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## FEDERAL HOUSING FINANCE BOARD

### 12 CFR Part 915

[No. 2007–23]

RIN 3069–AB–34

#### Financial Interests of Appointive Directors

**AGENCY:** Federal Housing Finance Board.

**ACTION:** Final rule.

**SUMMARY:** The Federal Housing Finance Board (Finance Board) is issuing a final regulation that is substantially the same as the proposed rule to clarify the types of financial interests an appointive Federal Home Loan Bank (Bank) director may maintain in a member of the Bank on whose board the director serves. The changes broaden the scope of financial interests an appointive director may have with a holding company that controls one or more members.

**DATES:** *Effective Date:* The final rule is effective July 19, 2007.

**FOR FURTHER INFORMATION CONTACT:** Neil R. Crowley, Acting General Counsel, [crowleyn@fhfb.gov](mailto:crowleyn@fhfb.gov) or 202–408–2990; or Thomas Hearn, Senior Attorney-Advisor, Office of General Counsel, [hearnt@fhfb.gov](mailto:hearnt@fhfb.gov) or 202–408–2512. You can send regular mail to the Federal Housing Finance Board, 1625 Eye Street NW., Washington, DC 20006.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

Section 7(a) of the Federal Home Loan Bank Act (Bank Act) (12 U.S.C. 1427(a)) authorizes the Finance Board to appoint directors to the board of each Bank. Under section 7(a), the individuals appointed to serve as Bank directors may not “during such Bank director’s term of office, serve as an officer of any Federal Home Loan Bank or a director or officer of any member of a Bank, or

hold shares, or any other financial interest in, any member of a Bank.” In the past, the Finance Board generally has applied this statutory restriction on a case-by-case basis. In order to ensure that this prohibition is applied consistently and to provide guidance to the Banks as they identify well qualified individuals as appointive director candidates, the Finance Board published a proposed rule intended to clarify the types of financial interests an appointive Bank director may maintain in a member of the Bank on whose board the director serves. See 72 FR 15627 (Apr. 2, 2007). The Finance Board requested comments from the public and established a 45-day comment period, which expired on May 17, 2007.

The key features of the proposed rule include:

- Incorporating long-standing policy that a financial interest in a Bank member acquired through ownership of shares of a diversified mutual fund is a permissible holding for an appointive director.
- Extending the rationale for permitting mutual funds investments to other types of vehicles and accounts that share certain of the same key features as mutual funds and thus are unlikely to pose a risk of conflict of interest for an appointive director.
- Establishing a threshold under which a financial interest in a holding company that controls one or more members of the Bank on whose board the director serves is a permissible interest if the assets of all such members constitute less than 25 percent of the assets of the holding company, on a consolidated basis.
- Asking whether the rule should extend this rationale to service as a director or officer of a holding company that controls one or more members of the Bank on whose board an appointive director serves.

• Incorporating long-standing policy that loans from or deposits in a member are not a financial interest in the member if the transaction occurs in the normal course of business and on terms that are no more favorable than those available under like circumstances to members of the public.

• Establishing a threshold under which a contractual relationship with a member is a permissible interest if the money paid to a director in a calendar year is 10 percent or less of the

director’s adjusted gross income in that year.<sup>1</sup>

• Attributing the financial interests of an appointive director’s spouse and minor children to the director for purposes of determining compliance.

• Making other technical and conforming changes to part 915.

##### II. Analysis of Public Comments

In response to the proposed rule, the Finance Board received three comments—two from Banks and one from a trade association. One Bank recommended against finalizing the rule because pending legislation would delete the provision prohibiting an appointive director from holding a financial interest in a member. The other Bank urged the Finance Board to increase the threshold for permissible financial interests in a holding company that controls Bank members from 25 to 50 percent and to apply the same standard to service as an officer or director of such a holding company. The trade association supported finalizing the proposed rule as written.

As stated in the proposed rule, the Finance Board believes that the changes to the regulations are warranted because they provide needed guidance to the Banks and to prospective appointive directors as to the types of relationships with members that are permissible under the current law. The possibility that the law may be amended at some point in the future is not a sufficient reason to decline to proceed with a rule that provides additional clarity to the persons most directly affected by the current law. The final rule also responds to the comments relating to the use of the 25 percent threshold by increasing that percentage, although not as much as suggested by the comment, and by applying it to determine whether service as an officer or director of a holding company is permissible. Other issues raised by the comment letters are described in the discussion of the final rule.

##### III. Analysis of the Final Rule

With the exception of the provisions concerning holding companies, discussed in detail below, the Finance Board is adopting the proposed rule as

<sup>1</sup> In the preamble to the proposed rule, the Finance Board described how it intended to calculate the amount of income attributed to a director where the contract was with a director’s spouse. See 72 FR at 15631.

written, with minor technical changes. The Finance Board also is designating the new text as § 915.10(e), rather than § 915.10(f), in order to replace the temporary provision concerning appointments to director positions that were vacant as of January 1, 2007.

One of the commenters urged the Finance Board not to extend these prohibitions to securities issued by a holding company or to persons who serve solely as an officer or director of the holding company, and who do not serve as an officer or director of the member institution, noting that the statute does not refer to holding companies. Alternatively, the commenter suggested that the Finance Board apply these prohibitions only to those holding companies whose subsidiary members constituted 50 percent or more of the consolidated assets of the holding company. This commenter also suggested that the Finance Board use a single standard for evaluating both investments in securities issued by a holding company and service as an officer or director of a holding company.

As was discussed in the preamble to the proposed rule, the Finance Board has long applied these provisions to holding companies of at least some members, and the current practice is to bar any person who serves as an officer or director of a holding company from also serving as an appointive director. The intent of the proposed rule was to adopt a workable standard that would distinguish those holding companies that are very closely associated with their member (such as a one bank holding company), and thus should be subject to the prohibitions in section 7(a), from those where the connection is considerably more remote, which should not be subject to those prohibitions. Accordingly, the Finance Board has declined to adopt the suggestion that the rule apply only to financial interests in, or service with, the members of a Bank.

The proposed rule would have established a safe harbor for ownership of securities issued by a holding company that controls members if the assets of all members of the Bank the holding company controls constitute less than 25 percent of the total assets of the holding company, on a consolidated basis. The Finance Board has considered the comment suggesting that the threshold be raised and has decided to increase the proposed threshold from 25 to 35 percent of the consolidated assets of the holding company. The Finance Board believes that a limit of 35 percent remains consistent with the previously stated

rationale that an investment in such a holding company is predominantly an investment in something other than a member of the Bank. The Finance Board is not prepared, however, to increase the threshold to the 50 percent of assets limit suggested by the commenter, principally because such a high threshold would not be consistent with the above stated rationale.

In the proposed rule, the Finance Board also sought comments with respect to application of these prohibitions to an appointive director's service as an officer or director of a holding company that controls a member of the director's Bank. At the time of the proposed rule, the Finance Board's policy was to prohibit an appointive director from serving as a director or officer of a holding company that controls a member of the director's Bank. The Finance Board proposed no regulatory amendments on this matter, but sought comment on whether it should apply a single standard for both investments in holding company securities and for other types of relationships, such as service as a director or officer of a holding company or contractual relationships with, or receipt of income from, such a company. The only comment received on this issue urged the Finance Board to apply a single standard for assessing all relationships that an appointive director may have with the holding company for a member. The Finance Board is persuaded that a single standard is the better approach and thus has revised the final rule to apply the same 35 percent of assets test in determining whether an appointive director's service as an officer or director of a holding company is permissible, as is used in determining whether a director's investments in securities issued by a holding company are permissible.

With respect to the 35 percent of assets test, the Finance Board emphasizes that this is an ongoing requirement for any appointive director, and is not simply to be applied on a "snapshot basis" at a particular point in time. Accordingly, it is possible that during the course of a person's service as an appointive director an investment in securities issued by a holding company that had been permissible at the outset may cease to be permissible if the assets of the members grow beyond the 35 percent threshold. The same also would be true with respect to a person's service as an officer or director of a holding company. The Finance Board expects that the individual appointive directors and their respective Banks will monitor the assets of the particular members and

holding companies to ensure that the directors remain in compliance with this requirement. In a similar fashion, the Finance Board expects that any appointive directors with any such financial interests, i.e., investments in members or their holding companies, whether directly or through various vehicles or accounts permitted under this rule, service as an officer or director of a holding company, or contractual relationships with a member or its holding company, will fully disclose those interests to the Finance Board prior to their initial appointment and as part of the annual certification process, as well as to their respective boards of directors. That disclosure requirement is embodied in the final rule through § 915.10(e) (with respect to the Finance Board) and in § 915.11(a)(4) (with respect to the board).

#### **IV. Paperwork Reduction Act**

The appointive director application form is part of the information collection entitled "Federal Home Loan Bank Directors." Under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Office of Management and Budget (OMB) has assigned control number 3069-0002, which is due to expire on November 30, 2007. The Finance Board and the Banks use the information contained in the application form to determine whether prospective appointive Bank directors satisfy the statutory and regulatory eligibility requirements and are well qualified to serve as a Bank director. Only individuals meeting these requirements may serve as Bank directors. See 12 U.S.C. 1427. This rule does not make substantive or material modifications to the "Federal Home Loan Bank Directors" information collection. Consequently, the Finance Board has not submitted any information to OMB for review.

#### **V. Regulatory Flexibility Act**

The rule applies only to the Banks and to individuals who may be willing to serve as Bank appointive directors. Neither the Banks nor individuals come within the meaning of "small entities" as defined in the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Thus, in accordance with section 605(b) of the RFA, 5 U.S.C. 605(b), the Finance Board hereby certifies that this final rule will not have a significant economic impact on a substantial number of small entities.

#### **List of Subjects in 12 CFR Part 915**

Banks, Banking, Conflict of interests, Elections, Ethical conduct, Federal home loan banks, Financial disclosure,

Reporting and recordkeeping requirements.

■ For the reasons stated in the preamble, the Finance Board amends 12 CFR part 915 as follows:

#### **PART 915—BANK DIRECTOR ELIGIBILITY, APPOINTMENT, AND ELECTIONS**

■ 1. The authority citation for part 915 continues to read as follows:

**Authority:** 12 U.S.C. 1422a(a)(3), 1422b(a), 1426, 1427, and 1432.

■ 2. Revise § 915.10(e) to read as follows:

#### **§ 915.10 Selection of appointive directors.**

\* \* \* \* \*

(e) *Financial interests.* Except as otherwise provided in this section, an appointive director may not: own any debt or equity securities issued by, or have any other financial interest in, a member of the Bank on whose board the director serves; serve as an officer or director of any member of the Bank on whose board the director serves; or serve as an officer of any Bank. An appointive director or appointive director candidate must disclose all financial interests to the Finance Board.

(1) *Investment vehicles.* An appointive director's investment in a legally recognized entity that owns debt or equity securities issued by a member is not deemed to be shares or other financial interests in a member if the appointive director neither controls the entity nor plays any role in the purchase or sale of the securities owned by the entity.

(2) *Investment accounts.* Debt or equity securities an appointive director owns through an account managed by an investment adviser registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 *et seq.*), for which the director pays a fee for advisory services and with respect to which the director has given the investment adviser complete investment discretion to buy and sell all securities in the account, are not deemed to be shares or other financial interests in a member if the director is not affiliated with the investment adviser and has no control over the selection of securities acquired for the account.

(3) *Holding companies.* Debt or equity securities issued by a holding company that controls one or more members of the Bank on whose board an appointive director serves are not deemed to be shares or other financial interest in a member if the assets of all such members constitute less than 35 percent of the assets of the holding company, on

a consolidated basis. Service as a director or officer of a holding company that controls one or more members of the Bank on whose board an appointive director serves is not deemed to be service as a director or officer of a member of the Bank if the assets of all such members constitute less than 35 percent of the assets of the holding company, on a consolidated basis.

(4) *Loans and deposits.* Loans obtained from a member and money placed on deposit with a member are not deemed to be a financial interest in a member if the transactions occur in the normal course of business of the member and are on terms that are no more favorable than those that would be available under like circumstances to members of the public.

(5) *Contractual relationships.* Any contractual relationship between an appointive director and one or more members of the Bank on whose board the director serves that includes a contractual right to the payment of money, is presumed not to constitute a financial interest in a member if the amount due to the director under such contracts in any calendar year is less than 10 percent of the director's adjusted gross income for that calendar year. The Finance Board will determine on a case-by-case basis whether a contractual relationship that exceeds the 10 percent threshold constitutes a financial interest in a member.

(6) *Attribution.* The Finance Board will attribute to the appointive director any debt or equity securities owned by the director's spouse or minor children and any contractual relationships between a member and the director's spouse for purposes of determining compliance with this section.

■ 3. Revise § 915.11(a) to read as follows:

#### **§ 915.11 Conflict of interests policy for Bank directors.**

(a) *Adoption of conflict of interests policy.* Each Bank shall adopt a written conflict of interests policy that applies to all Bank directors. At a minimum, the conflict of interests policy of each Bank shall:

(1) Require the directors to administer the affairs of the Bank fairly and impartially and without discrimination in favor of or against any member or nonmember borrower;

(2) Require appointive directors to comply with § 915.10(e) of this part;

(3) Prohibit the use of a director's official position for personal gain;

(4) Require directors to disclose actual or apparent conflicts of interest and establish procedures for addressing such conflicts;

(5) Provide internal controls to ensure that reports are filed and that conflicts are disclosed and resolved in accordance with this section; and

(6) Establish procedures to monitor compliance with the conflict of interests policy.

\* \* \* \* \*

#### **§ 915.16 [Removed]**

■ 4. Remove § 915.16.

#### **§ 915.17 [Removed]**

■ 5. Remove § 915.17.

#### **Appendix A to Part 915—[Removed]**

■ 6. Remove Appendix A to part 915.

Dated: June 13, 2007.

By the Board of Directors of the Federal Housing Finance Board.

**Ronald A. Rosenfeld,**

*Chairman.*

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## **DEPARTMENT OF TRANSPORTATION**

### **Federal Aviation Administration**

#### **14 CFR Part 39**

**[Docket No. FAA-2007-28251; Directorate Identifier 2007-CE-049-AD; Amendment 39-15099; AD 2007-12-21]**

**RIN 2120-AA64**

#### **Airworthiness Directives; Hawker Beechcraft Corporation (Type Certificate No. A00010W) Previously Held by Raytheon Aircraft Company) Model 390 Airplanes**

**AGENCY:** Federal Aviation Administration (FAA), DOT.

**ACTION:** Final rule; request for comments.

**SUMMARY:** The FAA is adopting a new airworthiness directive (AD) to supersede AD 2006-26-08, which applies to all Hawker Beechcraft Corporation (HBC) Model 390 airplanes. AD 2006-26-08 currently requires you to repetitively inspect the hydraulic pump outlet tube on both engines and immediately replace the tube if damage is found. AD 2006-26-08 also requires you to incorporate an airplane flight manual (AFM) change that limits operation of an engine with its associated firewall hydraulic shutoff valve closed. If an engine is operated with its firewall hydraulic shutoff valve closed, you must replace the hydraulic pump outlet tube. We issued AD 2006-26-08 as an interim action while we worked with the type certificate holder to develop a design change. HBC has