

Board of Governors of the Federal Reserve System

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# Following Established Processes Helped FRB New York and the Board Reduce Risks Associated With Lending Facility Contracts



**Office of Inspector General**

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



## Office of Inspector General

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

Executive Summary, 2023-FMIC-B-005, April 17, 2023

# Following Established Processes Helped FRB New York and the Board Reduce Risks Associated With Lending Facility Contracts

## Findings

For the 10 contracts related to the emergency lending facilities established in response to the COVID-19 pandemic that were directly negotiated with 5 vendors, the Federal Reserve Bank of New York (FRB New York) generally followed established vendor selection processes, and the Board of Governors of the Federal Reserve System's Division of Reserve Bank Operations and Payment Systems (RBOPS) provided oversight. Following established vendor selection processes helped FRB New York reduce risks by fostering consistency and transparency in its vendor selection decisions and mitigating conflicts of interest arising from potential employee- and institutional-vendor relationships. In addition, for the 17 contracts with the 8 vendors that supported the operations of these lending facilities, FRB New York generally followed established vendor management processes by confirming that it received the expected services and that associated risks and conflicts of interest were appropriately managed throughout the duration of the contracts. RBOPS provided oversight of FRB New York's vendor management processes as well.

Although FRB New York generally followed established processes, it can clarify vendor selection processes for lending facility acquisitions. Specifically, FRB New York excludes lending facility acquisitions from its *Acquisition Policy*, and that policy does not include a rationale for the exclusion. An FRB New York official acknowledged that the policy is not clear about whether vendor selection processes are applicable to lending facility acquisitions. Also, FRB New York has not updated its policy to incorporate lessons learned related to maximizing the use of competitive contracts; rather, it is incorporating those lessons learned into facility-specific reference guides. Clarifying vendor selection processes for lending facility acquisitions and incorporating lessons learned into policy or guidance can help reduce risks associated with lending facility contracts, should future facilities be needed.

## Recommendations

Our report does not contain any recommendations because FRB New York updated its *Acquisition Policy* to clarify that the policy applies to emergency lending facility acquisitions. In addition, FRB New York documented its lessons learned from the COVID-19 pandemic response in facility-specific reference guides. When our reports do not contain recommendations, providing an official response is optional. We received an official response from the Board conveying the Board's appreciation for our conclusions that RBOPS's oversight contributed to reducing risks associated with the lending facility contracts. FRB New York chose not to provide an official comment, but FRB New York management stated during a March 6, 2023, meeting that they concur with the content of the report.

## Purpose

The objective of our evaluation was to assess the Federal Reserve System's vendor selection and management processes related to lending facilities operated by FRB New York. The scope of our evaluation included FRB New York's vendor selection and management processes from March 2020 through September 2021 and RBOPS's associated oversight activities. For vendor selection testing, we included the 10 directly negotiated contracts. For vendor management testing, we included the 17 contracts that supported the operations of the lending facilities.

## Background

The COVID-19 pandemic disrupted economic activity in the United States and heightened the need for businesses and government institutions to obtain credit to sustain operations. Under section 13(3) of the Federal Reserve Act and with approval of the U.S. treasury secretary, the Board authorized 13 emergency lending programs to support state and local governments and businesses of all sizes. FRB New York used vendors to support 5 of the 6 lending facilities it operated; some of these vendors were selected through a noncompetitive procurement process.



Recommendations, 2023-FMIC-B-005, April 17, 2023

## **Following Established Processes Helped FRB New York and the Board Reduce Risks Associated With Lending Facility Contracts**

**Finding 1: Following Established Processes Helped FRB New York and RBOPS Reduce Risks Associated With the Lending Facility Contracts**

Number	Recommendation	Responsible office
	No recommendations.	

**Finding 2: FRB New York Can Clarify Vendor Selection Processes for Lending Facility Acquisitions**

Number	Recommendation	Responsible office
	No recommendations.	



**Office of Inspector General**

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

**MEMORANDUM**

**DATE:** April 17, 2023

**TO:** Matthew J. Eichner  
Director, Division of Reserve Bank Operations and Payment Systems  
Board of Governors of the Federal Reserve System

Sushmita Shukla  
First Vice President  
Federal Reserve Bank of New York

**FROM:** Cynthia Gray *Cynthia Gray*  
Deputy Associate Inspector General for Audits and Evaluations

**SUBJECT:** OIG Report 2023-FMIC-B-005: *Following Established Processes Helped FRB New York and the Board Reduce Risks Associated With Lending Facility Contracts*

We have completed our report on the subject evaluation. We conducted this evaluation to assess the Federal Reserve System’s vendor selection and management processes related to the Federal Reserve Bank of New York’s (FRB New York) lending facilities.

We provided the Board of Governors of the Federal Reserve System and FRB New York with a draft of our report for review and comment. Official comments were not required because our report did not contain recommendations. In its written response, the Board appreciated our conclusions that the Division of Reserve Bank Operations and Payment Systems’ oversight contributed to reducing risks associated with the lending facility contracts and noted that the division remains committed to providing effective oversight of the emergency lending facilities. We have included the response as appendix C to our report. FRB New York chose not to provide an official response but verbally concurred with the report and thanked the OIG for the collaborative effort.

We appreciate the cooperation that we received from the Board and FRB New York during our evaluation. Please contact me if you would like to discuss this report or any related issues.

cc: Andreas Lehnert, Director, Division of Financial Stability, Board  
Mark E. Van Der Weide, General Counsel, Board  
Jeff Walker, Associate Director, Division of Reserve Bank Operations and Payment Systems, Board

Jason Hinkle, Deputy Associate Director, Division of Reserve Bank Operations and Payment Systems, Board

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# Introduction

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## Objective

The COVID-19 pandemic disrupted economic activity in the United States, which affected many sectors of the financial system. This economic disruption heightened the need for businesses and government institutions to obtain credit to manage cash flows and sustain operations until economic conditions normalized. In response, under section 13(3) of the Federal Reserve Act and with approval of the U.S. treasury secretary, the Board of Governors of the Federal Reserve System authorized 13 emergency lending programs, known as *emergency lending facilities*, to support state and local governments and businesses of all sizes. The Federal Reserve Bank of New York (FRB New York) operated 6 emergency lending facilities, 5 of which were supported by multiple vendors, and awarded some of its related contracts noncompetitively.

The objective of this evaluation was to assess the Federal Reserve System’s vendor selection and management processes related to the 6 lending facilities operated by FRB New York. The scope of our evaluation included FRB New York’s vendor selection and vendor management processes from March 2020 through September 2021 and the Board Division of Reserve Bank Operations and Payment Systems’ (RBOPS) oversight of those activities. Our scope included 17 FRB New York contracts that related to the operations of the lending facilities, 10 of which were directly negotiated.<sup>1</sup> For vendor selection testing, we focused on those 10 contracts with 5 vendors; for vendor management testing, we focused on all 17 contracts with the 8 vendors included in our scope. For details on our scope and methodology, see appendix A. Appendix B contains a list of the vendors included in our scope.

## Background

### ***Lending Facilities Operated by FRB New York***

Section 13(3) of the Federal Reserve Act permits the Board, in “unusual and exigent circumstances” and with approval of the U.S. treasury secretary, to authorize the Federal Reserve Banks to extend credit through any program or facility with broad-based eligibility. In addition, the Coronavirus Aid, Relief, and Economic Security (CARES) Act authorized, among other things, the U.S. Department of the Treasury’s investment in certain lending facilities established by the Board. In response to the economic disruption caused by the COVID-19 pandemic, the Board established 13 lending facilities to provide support for the

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<sup>1</sup> Awarding those 17 contracts resulted in fees of approximately \$21.4 million as of December 31, 2022.

flow of credit to businesses. FRB New York operated 6 of the 13 lending facilities.<sup>2</sup> The following 5 lending facilities operated by FRB New York leveraged vendor support:<sup>3</sup>

1. Commercial Paper Funding Facility (CPFF)
2. Municipal Liquidity Fund (MLF)
3. Primary Market Corporate Credit Facility (PMCCF)
4. Secondary Market Corporate Credit Facility (SMCCF)
5. Term Asset-Backed Securities Loan Facility (TALF)

## ***FRB New York's Vendor Selection and Management Processes***

FRB New York's *Acquisition Policy* governs the acquisition of goods and services, ensuring that goods and services procured meet FRB New York's needs at the most favorable terms available. While the *Acquisition Policy* excludes lending facilities, FRB New York voluntarily elected to follow the policy when selecting vendors for the facilities. The policy includes vendor selection processes related to engaging in noncompetitive (directly negotiated) procurement processes; assessing reputational, credit, and other risks associated with vendors; reviewing the reasonableness of vendor prices; and identifying FRB New York employees' conflicts of interest with potential vendors.

Although the *Acquisition Policy* excludes lending facility acquisitions, FRB New York has several other policies related to vendor selection and management processes that apply to lending facility acquisitions. Specifically, FRB New York's *Vendor Management Policy* establishes standards to manage vendor performance and compliance with the terms and conditions of contracts. In addition, this policy includes minimum requirements for managing critically important vendors (CIVs). FRB New York defines a *CIV* as a vendor that would create significant financial, operational, reputational, or other risks if it fails to fulfill product, service, or service-level requirements. FRB New York also has an *Institutional Conflicts of Interest Policy*, which includes processes for managing actual and potential institutional conflicts of interest that arise from relationships with vendors, and a *Risk Event Management Policy*, which establishes processes to effectively address, communicate, and learn from risk events that may occur throughout the duration of lending facilities.<sup>4</sup> Further, supplemental guidance and considerations for FRB New York's vendor management practices are included in the Reserve Bank's *Vendor Risk Management Framework*, which includes practices to apply the Reserve Bank's vendor management standards, tools, and controls using a risk-based approach.

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<sup>2</sup> Four of FRB New York's lending facilities received equity investments from the U.S. Department of the Treasury pursuant to the CARES Act: the Primary Market Corporate Credit Facility, the Secondary Market Corporate Credit Facility, the Municipal Liquidity Fund, and the Term Asset-Backed Securities Loan Facility.

<sup>3</sup> FRB New York did not award any vendor contracts for its sixth lending facility, the Primary Dealer Credit Facility (PDCF). The Board established several other lending facilities, namely, the Money Market Mutual Fund Liquidity Facility; the Paycheck Protection Program Liquidity Facility; and the Main Street Lending Program, which itself comprised five lending facilities. Because these lending facilities were administered by other Reserve Banks, they were outside the scope of our evaluation.

<sup>4</sup> According to FRB New York's *Risk Event Management Policy*, a *risk event* is an occurrence arising from a failure in the design or operation of the system of controls or the absence of controls that leads to an actual or potential adverse effect.



## ***RBOPS Oversight of Lending Facilities Operated by FRB New York***

The Federal Reserve Act authorizes the Board to oversee the Reserve Banks. Within the Board, RBOPS assesses the Reserve Banks' strategies, projects, policy compliance, and ongoing operations and engages with Reserve Bank leadership to ensure efficient operations across the Reserve Banks.

To ensure that the Reserve Banks implemented and operated the lending facilities in a manner that demonstrated appropriate accountability, RBOPS developed a three-phase *Credit & Liquidity Programs Oversight Framework*:

- **Phase 1:** Provide assistance in quickly setting up the various lending facilities, including liaising with credit program working groups.
- **Phase 2:** Review the established governance structures, process workflows, and internal control design to assist in identifying any enhancements.
- **Phase 3:** Continue overseeing the lending facilities, focusing on identified risks.

In an April 17, 2020, memorandum, RBOPS communicated its oversight framework to FRB New York and stated that it would work closely with the Reserve Bank during the establishment and throughout the duration of each lending facility. RBOPS's oversight framework also includes expectations related to FRB New York's use of vendors, such as receiving advance notice of the intent to establish vendor relationships and timely notice of risk incidents related to the lending facilities.



# Finding 1: Following Established Processes Helped FRB New York and RBOPS Reduce Risks Associated With the Lending Facility Contracts

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FRB New York generally followed established processes when selecting and managing vendors for its lending facilities. In addition, RBOPS used its oversight framework to ensure that FRB New York followed its established vendor selection and management processes. Through this approach, FRB New York and RBOPS reduced risks associated with the lending facility contracts by fostering consistency and transparency in vendor selection decisions, confirming that the Reserve Bank received the expected services, and mitigating conflicts of interest arising from potential employee- and institutional-vendor relationships.

## FRB New York Generally Followed Established Vendor Selection Processes, and RBOPS Provided Oversight

We found that FRB New York generally followed the vendor selection processes outlined in its *Acquisition Policy* for the 10 contracts that were directly negotiated with 5 vendors.<sup>5</sup> FRB New York did not perform certain vendor selection processes on 2 of the 10 contracts that it deemed to have low costs or were limited in duration.<sup>6</sup> In addition, RBOPS followed its three-phase oversight framework to oversee FRB New York's vendor selection processes. Specifically, FRB New York generally performed, and RBOPS oversaw, the following vendor selection processes for the 10 directly negotiated contracts:

- **Documented justifications for directly negotiated contracts.** FRB New York documented its justifications for directly negotiated contracts and obtained the approval of the first vice president of FRB New York for the justifications. RBOPS reviewed FRB New York's justifications and did not object to the Reserve Bank initiating its directly negotiated contracts.
- **Limited terms of contracts.** To allow for subsequent competitive bidding of contracts, FRB New York limited the initial term of the contracts to a maximum of 4 months; thereafter, the contracts became month-to-month agreements. In addition, FRB New York included termination provisions

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<sup>5</sup> The scope of our evaluation included 17 FRB New York contracts; however, we focused our vendor selection testing on the 10 contracts that were directly negotiated.

<sup>6</sup> For example, FRB New York did not perform a price reasonableness review on two contracts because of the low cost of those contracts: One had incurred expenses of \$420,667 as of September 30, 2022, and the total cost of the other was \$28,000. Further, FRB New York did not include termination provisions in one contract because the entire length of that contract was limited to about 1 month.

in the contracts that could be exercised with 30 days' notice by either party. RBOPS confirmed that the directly negotiated contracts included limited initial terms of 4 months or less.

- **Assessed the risks associated with vendors.** FRB New York conducted vendor risk assessments before awarding the contracts. These assessments included (1) credit reviews to assess the risk of the vendor becoming insolvent and (2) integrity program screenings to determine whether the vendor possessed the skill, ability, financial resources, and integrity necessary for the faithful performance of an agreement. RBOPS did not identify any concerns with vendor risk assessments.
- **Reviewed the price reasonableness of contracts.** Although the *Acquisition Policy* does not require price reasonableness determinations for directly negotiated contracts, FRB New York assessed the price reasonableness of the lending facility contracts during the negotiation process. For example, FRB New York compared vendors' current fees with industry benchmarks and fees charged during the 2007–2009 financial crisis, as applicable. RBOPS did not identify any concerns with vendor fees in its review of FRB New York's fee reasonableness memorandums.

In addition, FRB New York conducted multiple assessments to evaluate the potential for conflicts of interest that may arise out of potential employee- and institutional-vendor relationships, and RBOPS followed its three-phase oversight framework for FRB New York's conflict-of-interest processes. Specifically, FRB New York conducted, and RBOPS oversaw, the following conflict-of-interest processes:

- **Assessed the potential for employee conflicts of interest.** In accordance with the *Acquisition Policy*, 26 of the 30 employees in our sample completed conflict-of-interest certifications for the acquisitions in which they participated.<sup>7</sup> The remaining 4 employees were not required to complete the certifications because they performed support functions. RBOPS did not identify any concerns during its review of FRB New York's policies related to employees' conflicts of interest.
- **Assessed the potential for institutional conflicts of interest.** As required by the *Institutional Conflicts of Interest Policy*, FRB New York performed assessments to determine whether the 5 vendors for the 10 directly negotiated contracts would, among other things, have access to sensitive information, benefit from sharing information with third parties, or provide services related to financial stability or monetary policy work. As a result of the assessments, FRB New York included conflict-of-interest provisions in the 10 directly negotiated contracts. For example, some provisions required that vendors maintain conflict-of-interest policies and procedures, safeguard and protect confidential information, and use designated employees for emergency lending facilities to create information barriers. We also confirmed that FRB New York coordinated with its relevant offices, including the Ethics Office, Legal, Procurement Value Management, and the Markets Group, to develop the conflict-of-interest provisions included in 1 investment management services contract. Further, we confirmed that the conflict-of-interest provisions in that contract were consistent with the conflict-of-interest provisions in the 2 other directly negotiated contracts for similar services. RBOPS reviewed lending facility contracts and determined that conflict-of-interest provisions were included to promote adherence to Reserve Bank and System ethics rules.

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<sup>7</sup> FRB New York's *Acquisition Policy* requires Reserve Bank employees who participate in acquisitions with an anticipated total value of \$100,000 or greater to certify that they do not have a conflict of interest with the vendor.

FRB New York's decision to follow established vendor selection processes, even though the *Acquisition Policy* excludes lending facility acquisitions, reduced risks associated with the lending facility contracts by ensuring that selected vendors met the Reserve Bank's needs at favorable terms and fostered consistency and transparency in its vendor selection decisions. Additionally, FRB New York protected itself and its employees against conflicts of interest arising from potential relationships with vendors. Further, RBOPS's oversight ensured that FRB New York followed established vendor selection processes during the establishment of the lending facilities.

## FRB New York Generally Followed Established Vendor Management Processes, and RBOPS Provided Oversight

FRB New York generally followed its established vendor management processes for the 8 vendors associated with the 17 contracts in our scope. In addition, RBOPS followed its three-phase oversight framework to oversee FRB New York's vendor management processes. Specifically, FRB New York conducted, and RBOPS oversaw, the following vendor management processes:

- **Developed vendor management plans.** In accordance with the *Vendor Management Policy* and *Vendor Risk Management Framework*, FRB New York performed vendor tier assessments by grouping vendors based on risk levels to determine which vendors were CIVs.<sup>8</sup> For the four CIVs identified, FRB New York completed onboarding risk assessments and developed management plans that included a performance monitoring plan, a communication plan, a vendor substitution plan, and a termination and offboarding plan. These plans helped FRB New York manage vendor relationships, monitor vendor performance through monthly and quarterly scorecards, and minimize a service disruption in the event a vendor was replaced. RBOPS did not identify any concerns with FRB New York's activities outlined in the vendor management plans, including vendor scorecards, or with vendor offboarding activities.
- **Followed risk event procedures.** FRB New York did not identify any significant risk events associated with the contracts in our scope. For one moderate risk event that had the highest potential and actual impact rating and that FRB New York identified as having a potential minor effect on its financial statements, we confirmed that FRB New York identified, escalated, reported, and closed this risk event in accordance with its *Risk Event Management Policy*. RBOPS inquired about all of FRB New York's risk events involving vendors and confirmed that appropriate actions were taken.
- **Managed conflicts of interest.** Although not required by policy, FRB New York hired a third party to evaluate vendors' conflict-of-interest policies, procedures, and practices. The reviews concluded that vendors maintained policies and procedures that were reasonably designed to ensure compliance with the contract requirements related to personal trading, safeguarding nonpublic and confidential information, and mitigating conflicts of interest. FRB New York followed up with vendors on the third-party review results by obtaining responses or documentation related to actions taken to address observations. RBOPS reviewed and concurred

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<sup>8</sup> A vendor tier assessment provides the recommended level of risk mitigation and contingency planning, performance tracking, and relationship management touch points based on the vendor's risk level.

with the third party's review of the vendors' policies and procedures related to personal trading, safeguarding nonpublic and confidential information, and mitigating conflicts of interest.

By following its established vendor management processes, FRB New York helped to ensure that expected services were received and that associated risks and conflicts of interest were appropriately managed throughout the duration of the contracts. Further, RBOPS's oversight ensured that FRB New York followed established vendor management processes when operating the lending facilities.

## **Management Response**

Since our report does not contain recommendations, an official response was not required. We received an official response from the RBOPS director conveying his appreciation for our conclusions that RBOPS's oversight contributed to reducing risks associated with the lending facility contracts, and noted that RBOPS remains committed to providing effective oversight of the emergency lending facilities over their remaining life. FRB New York management chose not to provide an official comment but stated during a March 6, 2023, meeting that they concur with the content of the report and thanked the OIG for the collaborative effort.



## Finding 2: FRB New York Can Clarify Vendor Selection Processes for Lending Facility Acquisitions

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FRB New York does not clearly define its vendor selection processes for lending facility acquisitions; these acquisitions are specifically excluded from FRB New York's *Acquisition Policy*. Despite this exclusion, FRB New York generally complied with the policy's requirements as a matter of due diligence. Further, FRB New York, in coordination with RBOPS, identified vendor selection lessons learned to maximize the use of competitive contracts but has not incorporated these lessons into policy. The U.S. Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* highlights the importance of establishing and updating policies. FRB New York's *Acquisition Policy* does not include a rationale for excluding lending facilities from the policy. Further, a Reserve Bank official stated that the policy is not clear about whether vendor selection processes are applicable to lending facility acquisitions and that lessons learned are being incorporated into facility-specific reference guides. Clarifying the vendor selection processes applicable to lending facility acquisitions and incorporating lessons learned into policy or guidance can reduce risks associated with lending facility contracts should future facilities be needed.

### FRB New York Does Not Clearly Define Vendor Selection Processes for Lending Facility Acquisitions

FRB New York does not clearly define vendor selection processes for lending facility acquisitions. Specifically, FRB New York's *Acquisition Policy*, which governs vendor selection activities, excludes lending facility acquisition from its requirements. Nevertheless, as noted in finding 1, FRB New York generally followed the *Acquisition Policy* requirements for these acquisitions during the COVID-19 pandemic response.

In addition, FRB New York, in coordination with RBOPS, identified and documented lessons learned from its COVID-19 pandemic response. Specifically, we found that during the establishment of the emergency lending facilities, FRB New York awarded some vendor contracts through direct negotiations and publicly announced plans to recompet those contracts at a later date. Since awarding the 10 directly negotiated contracts, FRB New York competitively recompet one part of a contract and brought services provided

under another contract in-house; the remaining 8 directly negotiated contracts were not recompeted.<sup>9</sup> Although FRB New York and RBOPS identified and documented some lessons learned related to vendor selection (see text box), FRB New York has not updated its policy.

*GAO's Standards for Internal Control in the Federal Government* sets internal control standards for federal entities and outlines the importance of establishing and maintaining effective internal control activities through policy.<sup>10</sup> Specifically, process-oriented policies should be documented and timely updated to ensure that processes are designed and implemented appropriately. Further, to address lessons learned from the 2007–2009 financial crisis response, FRB New York updated its *Acquisition Policy*, to include (1) limiting the duration of directly negotiated contracts to the period in which circumstances of unusual and compelling urgency exist and (2) including termination provisions in directly negotiated contracts. Similar lessons learned were also incorporated into acquisition guidance applicable to all Reserve Banks.

The *Acquisition Policy* does not include a rationale for excluding lending facilities from the policy. Nonetheless, FRB New York officials elected to follow the policy as a matter of due diligence because they anticipated that the lending facilities' contracts would face a high level of scrutiny from the public and oversight bodies, similar to the level of scrutiny for the acquisitions made in response to the 2007–2009 financial crisis. FRB New York officials acknowledged that the policy is not clear about whether vendor selection processes are applicable to lending facility acquisitions. In addition, an FRB New York official stated that lessons learned from the COVID-19 pandemic response related to vendor selection (see text box) are being incorporated into facility-specific reference guides.

As stated in finding 1, following established vendor selection processes during the COVID-19 pandemic response helped FRB New York reduce risks associated with the lending facility contracts by ensuring that (1) selected vendors met the Reserve Bank's needs at favorable terms, (2) vendor selection decisions were consistent and transparent, and (3) FRB New York and its employees were protected against conflicts of interest arising from potential employee- and institutional-vendor relationships. Clarifying vendor selection processes in policy or guidance for lending facility acquisitions can help reduce risks associated with the lending facility contracts, should future facilities be needed. In addition, including the vendor selection lessons learned from the COVID-19 pandemic response in policy or guidance should

#### **Lessons Learned From the COVID-19 Pandemic Response Related to Vendor Selection**

In July 2021, FRB New York, in consultation with RBOPS, completed a lessons-learned exercise and noted that (1) FRB New York's reliance on directly negotiated contracts created reputational risk for the System, which created pressure to recompet contracts, and (2) recompeting contracts midprogram created operational risk and diverted some business resources from program management.

To improve its operational readiness, FRB New York identified that it could better break down services and only use direct negotiations for the services most immediately needed. FRB New York also noted that it could avoid recompeting contracts midprogram to reduce risks and costs associated with replacing vendors.

<sup>9</sup> FRB New York did not recompet the remaining 8 contracts because of (1) the operational risks to the lending facilities by changing from vendors that had already developed facility-specific business processes, (2) the high costs and length of time associated with switching vendors, and (3) the winding down of operations for some of the lending facilities.

<sup>10</sup> The U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government*, September 2014.

result in FRB New York relying less on directly negotiated contracts during the establishment of future lending facilities and further reduce reputational risk to the System.

## Management Actions Taken During the Evaluation

In January 2023, after we had presented our draft findings to FRB New York and RBOPS officials, FRB New York's Corporate Group updated its *Acquisition Policy* to clarify that the policy applies to emergency lending facility acquisitions and to encourage maximum use of competitive contracts. FRB New York also documented its lessons learned—including ways to increase the use of competitive contracts—in facility-specific reference guides. Based on our review of FRB New York's actions and its related documentation, we do not have a recommendation for this finding.

## Management Response

Since our report does not contain recommendations, an official response was not required. We received an official response from the RBOPS director conveying his appreciation for our conclusions that RBOPS's oversight contributed to reducing risks associated with the lending facility contracts, and noted that RBOPS remains committed to providing effective oversight of the emergency lending facilities over their remaining life. FRB New York management chose not to provide an official comment but stated during a March 6, 2023, meeting that they concur with the content of the report and thanked the OIG for the collaborative effort.





# Appendix A: Scope and Methodology

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Our objective was to assess the System’s vendor selection and management processes related to lending facilities operated by FRB New York. The scope of our evaluation included FRB New York’s vendor selection and vendor management processes from March 2020 through September 2021 and RBOPS’s associated oversight activities, which occurred from March 2020 through December 2021.<sup>11</sup> We reviewed FRB New York’s processes and RBOPS’s oversight activities related to the 5 lending facilities operated by the Reserve Bank that leveraged vendor support.<sup>12</sup> Our scope included 17 FRB New York contracts that related to the operations of the lending facilities but did not include contracts related to audit, compliance, consulting, or legal services. The 17 contracts included 10 directly negotiated contracts. For vendor selection testing, we focused on these 10 contracts and the associated 5 vendors; for vendor management testing, we focused on all 17 contracts and the 8 vendors included in our scope. FRB New York awarded those 17 contracts resulting in fees of approximately \$21.4 million as of December 31, 2022. For a list of the vendors included in our scope, see appendix B.

We assessed the FRB New York’s vendor selection and management processes for the COVID-19 lending facilities because the Board authorized the lending facilities and reports to Congress and the public in accordance with sections 11(s) and 13(3) of the Federal Reserve Act as well as the CARES Act; the Board authorized FRB New York to establish and operate the lending facilities. These facilities are subject to the limitations, restrictions, and regulations of the Board.

To accomplish our objective, we reviewed applicable laws, policies, guidance, and RBOPS’s oversight framework. We also interviewed various Board officials and FRB New York officials.

To assess FRB New York’s vendor selection processes and RBOPS’s oversight of these processes, we tested the 10 directly negotiated contracts and the associated 5 vendors in our scope. Our testing included reviewing FRB New York’s processes and RBOPS’s oversight of justifications and approvals for noncompetitively bid contracts, limitations of contract terms, vendor credit reviews, integrity program screenings, and price reasonableness assessments.

To assess FRB New York’s employee conflict-of-interest processes and RBOPS’s oversight of these processes, we judgmentally selected a nonstatistical sample of 30 employees, composed of FRB New York employees, contingent workers, and other System employees who worked on one or more of the acquisition processes for the 17 contracts included in our scope. To make our sample selection, we used training and conflict-of-interest certification lists manually created by FRB New York with a population of 230 employees and focused our sample selection on certain factors, such as employee type and the number of acquisitions employees worked on. For each sample selected, we tested (1) the employees’

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<sup>11</sup> Our scope period for RBOPS’s oversight activities was 3 months longer than the scope for FRB New York’s vendor selection and management activities because RBOPS issues interim reports about every 6 months, and the report that included FRB New York’s activities through September 2021 covered FRB New York’s activities through December 2021.

<sup>12</sup> The PDCF did not have any vendor contracts related to the COVID-19 pandemic response and was not included for vendor selection and vendor management testing; however, we considered the PDCF in our overall assessment of how FRB New York and RBOPS implemented lessons learned from the 2007–2009 financial crisis because the PDCF created an operational readiness document after that crisis.

completion of conflict-of-interest training, (2) employees' certification that they did not have conflicts of interest with any vendor and that they understood the "Gifts, Meals and Entertainment Rule" contained in FRB New York's *Code of Conduct*, and (3) FRB New York's resolution of any identified conflicts of interest. Further, we confirmed RBOPS's review of FRB New York's conflict-of-interest policies for employees.

To assess FRB New York's institutional conflict-of-interest processes and RBOPS's oversight, we performed a walk-through of FRB New York's process to develop conflict-of-interest contract provisions and reviewed supporting documentation for one key contract—the BlackRock Financial Markets Advisory contract with the SMCCF for investment management services. We selected this contract because of the level of public scrutiny FRB New York faced for selecting BlackRock as a vendor. We also tested whether conflict-of-interest provisions in the BlackRock contract for the SMCCF were consistent with two other directly negotiated contracts for investment management services: (1) Pacific Investment Management Company LLC's Investment Management and Advisory Agreement with the CPFF and (2) BlackRock Financial Markets Advisory's Investment Management and Advisory Agreement with the PMCCF. Further, we confirmed that RBOPS reviewed conflict-of-interest contract provisions.

To assess FRB New York's vendor management processes and RBOPS's oversight, we tested all 8 vendors and the related 17 contracts in our scope. Specifically, for all 8 vendors and the related 17 contracts, we reviewed FRB New York's third-party report on vendor conflicts of interest. In addition, for the 4 CIVs, we reviewed FRB New York's vendor management plans and we tested whether FRB New York managed vendors in accordance with its vendor management plans. For the 10 directly negotiated contracts with 5 vendors in our scope, we also reviewed vendor management onboarding risk assessments and risk event contract provisions. Further, we confirmed RBOPS's review of FRB New York's vendor management activities, including those related to conflicts of interest.

To assess FRB New York's risk event escalation procedures and RBOPS's oversight, we performed a walk-through of FRB New York's risk event management system to understand the processes and procedures for documenting and escalating risk events. A system-generated report of 42 facility-related risk events from March 2020 through September 2021 included none that had a *significant* risk event rating. Therefore, we judgmentally selected 1 risk event from the report with the highest potential and actual impact rating to test FRB New York's risk escalation procedures. We selected a TALF-related risk event with a *moderate* potential impact rating because FRB New York identified it as having a minor effect on the Reserve Bank's financial statements; we reviewed supporting documentation to determine whether FRB New York analyzed and reported the risk event in accordance with FRB New York's *Risk Event Management Policy* and RBOPS's expectations.

Further, we conducted interviews with various FRB New York and RBOPS officials and reviewed available documentation related to lessons learned regarding FRB New York's vendor selection and management processes as well as RBOPS's related oversight. Specifically, we sought to understand how lessons learned from the 2007–2009 financial crisis response were implemented during the COVID-19 pandemic response and whether FRB New York and RBOPS identified and documented actions that would address lessons learned identified from the COVID-19 pandemic response.

We conducted this evaluation from September 2021 to February 2023. This evaluation was conducted in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*.



# Appendix B: Vendors and Contracts Included in Our Scope

Our scope included 8 vendors and 17 contracts (see table).

**Table. Vendors and Contracts Included in Scope**

Vendor	CIV?	Facility	Vendor name and services contracted	Directly negotiated?	Effective date	Termination date
State Street Bank & Trust Company	Yes	CPFF	State Street Bank & Trust Company, administrative services	Yes	04/06/2020	07/07/2021
		CPFF	State Street Bank & Trust Company, custodial services	Yes	04/06/2020	07/07/2021
		PMCCF	State Street Bank & Trust Company, custodial services	No	05/11/2020	12/16/2021
		SMCCF	State Street Bank & Trust Company, administrative and custodial services	No	05/11/2020	12/16/2021
Bank of New York Mellon Corp.	Yes	MLF	BNY Mellon Capital Markets, LLC, transaction/settlement/underwriter/bidding agent	Yes	05/26/2020	02/28/2021
		MLF	The Bank of New York Mellon, administrative and custodial services	No	05/26/2020	Ongoing
		MLF	Mellon Investments Corporation, investment management and advisory	No	05/26/2020	Ongoing
		TALF	The Bank of New York Mellon, administrative and custodial services	Yes	05/26/2020	Ongoing

Vendor	CIV?	Facility	Vendor name and services contracted	Directly negotiated?	Effective date	Termination date
Pacific Investment Management Company LLC	Yes	CPFF	Pacific Investment Management Company LLC, investment management and advisory	Yes	04/06/2020	04/16/2021
		TALF	Pacific Investment Management Company LLC, collateral monitoring	Yes	05/21/2020	08/16/2021
		MLF	Pacific Investment Management Company LLC, pricing validation services	Yes	04/15/2020	05/06/2020
BlackRock Financial Markets Advisory	Yes	PMCCF	BlackRock Financial Markets Advisory, investment management	Yes	06/29/2020	02/05/2021
		SMCCF	BlackRock Financial Markets Advisory, investment management	Yes	05/11/2020	10/15/2021
BLX Group LLC	No	MLF	BLX Group LLC, intake agent	Yes	05/15/2020	Ongoing
Eaton Vance Management	No	MLF	Eaton Vance Management, credit risk services	No	06/05/2020	Ongoing
PFM Financial Advisors LLC	No	MLF	PFM Financial Advisors LLC, design services	No	04/22/2020	05/31/2020
Payden & Rygel	No	SMCCF	Payden & Rygel, cash investment manager	No	02/04/2021	11/29/2021

Source: OIG compilation.

# Appendix C: Management Response



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, DC 20551

DIVISION OF RESERVE BANK  
OPERATIONS AND PAYMENT SYSTEMS

March 29, 2023

Cynthia Gray  
Deputy Associate Inspector General for Audits and Evaluations  
Board of Governors of the Federal Reserve System  
2001 C Street, N.W.  
Washington, D.C. 20551

Dear Ms. Gray:

Thank you for the opportunity to review and comment on the Office of Inspector General's draft report, *Following Established Processes Helped FRB New York and the Board Reduce Risks Associated With Lending Facility Contracts*. We appreciate your partnership with our division and with the Federal Reserve Bank of New York in the course of your work conducting your evaluation.

As part of your comprehensive review of the emergency lending facilities established in response to the COVID-19 pandemic, we are gratified by your conclusions that RBOPS oversight of the vendor management processes contributed to the reduction of risks associated with the lending facility contracts. We are extremely proud of the work of our division in collaboration with staff at the Federal Reserve Bank of New York to ensure that the strategic objectives of these facilities are realized in a well-managed and controlled manner. We remain committed to providing effective oversight of all the liquidity facilities over their remaining life.

Sincerely,

A handwritten signature in black ink, appearing to read "Matthew J. Eichner".

Matthew J. Eichner  
Director

cc: Sushmita Shukla, First Vice President, Federal Reserve Bank of New York

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# Abbreviations

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<b>CARES Act</b>	Coronavirus Aid, Relief, and Economic Security Act
<b>CIV</b>	critically important vendor
<b>CPFF</b>	Commercial Paper Funding Facility
<b>FRB New York</b>	Federal Reserve Bank of New York
<b>GAO</b>	U.S. Government Accountability Office
<b>MLF</b>	Municipal Liquidity Fund
<b>PDCF</b>	Primary Dealer Credit Facility
<b>PMCCF</b>	Primary Market Corporate Credit Facility
<b>RBOPS</b>	Division of Reserve Bank Operations and Payment Systems
<b>SMCCF</b>	Secondary Market Corporate Credit Facility
<b>TALF</b>	Term Asset-Backed Securities Loan Facility

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