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## FEDERAL HOUSING FINANCE AGENCY

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### **ADVISORY BULLETIN**

**AB 2012-01**

### **CATEGORIES FOR EXAMINATION FINDINGS**

#### **PURPOSE:**

This Advisory Bulletin establishes categories for safety and soundness and Affordable Housing Program (AHP) examination findings pertaining to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (the regulated entities). Examination findings are deficiencies related to risk management, risk exposure, or violations of laws, regulations, or orders that affect the performance or condition of a regulated entity. This Advisory Bulletin establishes a hierarchy of examination findings categories that distinguish levels of seriousness to identify priorities for remediation by the regulated entities and guide the FHFA in the development of supervisory strategies.

#### **ISSUE:**

The Division of Enterprise Regulation (DER) and the Division of FHLBank Regulation (DBR), currently follow different supervision policy guidance for the issuance of examination findings. The Division of Examination Programs and Support (DEPS) examiners apply the findings categories used by the supervision division for which it is providing examination support. A single framework for examination findings categories is necessary for a common FHFA supervision program across divisions.

#### **BACKGROUND**

The DER uses one category of examination finding, Matters Requiring Attention (MRA), to describe significant deficiencies at Fannie Mae or Freddie Mac as defined in the *Division of*

*Enterprise Regulation Supervisory Guide.* The DBR uses five categories of findings as outlined in the *Examination Manual*: Unsafe or Unsound Practice or Condition, Violation, Weakness, Recommendation, and Referral. As used in DBR, MRAs might be described as Unsafe or Unsound Practices or Condition, Violations, or Weaknesses.

## **CATEGORIES FOR EXAMINATION FINDINGS**

This Advisory Bulletin establishes the following categories and definitions for safety and soundness and AHP examination findings to be used by DBR, DER, and DEPS.

### ***Matters Requiring Attention***

This category identifies serious deficiencies that require prompt remediation by the regulated entity and timely follow-up by FHFA to check for resolution consistent with a remediation plan.

*Definition* – MRAs are the most serious supervisory matters. They include, among others, such matters as non-compliance with laws or regulations that result or may result in significant risk of financial loss or damage to the regulated entity; repeat deficiencies that have escalated due to insufficient action or attention; unsafe or unsound practices; and matters that have resulted, or are likely to result, in a regulated entity being in an unsafe or unsound condition. MRAs also include breakdowns in risk management, significant control weaknesses, or inappropriate risk-taking. MRAs may have program implications for the regulated entity or may establish precedent. The Examiner in Charge (EIC) or designee communicates MRAs to the management of the regulated entity or the board of directors, as appropriate.

*Remediation* – Corrective action for MRAs must be articulated in written remediation plans, prepared by the regulated entity, acceptable to the FHFA. The timeframes for submission of the remediation plans to the FHFA and specific milestones within remediation plans should reflect the seriousness of the MRA, taking into consideration the complexity of the issue, and the urgency regarding correction. The EIC or designee communicates in writing to the regulated entity the timeframe for submission of a remediation plan.

*FHFA Remediation Follow-up* – Due to the seriousness of MRAs, examiners must check and document progress at an interval determined by the EIC and guided by the remediation plan. Follow-up should include an assessment of materials provided by the regulated entity, discussions with the responsible parties at the regulated entity, and testing, if appropriate, to determine progress against a remediation plan. If progress toward remediation is not being made and/or milestones are missed, other supervisory action should be considered. Depending upon the nature of the MRA, elevating the

matter to an enforcement action might be determined to be appropriate after coordination and consultation with the Office of General Counsel. Examiners will document all follow-up activities, including details on the status of the MRA, to inform internal FHFA management reports.

## ***Violations***

Violations require action by the regulated entity to correct findings, if possible, of non-compliance with requirements and to change a program or practice to prevent recurrence. FHFA examiners evaluate steps taken by the regulated entity to determine the sufficiency of remediation efforts. Examiners should consult with the Office of General Counsel regarding the determination of a violation and/or the remedial action.

*Definition* – Violations are any matter in which the examination discloses reason to suspect that a regulated entity is in non-compliance with laws, regulations, or orders. Violations that have serious implications regarding the condition or practices of the regulated entity might also be identified as MRAs.

*Remediation* –The expected remediation time frame depends on the seriousness of the actual or potential consequences of the violation and the time required for the regulated entity to implement required corrective action, subject to FHFA approval. If the violation cannot be remediated immediately, a remediation plan must be submitted to the EIC for approval and contain measureable milestones, as appropriate. The EIC should communicate timeframes for the submission of a remediation plan and FHFA decisions on those plans to the regulated entity in writing.

*FHFA Remediation Follow-up* – Examiner follow-up occurs between examination cycles or at intervals determined by the EIC, guided by the approved remediation plan. Follow-up should include an assessment of materials provided by the regulated entity, discussions with the responsible parties at the regulated entity, and testing, as appropriate, to assess the efficacy of the regulated entity's corrective action. If the violation is not addressed consistent with the remediation plan, the EIC must respond appropriately, including consideration of revisions to the remediation plan or further supervisory action, as appropriate. The EIC must coordinate with the FHFA Office of General Counsel before pursuing an enforcement action. Examiners must document follow-up activities to inform internal FHFA management reports.

## ***Recommendations***

Recommendations identify policies, procedures, or practices at the regulated entity that could be improved. FHFA will evaluate the consequences, if any, if they are not implemented by the regulated entity.

*Definition* – Recommendations are advisory in nature and represent suggested changes to a policy, procedure, practice, or control to improve, or prevent deterioration in, condition, operations, or performance.

*Remediation* – Implementation is discretionary and therefore remediation plans are not required.

*FHFA Follow-up* – Follow-up by FHFA will occur during the normal course of the supervisory process and documented as part of the supervisory work papers. Follow-up activities may include an assessment of materials provided by the regulated entity or discussions with the responsible parties. If changes based on recommendations were not made, the finding may be elevated from a recommendation to an MRA, particularly if deterioration occurs.

## **EFFECTIVE DATE**

The examination findings categories defined in this Advisory Bulletin are effective with the 2012 examination cycle for Fannie Mae and Freddie Mac. The examination findings categories are effective upon issuance of this Advisory Bulletin for all Federal Home Loan Bank examinations not yet started.

Advisory Bulletins communicate guidance to FHFA supervision staff and the regulated entities on specific supervisory matters pertaining to the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. Contact Kari Walter, Senior Associate Director, Office of Examination Policy and Programs at (202) 649-3405 or Bobbi Montoya, Principal Advisor, Office of Examination Policy and Programs at (202) 649-3406 with questions pertaining to this Advisory Bulletin.