money wired overseas to Jordan and other countries. At least 10 Fannie Mae and Freddie Mac properties were stolen, which caused losses of over \$2.5 million.

This was a joint investigation with the FBI.

Two Guilty in Condo Scheme, Florida

On December 8, 2014, in U.S. District Court for the Southern District of Florida, Barry J. Graham and Ricky L. Stokes pled guilty to conspiracy to commit bank fraud.

Graham was the Director of Sales for Cay Clubs and Stokes was its Director of Investor Relations as well as a sales agent. Graham and Stokes conspired with others to fraudulently inflate the prices of Cay Clubs units through insider sales. Graham and other insiders specifically purchased units from Cay Clubs without disclosing their affiliation with Cay Clubs. Thereafter, these insider sale prices were used on marketing materials to make it appear to investors that the Cay Clubs' units were rapidly increasing in price. As Cay Clubs experienced financial difficulties, Graham and Stokes conspired with others to fraudulently market Cay Clubs to new investors by making false and misleading statements, including concealing Cay Clubs' failure to convert dilapidated properties into luxury resorts. The scheme caused losses to Freddie Mac of nearly \$5 million and to Fannie Mae of over \$2 million.

This was a joint investigation with the IRS, the SEC, and the Department of Homeland Security Investigations.

Indictment for Real Estate Owned Scheme, Illinois

On December 10, 2014, in U.S. District Court for the Northern District of Illinois, Scott Goldstein was indicted for wire fraud and mail fraud.

Goldstein allegedly claimed he was able to sell Fannie Mae and Freddie Mac properties at significantly reduced prices. Goldstein allegedly fabricated documents on Freddie Mac letterhead claiming to have access to real estate owned by the Enterprises through a program he referred to as the Freddie Mac and Fannie Mae "10 Block" program. Goldstein was not authorized to purchase or sell these properties at significantly reduced prices, and there is no "10 Block" program at either Enterprise. Goldstein collected upfront fees and money from approximately 18 victims. Goldstein never delivered or sold any real estate properties to the victims.

This was a joint investigation with the Elk Grove, Illinois, Police Department.

Officer at FHLBank Member Bank Charged, Minnesota

On December 15, 2014, in U.S. District Court for the District of Minnesota, Timothy Owens, Former Chief Executive Officer and Chairman of the Board for Voyager Bank in Eden Prairie, Minnesota, was indicted for false bank entries, reports, and transactions, and obstructing an examination of a financial institution.

From 2008 through 2011, Owens allegedly abused his position with the bank by carefully circumventing the bank's lending procedures to ensure his credit extensions were not subject to the full vetting and review of the bank's senior management, board, or the holding company's board (Voyager Financial Services

Corporation). Through his actions, Owens was able to obtain letters of credit, which included a \$7.5 million irrevocable confirming letter of credit from the FHLBank of Des Moines. Owens could not repay the debt to the detriment of Voyager Bank. The loss to Voyager due to Owens' activities is estimated at \$9.7 million.

This was a joint investigation with the FBI, FDIC-OIG, and the Board of Governors of the Federal Reserve System OIG.

Collaborations

Investigative Partnerships

As demonstrated by the investigation cases described above, FHFA-OIG has partnered with a wide variety of federal, state, and local law enforcement organizations, including fellow financial law enforcement entities. For example, FHFA-OIG's Office of Investigations maintains a close working relationship with Treasury's Financial Crimes Enforcement Network to review allegations of mortgage fraud. In addition, FHFA-OIG participates in the National Mortgage Fraud Working Group in Washington, D.C., as well as regional mortgage fraud task forces throughout the country. FHFA-OIG is also a member of the President's Financial Fraud Enforcement Task Force.

Residential Mortgage-Backed Securities (RMBS) Working Group

FHFA-OIG continues to play an active part in the RMBS Working Group, which was established by the President in 2012 to investigate those responsible for contributing to the financial crisis through misconduct in pooling mortgage loans and selling related securities. The RMBS Working Group involves dozens of federal and state law enforcement agencies. FHFA-OIG's participation has included, among other things, reviewing evidence, interviewing witnesses, and advising about the RMBS market and strategic litigation.

During the period covered by this report, the Working Group has successfully negotiated settlements with two of America's largest banks for their conduct and that of companies they acquired in relation to selling RMBS. The settlements with Bank of America and Citigroup totaled approximately \$24 billion, and FHFA-OIG played a key role in the associated investigations. To date, settlements negotiated by the Working Group total nearly \$37 billion.

Planned Oversight Work

Overall Strategy

FHFA-OIG's Strategic Plan describes the vision, mission, and values that drive its work. The plan also lays out goals, objectives, and strategies for ensuring the integrity, transparency, effectiveness, and soundness of both FHFA's operations and those of organizations it oversees (the plan is available at www.fhfaig.gov/Content/Files/FY20152017%20Strategic%20Plan.pdf).

Audit and Evaluation Planned Activities

Pursuant to FHFA-OIG's ongoing strategy of identifying vulnerabilities and risk areas in Agency and GSE programs, FHFA-OIG will continue to review and revise its Audit and Evaluation Plan (the plan is available at

http://www.fhfa.ig.gov/Content/Files/AuditAndEvaluationPlan_1.pdf). The audits and evaluations in the plan are based on: independent risk assessments; reviews of relevant reports and documents; interviews with FHFA officials; coordination with other Inspectors General, the Government Accountability Office, and other oversight organizations; and consultations with Members of Congress, their staffs, and other government officials. Key aspects of FHFA-OIG's current plan include reviews of conservatorship operations, Enterprise supervision, nonbank sellers, and information technology security.

Investigations Planned Activities

FHFA-OIG's Office of Investigations will continue to support the RMBS Working Group and its investigations involving fraudulent or overvalued securities sold to the GSEs and the FHLBanks. In addition, FHFA-OIG continues to develop working partnerships and information-sharing relationships with federal, state, and local law enforcement agencies.

Hotline

FHFA-OIG's Hotline (1-800-793-7724) allows concerned parties to confidentially report information regarding possible fraud, waste, or abuse related to the Agency or the GSEs. FHFA-OIG honors all applicable whistleblower protections. FHFA-OIG will continue to promote the Hotline through its website, posters, and emails targeted to Agency and GSE employees, and through its semiannual reports to Congress.

Regulatory Review

Consistent with the Inspector General Act, FHFA-OIG will continue to consider whether proposed Agency regulations and policies are efficient, economical, legal, and susceptible to fraud, waste, or abuse. FHFA-OIG will make recommendations to the Agency as necessary and will monitor its adoption of or deviation from those recommendations.



Office of Inspector General

U.S. Department of Housing and Urban Development

The HUD Office of Inspector General (OIG) strives to make a difference in HUD's performance and accountability and has a strong commitment to its statutory mission of detecting and preventing fraud, waste, and abuse and promoting the effectiveness and efficiency of government operations.

Background

The U.S. Department of Housing and Urban Development (HUD) Inspector General is one of the original 12 Inspectors General authorized under the Inspector General Act of 1978. The HUD Office of Inspector General (OIG) strives to make a difference in HUD's performance and accountability. HUD OIG has a strong commitment to its statutory mission of detecting and preventing fraud, waste, and abuse and promoting the effectiveness and efficiency of government operations.

While organizationally located within HUD, HUD OIG operates independently with separate budget authority. Its independence allows for clear and objective reporting to HUD's Secretary and Congress. HUD's primary mission is to improve housing and expand opportunities for families seeking to improve their quality of life. HUD does this through a variety of housing and community development programs aimed at helping Americans nationwide obtain affordable housing. These programs are funded through a \$45 billion annual congressional budget.

Also, within HUD are the Federal Housing Administration (FHA) and Government National Mortgage Association (Ginnie Mae). FHA provides mortgage insurance for single-family and multifamily properties, nursing homes, and hospitals. FHA is self-funded through mortgage insurance premiums and receives limited congressional funding. FHA generated almost a trillion dollars in insured loans in fiscal year 2014.

Ginnie Mae guarantees the timely payment of principal and interest on mortgage-backed securities to institutional investors worldwide. These securities, or "pools" of mortgage loans, are used as collateral for the issuance of securities. Mortgage-backed securities are commonly referred to as "pass-through" certificates because the principal and interest of the underlying loans are passed through to investors. Ginnie Mae guarantees only securities backed by mortgage loans insured by government agencies, including FHA, the U.S. Department of Veterans Affairs, HUD's Office of Public and Indian Housing, and the U.S. Department of Agriculture's Rural Development. Ginnie Mae offers the only mortgage-backed securities carrying the full faith and credit guaranty of the United States Government, which means that its investors are guaranteed payment of principal and interest in full and on time.

While there are other HUD programs that are vulnerable to fraud and abuse, HUD OIG expends substantive time on the FHA program because of the mortgage crisis and an increased reliance on HUD to resolve foreclosure matters.

The degree of FHA predominance in the market is unparalleled. In recent testimony to Congress OIG stated it continues to have concerns regarding the ability of FHA's systems and infrastructure to adequately meet its requirements and perform its services. These concerns were also expressed by OIG to FHA through audits and comments on proposed rule changes. Some of these are longstanding issues that were highlighted in our work products from as far back as the early to mid-1990s.

As an example, the FHA Mutual Mortgage Insurance (MMI) fund did not meet the statutorily required minimum capital ratio of 2 percent in fiscal year 2014. The capital ratio is defined as the ratio of capital to unamortized insurance in force. This marks the sixth year in which FHA did not meet the requirement.

OIG continues to have concerns that an increase in demand on the FHA program will have collateral implications for the integrity of the Ginnie Mae mortgage-backed securities program, including the potential for increases in fraud in that program. Ginnie Mae securities are the only mortgage-backed securities to carry the full faith and credit guaranty of the United States. In addition, if an issuer fails to make the required pass-through payment of principal and interest to mortgage-backed securities investors, Ginnie Mae is required to assume responsibility for it by defaulting the issuers and assuming control of the issuers' mortgage-backed securities pools. Like FHA, Ginnie Mae has seen an increase in its market share. From a different vantage point, the industry has noted that Ginnie Mae's struggle to keep pace with FHA could also reduce liquidity in the housing market at a critical moment.

A significant problem facing FHA and the lenders it works with was decreasing home values. This condition increased the risk of default, abandonment, and foreclosure and made it difficult for FHA to resell the properties. Although FHA endorsement levels meet or exceed previous peaks in its program history, FHA defaults have already exceeded those of previous years. This issue reinforces the importance for FHA-approved lenders to maintain solid underwriting standards and quality control processes to withstand severe adverse economic conditions.

Over the years, HUD OIG has continued to report on the mediocre underwriting efforts and quality control processes of some FHA's approved lenders. Based on the results of the mortgage loan origination and underwriting initiative, HUD OIG again partnered with the U.S. Department of Justice's Civil Division, as well as a number of U.S. Attorneys' offices and HUD's Office of General Counsel, to investigate FHA-approved lenders for potential fraud and to facilitate litigation under the False Claims Act or other statutes when warranted. Our reviews focused on FHA's larger mortgage lenders regarding their compliance with FHA's underwriting requirements and their quality control processes. HUD OIG staff will continue assisting in these efforts into fiscal year 2016.

This year, HUD OIG is highlighting three areas of concern related to the financial market. They are:

1. Disclaimer of opinion on the Ginnie Mae fiscal year 2013-2014 financial statements.

We were unable to obtain sufficient evidence to express an opinion on the fairness of the \$6.6 billion in nonpooled loan assets from Ginnie Mae's defaulted issuers' portfolio and \$735 million in liability for losses on the mortgage-backed securities program guaranty. In addition, Ginnie Mae improperly

accounted for FHA's reimbursable costs as an expense instead of capitalizing the costs as an asset. This error resulted in the misstatement of the asset and net income.

Overall, the issues cited in the report were tied to problems associated with the acquisition and management of a multi-billion-dollar defaulted issuers' portfolio, which is a noncore segment of Ginnie Mae's business. Due to the scope limitation in our audit work and the effects of material weaknesses in internal control, we have not been able to obtain sufficient evidence to provide a basis for an audit opinion on Ginnie Mae's fiscal year 2014 financial statements and accordingly, we do not express an opinion. We identified four material weaknesses and one significant deficiency. Ginnie Mae's inadequate monitoring, oversight, and governance of its accounting and reporting functions by the executive management team; loss of several key Office of the Chief Financial Officer personnel; and the inability to track accounting transactions and events at a loan level due to system limitations were all factors contributing to these issues.

Ginnie Mae's financial statements as of September 30, 2013, were audited by a predecessor auditor, Clifton Larson Allen LLP (CLA). In this audit, CLA provided an unqualified opinion on those statements on November 25, 2013. In fiscal year 2014, we conveyed to CLA the material misstatements in the financial statements that affected previously issued financial statements. CLA reviewed the issues raised and agreed with our conclusion. Accordingly, CLA notified OIG that it was withdrawing the opinion given in connection with its audit of Ginnie Mae's 2013 financial statements because the opinion could no longer be relied upon.

2. OIG's fiscal year 2014 settlement agreements with five lenders related to their origination of single-family mortgage loans.

JP Morgan Chase, February 4, 2014, \$614 million civil settlement – FHA's MMI fund received approximately \$336 million in FHA from this settlement. The U.S. Attorney's Office of the Southern District of New York investigated the FHA loan origination and underwriting practices of Chase due to a qui tam⁴ filing. A relator⁵ alleged that Chase had not followed FHA requirements when underwriting loans according to the FHA insurance program. As a result, the insurance fund incurred significant losses when the borrowers defaulted on the loans. The Government intervened and alleged that during the period January 2002 to February 2014, Chase routinely approved loans for FHA insurance and refinancing that did not meet applicable underwriting requirements and were, therefore, ineligible for insurance. However, FHA had insured the loans based on per loan certifications submitted by Chase that it had complied with FHA requirements when underwriting the loans. When the borrowers defaulted on the loans, FHA incurred substantial losses. As part of the settlement, Chase admitted, acknowledged, and accepted responsibility for certain conduct in failing to follow HUD FHA insurance program requirements.

4 Qui tam suits are brought for "the government as well as the plaintiff." In a qui tam action, the plaintiff (the person bringing the suit) will be entitled to a percentage of the recovery of the penalty (which may include large amounts for breach of contract) as a reward for exposing the wrongdoing and recovering funds for the government. Sometimes the Federal or State government will intervene and become a party to the suit to guarantee success and be part of any negotiations and conduct of the case.

5 A person who has supplied the facts required for a criminal prosecution or a civil suit on behalf of the government.

SunTrust, June 17, 2014, \$968 million civil settlement – In this investigation, the U.S. Department of Justice, the Consumer Financial Protection Board, 49 State Attorneys General, and the District of Columbia Attorney General filed a suit alleging misconduct in SunTrust’s origination and servicing of FHA mortgages. The lawsuit alleged that from January 2006 through March 2012, SunTrust knowingly failed to comply with HUD regulations and requirements of the direct endorsement lender program governing FHA mortgage originations and underwriting. As a participant in that program, SunTrust had the authority to originate, underwrite, and certify mortgages for FHA insurance. FHA insured loans based on annual and per loan certifications submitted by SunTrust, which stated that it had complied with the FHA program requirements. Of the \$968 million settlement, FHA received \$300 million. The settlement also required SunTrust to provide \$500 million in consumer relief for homeowners and SunTrust also admitted to certain misconduct.

U.S. Bank, June 30, 2014, \$200 million civil settlement – FHA’s MMI fund received \$144.2 million. This settlement resolved allegations that, between January 2006 and December 2011, U.S. Bank violated the False Claims Act by knowingly originating and underwriting mortgage loans insured by FHA that did not meet applicable requirements. U.S. Bank agreed that it engaged in certain conduct in connection with its origination, underwriting, quality control, and endorsement of FHA mortgages, which resulted in claims being submitted to HUD. As a result of the lender’s conduct, FHA insured loans that were not eligible for FHA insurance and incurred substantial losses when it paid insurance claims on these loans.

Bank of America Corporation, August 21, 2014, \$16.5 billion civil settlement – This was the largest civil settlement with a single entity in American history. It resolved multiple Federal and State claims against Bank of America and its former and current subsidiaries, including Countrywide Financial Corporation and Merrill Lynch. In one facet of the overall investigation and settlement, the U.S. Attorney’s Office of the Eastern District of New York and HUD conducted a 2-year investigation into whether Bank of America knowingly made loans insured by FHA in violation of applicable underwriting guidelines. The investigation established that Bank of America caused FHA to insure loans that were not eligible for FHA mortgage insurance. As a result, HUD incurred hundreds of millions of dollars in losses. In addition, many of Bank of America’s borrowers defaulted on their FHA mortgage loans and either lost or were in the process of losing their homes to foreclosure. Bank of America agreed to pay \$16.65 billion, of which \$9.65 billion was to resolve pending and potential legal claims. Of the \$9.65 billion, \$800 million was attributable to FHA loans for which FHA received \$437.6 million. Bank of America also agreed to provide \$7 billion in consumer relief.

Golden First and David Movtady, December 31, 2014, \$36 million civil judgment and \$300,000 settlement from Movtady – FHA’s MMI fund is to receive \$300,000 from Movtady, and FHA holds the \$36 million judgment against Golden First. The U.S. Attorney’s Office of the Southern District of New York settled a civil mortgage fraud lawsuit against Golden First and David Movtady (its owner, operator and president). The Government’s complaint, filed in April 2013 and amended in August 2013, sought damages and civil penalties under the False Claims Act for years of misconduct in connection with Golden First’s participation in the FHA direct endorsement lender program. As a direct endorsement lender, Golden First had the authority to originate, underwrite, and certify mortgages for FHA insurance. Direct endorsement lenders are required to follow HUD’s program rules, including certifying mortgages and maintaining a quality control program that can prevent and correct

underwriting deficiencies. Movtady fraudulently certified to HUD that Golden First conformed to all HUD FHA regulations necessary to maintain its HUD FHA approval. Golden First and Movtady admitted, acknowledged, and accepted responsibility for failing to maintain a compliant quality control program and as a result, did not conform to all HUD FHA regulations applicable to originating and underwriting FHA loans. This conduct was contrary to the representations in the lender's annual certifications to HUD, including those signed by Movtady. In addition to the financial judgment and Movtady payment, the settlement permanently barred Movtady from conducting business with the Federal Government.

3. Sample of HUD OIG's criminal mortgage fraud cases closed in fiscal year 2014.

President of title company sentenced – The president of a St. Louis-based title company and owner of an FHA-approved loan correspondent was sentenced in U.S. District Court to 24 months incarceration and 36 months probation and ordered to pay restitution of \$494,407 to HUD, the Internal Revenue Service, and other financial institutions following a conviction of conspiracy to defraud the United States. As the owner of The Mortgage Store, an FHA-approved lender, the president falsely claimed \$200,000 in liquid assets to HUD to fraudulently inflate the lender's net worth. The president also engaged in a criminal "check kiting" scheme and failed to remit employment taxes to the Internal Revenue Service. Without those fraudulent activities and false representations, the lender would not have met the FHA net worth requirements and would not have been allowed to originate new mortgage loans. Mortgages originated by The Mortgage Store after the fraudulent representations to HUD resulted in 331 foreclosures with losses to FHA in excess of \$20 million.

Realtors and mortgage loan officer imprisoned for fraud – Two real estate agents and a mortgage loan officer were sentenced after earlier guilty pleas to conspiracy, wire fraud, and money laundering. One real estate agent was sentenced to 48 months incarceration and the other to 18 months incarceration and 3 years supervised release. The mortgage loan officer was sentenced to 36 months incarceration and 3 years supervised release. From 2001 to August 2011, the three acquired more than 40 properties and then recruited buyers to purchase the properties at inflated prices. The three acted as the buyers' real estate agents, prepared loan applications with false information for the borrowers, created false documents in support of those applications, and then processed those applications for mortgage loans through the loan officer. Many of those mortgages resulted in foreclosure, and losses to FHA are expected to reach \$3.7 million.

Prison time in foreclosure rescue scheme – The owner of the foreclosure rescue businesses, US Mortgage Bailout, USMortgageBailout.com, and iLoanAudit, was sentenced to 60 months incarceration and 3 years supervised release and ordered to pay restitution of \$1.4 million following guilty pleas to mail fraud, wire fraud, money laundering, and bankruptcy fraud. The owner ran a multiyear scheme to collect money from thousands of distressed borrowers by promising to provide loan modifications. The companies' websites claimed to be "an experienced legal team made up of attorneys and paralegals to handle all of the negotiations with your current lender" who had "helped thousands of homeowners avoid foreclosure" and boasted a 97 percent success rate. However, no foreclosure rescue assistance was provided.

Loan modification company owner sentenced for Home Affordable Modification

Program fraud – The owner of a mortgage loan modification telemarketing business was sentenced to 1 month incarceration and 3 years probation and ordered to pay restitution of \$121,400 to victimized homeowners after pleading guilty to mail fraud and aiding and abetting. Between 2009 and 2011, the owner solicited distressed homeowners, claiming that his telemarketing business was affiliated with HUD and could provide assistance through the Home Affordable Modification Program for a fee. The owner then collected fees from an estimated 124 distressed homeowners but did not attempt to help the homeowners avoid foreclosure.

The tasks before HUD OIG continue to be daunting. Challenges remaining include addressing the elements of fraud that were involved in the collapse of the mortgage market and monitoring the rollout of new FHA loan products to reduce exploitation of program vulnerabilities. In addition, HUD OIG is combating perpetrators of fraud, including those who have migrated from the subprime markets, who seek to exploit FHA loan programs.

The consequences of the mortgage crisis, its worldwide economic implications, and the resulting pressures placed on HUD and OIG came at a time when HUD has had significant new leadership responsibilities. Over the last 7 years, HUD has also been focused on rebuilding communities devastated by disasters, such as Lower Manhattan post-September 11 and Hurricanes Katrina, Rita, and Wilma that have added tens of billions of dollars in new program funds requiring quick distribution and keen oversight. In addition, in the last few years, Congress appropriated \$16 billion to assist States and people affected by Superstorm Sandy, and HUD OIG continues to work closely with the Department as it implements the funding for recovery from this natural disaster.



Office of Inspector General National Credit Union Administration

The NCUA OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste and abuse, thereby supporting the NCUA's mission of providing, through regulation and supervision, a safe and sound credit union system which promotes confidence in the national system of cooperative credit.

Agency Overview

The National Credit Union Administration (NCUA) is responsible for chartering, insuring, and supervising Federal credit unions and administering the National Credit Union Share Insurance Fund (NCUSIF). The NCUA also manages the Operating Fund (OF),⁶ the Temporary Corporate Credit Union Stabilization Fund (TCCUSF),⁷ the Community Development Revolving Loan Fund (CDRLF),⁸ and the Central Liquidity Facility (CLF).⁹

Credit unions are member-owned, not-for-profit cooperative financial institutions formed to permit members to save, borrow, and obtain related financial services. NCUA charters and supervises federal credit unions, and insures accounts in federal and most state-chartered credit unions across the country through the NCUSIF, a federal fund backed by the full faith and credit of the United States government.

The NCUA's mission is to provide through regulation and supervision, a safe and sound credit union system that promotes confidence in the national system of cooperative credit. The agency also has a vision to protect consumer rights and member deposits. Finally, the NCUA is further dedicated to upholding the integrity, objectivity, and independence of credit union oversight. NCUA continually implements initiatives designed to continue meeting these goals.

6 The OF was created by the Federal Credit Union Act of 1934. The OF was established as a revolving fund in the United States Treasury under the management of the NCUA Board for the purpose of providing administration and service to the Federal credit union system. A significant majority of the OF's revenue is comprised of operating fees paid by Federal credit unions. Each Federal credit union is required to pay this fee based on its prior year asset balances and rates set by the NCUA Board.

7 The TCCUSF was established as a revolving fund in the U.S. Treasury under the management of the NCUA Board. The purposes of the TCCUSF are to accrue the losses of the corporate credit union system and, over time, assess the credit union system for the recovery of such losses.

8 The NCUA's CDRLF, which was established by Congress, makes loans and Technical Assistance Grants to low-income designated credit unions.

9 The CLF is a mixed-ownership government corporation the purpose of which is to supply emergency loans to member credit unions.

Major NCUA Programs

Supervision

NCUA's supervision program ensures the safety and soundness of the credit union system. Identifying and resolving risk concerns such as credit risk, concentration risk, and strategic risk continue to be the primary focus of the agency's supervision program. NCUA supervises natural person credit unions through annual examinations, regulatory enforcement, providing guidance in regulations and Letters to Credit Unions, and taking supervisory and administrative actions as necessary to manage credit union risk.

On January 1, 2013, the NCUA established the Office of National Examinations and Supervision (ONES) to oversee the unique examination and supervision issues related to consumer credit unions with assets greater than \$10 billion and all corporate credit unions. Large consumer credit unions pose unique challenges in light of their size in comparison to the NCUSIF. Corporate credit unions touch the operations of thousands of consumer credit unions through the critical services they provide. ONES staff includes examiners, lending specialists, capital markets specialists, information systems specialists, and payment systems specialists to focus on key areas of potential risk. ONES is positioned to adapt its examination and supervision process and procedures to keep pace with a changing financial and operational environment.

Insurance

The NCUA administers the NCUSIF, which provides insurance for deposits held at federally insured natural person and corporate credit unions nationwide. The fund is capitalized by credit unions. NCUA manages the fund to ensure members' deposits are insured. In 2010, Congress permanently increased the insurance limit from \$100,000 to \$250,000 per depositor.

Small Credit Union Initiatives

Through its Office of Small Credit Union Initiatives (OSCUI), NCUA fosters credit union development, particularly the expansion of services provided by small credit unions to eligible consumers. NCUA fulfills this goal through training, partnerships and assistance. A major source of assistance is the CDRLF, which provides loans and grants to credit unions which serve low-income customers. CDRLF assistance enables these credit unions to provide basic financial services and stimulate economic activities in their communities. NCUA's OSCUI is also responsible for assisting the agency's risk mitigation program.

Consumer Protection

NCUA protects credit union members through effective enforcement of consumer protection regulations and requirements. NCUA's Office of Consumer Protection (OCP), created in 2010, is responsible for consumer protection in the areas of fair lending examinations, member complaints, and financial literacy. OCP consults closely with the Consumer Financial Protection Bureau (CFPB). CFPB has direct supervisory authority over credit unions with assets of \$10 billion or more, but can request to accompany NCUA on examinations of other credit unions. In addition to consolidating consumer protection examination functions within NCUA, OCP responds to inquiries from credit unions, their members, and consumers involving consumer protection and share insurance matters. Additionally, OCP processes member complaints filed against federal credit unions.

Asset Management

The NCUA's Asset Management and Assistance Center (AMAC) conducts credit union liquidations and performs management and recovery of assets. AMAC assists NCUA regional offices with the review of large, complex loan portfolios and actual or potential bond claims. AMAC also participates extensively in the operational phases of conservatorships and records reconstruction. AMAC's purpose is to minimize costs to the NCUSIF and to credit union members.

Office of Minority and Women Inclusion

NCUA formed the Office of Minority and Women Inclusion (OMWI) in January 2011, in response to the "Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010" (Dodd-Frank). OMWI is responsible for all matters relating to measuring, monitoring and establishing policies for diversity in the agency's management, employment and business activities. OMWI is also responsible for measuring, monitoring, and providing guidance about diversity for NCUA's regulated entities, excluding the enforcement of statutes, regulations and executive orders pertaining to civil rights.

The NCUA Office of Inspector General

The 1988 amendments to the Inspector General Act of 1978 (IG Act), 5 U.S.C. App. 3, established IGs in 33 designated Federal entities (DFEs), including the NCUA.¹⁰ The NCUA Office of Inspector General (OIG) was established in 1989. The NCUA IG is appointed by, reports to, and is under the general supervision of, a three-member presidentially-appointed Board. The OIG staff consists of ten (10) FTEs: the IG, the Deputy IG/Assistant IG for Audit, the Counsel to the IG/Assistant IG for Investigations, the Director of Investigations, three (3) senior auditors, two (2) auditors, and an office manager. The OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste, and abuse, thereby supporting the NCUA's mission of facilitating the availability of credit union services to all eligible consumers through a regulatory environment that fosters a safe and sound credit union system. The OIG supports this mission by conducting independent audits, investigations, and other activities, and by keeping the NCUA Board and the Congress fully and currently informed of its work.

¹⁰ 5 U.S.C. App. 3, §8G.

Role in Joint Financial Oversight Working Groups

Interest Rate Risk

During the past year we continued coordination with our financial IG counterparts in CIGFO on issues of mutual interest, including participation in a working group to assess the extent to which FSOC oversees interest rate risk to the financial system. Federal Housing Finance Agency OIG staff members are leading and coordinating this review. In support of the review, the NCUA OIG and other participating OIGs performed audit steps to determine the extent to which their respective member agencies are involved in interest rate risk oversight and actions taken in response to FSOC recommendations. The scope of this review includes FSOC's monitoring of interest rate risk during 2013 and 2014. The CIGFO working group will issue a report to the FSOC, which could include recommendations.

Recent, Current, and Projected Oversight Work

In accordance with section 989(a)(2)(B) of Dodd-Frank, the following highlights the completed, ongoing, and projected work of our office, with a focus on issues particular to NCUA as well as those that may apply to the broader financial sector.

Mobile Security Devices Review

NCUA provides iPhones and iPads for use by select employees and contractors. In addition, NCUA allowed employees and contractors to connect their personally-owned mobile devices such as the Apple iPhone and iPad, and Android and Windows phones to the NCUA Exchange server to access agency email, calendar, and contacts. Mobile handheld devices could be used not only for voice calls, text messages, and Personal Information Management, but also for many functions done with a computer. While mobile handheld devices provide many productivity benefits, they also pose new risks to an organization's security. We conducted a review to determine whether NCUA had adequate mobile device security controls to sufficiently protect NCUA information and information systems assets.

We determined that NCUA policies, along with the agency's practices and controls associated with its NCUA-issued mobile devices provided adequate security to protect NCUA information, data, and resources. However, we also determined that NCUA could improve security of its mobile devices by addressing the following issues we identified:

- NCUA's System Security Plan (SSP) did not adequately address mobile device security; and
- NCUA could include additional or enhanced policies or controls in its SSP.

In addition, we determined that the controls associated with managing and securing personal mobile devices operating within the NCUA environment did not provide adequate protections over NCUA information, data, and resources. Based on the significant risks associated with this practice, we issued a management letter to the NCUA Office of the Executive Director in November 2014, recommending that the agency cease this practice immediately. In response, the agency immediately prohibited this practice and also disconnected this service. However, we recommended further that NCUA take additional steps in an effort to address NCUA accounts that might still exist on previously connected inactive devices and to address NCUA

documentation that users may have downloaded to active or inactive devices which had connected to NCUA's Exchange Server at any time.

Furthermore, we made two recommendations where NCUA could improve the security policies and controls associated with its agency-issued mobile devices to help the agency better protect its information, data, and resources.

NCUA's Breach Notification Policies and Procedures

In October 2014, an NCUA examiner lost an unencrypted, external flash drive, provided by a credit union manager, containing the names, addresses, social security numbers, and account numbers belonging to approximately 1,600 credit union members. The flash drive did not include passwords or PINS. Moreover, there was no indication of any unauthorized access to members' accounts or attempts to gain improper access as a result of the incident. Because of our ongoing oversight of the agency's progress in monitoring its own and credit unions' efforts to assess and mitigate cybersecurity threats, we undertook the following actions in response to this incident:

An audit to determine whether NCUA has adequate controls in place to protect the security, confidentiality and integrity of electronic sensitive, confidential, and personally identifiable credit union information during the examination process; and

A review examining the agency's decision not to publicly announce, on the NCUA website, the loss of the flash drive and how the agency could improve if a similar loss or an actual breach incident were to occur in the future.

With regard to the audit, we have initiated that project and it is ongoing. With regard to the review, we conducted a Management Advisory Review (MAR) and issued a final report on March 2, 2015.

The MAR concluded that the NCUA Executive Director's (ED) decision not to publicly announce the incident on NCUA's website was appropriate under the circumstances. As part of our review, we noted that in response to OMB guidance issued in 2006 and 2007, respectively, NCUA had formalized internal policies documenting how it should respond in the event of a security breach incident as well as for securing documentation about or acquired from credit unions or other external parties. We reported further that NCUA was fortunate, prior to the incident at hand, in not having to test the adequacy of these policies, because a security breach had not occurred as a result of the loss of the flash drive. However, in light of the flash drive loss incident, we examined the relevance and effectiveness of those internal policies. In so doing, the MAR report also reiterated the agency's Office of the Chief Information Officer's (OCIO) non-technical solutions to address and prevent incidents such as the one we reviewed, which OCIO offered in the aftermath of the incident. We credited the agency with fully implementing some of OCIO's recommended solutions and initiating implementation of the remainder. With regard to the agency's internal policies, we offered three specific recommendations pertaining to internal NCUA breach notification policies which the agency immediately notified us that it had accepted. The agency is currently editing existing policies to reflect those recommendations.

Interest Rate Risk

Because interest rate risk¹¹ is the most significant risk the credit union industry faces right now, we continued to focus on how NCUA examiners are evaluating a credit union's ability to mitigate interest rate and liquidity risk. This focus is especially necessary where there are high levels of long-term assets funded by short-term, less stable funds. As interest rates have risen above record lows, many credit unions' unrealized gains have swung to unrealized losses. These unrealized losses may foreshadow the actual losses credit unions will face if continuing rate increases eventually result in more compression of net interest margins.

Several of the Material Loss Reviews the OIG conducted over the past several years noted that credit unions without an appropriate interest rate risk policy, and a program to effectively implement that policy as part of their asset liability management responsibilities, caused losses to the NCUSIF and/or contributed to the credit union's failure. The MLR reports we issued further identified where improvements could be made in NCUA's monitoring of interest rate risk.

Incorporating lessons learned from some of the earlier MLR reports, in January 2012, the NCUA Board adopted a final amendment to the agency's insurance rules requiring certain federally-insured credit unions to have a written policy to address interest rate risk management as well as an effective interest rate risk program for successful asset liability management.¹² In the past year, we observed how NCUA impressed upon credit unions that it is imperative for them to make the necessary adjustments to account for a rising rate environment. Indeed, as part of its 2013 supervisory focus, the agency emphasized that even a slow, gradual increase in rates could have significant consequences for credit unions with high concentrations in certain long-term investments and loans.

In light of the foregoing, we recently initiated an audit to determine (1) whether NCUA's interest rate risk policies and procedures are helping to effectively reduce interest rate risk in credit unions, and (2) what action NCUA has taken or plans to take to identify and address credit unions with interest rate risk concerns.

11 The term "interest rate risk" refers to the vulnerability of a credit union's financial condition to adverse movements in market interest rates. For example, changes to a credit union's funding costs generally are considered part of the inherent rate risk associated with a fixed-rate mortgage loan. A borrower with a fixed-rate mortgage loan is unaffected by increases in market interest rates because his payment is based on a "fixed" rate. The credit union that originated the mortgage loan, however, is subject to losses in the market value of these mortgages from the increases in the market interest rates. Furthermore, as market interest rates rise, there is a concomitant increase in the credit union's funding costs, or the interest rate the credit union pays on the money it uses to "fund" the mortgage loan.

12 <http://www.ncua.gov/Legal/Documents/Regulations/FIR20120126InterestRateRiskProg.pdf>



Office of Inspector General U. S. Securities and Exchange Commission

The U.S. Securities and Exchange Commission (SEC or agency) Office of Inspector General (OIG) promotes the integrity, efficiency, and effectiveness of the critical programs and operations of the SEC and operates independently of the agency to help prevent and detect fraud, waste, and abuse in those programs and operations, through audits, evaluations, investigations, and other reviews.

Background

The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and effective oversight. Its core values are integrity, effectiveness, fairness, accountability, teamwork, and excellence. The SEC's strategic goals are to establish and maintain an effective regulatory environment; foster and enforce compliance with the Federal securities laws; facilitate access to the information investors need to make informed investment decisions; and enhance the SEC's performance by effectively aligning and managing human resources, information, and financial capital.

The SEC is charged with overseeing over 25,000 market participants, including nearly 12,000 investment advisers, approximately 10,500 mutual funds and exchange traded funds, nearly 4,500 broker-dealers, and about 450 transfer agents. The agency also oversees 18 national securities exchanges, 10 credit rating agencies, and 8 active registered clearing agencies, as well as the Public Company Accounting Oversight Board, the Financial Industry Regulatory Authority, the Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, and the Financial Accounting Standards Board. In addition, the SEC is responsible for reviewing the disclosures and financial statements of some reporting companies.

In recent years, the SEC's responsibilities have increased, with new or expanded jurisdiction over securities-based derivatives, hedge fund and other private fund advisers, credit rating agencies, municipal advisors, and clearing agencies. The SEC has also been required to implement and oversee a new regime for securities offerings that utilize crowdfunding, among other changes. The SEC has reported that it has proposed or adopted nearly all the mandatory rulemakings required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act). As the SEC's jurisdiction has expanded, the size and complexity of the markets and entities it oversees have grown significantly.

The SEC OIG was established as an independent office within the SEC in 1989 under the Inspector General Act of 1978, as amended (IG Act). The SEC OIG's mission is to promote the integrity, efficiency, and effectiveness of the SEC's critical programs and operations. The SEC OIG prevents and detects fraud,

waste, and abuse through audits, evaluations, investigations, and other reviews related to SEC programs and operations.

The SEC OIG Office of Audits conducts, coordinates, and supervises independent audits and evaluations of the SEC's programs and operations at its headquarters and 11 regional offices. These audits and evaluations are based on risk and materiality, known or perceived vulnerabilities and inefficiencies, and information received from the Congress, SEC staff, the U.S. Government Accountability Office, and the public.

The SEC OIG Office of Investigations performs investigations into allegations of criminal, civil, and administrative violations involving SEC programs and operations by SEC employees, contractors, and outside entities. These investigations may result in criminal prosecutions, fines, civil penalties, administrative sanctions, and personnel actions. The Office of Investigations also identifies vulnerabilities, deficiencies, and wrongdoing that could negatively impact the SEC's program and operations.

In addition to the responsibilities set forth in the IG Act, Section 966 of the Dodd-Frank Act required the SEC OIG to establish a suggestion program for SEC employees. The SEC OIG established its SEC Employee Suggestion Program in September 2010. Under this program, the OIG receives, reviews, and processes suggestions from agency employees for improvements in the SEC's work efficiency, effectiveness, and productivity, and use of its resources, as well as allegations by employees of waste, abuse, misconduct, or mismanagement within the SEC.

SEC OIG Work Related to the Broader Financial Sector

In accordance with Section 989E(a)(2)(B)(i) of the Dodd-Frank Act, we discuss below the SEC OIG's completed and ongoing work, focusing on issues that may apply to the broader financial sector.

Completed Work

OIG Work Related to Prohibited Securities Holdings by SEC Employees

Because the SEC is responsible for oversight of the securities industry and the protection of investors, SEC employees must maintain high standards of conduct. To that end, in August 2010, the SEC adopted a regulation that supplements the government-wide ethics standards. The supplemental ethics regulation addresses what investments SEC employees are allowed to make, as well as when and how they conduct such transactions. The SEC's Office of Ethics Counsel (OEC) is responsible for advising and counseling employees and members of the Commission on personal and financial conflicts of interest, financial disclosure, and securities holdings.

The SEC OIG Office of Investigations has investigated several employees for conducting securities transactions that violate the SEC's personal trading rules and regulations. Some of those investigations were described in the SEC OIG section of the 2014 CIGFO Annual Report, which was issued in July 2014. Since that time, the SEC OIG has continued to investigate allegations of prohibited holdings by SEC employees.

For example, the SEC OIG completed investigations into allegations that an SEC staff accountant and an SEC attorney held stock that the SEC's supplemental ethics regulation prohibited them from owning. In one matter, the OIG found that an SEC staff accountant held prohibited stocks for a 2 year period after she joined

the SEC. This employee also did not pre-clear a purchase, executed in her husband's account, of a security that SEC employees were prohibited from purchasing or selling at that time. In the other matter, the OIG found that an SEC attorney had several prohibited holdings that her spouse had purchased before these securities were added to the SEC's prohibited holdings list. The OIG also determined that the attorney did not pre-clear the transactions and did not accurately report her holdings on the annual Office of Government Ethics (OGE) Forms 450 she filed or in the SEC's current trading compliance system. The OIG did not find evidence that either employee worked on matters related to the prohibited holdings. The OIG referred both matters to United States Attorney's Offices, which declined criminal prosecution.

During its investigations of prohibited holdings by SEC employees, the SEC OIG Office of Investigations identified potential issues related to the manner in which OEC oversees employee securities holdings and provided this information to the SEC OIG Office of Audits. Based on that information, the SEC OIG Office of Audits performed the *Audit of the Office of the Ethics Counsel's Oversight of Employee Securities Holdings, Report No. 527, December 10, 2014*. The purpose of this audit was to evaluate OEC's effectiveness in ensuring employees comply with ethics regulations on prohibited holdings and temporarily restricted trades. Specifically, the SEC OIG sought to (1) determine whether OEC has developed and implemented policies and procedures in accordance with Federal laws and regulations, including 5 CFR § 4401.102, Prohibited and restricted financial interests and transactions; (2) evaluate the operating effectiveness of internal controls that OEC designed and implemented over the process for clearing and reporting employee securities transactions and holdings; and (3) determine whether OEC has established a mechanism to ensure employees comply with 5 CFR § 4401.102.

The SEC OIG found that OEC has developed and implemented policies and procedures in accordance with Federal laws and regulations, and has voluntarily implemented additional compliance processes. However, the SEC OIG identified areas for improvement in OEC's oversight of employee securities holdings and transactions. The SEC OIG issued its final report on December 10, 2014, and made nine recommendations to improve the SEC's oversight of employee securities holdings. The recommendations addressed improvements in the review of employment candidates' securities holdings, the functionality of the trading clearance system, and OEC's annual compliance testing. Management concurred with all of the recommendations. Eight recommendations have been closed and the remaining recommendation will be closed upon completion and verification of corrective action.

Audit of the Representation of Minorities and Women in the SEC's Workforce, Report No. 528, November 20, 2014

Embracing diversity increases the SEC's ability to attract the best and the brightest in the securities industry, thereby empowering the agency to achieve professional excellence and remain steadfast in its commitment to protect the investing public. In March 2014, members of the U.S. House of Representatives Committee on Financial Services, affirming the importance of diversity, asked the SEC OIG to review the SEC's internal operations to determine whether any personnel practices have created a discriminatory workplace or otherwise systematically disadvantaged minorities. The members also asked the OIG to assess the operations of the SEC's Office of Minority and Women Inclusion (OMWI), which was established pursuant to Section 342 of the Dodd-Frank Act. The members sent similar requests to the Inspectors General of five other Federal financial regulators.

The SEC OIG performed this audit to assess the SEC's personnel operations and other efforts to (1) increase the agency's representation of minorities and women; (2) create a workplace free of systemic discrimination against minorities and women, and (3) provide equal opportunity for minorities and women to obtain senior management positions. The SEC OIG also sought to identify factors that may impact the SEC's ability to increase the representation of minorities and women at the SEC, in general, and in senior management positions, in particular.

The SEC OIG assessed diversity at the SEC and compared the agency's workforce between Fiscal Years 2011 and 2013 to U.S. civilian labor force, Federal, and securities industry workforce data. The SEC OIG found that the SEC has made efforts to promote diversity. However, the SEC OIG found that some minority groups and women (1) were underrepresented in the SEC's workforce; (2) received relatively fewer and smaller cash awards and bonuses; (3) experienced statistically significant lower performance management and recognition scores; and (4) filed equal employment opportunity complaints at rates higher than their percentage of the workforce.

The SEC OIG noted that the conditions observed may have occurred or may not have been remedied, in part, because the SEC's Office of Equal Employment Opportunity (OEEO) did not take required initial steps to identify areas where barriers may operate to exclude certain groups. Therefore, the SEC did not examine, eliminate, or modify, where appropriate, policies, practices, or procedures that create barriers to equal opportunity. As a result, the SEC lacked assurance that it has uncovered, examined, and removed barriers to equal participation at all levels of its workforce. The SEC OIG also found that OMWI lacked a systematic and comprehensive method for evaluating the effectiveness of its programs and diversity efforts. Specifically, OMWI had not fully established internal policies and procedures or required workforce diversity standards to monitor, evaluate, and, as necessary, improve its operation and comply fully with Section 342 of the Dodd-Frank Act.

The SEC OIG issued its final report on November 20, 2014, and made five recommendations for corrective action designed to identify and eliminate potential barriers to equal opportunity. The recommendations addressed OEEO policies and procedures; review and submission of required data to the U.S. Equal Employment Opportunity Commission; performance of barrier analyses; and OMWI policies, procedures, and workforce diversity standards. Management concurred with all of the recommendations. One recommendation has been closed and the remaining four recommendations will be closed upon completion and verification of corrective action.

Ongoing Work

Evaluation of the Office of Compliance Inspections and Examinations' Resource Allocation

The Office of Compliance Inspections and Examinations (OCIE) protects investors by administering the SEC's nationwide examination and inspection program. Examiners in Washington, DC, and the SEC's 11 regional offices conduct examinations of the nation's registered entities, including broker-dealers, transfer agents, investment advisers, investment companies, the national securities exchanges clearing agencies, self-regulatory organizations, and the Public Company Accounting Oversight Board. As noted in the OIG's Statement of the SEC's Management and Performance Challenges for FY 2014, the SEC has identified an immediate and pressing need to ensure sufficient examination coverage of investment advisers.

On January 28, 2015, the SEC OIG initiated an evaluation of OCIE's resource allocation. The overall objective of the evaluation is to assess OCIE's human resources management to ensure it efficiently and effectively addresses mission priorities that the SEC Chair identified in Congressional testimony. Specifically, the SEC OIG will evaluate OCIE's methodology for establishing staffing requests, personnel allocations, and examination priorities by program area. The SEC OIG will also determine how OCIE adjusted its examination priorities or resource allocations based on the FY 2015 approved budget. The SEC OIG expects to issue a report summarizing its findings before the end of 2015.

Audit of Controls Over Distributions to Harmed Investors

Investors who are harmed by securities fraud or other securities law violations may be eligible, in some instances, to receive money recovered by the SEC. For example, when the SEC brings a successful enforcement action, either in court or in an administrative proceeding, the court or the SEC may order an individual or entity to disgorge the funds (i.e., give up the ill-gotten gains) resulting from the illegal conduct. The disgorged funds may be distributed to investors who were harmed by the securities violation. A court or the SEC may also impose a monetary penalty to punish the party and to deter others from committing similar misconduct. The monetary penalty may be distributed to investors if the court or the SEC orders that any penalty collected be placed in a "fair fund" for distribution to harmed investors. Typically, a third-party such as a fund administrator or distribution agent assists with the distribution process.

On February 5, 2015, the SEC OIG initiated an audit of the SEC's controls over distributions to harmed investors. The audit objectives are to assess (1) the SEC's policies, procedures, and efforts to collect disgorgement and penalty funds and to accurately and timely distribute those funds to harmed investors; and (2) the SEC's policies, procedures, and controls for overseeing the work of third-party entities used in the distribution process. The SEC OIG expects to issue a final report summarizing its findings by the end of 2015.

Evaluation of the SEC's Use of the Reserve Fund

Section 991(e) of the Dodd-Frank Act authorized the U.S. Department of the Treasury to create an SEC Reserve Fund, which is funded from fees paid under Section 6(b) of the Securities Act of 1933 and Section 24(f) of the Investment Company Act of 1940, subject to certain limits. Section 991(e) specifies that the SEC can use the Reserve Fund as "the Commission determines is necessary to carry out the functions of the Commission." This section also requires the SEC to notify Congress, within 10 days of the obligation of amounts from the Reserve Fund, of the date, amount, and purpose of the obligation. In Congressional testimony, the SEC Chair has identified a number of key information technology modernization initiatives that are being supported by the use of the Reserve Fund.

On February 27, 2015, the SEC OIG initiated an evaluation of the SEC's use of the Reserve Fund. The SEC OIG's objective is to assess how the Reserve Fund was used during Fiscal Years 2012, 2013, and 2014. The SEC OIG expects to complete and report on the results of its evaluation during 2015.



Special Inspector General for the Troubled Asset Relief Program

The Special Inspector General for the Troubled Asset Relief Program has the duty, among other things, to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program ("TARP") or as deemed appropriate by the Special Inspector General.

Background

The Special Inspector General for TARP ("SIGTARP") was created by Section 121 of the Emergency Economic Stabilization Act of 2008 ("EESA"). Under EESA, as amended by the Special Inspector General Act of 2009, SIGTARP has the responsibility, among other things, to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program ("TARP") or as deemed appropriate by the Special Inspector General. SIGTARP is required to report quarterly to Congress to describe SIGTARP's activities and to provide certain information about TARP over that preceding quarter. EESA, as amended, also gives SIGTARP the authorities listed in Section 6 of the Inspector General Act of 1978, including the power to obtain documents and other information from Federal agencies and to subpoena reports, documents, and other information from persons or entities outside the Government.

Investigations

SIGTARP is a white-collar law enforcement agency. SIGTARP takes its law enforcement mandate seriously, working hard with our partners to deliver the accountability the American people demand and deserve. As of May 2015, SIGTARP's investigations have delivered substantial results, including:

- criminal charges against 256 individuals, including 167 senior officers (CEOs, owners, founders, or senior executives) of their organizations;
- criminal convictions of 182 defendants;
- prison sentences for 101 defendants (others are awaiting sentencing);
- civil cases and other actions against 66 individuals (including 52 senior officers) and 67 entities (in some instances an individual will face both criminal and civil charges);
- orders temporarily suspending or permanently banning 93 individuals from working in the banking or financial industry, working as a contractor with the Federal Government, or working as a licensed attorney;
- orders of restitution and forfeiture and civil judgments and other orders entered for \$7.4 billion. This includes restitution orders entered for \$4.2 billion, forfeiture orders entered for \$252.8 million, and civil

judgments and other orders entered for \$2.95 billion. Although the ultimate recovery of these amounts is ongoing, to date SIGTARP has already returned \$1.58 billion to the government and other victims as a result of SIGTARP investigations. These orders happen only after conviction and sentencing or civil resolution and many SIGTARP cases have not yet reached that stage; accordingly, any recoveries that may come in these cases would serve to increase the amount returned, and;

- savings of \$553 million in TARP funds that SIGTARP prevented from going to at least one bank – the now-failed Colonial Bank

SIGTARP's investigations concern a wide range of possible wrong-doing, and result in charges including: bank fraud, TARP fraud, conspiracy to commit fraud or to defraud the United States, wire fraud, mail fraud, making false statements to the Government (including to SIGTARP agents), securities fraud, money laundering, and bankruptcy fraud, among others.

SIGTARP Oversight Activities

SIGTARP continues to fulfill its oversight role on multiple parallel tracks: investigating allegations of fraud, waste, and abuse related to TARP; conducting oversight over various aspects of TARP and TARP-related programs and activities through 24 published audits and evaluations, and 176 recommendations; and promoting transparency in TARP and the Government's response to the financial crisis as it relates to TARP. Below are some brief summaries of SIGTARP's oversight work over the last year.

The Legacy of TARP's Bank Bailout Known as the Capital Purchase Program (January 28, 2015)¹³

On January 28, 2015, SIGTARP published a report discussing the legacy of the Capital Purchase Program ("CPP"). The report reflected lessons learned from CPP that were derived from SIGTARP's oversight work, particularly three aspects of the bank rescue program.

First, Treasury's treatment of smaller TARP banks has and still does differ markedly from its treatment of the largest TARP banks. CPP is a TARP program that took place in two stages. The first stage focused on the stability of the financial system with Treasury taking swift action to work with the largest financial institutions. During the second stage, which occurred after the largest TARP banks exited CPP in December 2009, Treasury changed its approach dramatically, focusing on winding down CPP.

Treasury's framework and actions changed course after year one of its more than six years, when all but one of the largest TARP banks were out of TARP. Unlike the extraordinary actions Treasury took for the largest banks, for smaller TARP banks whose size did not threaten the entire financial system, Treasury's actions related to investment and divestment (to buy or sell).

Treasury shifted course from the very public and active role it took with the largest CPP banks, to becoming more like a passive, private investor concerning the smaller banks in CPP. This shift occurred despite the fact the TARP investments were still held by the US Government, TARP is an emergency Government program with important public policies, and that Treasury was using public funds.

13 See "The Legacy of TARP's Bank Bailout Known as the Capital Purchase Program," January 28, 2015; http://www.sig tarp.gov/Audit%20Reports/SIGTARP_CPP_Report.pdf

Unlike Treasury's immediate investing of TARP funds in the largest banks, it would take up to six months to invest in small banks. Unlike those large banks which were permitted by the Government to exit TARP without meeting established criteria, the Government held smaller TARP banks to stricter capital and other standards, even though community banks faced challenges raising capital to repay TARP. As SIGTARP reported, Treasury allowed some of the largest banks to exit TARP without meeting the Government's criteria because of pressure from the banks that wanted to exit TARP to avoid the public stigma of remaining in TARP and limits on executive compensation. Unlike the restructurings, exchanges, or discounts that Treasury made for Citigroup and other large TARP recipients including AIG, GM, and Ally, Treasury only agreed to a small number (5% of 707 original CPP banks) of restructurings or exchanges for smaller banks, instead auctioning its CPP shares in smaller community banks when Treasury deemed it was ready to exit, rather than allowing the smaller banks to determine the timing of their own TARP exit.

Second, while stability of the nation's financial system was the goal of TARP as initially proposed by Treasury, it was not the only worthwhile and necessary purpose or policy goal that Congress required for Treasury to use TARP funds. Treasury and other Government officials told SIGTARP, and have publicly stated, that they were empowered to take on these extraordinary measures for the largest CPP banks to achieve a particular policy goal—financial stability—the sole purpose of TARP as initially proposed by Treasury. However, even though our financial system was at risk of collapse from the threat of too-big-to-fail banks, Congress required in the final TARP law that Treasury use TARP funds to do more than just save the financial system, but also to protect home values, life savings, retirement funds, and college funds, to preserve homeownership, and to promote jobs and economic growth. These policies were to be met throughout the lifetime of TARP programs.

Treasury's actions and statements through CPP, after the initial TARP injections, have been singularly focused on Treasury's original purpose in devising TARP—to save the national financial system—a purpose tied only to the largest banks (2% of the number of banks in CPP) and announced by Treasury as having been achieved by the time all but one of the largest banks exited TARP in December 2009, when Treasury Secretary Geithner announced the program as "effectively closed." Beyond initial TARP injections, Treasury had far less focus on applying the other worthwhile and necessary purposes and policies that apply to smaller banks, banks that provide liquidity to their communities, hold families' life savings and college savings accounts, make mortgages, and promote local jobs and economic growth. While stability needed to be the primary and initial goal to help prevent a financial collapse of the whole system, the importance of the remaining goals and policies have been, and remain critical to, the goals of TARP for the smaller banks in TARP and the communities they serve around our nation, throughout the lifetime of CPP.

Just as Treasury previously believed it was empowered to take an active and public role to achieve one purpose of TARP—stability—it could have acted to have a more immediate impact on the daily economic lives of Americans who funded TARP, based on the other policy objectives of TARP, by not forcing smaller community banks out of the program owing money to private parties. Treasury could have either waited a short time for repayment or helped the banks to repay by restructuring or exchanging the shares. While Treasury has preferred to exit its CPP investments as soon as practicable, it is unclear what drives the desire to end forcibly a program that it deemed effectively closed and in wind-down five years ago. It is not as though Treasury's involvement in TARP banks is over. As of January 28, 2015, Treasury remained invested in over 23% of the original 707 CPP banks, including 28 institutions whose CPP investments were transferred to CDCI

(another TARP program) and another 137 banks whose TARP funds were refinanced into the non-TARP Small Business Lending Fund (“SBLF”) program (two-thirds of SBLF’s participating banks transferred out of CPP).

Third, Treasury auctions leave community banks on the hook for TARP investments and dividend payments, only now these are owed to private entities, typically unknown to the bank, that are benefitting from these auctions. These private entities did not replace banks’ capital because they did not provide the banks with any new capital, but instead bought out Treasury’s stake at discounts from 1% to 90%.

While the auctioned banks are out of TARP, they still have the same financial obligations and responsibilities they had when they were in TARP. Treasury has shifted its stake to private entities that do not have any responsibilities to follow the purposes and goals of TARP and CPP. Instead, these private entities hope to profit off these bailout shares of stock, and some already have. While taxpayers have already suffered a \$1.1 billion loss on these auctions, some of these private entities are turning a profit by buying the TARP bank shares at a discount, and watching banks scramble to find a source of funds to buy them out at a premium (such as in the full amount of what was owed on TARP stock) within a short time. The large private investors who bought the shares are mostly unknown to the banks and not from their communities. Historically, investors and board members of community banks have often come from within those communities and therefore have a vested interest in those communities. The buyers of Treasury’s TARP shares at auctions typically lack ties to the communities that these banks serve, and have purchased Treasury’s powerful right to place a non-voting director on the board after six missed dividends, which motivated the banks to want to buy them out.

In essence, Treasury created a market in which large private investors are not replacing Treasury’s TARP capital with new capital into the bank, but instead, in some instances, buying and flipping TARP shares at a profit, often in a matter of weeks or months. Presumably, if the bank was able to obtain the funds needed to pay the auction buyer the full amount owed on the TARP stock within weeks or months of the auction, it also could have paid Treasury off in that same time frame.

Treasury Significantly Loosened Executive Pay Limits Resulting In Excessive Compensation For Top Employees At GM And Ally Financial (September 24, 2014)¹⁴

On September 24, 2014, SIGTARP reported on executive compensation for the top employees at GM and Ally Financial – the third report issued by SIGTARP evaluating compensation set by Treasury at companies that received exceptional assistance through TARP.

When Congress passed TARP and subsequent economic stimulus legislation, it placed limitations on executive compensation for TARP recipients, and left it to the Treasury to implement the limitations. Treasury created the Office of the Special Master for TARP Executive Compensation (“OSM”). Kenneth R. Feinberg served as the Special Master – often called the pay czar – and was succeeded by Patricia Geoghegan, currently serving as the Acting Special Master. OSM has jurisdiction over compensation at companies that stood out from the more than 700 TARP recipients because of the amount and nature of their exceptional bailout. OSM sets pay for the Top 25 employees at these TARP exceptional assistance recipients. The Top 25 includes the 5 senior executive officers and the next 20 most highly compensated employees.

14 See “*Treasury Significantly Loosened Executive Pay Limits Resulting In Excessive Compensation For Top Employees At GM And Ally Financial*,” September 24, 2014; http://www.sig tarp.gov/Audit%20Reports/SIGTARP_Special_Master_Report.pdf

In January 2012 and January 2013, SIGTARP reported on the compensation set by Treasury for Top 25 employees at companies that received TARP help deemed exceptional. SIGTARP's reports highlighted that Treasury had failed to rein in excessive pay and failed to implement meaningfully SIGTARP's recommendations to develop robust criteria, policies, and procedures to ensure it could meet its own pay-setting guidelines.

In April 2013, shortly before the Acting Special Master approved compensation for Top 25 employees of the two remaining companies that received exceptional TARP assistance – Ally Financial Inc. ("Ally") and General Motors Corporation ("GM") – Representative Jim Jordan, Chairman of the U.S. House Committee on Oversight and Government Reform Subcommittee on Economic Growth, Job Creation, and Regulatory Affairs, requested that SIGTARP determine the number and value of pay raises requested by Ally and GM and approved by Treasury, and the company proposed and Treasury-approved compensation that exceeded Treasury's pay-setting guidelines. Shortly after receiving Congress' request, SIGTARP initiated its third evaluation on executive compensation with the specific objective to assess the 2013 pay packages proposed by the companies and the decisions made by Treasury for compensation for the Top 25 employees at Ally and GM.

What SIGTARP Found

Overall, SIGTARP found Treasury significantly loosened executive pay limits, resulting in excessive pay for Top 25 employees at GM and Ally while the companies were not repaying TARP in full and taxpayers were suffering billions of dollars in losses.

Treasury also made limited progress implementing recommendations previously made by SIGTARP. These were designed to promote good Government practices, improve transparency, consistency, and accountability and ultimately protect taxpayers from subsidizing excessive compensation at TARP companies.

In 2013, OSM continued awarding excessive pay raises and only put back a minimal amount of long-term restricted stock as part of pay packages and eliminated it altogether again in 2014 from pay packages. In June 2013, OSM created for the first time a written policy and procedures. However, OSM's policy merely recites TARP legislation and the TARP Standards for Compensation and Corporate Governance; Interim Final Rule ("IFR," or "Treasury's Rule"), both in existence prior to the establishment of OSM, leaving OSM as an office of Treasury that operates without formal written policies developed by that office. SIGTARP found that Treasury still lacks robust policies, procedures, or criteria to ensure that OSM's guidelines are met.

Both GM and Ally stood out from the other five companies previously under OSM's jurisdiction. At the time OSM set pay for the Top 25 employees at GM and Ally in April 2013, SIGTARP found that pay set by Treasury for Ally's and GM's top employees did not reflect that those companies were not repaying TARP in full after four years, resulting in billions of dollars in taxpayer losses. Moreover, at the time of Treasury's pay determinations, it was public knowledge that the companies were not repaying TARP in full and Treasury had already suffered an \$8.2 billion loss in GM, and Ally had made no repayments of the principal TARP investment. While Ally was under a March 2013 failed stress test, taxpayers suffered a loss of \$845 million when Treasury sold Ally common stock in the market. While SIGTARP was conducting the third executive compensation evaluation, Treasury sold its remaining TARP shares of GM in the market to arrive at a total loss to taxpayers of \$11.2 billion, and sold some additional Ally common stock in the market to arrive at total losses of \$1.8 billion.

In 2013, OSM approved cash salaries over \$500,000 for more than one-third (16 of 47) of the top employees of GM and Ally. Year after year, Treasury has loosened executive pay limits, getting further and further away from the President's announced pay reforms and pay limits used by Treasury in 2009, even as taxpayer losses mount. The President announced that top executives at firms receiving extraordinary help from U.S. taxpayers would have their compensation capped at \$500,000, with any additional compensation in the form of stock that can't be paid up until taxpayers are paid back for their assistance. Treasury, however, did not limit additional compensation beyond \$500,000 to "stock that cannot be paid up until taxpayers are paid back," as the President announced. For example, in 2013, OSM approved effectively only 5% of Ally employees' compensation in the form of long-term restricted stock and then eliminated it entirely from Ally employees' pay packages in 2014.

Treasury's mounting exceptions to its own guideline restrictions on executive compensation resulted, by 2013, in OSM moving further and further away from the President's announcement and OSM's prior guidelines. Instead of making meaningful reforms to its process, OSM rolled back its application of guidelines aimed at curbing excessive pay, whereby approving high pay driven by Ally and GM's excessive pay proposals without independent analysis and under an ill-defined, pay-setting process that lacked objective criteria.

SIGTARP found several examples delineating OSM's rolling back of guidelines. For example, Treasury approved at least \$1 million in pay for every Top 25 employee in 2013 and increased compensation by 28% for GM and Ally Top 25 employees from 2009 to 2013. Treasury tripled the number of GM and Ally employees who received cash salaries exceeding \$500,000 from 2009 to 2013 and allowed 89% of the employees to be paid cash salaries of \$450,000 or more in 2013. Treasury approved \$3 million in pay raises, ranging from 4% to 20%, for nine GM employees in 2013, most of whom received raises in consecutive years. Treasury also continued to loosen time restrictions by a full year for employees to cash out company stock received as pay.

Additionally, in 2009, Treasury's guideline was to set pay to "generally not exceed the 50th percentile of total compensation for similarly situated employees." The pay Treasury awarded most of the employees in 2013 exceeded the market median based on comparable positions and companies as determined by Treasury. Treasury set pay for 88% (30 of 34 employees) of these proposed employees, which exceeds market medians. On an individual basis, these pay packages exceeded market medians by amounts ranging from \$17,700 to \$2.7 million, for a total of \$22.9 million. Of the 30, Ally received 18 and GM received 12. Treasury appears to have done away with this guideline because by 2014, Treasury set most of Ally's pay between the 50th and 75th percentiles.

The pendulum in OSM's pay decisions has swung too far in the direction of keeping companies competitive, without regard for the fact that the reason to keep companies competitive is so that they can repay taxpayers in full, but GM and Ally were not repaying taxpayers in full. Rather, taxpayers have suffered billions of dollars in losses on those TARP investments.

Two aspects of Treasury's pay-setting process and pay decisions serve as important lessons learned. First, loosening limits on executive compensation for companies unable to repay TARP subjects Treasury to criticism that is rewarding top executives at companies that are losing taxpayers' money over the interests of the taxpayers already shouldering billions of dollars in losses on those investments.

Second, by setting pay further and further away from the President's and Treasury's announced limitations on executive compensation for TARP company officials, Treasury is missing an opportunity for critical reforms to a material cause of the financial crisis and a strong deterrent to future bailouts.

What SIGTARP Recommended

In the report, SIGTARP made 11 recommendations aimed at enhancing OSM's pay-setting process and pay decisions. These recommendations include maintaining improved documentation of OSM and Treasury's communications regarding compensation, performing and documenting independent analyses before OSM approves company requests for cash salaries exceeding \$500,000, cash salaries exceeding market medians, and annual pay increases. SIGTARP also recommended OSM use long-term restricted stock as part of each employee's compensation package to ensure compensation is tied to both the employee's and the company's performance, and the full repayment of TARP funds. Finally, SIGTARP recommended OSM enhance its written procedures regarding targeting median total compensation.

Treasury provided an official written response to a draft of the report in a letter dated September 21, 2014. Treasury did not clearly agree to implement any of the report's recommendations, which were intended to improve transparency and program performance.

***SIGTARP Interim Letter to Treasury Regarding TARP Use of Capital Surveys (September 2, 2014)*¹⁵**

In a September 2, 2014 letter to Treasury, SIGTARP outlined some results of fieldwork conducted as part of SIGTARP's ongoing audit of the Results of Treasury's Use of Capital Surveys to and Responses from Recipients of Funds from the Troubled Asset Relief Program, including the CPP and the CDCI.

According to Treasury, the purpose of the annual Use of Capital Survey is for Treasury to obtain insight into the lending, financial intermediation, and capital building activities of all CPP and CDCI fund recipients. The surveys not only provide Treasury with valuable information on the financial stability of TARP recipients, but the surveys also provide transparency to the American taxpayer concerning how these institutions used the billions of TARP dollars provided to them.

One of SIGTARP's first recommendations when it opened its office in December 2008, soon after TARP was established, was that Treasury require all TARP recipients to report periodically on their use of TARP funds. Treasury rejected this recommendation. SIGTARP then sent its own survey to all TARP institutions and received responses from 100% of the institutions. These responses are posted on SIGTARP's website for the public to view.

SIGTARP reiterated its recommendation in a July 2009 audit report and again in a December 2009 audit report. It was not until 2010 that Treasury began issuing annual surveys to TARP financial institutions on how they used TARP funds. Treasury requested that the institutions complete the surveys that addressed eight key elements including, but not limited to, increased lending activities, capital restoration, and increases to the reserves. In March 2010, SIGTARP recommended that Treasury require quarterly reporting by all CDCI

15 See "SIGTARP Interim Letter to Treasury Regarding TARP Use of Capital Surveys," September 2, 2014; [http://www.sigtar.gov/Audit%20Reports/SIGTARP Interim Letter to Treasury Regarding TARP Use of Capital Surveys.pdf](http://www.sigtar.gov/Audit%20Reports/SIGTARP%20Interim%20Letter%20to%20Treasury%20Regarding%20TARP%20Use%20of%20Capital%20Surveys.pdf)

recipients on their use of TARP funds in an effort to encourage lending to their underserved communities. Treasury rejected this recommendation, saying that the annual surveys would provide sufficient transparency.

In June 2013, SIGTARP initiated an audit to report on the results from these surveys to bring transparency to TARP financial institutions reporting to Treasury on how they used TARP funds.

Although Treasury sends the surveys each year to CPP and CDCI institutions, while conducting our audit fieldwork, SIGTARP discovered areas in the survey process, tabulation, and reporting that raised concerns that warrant immediate attention and corrective action by Treasury.

What SIGTARP Found

As an integral part of SIGTARP's audit, our review of the surveys and responses for years 2009 through 2012 indicated several deficiencies in Treasury's processing of the Use of Capital Surveys. First, we discovered that the surveys posted on Treasury's website are not the original documents submitted by the institutions that received TARP funds. Rather, Treasury posts surveys that are created from the survey data. We identified errors in the survey data, made during the conversion process, which resulted in omissions and/or inconsistencies between what the institutions reported and what Treasury posted on its website. We were also informed by the Treasury official responsible for this conversion that Treasury modifies some of the data reported by the financial institutions during this conversion process. The impact of that modification is unclear. However, any modification can present a risk of inaccurate reporting. Second, Treasury summarizes the information provided by the institutions. However, SIGTARP found that Treasury's summary contains mathematical errors, Treasury's narrative contains inaccuracies, and Treasury-converted data for the institutions contain errors and/or omissions.

Also, SIGTARP attempted to reconcile the number of institutions shown as providing survey responses on the Treasury website with the number of respondents Treasury shows in the summary section of the website, and the numbers do not match. Therefore, SIGTARP is unable to support the veracity of the survey responses posted on Treasury's website. The American public, SIGTARP, and other oversight agencies rely on the information on Government websites for the truth and transparency. At the time the letter was published, the Treasury website for CPP and CDCI institutional data provided neither.

As long ago as December 2008, SIGTARP recommended that Treasury begin collecting information from CPP recipients. According to Treasury, because Treasury had already entered into contracts with some CPP recipients, Treasury decided not to add a requirement that CPP participants submit an annual survey. Instead, Treasury requested that CPP recipients voluntarily respond to the surveys. However, the CDCI program, which the Administration announced as a means of boosting credit and spurring lending to small businesses in the hardest hit rural and underserved communities, was not initiated until 2010. As part of the requirement to obtain funds under this program, CDCI participants are required under their contractual agreements with Treasury to submit annual surveys. SIGTARP's Quarterly Report to Congress dated April 30, 2014, raised serious concerns that, despite this requirement to submit surveys, there has never been 100% compliance from the CDCI recipients. Since CDCI began, never have all of the institutions in the CDCI program complied with this mandatory requirement to submit a survey. In fact, eight banks and credit unions have never responded to Treasury to inform it how they used the CDCI funds. The eight institutions that never submitted surveys were listed in SIGTARP's April 30, 2014, Quarterly Report. As a result of SIGTARP's publication of these institutions'

names, one credit union contacted Treasury and submitted the past due surveys and notified SIGTARP of its actions.

SIGTARP found that Treasury does not appear to take any action if a CPP institution or CDCI institution fails to respond to the survey each year on how it is using TARP funds, despite the fact that these institutions remain in TARP. Treasury sends a Use of Capital Survey letter with the surveys to CPP and CDCI institutions. Treasury's letter to CDCI institutions states that the institutions are required to submit the survey; however, Treasury does not appear to take any action for CDCI institutions that fail to comply with their contractual requirement.

In Treasury's letter to CPP institutions, Treasury requests the completion of the survey and explicitly states that institutions that do not comply with the request will have the institutions' names published on the Treasury website. According to the Treasury archives on the website, a list of noncompliant institutions was compiled and posted to the Treasury website for the 2011 survey.

However, at the time SIGTARP's letter to Treasury was published, SIGTARP was unable to verify Treasury's publishing of the names of noncompliant institutions for 2009, 2010, and 2012, because the list of those institutions that have failed to report on their use of funds was not currently posted, further harming transparency to the American taxpayer, who funded these institutions and has not been paid back in full. If Treasury does not enforce its requirement that CDCI institutions report on the use of TARP funds, or take additional effort to get CPP institutions to report on the use of TARP funds, Treasury is not implementing what SIGTARP recommended, which was designed to bring significant transparency.

SIGTARP's fieldwork revealed that Treasury does not have an adequate review process during or after the survey process. Treasury officials told SIGTARP that there was no oversight concerning whether or not the changes from the institutions' data should have been made, nor did Treasury follow up with the institutions to ensure the changes reflected accurate data. According to Treasury officials, the only review provided by Treasury supervisors was a cursory review of the summary table and the text posted on the website prior to the submission to the Treasury official responsible for coordinating the posting. A cursory review without researching the underlying documents may not have revealed many of the deficiencies that SIGTARP found.

However, SIGTARP found errors that even a cursory review should have detected errors that any member of the public would have encountered. For example, of the eight categories of use of TARP funds presented in Treasury's summary for 2009, only two categories were presented correctly. Moreover, all eight categories presented in Treasury's summary for 2011 and 2012 were incorrect. Additional obvious errors that should have been detected, including misspelled words and the omission of information that should have been included in the narrative section of the website, went undetected and were posted on the website. In addition, on Treasury's website, under the caption "Survey Results," Treasury's website states that there are eight categories of use of TARP funds. However, only seven are listed, and the one that is missing is "increase lending or reduce lending less than otherwise would have occurred," arguably the most important use of TARP funds. As another example, in the 2012 surveys, SouthFirst Bank has two surveys listed under its name. However, only one of those belongs to that institution. The second survey is data on Pulaski Financial Corporation.

A taxpayer looking for information on Pulaski Financial Corporation who went to Treasury's website under the "P" listing of institutions would find no survey for Pulaski Financial Corporation. In one more example, the surveys for 2011 were posted under the headings for financial data while the financial data were posted under the headings for surveys.

The financial crisis of 2008 had a detrimental impact on the financial industry. Through their tax dollars, American taxpayers funded the efforts to support institutions that were on the brink of financial ruin. Simply put, the American public has a right to know how taxpayer dollars in TARP are being spent. Instead, Treasury, as well as CPP and CDCI recipients, have left them in the dark. Treasury must ensure that full disclosure is made concerning how the CPP and CDCI recipients used these funds in Treasury's efforts to help the financial system recover from the financial crisis. To provide transparency to the American public of the financial stability of the banking industry, Treasury must begin by providing direct transparency to institutions' reporting on their use of TARP funds, and accurate Treasury summaries of the institutions' use of funds. In addition, because Treasury's stated purpose of the Use of Capital Survey is for Treasury to obtain insight into the lending, financial intermediation, and capital building activities of all CPP and CDCI fund recipients, Treasury does not have that insight if the

TARP institution does not report annually. Without that information, Treasury misses an opportunity to monitor CDCI effectively, prevent fraud, waste, and abuse, and ensure that small businesses in struggling communities get the loans CDCI was meant to provide. In this respect, Treasury's oversight responsibilities to ensure this occurs accurately and timely are of paramount importance.

What SIGTARP Recommended

To improve transparency and oversight, SIGTARP recommended:

- (1) Treasury should post the original surveys received from CPP and CDCI institutions on how they used TARP funds for each year to the Treasury website. The original surveys and responses should not be subjected to any manipulations or changes to calculate survey results.
- (2) Treasury should develop written repeatable operating procedures for submitting and receiving survey responses from CPP and CDCI recipients on how they used TARP funds. The procedures should include the functional roles and responsibilities and automated and manual process steps involved, such as documenting and determining the survey population, compiling and analyzing the responses, verifying and validating the data, resolving discrepancies, and posting the responses on the Treasury website.
- (3) Treasury should take aggressive action to enforce its requests that all CPP institutions report annually on their use of TARP funds, and its requirement that all CDCI institutions report annually on their use of TARP funds. At a minimum, Treasury should draft a letter to each CPP and CDCI institution that fails to report each year, and follow up on that letter with the institution. Treasury should exercise its rights to compel reporting on use of TARP funds by CDCI institutions.
- (4) Treasury should fix all errors and/or deficiencies, which SIGTARP previously provided to Treasury, and submit documentation to SIGTARP confirming the correction/elimination of these errors.
- (5) Treasury should perform a thorough review of any and all submissions by TARP recipients on their use of TARP funds prior to posting the surveys on the Treasury website, and follow up with the institution for any missing information or information that is inconsistent or has an obvious error.

(6) Treasury should publicly report on all CPP and CDCI institutions that have not submitted a survey response on their use of TARP funds for prior years and continue that reporting in future years.

On August 27, 2014, Treasury provided a response to a draft of SIGTARP's letter, in which it stated that it generally agreed with each of the recommendations and that it would keep SIGTARP apprised of its actions to address the recommendations.

Treasury must address the deficiencies SIGTARP identified by fully implementing each of SIGTARP's recommendations, so that the American taxpayer can be better assured of basic transparency through accurate information about how TARP institutions are using TARP funds, and to give Treasury insight into these TARP institutions.



Office of Inspector General Department of the Treasury

The Department of the Treasury Inspector General performs independent, objective reviews of specific Treasury programs and operations with oversight responsibility for one federal banking agency--the Office of the Comptroller of the Currency. That federal banking agency supervises approximately 1,700 financial institutions.

Introduction

The Department of the Treasury Office of Inspector General (OIG) was established pursuant to the 1988 amendments to the Inspector General Act of 1978. The Treasury Inspector General is appointed by the President, with the advice and consent of the Senate. Treasury OIG performs independent, objective reviews of Treasury programs and operations, except for those of the Internal Revenue Service (IRS) and the Troubled Asset Relief Program (TARP), and keeps the Secretary of the Treasury and Congress fully informed. Treasury OIG is comprised of four divisions: (1) Office of Audit, (2) Office of Investigations, (3) Office of Counsel, and (4) Office of Management. Treasury OIG is headquartered in Washington, DC, and has an audit office in Boston, MA.

Treasury OIG has oversight responsibility for one federal banking agency--the Office of the Comptroller of the Currency (OCC). OCC is responsible for approximately 1,150 national banks, 460 federal savings associations, and 50 federal branches of foreign banks. The total assets under supervision are \$10.9 trillion, making up 71 percent of the total U.S. commercial banking assets. Treasury OIG also oversees several offices created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) which are (1) the Office of Financial Research (OFR), (2) the Federal Insurance Office, and (3) the Offices of Minority and Women Inclusion within Treasury's Departmental Offices (DO) and OCC. Additionally, Treasury OIG oversees Treasury's role related to the financial solvency of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) under the Housing and Economic Recovery Act of 2008 (HERA), to include Treasury's Senior Preferred Stock Purchase Agreements established for the purpose of maintaining the positive net worth of both entities. As of March 2015, the funding capacity available to the two entities is \$258 billion covering future net worth deficiencies.

Treasury Management and Performance Challenges Related to Financial Regulation and Economic Analysis

In accordance with the Reports Consolidation Act of 2000, the Treasury Inspector General annually provides the Secretary of the Treasury with his perspective on the most serious management and performance challenges facing the Department. In a memorandum to the Secretary dated October 23, 2014, the Inspector

General reported three management and performance challenges that were directed towards financial regulation and economic recovery. Those challenges were: Cyber Threats, Continued Implementation of Dodd-Frank, and Management of Treasury's Authorities Intended to Support and Improve the Economy.

Cyber Threats

For the last several years, we have reported on our growing concern with cybersecurity. This year we elevated cyber threats to the Department's top management challenge. Not surprisingly, Treasury's systems are interconnected and critical to the core functions of government and the Nation's financial infrastructure. In this regard, information security remains a constant area of concern and potential vulnerability for Treasury's systems. Accordingly, Treasury management must continuously monitor Treasury's systems for vulnerabilities and ensure all employees and others connected to those systems maintain a heightened awareness of their roles in protecting these critical assets. Additionally, cyber attacks facing banking institutions continue, ranging from distributed denial of service attacks on bank websites to phishing attacks to fraudulent wire payments, depending on the goals of the attacking entities. Organized hacking groups leverage published and unpublished vulnerabilities and vary their methods to make attacks hard to detect and even harder to prevent. Considering the multitude of threats, Treasury will need to continue to strengthen partnerships among law enforcement, financial institutions, regulators, and private entities in the financial sector, to address these threats.

Continued Implementation of Dodd-Frank

With the intention to prevent, or at least minimize, the impact of a future financial sector crisis on the U.S. economy, Dodd-Frank placed a great deal of responsibility within Treasury and on the Treasury Secretary. Accordingly, this challenge, among other things, primarily focused on a number of Dodd-Frank mandates related to the Department of the Treasury. It broadly addressed the challenge of FSOC and its Federal agency members continuing to work to meet all of FSOC's responsibilities. It also recognized FSOC's accomplishments over the previous year including the designation of nonbank financial institutions for consolidated supervision

This management challenge is to maintain an effective FSOC process that timely identifies and appropriately responds to emerging risks and is supported by OFR and FIO within Treasury. This is especially important in times of economic growth and financial institution profitability, when such government action is generally unpopular.

Management of Treasury's Authorities Intended to Support and Improve the Economy

This challenge, among other things, focused on a number of broad authorities the Congress provided to Treasury to address the financial crisis under HERA, the Emergency Economic Stabilization Act (EESA), the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Small Business Jobs Act of 2010. It acknowledged that certain authorities in HERA and EESA expired, but pointed out the fact that challenges remain in managing Treasury's outstanding investments.

To a large extent, Treasury's program administration under these acts have matured, however, the long-term impact on small business lending resulting from investment decisions under the Small Business Jobs Act are still not clear.

Another challenge that the Treasury Inspector General has reported on for a number of years is Treasury's anti-money laundering and terrorist financing/Bank Secrecy Act enforcement efforts. Among other things, this challenge pointed out our concern with respect to ensuring continued cooperation and coordination of all organizations involved in anti-money laundering and combating terrorist financing efforts. Specifically, we expressed our concern that the Financial Crimes Enforcement Network and the Office of Foreign Assets Control have to rely on help from other Federal agencies, the States, and financial institutions to enforce compliance with their programs. Accordingly, to be effective, Treasury must establish and maintain working relationships with these entities.

Completed and In-Progress Work on Financial Oversight

Review of Treasury's Controls over the Separation of Funds and Activities

House Report 112-550, Report on the Financial Services and General Government Appropriations Bill, 2013, included a recommendation directing Treasury OIG to report on the separation of funds and activities between mandatory-funded offices, such as OFR, and discretionary-funded offices that carry out related or overlapping work, such as the Office of Domestic Finance (ODF) or Office of Economic Policy (OEP). To address this congressional interest, we conducted a review to assess Treasury DO's controls over the separation of funds.

We reported that the funds and activities of OFR were separate from ODF and OEP. In accordance with the Dodd-Frank, Treasury established the Financial Research Fund to account for the financial activity of OFR and FSOC. Activities such as assessments and outlays for labor and non-labor expenditures were properly posted to the fund; however, we did note a weakness in the coding of certain payroll transactions that increased the risk that certain DO labor expenses could have been applied to the Financial Research Fund. Furthermore, while the OFR Director is organizationally located within ODF, we found no evidence of commingling of resources among projects undertaken by OFR and projects undertaken by ODF and OEP.

We recommended that Treasury enhance controls over the coding of payroll transactions by DO personnel who provide support to OFR and FSOC. OFR and DO management agreed with the recommendation and stated that training had been developed and implemented for all DO users that allocate time to the OFR payroll code. Additionally, a process had been developed that includes review of payroll charges to OFR before those payroll transactions are approved.

Review of OCC's Personnel Practices

The Ranking and other Members of the House Committee on Financial Services requested our office review OCC's personnel practices. Consistent with the request, our objective was to assess OCC's personnel practices and other efforts to increase agency diversity, create a workplace free of systemic discrimination, and provide equal opportunity for minorities and women to obtain senior management positions

We reported that OCC tracks diversity levels and has taken steps to increase diversity in its workforce that has resulted in OCC employing minorities and females at a rate generally equivalent to nationwide participation rates. Additionally, OCC's Office of Minority and Women Inclusion has made efforts to increase diversity across the workforce by participating in outreach programs and supporting employee network groups. These efforts maintain ongoing relationships that provide perspective on diversity at OCC and assist with the

development of programs and activities to bolster OCC's recruitment, career-development, and retention efforts.

However, participation of minorities and women in OCC supervisory and senior-level positions fell below their workforce participation rates across the entire organization. Although their participation rates in these positions has increased, we believe that further increases in the participation of minorities and women in these positions will be slow because of the limited number of supervisory and senior-level positions, the infrequency of position openings, and the internal hiring to meet specialized skill requirements.

We recommended that OCC continue its efforts to increase participation of minorities and women in supervisory and senior-level positions, consistent with applicable law. OCC agreed with the recommendation and stated that it remains committed to ensuring a diverse and inclusive work environment.

OCC Oversight of Amended Foreclosure Consent Orders

In April 2011, OCC, the former Office of Thrift Supervision, and the Board of Governors of the Federal Reserve System issued foreclosure-related consent orders against 14 major mortgage servicers for unsafe and unsound practices in residential mortgage servicing and foreclosure processing. These unsafe and unsound practices, including such things as the "robo-signing" of documents, were identified during a horizontal review performed in 2010. Pursuant to the orders, the servicers engaged independent consultants to perform independent foreclosure reviews to identify and remediate financial injury to borrowers who were in the foreclosure process during 2009 and 2010. These reviews were performed in 2011 and 2012.

In late 2012, OCC officials concluded that the independent foreclosure review process was taking longer than anticipated and delaying the compensation to harmed borrowers. In January 2013, OCC negotiated a change to the terms of the consent orders for the mortgage servicers. Upon the 2013 amending of the April 2011 foreclosure consent orders, we initiated a review of the amended consent orders. Our objectives were to: (1) report on the circumstances and processes used to determine that the foreclosure consent orders issued in April 2011 should be amended, including how the settlement amounts were derived; and (2) assess OCC's oversight of servicers' compliance with the amended foreclosure consent orders, including the servicers' categorization of the "in scope" population of borrowers due payment, the payment of funds to the borrowers, and the servicers' loss mitigation or other foreclosure prevention actions.

As discussed in our August 2014 report, OCC pursued the amendment of the original foreclosure consent orders to facilitate more timely relief to borrowers potentially harmed during the foreclosure process. We found the cash payment (\$3.4 billion) and foreclosure prevention (\$5.3 billion) figures in the amended OCC consent orders were negotiated amounts with the servicers that had limited analytical support. We also found that OCC provided oversight of servicers' borrower categorization and the payment processes. This oversight identified weaknesses and concerns with both processes of which OCC is continuing to address the concerns with the payment process. We noted that OCC oversight of servicers' foreclosure prevention actions has not yet substantively begun. We recommended that OCC (1) continue to work to ensure that errors and concerns that it identified in the payment process are addressed; (2) finalize its determination on the disposition of funds remaining in Qualified Settlement Funds – funds established by the amended consent orders from which payments to potentially harmed borrowers are made – after the distribution is complete; (3) ensure servicer system weaknesses and data limitations identified during OCC's validation work

are addressed in the corrective action plans developed by the servicers and that these corrective action plans are implemented; and (4) implement processes to monitor the sufficiency of foreclosure prevention measures taken by servicers subject to the amended consent orders. OCC agreed with our recommendations.

We have two audits in-progress related to the foreclosure consent orders.

Oversight of Servicers' Operational Improvement and Foreclosure Prevention Activities The objectives of this audit are to assess OCC's oversight of actions taken by servicers to (1) address those articles of the foreclosure consent orders designed to correct the unsafe and unsound operational practices identified in the 2010 horizontal review of servicers' foreclosure practices and (2) provide a range of foreclosure prevention actions.

Oversight of Servicers' Determination of In-Scope Borrowers Under the Amended Consent Orders Expressing concern that one servicer under an amended foreclosure consent order, failed to identify and send payments to 24,000 borrowers until after a private citizen contacted OCC, the Ranking Member of the House Committee on Financial Services asked the Treasury Inspector General and the Board of Governors of the Federal Reserve System/Consumer Financial Protection Bureau Inspector General to look into the matter. In response, we initiated an audit of OCC's oversight of the determination of the population of in-scope borrowers related to the amended foreclosure consent orders. Our planned objectives, consistent with the request, are to determine: (1) the facts and circumstances surrounding the increase in the population of the one servicer's in-scope borrowers; (2) the methodology used and procedures performed by OCC to test and validate the universe of in-scope borrowers and whether such borrowers were appropriately sent checks for the five servicers not covered in prior Treasury OIG reviews; (3) OCC's process for vetting any individual questions, complaints, or requests for appeal related to the in-scope population from borrowers; (4) any direction that OCC has provided to servicers outlining how the servicer should process questions, complaints, or request to appeal the determination of the in-scope population that they receive from borrowers; and (5) what data gaps existed within servicers' systems that made it difficult to identify in-scope borrowers and whether such data gaps or system integration issues have been fixed.

OCC Financial Institution Assessment Process (In Progress)

From March 2009 through March 2013, OCC under-assessed five financial institutions by a total of approximately \$4.9. In September 2013, OCC under-assessed six financial institutions (including the five previously mentioned) by a total of approximately \$860,000. During these periods, the financial institutions were assessed as commercial banks instead of independent trust banks. Independent trust banks are supposed to be assessed a surcharge above the commercial bank assessment. OCC subsequently waived the assessment and collection of the \$4.9 million and collected the September 2013 under-assessment \$860,000 in October 2013. We initiated an audit to evaluate (1) OCC's authority and decision-making process for waiving the under-assessments and (2) the actions taken by OCC to identify and correct internal control deficiencies in the financial institution assessment process.

OCC's Supervision of Banks' Use of Independent Consultants Under Enforcement Actions (In Progress)

We initiated an audit of OCC's use of OCC Bulletin No. 2013-33 (Use and Review of Independent Consultants in Enforcement Actions). Our objective is to evaluate OCC's supervision when requiring banks to employ

independent consultants as part of enforcement actions to address significant violations of law, fraud, or harm to customers.

OCC's Supervision of Financial Institutions' Student Loan Lending Activities (In Progress)

We initiated an audit of OCC's supervision of banks' student loan lending activities. The objective of this audit is to assess the adequacy and effectiveness of OCC's supervision over financial institutions' risk management controls and practices in place to mitigate losses in their student loan portfolios.

Failed Bank Reviews

In 1991, Congress enacted the Federal Deposit Insurance Corporation Improvement Act (FDICIA) amending the Federal Deposit Insurance Act (FDIA). The law was enacted following the failures of about a thousand banks and thrifts from 1986 to 1990, which resulted in billions of dollars in losses to FDIC's Deposit Insurance Fund. The amendments require that banking regulators take specified supervisory actions when they identify unsafe or unsound practices or conditions. Also added was a requirement that the Inspector General for the primary federal regulator of a failed financial institution conduct a material loss review when the estimated loss to the Deposit Insurance Fund is "material." FDICIA defines the loss threshold amount to the Deposit Insurance Fund triggering a material loss review to a loss that exceeds \$50 million for 2014 and thereafter (with a provision to temporarily raise the threshold to \$75 million in certain circumstances). The act also requires a review of all bank failures with losses under these threshold amounts for the purposes of (1) ascertaining the grounds identified by OCC for appointing FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. As part of the material loss review, OIG auditors determine the causes of the failure and assess the supervision of the institution, including the implementation of the prompt corrective action provisions of the act.¹⁶ As appropriate, Treasury OIG also makes recommendations for preventing any such loss in the future.

From the beginning of the current economic crisis in 2007 through May 2015, FDIC and other banking regulators closed 512 banks and federal savings associations. One hundred and thirty-nine (139) of these were Treasury-regulated financial institutions; in total, the estimated loss to FDIC's Deposit Insurance Fund for these failures was \$36.2 billion. Of the 139 failures, 56 resulted in a material loss to the Deposit Insurance Fund, and our office performed the required reviews of the failures.

During the period covered by this annual report, we completed a material loss review of The National Republic Bank of Chicago (NRB), whose failure in October 2014 resulted in a loss to the Deposit Insurance Fund is estimated at \$111.6 million. We determined that NRB failed primarily because of undue influence by the chairman of the board over the bank's operations and critical decisions, as well as deficient senior management oversight and governance. These underlying causes further led to the bank having improper credit administration processes; aggressive growth resulting in a high concentration in commercial real estate loans without commensurate credit risk management practices and adequate capital, particularly in the

¹⁶ Prompt corrective action is a framework of supervisory actions for insured institutions that are not adequately capitalized. It was intended to ensure that action is taken when an institution becomes financially troubled in order to prevent a failure or minimize the resulting losses. These actions become increasingly severe as the institution falls into lower capital categories. The capital categories are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

hotel/motel industry and to gas station/convenience stores throughout the United States; overreliance on brokered deposits; and irregular banking transactions. Regarding supervision, we found that although OCC's supervision did not prevent a material loss to the DIF, it was appropriate. We also reported that certain matters involving NRB were being reviewed by the Treasury OIG's Office of Investigations.

**Appendix A:
Audit of the Financial Stability Oversight Council's
Monitoring of Interest Rate Risk
to the Financial System**

Prepared by the Council of Inspectors General on Financial Oversight

2015



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 27, 2015

The Honorable Jacob J. Lew
Chair, Financial Stability Oversight Council
Washington, D.C. 20220

Dear Mr. Chairman:

I am pleased to present you with the Council of Inspectors General on Financial Oversight (“CIGFO”) report titled, *Audit of the Financial Stability Oversight Council’s Monitoring of Interest Rate Risk to the Financial System*.

Since 2011, interest rate risk has been identified as a recurring potential threat and recommendation topic in the annual reports of the Financial Stability Oversight Council (“FSOC”), and this risk affects every financial institution to some degree. Accordingly, CIGFO convened a Working Group, based on the audit proposal submitted by the Federal Housing Finance Agency’s Office of Inspector General, to assess the extent to which FSOC is monitoring interest rate risk to the financial system.

In this resulting audit report, we make one recommendation, which if adopted and implemented, should increase transparency in FSOC’s annual reports. While the recommendation included in this report relates specifically to interest rate risk, it should be applied, as applicable, to other annual report recommendations.

I would like to take this opportunity to thank the FSOC members for their support, especially the Department of the Treasury staff who assisted with this effort.

CIGFO looks forward to working with you on this and other issues. In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act, CIGFO is also providing a copy of this report to Congress.

Sincerely,

/s/

Eric M. Thorson
Chair
Council of Inspectors General on Financial Oversight

Executive Summary

Why and How We Conducted this Audit

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) created a comprehensive regulatory and resolution framework designed to reduce the severe economic consequences of economic instability. The Dodd-Frank Act established the Financial Stability Oversight Council (“FSOC” or “Council”) and charged it with identifying risks to the nation’s financial stability, promoting market discipline, and responding to emerging threats to the stability of the nation’s financial system. Among other things, Title I of the Dodd-Frank Act charges FSOC with the duty to make recommendations to Federal agencies and others. It also requires FSOC to report to Congress annually about: (1) its activities; (2) significant financial market and regulatory developments; (3) potential emerging threats to the financial stability of the United States; and (4) recommendations (I) to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets; (II) to promote market discipline; and (III) to maintain investor confidence, among other things.

The Dodd-Frank Act also created a Council of Inspectors General on Financial Oversight (“CIGFO”), whose members include the Inspectors General with oversight authority for the majority of FSOC’s members, and authorizes it to evaluate the effectiveness and internal operations of FSOC. In May 2014, CIGFO convened a Working Group to assess the extent to which FSOC is monitoring interest rate risk to the financial system.

To accomplish CIGFO’s objective, the Working Group reviewed the Dodd-Frank Act to determine FSOC’s statutory authority and duties.

It inspected FSOC’s governance documents, annual reports, and public meeting minutes to understand FSOC’s organizational structure, and operational policies and procedures. It reviewed FSOC’s interest rate risk monitoring plans developed by its Systemic Risk Committee (“SRC”). The Working Group reviewed information, collected by participating Offices of Inspectors General, from FSOC federal member agencies related to their involvement in FSOC’s interest rate risk working groups in 2013 and 2014 and efforts to respond to FSOC’s annual report recommendations on interest rate risk. It also interviewed staff from the office of FSOC Secretariat at the Department of the Treasury to develop a better understanding of FSOC’s monitoring activities related to interest rate risk. The Working Group conducted fieldwork from October 2014 through April 2015 in accordance with generally accepted government auditing standards. On June 11, 2015, the Working Group briefed FSOC representatives on the overall results of our audit. Appendix I provides additional details about the objective, scope, and methodology of this audit.

Interest Rate Risk

is the exposure of an individual’s or an institution’s financial condition to changing interest rates.

What We Learned and What We Recommend

FSOC monitors interest rate risk on an ongoing basis by facilitating the sharing of financial expertise and information among FSOC members and member agencies and by making annual report recommendations.

As we explain more fully within the report, we are recommending that FSOC document in its annual reports to Congress its rationale for removing prior year recommendations related to interest rate risk. The lack of public documentation explaining the Council's decision to remove any recommendations with respect to interest rate risk creates a lack of transparency around the process for removing recommendations from previous years. Our recommendation, if adopted and implemented, would increase transparency in FSOC's annual reports.

While the recommendation included in this report relates specifically to interest rate risk, it should be applied, as applicable, to other annual report recommendations.

FSOC Response

In a written response, FSOC stated that its annual reports are designed to focus the attention of regulators, policymakers, Congress, and members of the public on potential risks to financial stability and how they should be addressed, rather than describing all market developments and potential risk hypotheses. At the same time, the Council is committed to providing as much transparency as possible regarding its work. Since the publication of the 2014 annual report, the Council has adopted enhancements to its transparency policy that provide the public with greater visibility into the Council's deliberations on an ongoing basis, in addition to the accountability provided in its annual report. Nevertheless, to the extent that the Council no longer recommends action related to a risk area identified in the prior annual report, FSOC will consider how to provide additional information regarding the Council's analysis.

CIGFO Working Group Comments

We note that FSOC did not specifically agree or disagree with our recommendation in its response. To the extent that FSOC intends to include the rationale for removing recommendations in its annual reports, we consider FSOC's comments and planned action responsive to our recommendation. Implementation of the recommendation will further enhance transparency and will provide accountability in its annual report.

CIGFO Working Group Audit

This report presents the results of the CIGFO Working Group's audit of FSOC's monitoring of interest rate risk to the financial system. This is the fourth audit report that a CIGFO Working Group has issued to FSOC and the Congress as part of CIGFO's responsibility to oversee FSOC under the Dodd-Frank Act. CIGFO issued its first three audits in June 2012,¹⁷ July 2013,¹⁸ and July 2014.¹⁹

Background

Congress recognized that no one regulator had responsibility to identify potential risks to the stability of the nation's financial system, promote market discipline, and respond to emerging threats, and that such efforts would require collective engagement by the entire financial regulatory community. One element of the Dodd-Frank Act's comprehensive framework was the creation of FSOC, a body that includes federal financial regulators, an independent insurance expert appointed by the President, and state regulators. The Dodd-Frank Act vests FSOC with authorities to constrain excessive risk in the financial system. Among other things, Title I of the Dodd-Frank Act established FSOC to monitor potential threats to the financial system and provide for more stringent regulation of nonbank financial companies and financial activities that the Council determines, based on consideration of risk-related factors, pose risks to financial stability. As shown in Figure 1, the Council consists of 10 voting members and 5 non-voting members.

17 CIGFO, *Audit of the Financial Stability Oversight Council's Controls over Non-public Information*, June 2012, <http://www.treasury.gov/about/organizational-structure/ig/Documents/CIGFO%20Document/Audit%20of%20the%20Financial%20Stability%20Oversight%20Council%27s%20Controls%20over%20Non-public%20Information.pdf>, accessed on May 13, 2015.

18 CIGFO, *Audit of the Financial Stability Oversight Council's Designation of Financial Market Utilities*, July 2013, http://www.treasury.gov/about/organizational-structure/ig/OIG%20Sorter/CIGFO_AUDIT_71713.pdf, accessed on May 13, 2015.

19 CIGFO, *Audit of the Financial Stability Oversight Council's Compliance with Its Transparency Policy*, July 2014, <http://www.treasury.gov/about/organizational-structure/ig/Documents/CIGFO%20Audit%20July%202014.pdf>, accessed on May 13, 2015.

Figure 1: FSOC Council Membership²⁰

Federal and Independent Members	State Members
<ul style="list-style-type: none"> • Secretary of the Treasury, Chairperson (v) • Chairman of the Board of Governors of the Federal Reserve System (v) • Comptroller of the Currency (v) • Director of the Consumer Financial Protection Bureau (v) • Chairman of the Securities and Exchange Commission (v) • Chairperson of the Federal Deposit Insurance Corporation (v) • Chairperson of the Commodity Futures Trading Commission (v) • Director of the Federal Housing Finance Agency (v) • Chairman of the National Credit Union Administration Board (v) • Director of the Office of Financial Research • Director of the Federal Insurance Office • Independent member with insurance expertise (v) <p>(v) Indicates Voting Member</p>	<ul style="list-style-type: none"> • State Insurance Commissioner • State Banking Supervisor • State Securities Commissioner

The statutory purposes of FSOC are to:

- identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;
- promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the United States Government will shield them from losses in the event of failure; and
- respond to emerging threats to the stability of the United States financial system.²¹

Each year, FSOC issues an annual report to fulfill its Congressional mandate to report on the activities of the Council, significant financial market and regulatory developments, potential emerging threats, and its recommendations, among other things.²²

Within the Department of the Treasury (“Treasury”), a dedicated policy office, led by a Deputy Assistant Secretary, functions as the FSOC Secretariat and assists in coordinating the work of the Council among its members and member agencies. The voting members of FSOC provide a federal financial regulatory perspective as well as an independent insurance expert’s view. The non-voting members offer different insights as state-level representatives from bank, securities, and insurance regulators or as the directors of offices within Treasury — the Office of Financial Research and the Federal Insurance Office (“FIO”).

²⁰ 12 U.S.C. § 5321(b).

²¹ 12 U.S.C. § 5322(a)(1).

²² 12 U.S.C. § 5322(a)(2)(N).

FSOC's committee structure – interest rate risk

FSOC has developed a committee structure — for monitoring interest rate risk and other issues that could affect financial stability — to promote its members' mutual responsibility to share information and coordinate expertise among the member agencies. See Figure 2 below.

Figure 2: FSOC's Committee Structure – Interest Rate Risk^{23,24}



The Council is a collaborative body chaired by the Secretary of the Treasury that brings together the expertise of the federal financial regulators, an independent insurance expert appointed by the President, and state regulators, and is charged with constraining risks to financial stability. See Figure 1. The Deputies Committee, composed of senior officials from each Council member or member agency, reports to the Council and coordinates and oversees the work of the SRC. See Figure 2. The SRC, composed primarily of member agency staff in supervisory, monitoring, examination, and policy roles, serves as a forum to assist the Council with the identification and analysis of potential risks, including risks that may extend beyond the jurisdiction of any one agency. The SRC, in consultation with the Deputies Committee, is charged with prioritizing the review of sources of risk and guiding the work of staff and working groups of the SRC. FSOC Secretariat staff advised us that working groups — which could include participants of the SRC — monitor areas of risk the Council identifies, follow trends, and determine if changes have occurred that may mitigate risks or address recommendations noted in the previous annual report. The Council, Deputies Committee, SRC, and working groups each meet periodically to discuss risks to the nation's financial stability, including interest rate risk.

23 Figure derived from CIGFO Working Group's analyses of FSOC's governance documents, *Rules of Organization of the Financial Stability Oversight Council*; *Bylaws of the Deputies Committee of the Financial Stability Oversight Council*; and *Council's Committee Charters*, <http://www.treasury.gov/initiatives/fsoc/governance-documents/Pages/default.aspx>, accessed June 11, 2015, along with information obtained from FSOC Secretariat staff.

24 In addition to the Systemic Risk Committee, the Deputies Committee also oversees other staff-level committees that help carry out the responsibilities and authorities of FSOC.

FSOC's responsibilities

The Dodd-Frank Act charges FSOC with, among other things, reporting annually to Congress on the Council's activities; significant financial market and regulatory developments; potential emerging threats to the financial stability of the United States; and recommendations to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets to promote market discipline and to maintain investor confidence.²⁵

Based on the recommendations included in its annual report from the prior year, the SRC is tasked with creating monitoring plans to follow-up on prior year recommendations. The monitoring plans include establishing working groups, describing the expected deliverables from these groups, and presenting questions the working groups should consider while performing monitoring activities. FSOC Secretariat staff explained to us that the working groups are tasked with reassessing risks within the current economic environment. The results of the working groups' activities are presented to the SRC, Deputies Committee, and the Council in the form of PowerPoint presentations. For example, the presentations included the working groups' analyses of the impacts of sustained low interest rates, such as increased risk-taking in search of yield, and the potential impacts of rising interest rates, such as liquidity issues, at various types of financial institutions. Based on analyses of the working groups, FSOC decides which recommendations should be included in its subsequent annual report.

FSOC's Approach to Monitoring Interest Rate Risk

Interest rate risk is experienced by all financial institutions.^{26,27} FSOC defines interest rate risk as the exposure of an individual's or an institution's financial condition to changes in interest rates.²⁸ In FSOC's view, a prolonged low interest rate environment weighs on financial institutions' earnings and puts pressure on pension and retirement funds' ability to meet long-term liabilities.²⁹ A rise in interest rates could lead to: (1) weakening of some financial sectors and (2) sizeable losses incurred by investors.³⁰ Sizeable spikes in interest rates could result in damage to the entire financial system.³¹ It should also be noted that the Federal Financial Institutions Examination Council issued an advisory statement in 2010 that financial institutions should have

25 12 U.S.C. § 5322(a)(2)(N). FSOC Secretariat staff informed us that they rely on 12 U.S.C. § 5322 as the authority to make recommendations in the FSOC's annual reports.

26 Federal Deposit Insurance Corporation, *Types of Interest Rate Risk*, August 6, 2013, <https://www.fdic.gov/regulations/resources/director/technical/irr.html#two>, accessed on March 30, 2015.

27 Federal Financial Institutions Examination Council, *Advisory on Interest Rate Risk Management*, January 6, 2010, <https://www.fdic.gov/news/news/press/2010/pr1002.pdf>, accessed on April 30, 2015.

28 Financial Stability Oversight Council, *2011 Annual Report*, <http://www.treasury.gov/initiatives/fsoc/Pages/annual-report2011.aspx>, accessed on March 29, 2015.

29 Financial Stability Oversight Council, *2014 Annual Report*, <http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2014-Annual-Report.aspx>, accessed on April 6, 2015.

30 Financial Stability Oversight Council, *2014 Annual Report*, <http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2014-Annual-Report.aspx>, accessed on April 6, 2015.

31 William Bednar and Mahmoud Elamin, *Interest Rate Risk and Rising Maturities*, Federal Reserve Bank of Cleveland, October 16, 2014, <https://www.clevelandfed.org/en/Newsroom%20and%20Events/Publications/Economic%20Commentary/2014/Interest%20Rate%20Risk%20and%20Rising%20Maturities.aspx>, accessed on March 25, 2015.

sound practices in place to monitor interest rate risk, especially in the environment of historically low interest rates.³²

In interviews, FSOC Secretariat staff stated that FSOC mainly monitors interest rate risk in two ways: by making recommendations in its annual reports and by sharing and coordinating information among FSOC members.

FSOC's recommendations relating to interest rate risk

Since 2011, FSOC's annual reports to Congress have discussed interest rate risk and recommended actions that would address that risk. FSOC's 2013 annual report made three recommendations related to interest rate risk:

- **Depository Institutions, Broker-Dealers, and Bank Holding Companies:** The Council recommends that regulatory agencies and private sector risk managers continue their scrutiny of the ways in which potential changes in interest rates could adversely affect the risk profiles of financial firms. This should be done with regular assessments of interest rate and credit risk management strategies, including thorough assessments of how institutions will perform in a stressed or rapidly changing market environment.
- **Insurance Companies:** The Council recommends that FIO and state insurance regulators continue to be vigilant in monitoring the impact of the low interest rate environment on insurance companies and that state insurance regulators continue to ensure that the economic scenarios run by insurance companies are sufficiently robust and appropriately capture interest rate and other economic risks.
- **Pension Funds:** The Council recommends that appropriate authorities continue their scrutiny of the ways in which low interest rates could adversely affect the risk profiles of pension funds and continue to address the funding status of pension funds.

FSOC's 2014 annual report contained two interest rate risk recommendations:

- **Depository Institutions, Broker-Dealers, and Bank Holding Companies:** The Council recommends that supervisors, regulators, and firm management continue to monitor and assess the growing risks resulting from the continued search-for-yield behaviors as well as the risks from potential severe interest rate shocks.
- **Insurance Companies:** The Council recommends that FIO and state insurance regulators continue to monitor and assess interest rate risk resulting from severe interest rate shocks.

32 Federal Financial Institutions Examination Council, *Advisory on Interest Rate Risk Management*, January 6, 2010, <https://www.ffiec.gov/press/pr010710.htm>, accessed on April 6, 2015. The Federal Financial Institutions Examination Council is a formal interagency body empowered to prescribe uniform policies, standards, and report forms for the federal examination of financial institutions in the supervision of financial institutions and to make recommendations to promote uniformity in the supervision of financial institutions.

FSOC's efforts to share and coordinate information relating to interest rate risk

After the issuance of its 2013 annual report, FSOC developed three working groups for the interest rate risk recommendations: (1) Depository Institutions, Broker-Dealers, and Bank Holding Companies, (2) Insurance Companies, and (3) Pension Funds. The working groups performed a reassessment of interest rate risk, within the then current economic environment, which looked at a number of different data points to include an evaluation of whether the related risk had been mitigated or had changed since the 2013 report. The working groups presented their reassessment of interest rate risk to the SRC, the Deputies Committee, and the Council; and we were told by FSOC Secretariat staff that this analysis factored into the findings and recommendations of the 2014 FSOC annual report. Also, member agencies provided updates on their respective agency's own actions to monitor interest rate risk. FSOC implemented the same process following the issuance of its 2014 annual report. In addition, in December 2014, a presentation regarding the status of a number of working groups was presented to the Council during an open session. Further, the Office of Financial Research presented updates at the monthly SRC meetings which included information and analyses related to interest rate risk.

Assessment Of FSOC's Efforts to Monitor Interest Rate Risk

As noted above, FSOC's 2013 annual report to Congress included an interest rate risk recommendation related to pension funds, but its 2014 annual report did not continue the recommendation. FSOC Secretariat staff told us that FSOC relied on the collective judgment of its members to determine whether to continue any recommendations from the prior year but did not document the reasons for its decision in its annual report.

When asked why the pension funds recommendation was not continued in 2014, FSOC Secretariat staff explained that working group analyses indicated that the interest rate risk stemming from pension funds was more of an economic issue than a financial stability concern.³³ FSOC's 2014 annual report discussed the continuing interest rate risk related to pension funds but did not distinguish between economic issue and financial stability concern:

“The prolonged period of low interest rates and low volatility has led financial institutions and investors to search for yield. Low interest rates weigh on earnings of banks, credit unions, broker-dealers and insurance companies, thereby incenting companies to seek higher-yielding investments. The ability of pension and retirement funds to meet their long-term liabilities is under pressure, incenting them to seek more yield.”³⁴

FSOC did not document in its annual report the rationale for removing the interest rate risk recommendation related to pension funds. We believe that public documentation of the rationale for removing interest rate risk recommendations helps to contextualize those decisions. In this instance, documentation would have publicly memorialized the efforts undertaken by the working groups, the SRC, and the Deputies Committee to reassess interest rate risk throughout the year, thus enhancing transparency.

33 The distinction between economic issues and financial stability concerns is based on the Council's judgment about whether a risk rises to a level that will have an impact on financial stability.

34 Financial Stability Oversight Council, *2014 Annual Report*, <http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2014-Annual-Report.aspx>, accessed on April 6, 2015.

Conclusion and Recommendation

Based on our interviews with FSOC Secretariat staff, we were able to gain an understanding of the efforts by FSOC's working groups, SRC, Deputies Committee, and Council to monitor interest rate risk during the year. That said, we are concerned that a lack of discussion in its annual reports explaining the Council's decision to remove any prior year recommendation could raise a question of transparency around the process to monitor recommendations and decisions with respect to them.

Accordingly, to further increase transparency around monitoring of interest rate risk, we recommend that FSOC document in its annual report to Congress its rationale for removing prior year recommendations related to interest rate risk.

While the recommendation included in this report relates specifically to interest rate risk, it should be applied, as applicable, to other annual report recommendations.

FSOC response

In a written response, FSOC stated that its annual reports are designed to focus the attention of regulators, policymakers, Congress, and members of the public on potential risks to financial stability and how they should be addressed, rather than describing all market developments and potential risk hypotheses. At the same time, the Council is committed to providing as much transparency as possible regarding its work. Since the publication of the 2014 annual report, the Council has adopted enhancements to its transparency policy that provide the public with greater visibility into the Council's deliberations on an ongoing basis, in addition to the accountability provided in its annual report. Nevertheless, to the extent that the Council no longer recommends action related to a risk area identified in the prior annual report, FSOC will consider how to provide additional information regarding the Council's analysis.

CIGFO working group comments

We note that FSOC did not specifically agree or disagree with our recommendation in its response. To the extent that FSOC intends to include the rationale for removing recommendations in its annual reports, we consider FSOC's comments and planned action responsive to our recommendation. Implementation of the recommendation will further enhance transparency and will provide accountability in its annual report.

Appendix I: Objective, Scope, and Methodology

Objective

The audit objective was to assess the extent to which FSOC is monitoring interest rate risk to the financial system.

Scope and methodology

The scope of this audit included FSOC's monitoring of interest rate risk during 2013 and 2014.

To accomplish our objective, we:

- reviewed the Dodd-Frank Act to determine FSOC's statutory authority and duties;
- reviewed FSOC's governance documents, annual reports, and meeting minutes to understand FSOC's organizational structure and operational policies and procedures;
- analyzed FSOC's 2010 through 2014 membership to determine the level of turnover;
- reviewed FSOC's interest rate risk monitoring plans developed by the SRC and the results of interest rate risk research (presented in PowerPoint presentations) conducted by FSOC member agency representatives to assess FSOC's monitoring and recommendation process;
- reviewed information, collected by participating Offices of Inspectors General, from FSOC's federal member agencies relating to the member agency's involvement in FSOC's interest rate risk working group committees in 2013 and 2014 and efforts of their agencies to respond to FSOC annual report recommendations on interest rate risk;
- viewed FSOC meeting webcasts where staff from the FSOC Secretariat provided updates on selected annual report recommendations from 2013 and 2014; and
- interviewed staff from the FSOC Secretariat to determine FSOC's monitoring activities related to interest rate risk. Topics discussed included FSOC's information sharing and coordination, processes for development and inclusion of recommendations in the annual report, and identifying regulatory gaps.

We performed field work from October 2014 through April 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix II: FSOC Response



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

July 8, 2015

The Honorable Eric M. Thorson
Chair, Council of Inspectors General
on Financial Oversight (CIGFO)
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Response to CIGFO's Draft Audit Report: *Audit of the Financial Stability Oversight Council's Monitoring of Interest Rate Risk to the Financial System*

Dear Mr. Chairman:

Thank you for the opportunity to review and respond to your draft audit report, *Audit of the Financial Stability Oversight Council's Monitoring of Interest Rate Risk to the Financial System*, dated June 2014 (the Draft Report). The Financial Stability Oversight Council (Council) appreciates the CIGFO working group's review of the Council's efforts related to interest rate risk. This letter responds on behalf of Secretary Lew to the Draft Report.

As noted in the Draft Report, the Council has highlighted potential risks related to a sustained period of low interest rates in each of its annual reports since its first report in 2011. Beginning in 2013, the Council's staff-level Systemic Risk Committee established working groups after the publication of each annual report to monitor the risks and recommendations made by the Council in the report. These working groups presented their findings to the Systemic Risk Committee, the Council's Deputies Committee, and the Council itself, as appropriate. These findings help inform the Council's subsequent deliberations on whether certain risk areas should continue to be included in future annual reports.

After the Council published its 2013 annual report, staff working groups investigated potential risks created by the low-risk environment's impact on pension funds. The staff surveyed relevant literature, spoke with external subject matter experts, and analyzed pension data. The staff found that the impact of the low interest rate environment on pension funds was less likely to cause an impairment of financial intermediation in the near term. Based on this analysis, which was provided to CIGFO during the course of its fieldwork, the Council did not include a recommendation on potential interest rate risk related to pension funds in the 2014 annual report. While the Draft Report acknowledges the continuing work conducted by the Council and its staff committees with regard to monitoring interest rate risk, the Draft Report notes that the Council did not state in its 2014 annual report the rationale for not including a recommendation made the previous year related to pension funds.

The Council's annual reports are designed to focus the attention of regulators, policymakers, Congress, and members of the public on potential risks to financial stability and how they should



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

be addressed, rather than describing all market developments and potential risk hypotheses. At the same time, the Council is committed to providing as much transparency as possible regarding its work. Since the publication of the 2014 annual report, the Council has adopted enhancements to its transparency policy that provide the public with greater visibility into the Council's deliberations on an ongoing basis, in addition to the accountability provided through its annual report. For example, as the Draft Report notes, the status of staff work regarding interest rate risk was presented to the Council during a public session in December 2014. Nevertheless, to the extent that the Council no longer recommends action related to a risk area identified in the prior annual report, we will consider how to provide additional information regarding the Council's analysis.

Thank you again for the opportunity to review and comment on the Draft Report. We value CIGFO's input and recommendations and look forward to working with you in the future.

Sincerely,

/s/

Patrick Pinschmidt
Deputy Assistant Secretary
Financial Stability Oversight Council

Appendix III: CIGFO Working Group

Federal Housing Finance Agency Office of Inspector General, Lead Agency		
Laura Wertheimer, Inspector General, Federal Housing Finance Agency		
Tara Lewis	Patrice Wilson	Terese Blanchard
Pamela L. Williams		
Department of the Treasury Office of Inspector General		
Eric M. Thorson, Inspector General, Department of the Treasury, and CIGFO Chair		
Jeffrey Dye	Dana Duvall	Marla Freedman
April Ellison	Susan Marshall	Robert Taylor
Federal Deposit Insurance Corporation Office of Inspector General		
Fred Gibson, Acting Inspector General, Federal Deposit Insurance Corporation		
Michael Lombardi	Jeffery Smullen	Mary Carmichael
David Rubin	Marshall Gentry	Corinne Torongo
National Credit Union Administration Office of Inspector General		
James Hagen, Inspector General, National Credit Union Administration		
Marvin Stith		
Securities and Exchange Commission Office of Inspector General		
Carl Hoecker, Inspector General, Securities and Exchange Commission		
Kelli Brown-Barnes	Carrie Fleming	Rebecca Sharek
Board of Governors of the Federal Reserve System Office of Inspector General		
Mark Bialek, Inspector General, Board of Governors of the Federal Reserve System		
Michael VanHuysen	Shannon Williams	Michael Zeitler
Sopeany Keo		
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