September 18, 2023

Mr. Clinton Jones
General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Suspended Counterparty Program - Notice of Proposed Rulemaking [RIN 2590-AB23]

The American Bankers Association[1] (ABA), Independent Community Bankers of America[2] (ICBA), and Mortgage Bankers Association[3] (MBA) appreciate the opportunity to comment on the Federal Housing Finance Agency's (FHFA) proposal to amend the existing Suspended Counterparty Program (SCP). FHFA proposes to expand the categories of "covered misconduct"[4] under which a counterparty (e.g., seller/servicer,

[1] The American Bankers Association is the voice of the nation's $23.5 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $18.6 trillion in deposits and extend $12.3 trillion in loans.

[2] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding $5.8 trillion in assets, $4.8 trillion in deposits, and $3.8 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

[3] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,200 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[4] *"Covered misconduct"* is defined in the proposal as any conviction or administrative sanction within the past three (3) years if the basis of such action involved fraud, embezzlement, theft, conversion, forgery, bribery, perjury, making false statements or claims, tax evasion, obstruction of justice, or any similar

vendor) suspension could be based. The new categories include sanctions arising from forms of civil misconduct in connection with, for example, the management or ownership of real property. Additionally, FHFA would be able to issue an immediate suspension order when the misconduct has resulted in debarment, suspension, or limited denial of participation imposed by a federal agency.[5]

The Associations understand the importance of ensuring the safety and soundness of the GSEs and insulating FHFA regulated entities from bad actors. However, the proposed rule completely fails to demonstrate why drastically expanding the SCP is necessary and why the administration of the existing program is not meeting the relevant policy objectives. It provides no rationale for the need for the expansion, nor does it offer any data suggesting that the GSEs have been in any way materially harmed by FHFA's inability to suspend counterparties for civil or administrative sanctions. The SCP has been operating for over a decade. Presumably, FHFA should be able to provide a detailed explanation or evidence as to why the program should be vastly expanded, other than "the proposed rule will strengthen FHFA's ability to ensure the regulated entities remain safe and sound, so they continue to serve as reliable sources of liquidity."

The proposed rule completely disregards the impact of being suspended from FHFA regulated sources of funding – placement on the SCP results in the inability of the mortgage business to operate. Given the extreme economic and reputational harm that counterparties could face, FHFA should not impose such disproportionate and draconian sanctions on the basis of findings of misconduct in the context of civil enforcement actions. Immediate suspension orders should not be issued under a reduced standard. Instead, FHFA should work to improve and ensure proper administration of the *current* SCP.

I. FHFA Should Not Expand the Current Suspended Counterparty Program

FHFA's proposed rule would authorize the suspension of business between the regulated entities and counterparties who are found to have committed civil violations in connection with a mortgage, mortgage business, mortgage securities or other lending product, or in connection with the management or ownership of real property. FHFA asserts that this proposal will ensure the GSEs remain safe and sound and are protected from certain financial and reputational risks. However, FHFA does not offer any factual record to support the need for such broad expansion founded on subjective criteria, a particularly glaring omission in light of the fact that the GSEs have made large returns to the Treasury

offense, in each case in connection with a mortgage, mortgage business, mortgage securities or other lending product, or in connection with the management or ownership of real property.

[5] Suspended Counterparty Program, 88. Fed. Reg. 47,077 (July 21, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-07-21/pdf/2023-14723.pdf.

in the past few years, certainly while dealing with counterparties that have settled civil or administrative actions that meet FHFA's broad definition.[6]

First, it is important to note that the proposed list of "covered misconduct" dramatically broadens the basis for possible suspension. While the proposal attempts to suggest that these are simply administrative or regulatory analogues for criminal misconduct, such an interpretation would be misleading. Putting aside the obvious and important differences in the required burdens of proof, some of the enumerated offenses have different meanings in the criminal or civil context. Civil fraud, for instance, can be proved by demonstrating a negligent misrepresentation rather than intentional deceit. Allegations of making false claims or statements are routine claims raised in contract disputes and therefore are materially different than criminal fraud. Suspending counterparties for these acts in the civil context constitutes a dramatic expansion of FHFA's authority to suspend entities, despite any evidence presented in the proposal of risk or harm to the GSEs. The proposal exposes lenders and servicers to a draconian remedy – suspension from accessing the most important sources of mortgage market liquidity – for what could be low-level civil or contractual transgressions.

We are also concerned about the effect this proposal may have on companies entering into consent orders, particularly in instances without admission of guilt. FHFA contends that in its "experience admissions of misconduct in the context of civil enforcement are uncommon… [I]n the civil context, where the stakes for the applicable counterparties may be lower and where the costs of any such chilling effects would therefore be more limited, FHFA has determined that it is appropriate to permit suspension where enforcement claims are resolved without admission of misconduct."[7] This assertion warrants a more robust explanation – and evidence – given that a company may have to cease working with a FHFA-regulated entity and could suffer significant reputational and economic harm if placed on the suspension list. In fact, an inability to access the primary mortgage market sources of liquidity could result in the closure of the entity, a sanction far disproportionate to the vast majority of issues that are adjudicated in civil or administrative claims.

One could argue that FHFA would not suspend a company following a minor regulatory violation and subsequent settlement. This may be true, or it may not be – the proposal offers no specific delimiting factors for how this draconian power will be used, which highlights the subjectivity and vagueness of the rule. The threat of a harsh sanction following minor – and satisfactorily resolved – violations will give FHFA and the GSEs inappropriate coercive power, making it very difficult for businesses to appreciate the risks they incur by settling allegations from other regulators or certain civil plaintiffs.

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[6] FHFA does not provide any evidence or data as to why the current program standard is too narrow other than merely citing its general supervisory authority under section 1313, 1313B, and 1313G of the Safety and Soundness Act.

[7] 88. Fed. Reg. 47077, 47079.

This proposed rule ignores the reality of litigation in the civil and administrative context. Companies sometimes settle with regulators without admission of liability in order to avoid conflict with their respective regulators, which may expedite consumer relief. Companies may similarly settle with consumers even when the consumers might not have a solid case for liability, because it is often less expensive to provide redress than it is to engage in protracted litigation on the underlying claim – particularly for technical violations. However, if the proposed rule is finalized, rather than deciding to settle a lawsuit to expedite resolution, covered entities may instead opt to litigate an issue for fear of being placed in the SCP, which will increase costs for the lender and borrower and hamper the efficient resolution of certain disputes.

Overall, the expansion of this program gives FHFA wide discretion to expand the scope of the SCP and could have major impacts on sellers and servicers, exposing them to suspension risk for relatively minor regulatory or legal settlements. It does so with no supporting evidence and little rationale for its necessity. Accordingly, without more support and objective evidence, FHFA should not expand the SCP.

II. FHFA Should Improve the Administration of the Current Suspended Counterparty Program Rather than Expanding the Program to Civil Actions

FHFA should improve the administration of the current SCP and resolve any major deficiencies instead of making these changes. Previous compliance reviews of FHFA's SCP conducted by the FHFA Office of Inspector General (FHFA OIG) have reported on FHFA's[8] inability to resolve a large backlog of SCP referrals and its failure to implement timeliness standards to prevent future backlogs.[9] This suggests that the current program procedures are not effective or properly followed and, as a result, more "bad actors" are not being timely suspended – not because the current standard is too "narrow" or because civil enforcement actions are not captured.

In the 2021 FHFA OIG report, which reviewed actionable items from 2017 and 2019, the OIG found that FHFA had failed to resolve a large backlog of SCP referrals, and recommended it develop a plan with timeliness standards to prevent future backlogs. For example, one of the OIG's recommended remedial actions included implementation of a 30-day deadline for FHFA to send referrals to the regulated entities for their review. The 2019 compliance review found that FHFA never implemented those timeliness standards, so the OIG reopened the recommendation. This occurred in the span of two consecutive compliance reviews – or approximately five years.

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[8] FHFA's Office of General Counsel (OGC) reviews each referral to determine whether to propose that the referred counterparty be suspended from conducting further business with the regulated entities for a fixed period of time.

[9] *See* FHFA OIG, *COM-2021-008, Compliance Review of FHFA's Suspended Counterparty Program* (Aug. 25, 2021), available at https://www.oversight.gov/sites/default/files/filefield_paths/COM-2021-008.pdf.

In sum, the Associations recommend that FHFA resolve any outstanding issues related to the administration of its current program requirements rather than drastically expanding it.

III. Immediate Suspension Orders Should Not Be Issued Under a Reduced Standard

The proposed rule would allow FHFA to immediately suspend businesses without prior notice when the covered misconduct is based on an administration sanction such as debarment, suspension, or limited denial of participation imposed by a federal agency. The ability to impose such a harsh sanction immediately is not warranted when the bar for the misconduct subject to that sanction is dramatically lowered. While it may perhaps make sense to allow for immediate suspension following a criminal conviction, this proposal does not provide adequate due process when paired with a lower standard.

Given the need to balance general Constitutional requirements for due process and the need to avoid immediate injury to its regulated entities, it is foreseeable that there may be instances where FHFA feels it needs to issue the suspension first and then allow the party to contest it. This may also be more appropriate following a criminal conviction given the robust protections built into criminal proceedings, the high evidentiary standards and seriousness of the underlying claims. However, the balance tipping toward immediate suspension makes far less sense when applied to the administrative context.[10]

FHFA also fails to demonstrate any harm to the GSEs, or other regulated entities, caused by a requirement to first establish the basis for a suspension before it goes into effect. This lack of a record is under a standard of more serious misconduct. We are unaware of the record of contesting suspensions, but it can be assumed that those subject to a criminal conviction may be unlikely to challenge their suspension in light of the other consequences for such misconduct. If FHFA were to immediately suspend a counterparty following an administrative sanction, it is very likely those suspensions would be contested. While the Associations believe the entire SCP expansion should be withdrawn, should FHFA proceed to a final amended rule, the provision allowing for immediate suspension should be eliminated.[11]

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[10] There are serious Constitutional claims about the appropriateness of the use of in-house administrative adjudications, yet this proposal would allow for immediate suspension following one of those cases. *See*, Jarkesy v. Sec. & Exch. Comm'n, 34 F. 4th 446 (5th Cir. 2022), *petition for cert filed*.

[11] While we understand the proposal is intended to give FHFA the discretion to either issue an immediate suspension or allow it to be contested before taking effect, the proposal makes no effort at defining standards for when that is appropriate. This opens up the potential for arbitrary or capricious use of immediate suspensions ungoverned by any limiting principle.

Conclusion

The Associations strongly oppose the proposed expansions to the SCP and believe FHFA should withdraw this proposal. FHFA has provided little – if any – evidentiary support as to why the SCP should be expanded and why it is proper to advance with program changes that will most likely result in severe and disproportionate consequences.

Sincerely,

Mortgage Bankers Association
American Bankers Association
Independent Community Bankers of America