

Federal Housing Finance Agency
Office of Inspector General



Compliance Review of FHFA's Suspended Counterparty Program



COM-2021-008

August 25, 2021

Executive Summary

The Federal Housing Finance Agency (Agency or FHFA) regulates and supervises Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (collectively the regulated entities). In June 2012, FHFA promulgated a Suspended Counterparty Program (SCP) to provide the regulated entities with protection from counterparty risks.

Under the SCP, each regulated entity must refer to FHFA any current or former counterparty or an affiliate that has been convicted of, or sanctioned administratively for, engaging in mortgage-related fraud or other financial misconduct within the last three years (“covered misconduct”). The U.S. Department of Housing and Urban Development (HUD) and FHFA’s Office of Inspector General (OIG) also make SCP referrals to FHFA. 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.

In a 2017 report, we found that OGC had failed to resolve a large backlog of SCP referrals, and recommended it develop a plan with timeliness standards to prevent future backlogs. One of OGC’s remedial actions included implementation of a 30-day deadline for OGC to send referrals to the regulated entities for their review. Our 2019 compliance review found that OGC never implemented those timeliness standards so we reopened the recommendation.

OGC subsequently notified us that it had implemented a new timeliness standard under which it transmitted SCP referrals to the regulated entities for review – increasing the deadline from 30 to “approximately” 90 days of OGC having received the referrals. OGC’s new deadline provided that extensions required a documented showing of good cause, such as the lack of all necessary information. We closed the reopened recommendation on September 10, 2019.

We initiated this compliance review to test OGC’s adherence to its new SCP referral timeliness standard for the 44 referrals received from October 1, 2019, through November 30, 2020. Our examination of OGC’s processes for administering the SCP program revealed that OGC implemented a “dashboard” that provides information on which referrals have been sent to the regulated entities, but that it does not track whether these transmissions occurred within approximately 90 days of their receipt by OGC. Absent a process to track SCP referral time deadlines, OGC’s corrective action once again fails to address our recommendation to implement a plan with timeliness standards to prevent future backlogs.



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To address this issue, OGC has requested that FHFA's technology office add alerts for the appropriate 90-day period. OGC does not know when its system updates will become operational, and it has not implemented another process to track referral deadlines.

Because OGC has not implemented effective timeliness standards for SCP referrals as found in two consecutive compliance reviews, we are closing the 2017 recommendation as rejected.

In its written management comments, OGC disagreed with certain conclusions related to OGC's procedures.

This report was prepared by Wesley M. Phillips, Senior Policy Advisor. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaog.gov.

/s/

Brian W. Baker
Deputy Chief Counsel

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ABBREVIATIONS

Agency or FHFA	Federal Housing Finance Agency
Desktop Instructions	OGC's 2019 revised version of Desktop Instructions, Federal Housing Finance Agency's Suspended Counterparty Program
Fannie Mae	Federal National Mortgage Association
FHLBank	Federal Home Loan Bank
Freddie Mac	Federal Home Loan Mortgage Corporation
HERA	Housing and Economic Recovery Act of 2008
HUD	U.S. Department of Housing and Urban Development
OGC	Federal Housing Finance Agency Office of General Counsel
OIG	Federal Housing Finance Agency Office of Inspector General
Regulated Entities	Fannie Mae, Freddie Mac, and the FHLBanks
Review Period	October 1, 2019 to November 30, 2020
SCP	Suspended Counterparty Program

BACKGROUND

Overview of the Suspended Counterparty Program

Pursuant to the Housing and Economic Recovery Act of 2008 (HERA), FHFA has regulatory and supervisory authority over the regulated entities. The regulated entities have adopted counterparty risk management programs designed to protect them from excessive financial loss caused by deterioration in a counterparty's financial condition.

In June 2012, FHFA promulgated the SCP to augment the regulated entities' programs and provide them with additional protection from the financial and reputational risks posed by individuals and businesses with a history of engaging in fraudulent conduct. Under the SCP, each regulated entity must refer to FHFA any current or former counterparty or affiliate that has been convicted of, or sanctioned administratively for, covered misconduct within the last three years.¹ In addition to the regulated entities, OIG and HUD also make SCP referrals to FHFA.

FHFA charged its OGC with responsibility for reviewing SCP referrals and recommending resolutions. Among its responsibilities, OGC sends referrals to the regulated entities to determine whether they have engaged in a "covered transaction," as defined in 12 C.F.R. § 1227.2, within the past three years with any individuals or entities named in the referrals.²

FHFA has delegated to its General Counsel the authority to suspend counterparties under the SCP. The Agency has issued guidelines for the terms of counterparty suspensions, which are published on its website.

¹ 12 C.F.R. §§ 1227.2, 1227.4(a). Since the regulation limits FHFA to suspending a counterparty within three years of when a conviction or sanction (for any of various specified offenses in connection with a mortgage, mortgage business, mortgage securities, or other lending product) was imposed on the counterparty, OGC asserts that it may rely on its statutory authorities under HERA to effectuate suspensions in cases where this time bar has passed. *See* Housing and Economic Recovery Act of 2008, Pub. L. 110-289 (HERA). In this compliance review, we defer to FHFA's interpretation of its legal basis to issue suspensions.

² A covered transaction means a contract, agreement, or financial or business relationship between a regulated entity and a person and any affiliates thereof. 12 C.F.R. § 1227.2. However, a final suspension order issued pursuant to the SCP shall have no effect on any transaction involving a residential mortgage loan if the loan is secured by the respondent's own personal or household residence. *Id.* § 1227.3(d).

Prior Reports Identified Deficiencies in OGC’s Administration of the SCP Program

In July 2017, an OIG special report found that OGC had failed to resolve a backlog of 424 SCP referrals and that most had been pending with OGC for a year or more.³ We recommended that OGC develop and implement a review plan containing a timeliness standard to eliminate the current backlog of referrals and prevent future backlogs.⁴ We closed this recommendation in February 2018, following OGC actions including its purported adoption and implementation of 30-day timeliness standards for processing referrals.

However, our January 2019 compliance review found that OGC had not actually implemented any standard or process that set timelines for completing specific tasks associated with the disposition of all SCP referrals in order to prevent future backlogs.⁵ We reopened the recommendation and stated that it would remain open until OGC implemented timeliness standards, as it agreed to do in July 2017.

On September 5, 2019, OGC notified us for a second time that it had issued revised timeliness processing standards, increasing the referral deadline from 30 to “approximately 90 days.” That revision of “Desktop Instructions, Federal Housing Finance Agency’s Suspended Counterparty Program” (Desktop Instructions) contained the following timeliness standard for referral processing:

Incoming referrals are included on a ... spreadsheet and sent to the regulated entities within approximately 90 days of receipt by SCP staff, unless it has been determined that the referral does not meet the regulatory requirements to be considered for suspension. This deadline may be extended as needed upon a documented showing of good cause, including, but not limited to, receipt of all necessary information.

Based upon OGC’s corrective action, we closed the reopened recommendation on September 10, 2019.

³ See OIG, *FHFA Should Improve its Administration of the Suspended Counterparty Program* (July 31, 2017) (COM-2017-005).

⁴ The 2017 report made a second recommendation that is not within the scope of this compliance review.

⁵ See OIG, *Compliance Review of FHFA’s Suspended Counterparty Program* (January 25, 2019) (COM-2019-002).

FINDINGS

We initiated this compliance review in March 2021 to determine, for all SCP referrals received by OGC for the period October 1, 2019, through November 30, 2020 (review period), whether OGC complied with its revised Desktop Instructions by transmitting those referrals to the relevant regulated entities within “approximately” 90 days of OGC having received the referrals, and if not, whether OGC had a “documented showing of good cause” for an extension.

OGC Does Not Track Whether it Sends SCP Referrals to the Regulated Entities within Approximately 90 Days of Receipt

During our fieldwork, OGC stated that it uses a document called a “dashboard” to monitor its disposition of SCP referrals. According to OGC, the dashboard provides information on which referrals have been sent to the regulated entities, but it does not monitor whether these transmissions occurred within approximately 90 days of their receipt by OGC. OGC also stated that the dashboard may include notations as to why referrals may be facing delays in their disposition, but the notations are not maintained as the referrals move through the process and are finalized.

Since OGC does not track how long it takes to transmit referrals to the relevant regulated entities, it has no internal controls to determine whether it complies with its “approximately 90 days” standard. Accordingly, we must note that for the second time OGC has failed to implement a timeliness standard for transmitting SCP referrals, its commitment to do so notwithstanding.

In its technical comments on a draft of this report, FHFA states that “OGC/SCP staff is working with [FHFA’s IT department] on updates to the SCP electronic database to address matters that include adding (1) alerts for the appropriate 90-day period and (2) alerts for documents uploaded by the regulated entities to addresses [sic] several of the OIG recommendations. The SCP has been on a waitlist for these updates for a significant amount of time.” We appreciate that IT solutions can take time, but determining whether – and if so, when – a referral has been sent to a regulated entity is not unduly complex, nor is it necessarily dependent on technology; it requires only OGC’s commitment to track this data plus the ability to count calendar days. Thus, OGC’s continued wait for IT assistance to complete this basic administrative task – two years after we closed the reopened recommendation in September 2019 – underscores FHFA’s failure to make implementing the timeliness standard a priority.

OIG Independently Calculated OGC's Compliance with the Timeliness Standard

Because OGC does not track whether it complies with the “approximately” 90-day standard, we independently assessed how long it took OGC to transmit to the regulated entities the 44 referrals it received during our review period. To do so, we requested records for these 44 referrals. OGC provided materials including copies of emails from the referring agencies to OGC and the emails from OGC to the regulated entities.

Of the 44 referrals, we determined that all but 9 were referred within 90 days of receipt by OGC. The documents reflect that 4 of the 9 referrals were made within 8, 9, 9, and 14 days of receipt by OGC, which could be characterized reasonably as being within the “approximately 90-day” standard. The remaining 5 referrals were made 36, 36, 70, 160, and 385 days past the 90-day mark.

For the referral OGC sent 385 days past the 90-day mark, it asserted that it was awaiting receipt of a final debarment notice from HUD and that OGC needed to review the issue after it received the debarment notice.⁶ For a referral OGC sent 160 days past the 90-day mark, it maintained that there was a delay in moving the document from a secure portal and that OGC was working with the Agency's technology office to resolve this issue. For a referral OGC sent 70 days past the 90-day mark, it claimed that additional time was needed to identify a valid address for the referred party.

OGC Lacks Contemporaneous Documentation of Good Cause for Transmitting Referrals Later Than Approximately 90 Days After Receipt

As noted above, OIG found in 2017 that OGC had accumulated a backlog of 424 SCP referrals, some of which had been pending for a year or more. While OGC notes correctly that it has eliminated this backlog, OIG's ongoing attention to the SCP since 2017 stems from this original failure by OGC to manage referrals in a time-effective manner. Our recommendation – that OGC develop and implement a review plan containing a timeliness standard to eliminate the referral backlog *and* prevent future backlogs – must be understood in this context.

For this reason, OIG had viewed with approval OGC's 2019 revision of its Desktop Instructions, because not only that as a general rule OGC was committing to transmit referrals to the regulated entities within a reasonably concise period (i.e., approximately 90 days of receipt), but also that transmission delays past that point would require “*a documented showing of good cause*, including, but not limited to, receipt of all necessary information”

⁶ A Notice of Proposed Debarment is not a final action, according to OGC, and a final action is required for SCP suspension. After receiving the notice of final action in this matter, OGC explained that it referred this counterparty to the regulated entities within 90 days of receipt.

(Emphasis added).⁷ However, we found during this compliance review that when such a delay actually occurs, OGC does not affirmatively document its good cause for delay. Instead, in the unlikely event OGC is ever asked why it did not transmit a particular referral within approximately 90 days, it subsequently reviews whatever documents happen to be maintained in the referral file, to attempt to reconstruct after the fact what its earlier good cause for delay might have been. In technical comments on a draft of this report, OGC defended its practice, stating that “OGC/SCP staff deems it imprudent to create new contemporaneous documents/records that are not necessary for resolving case files.” Thus, OGC could not produce any such contemporaneous documents for nine late referrals when asked to do so during this compliance review. Instead, OGC provided us with written, post hoc explanations for eight of those nine referrals. OGC also provided documentation indicating that by May 2021 it had concluded 43 of the 44 referrals from our review period either through the issuance of a suspension or the declination to do so.

It is not clear how OGC can claim to have developed a credible process to document good cause exceptions to its timeliness standard. By not contemporaneously documenting its claimed good cause for a delay, OGC precludes any subsequent assessment of whether that good cause existed, and if so, whether it justified OGC taking longer than approximately 90 days to transmit the referral. We are asked essentially to take OGC’s word for it, with no basis by which to evaluate OGC’s claim such as would be provided by a contemporaneously produced email or memo documenting OGC’s rationale, rather than subsequently deduced by OGC from materials in the file. Further and more importantly, OGC’s practice does not help to ensure that it manages referrals in a time-effective manner, much less to prevent the potential recurrence of a sizable referral backlog. In reality, OGC may take as long as it wants to transmit a referral, and when pressed, it may provide a post hoc explanation without having to also supply a contemporaneous evidentiary basis for that explanation. When considered along with OGC’s acknowledged failure to track whether it sends SCP referrals to the regulated entities within approximately 90 days of their receipt, we find that OGC has rejected the recommendation.

CONCLUSION.....

In this compliance review, we found that OGC has not created any internal controls to track whether it sends SCP referrals to the regulated entities within approximately 90 days as required in its revised Desktop Instructions. By not tracking whether it complies with the standard, and by not contemporaneously documenting whatever good cause may have existed

⁷ As noted previously, OGC sends referrals to the regulated entities to determine whether they engaged in covered transactions with individuals and entities named in the referrals.

for not complying with the standard, OGC has failed to implement it. Since this is OGC’s second failure to implement its own timeliness standards for SCP referral disposition, as documented in two consecutive compliance reviews, we are closing the 2017 recommendation as rejected.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this compliance review report. In its written management response, which is included as an appendix to this report, OGC disagreed with the draft report’s conclusions about its SCP processes, making the following three main comments:

- OGC first contended that its transmission of three referrals to the regulated entities within 14 days past the 90-day mark was sufficiently timely as to meet the revised Desktop Instructions’ requirement that a referral be sent to the relevant regulated entity within approximately 90 days of receipt. We have revised the report in response to OGC’s comment.
- OGC’s second contention involved a referral that it transmitted to the regulated entities 385 days past the approximately 90-day standard in the Desktop Instructions. OGC claims that it in fact processed the referral pursuant to the standard because it could not transmit it to the regulated entities until it received the final action on a Debarment Order. We believe OGC’s argument is inconsistent with a plain reading of its revised Desktop Instructions, which state that the referral timeline clock starts ticking upon the referral’s “...receipt by SCP staff” (emphasis added) but this “...deadline may be extended as needed upon a documented showing of good cause, including, but not limited to, receipt of all necessary information.” In this case, the clock started ticking upon OGC’s receipt of the referral in November 2019 and the deadline could have been extended for good cause 90 days later in February 2020 due to the missing final action.⁸ The clock did not start ticking as OGC alleges when it apparently received the final action in late 2020 or early 2021.
- Finally, OGC contended that the draft report allegedly failed to note that OGC provided OIG with written explanations for eight of the nine referrals that took longer than 90 days to transmit. The draft report did in fact include this information, as does this final report.

⁸ OGC received this referral on November 26, 2019, and transmitted it to the regulated entities on March 15, 2021.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this compliance review in March 2021 to determine, for all SCP referrals received by OGC for the period October 1, 2019, through November 30, 2020, whether OGC complied with its revised Desktop Instructions by transmitting those referrals to the relevant regulated entities within approximately 90 days of OGC having received the referrals, and if not, whether OGC had a documented reason showing good cause for the untimely transmissions. To do so, we obtained and reviewed applicable OGC documentation, including emails from referring agencies and OGC emails to the regulated entities. We also interviewed the OGC official who administers the SCP on a day-to-day basis.

We conducted our compliance review from March to May 2021 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the Quality Standards for Inspection and Evaluation (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment.

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Brian Baker, Deputy Chief Counsel, Office of Inspector General

FROM: Clinton Jones, III, General Counsel, Federal Housing Finance Agency

SUBJECT: Draft Report: *Compliance Review of FHFA's Suspended Counterparty Program*

DATE: July 27, 2021

CLINTON JONES

Digitally signed by
CLINTON JONES
Date: 2021.07.27
15:05:18 -04'00'

Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft report referenced above (Report). The Report presents the results of the OIG's review of the 44 Suspended Counterparty (SCP) referrals transmitted to the Federal Housing Finance Agency's (FHFA) regulated entities for review.

The Office of General Counsel (OGC) has reviewed the Report and disagrees with its conclusions related to OGC's procedures. Specifically:

1. The report states that OGC has failed to implement its own timeliness standard for SCP referral disposition, but the Report did not acknowledge that of the nine referrals not submitted to the Government Sponsored Enterprises (GSEs) for review within 90 days, three were submitted within 14 days of the elapse of the 90 day period - which meets the "approximate" standard in the procedure.
2. The report states that one of the nine referrals was referred to the GSEs for review 385 days after receipt, but, OIG did not consider that this referral was made with a Notice of Proposed Debarment, to which the counterparty could respond. A Notice of Proposed Debarment is not a final action, and a final action is required for SCP suspension. After receiving the notice of final action in this matter, OGC referred this counterparty to the GSEs within 90 days of receipt.
3. The report failed to note that of the nine referrals not provided to the GSEs for review within 90 days (*which is different from the "approximate" standard provided in the Desktop Instructions*), FHFA provided information to support the "delayed timeline" through documentation in all matters, except one. OGC has determined that it is obligated to create only those records necessary to conduct official business, which for the SCP includes managing the review and processing of referrals to the SCP.

Stakeholders should be aware that FHFA designed and implemented internal controls that, among other important objectives, help protect the regulated entities against counterparty risk, as demonstrated through the reduction of previously defined “back-log” cases from 424 to zero. This has been achieved while developing a customized electronic database to process and manage the case files, which continues to be improved and enhanced.

cc: Sean C. Dent, Senior Deputy General Counsel

ADDITIONAL INFORMATION AND COPIES.....

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