FEDERAL HOUSING FINANCE BOARD

12 CFR Part 932

[No. 98–24]

RIN 3069–AA76

Compensation and Conflicts-of-Interest Rules for Federal Home Loan Bank Employees

AGENCY: Federal Housing Finance Board.

ACTION: Final rule.

SUMMARY: The Federal Housing Finance Board (Finance Board) is issuing a final rule amending its regulation on compensation of Federal Home Loan Bank (Bank) employees (Compensation regulation) and its regulation governing conflicts of interest of Bank employees (Conflicts regulation). The final rule makes two specific changes to the existing Compensation regulation to address issues that have arisen since the regulation was last revised in January of 1997. First, the final rule eliminates the existing limits on the base salaries and incentive payment opportunities of a Bank's employees other than the President, and establishes an overall limit on cash compensation for such employees equal to 125 percent of the base salary cap established by the Finance Board for the Bank's President. Second, the final rule eliminates unnecessary regulatory requirements regarding the payment of bonuses to Bank employees. The final rule amends the Conflicts regulation by adding an exception for non-exempt hourly Bank employees.

DATES: The final rule is effective on June 5, 1998.

FOR FURTHER INFORMATION CONTACT: Ellen Hancock, Associate Director, Compliance Assistance Division, Office of Policy, (202) 408–2906; or David Guy, Associate General Counsel, (202) 408–2536, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006.

SUPPLEMENTARY INFORMATION:

I. Statutory and Regulatory Background

A. Base Salaries and Incentive Payments for Bank Employees

Section 12(a) of the Federal Home Loan Bank Act (Bank Act) provides that each Bank may fix the compensation of Bank employees, subject to the approval of the Finance Board. *See* 12 U.S.C. 1432(a). From 1992 to 1996, the Finance Board approved the compensation of Bank Presidents pursuant to § 932.41(a) of its regulations and the Bank Presidents' Compensation Plan (Compensation Plan) established by the Finance Board. *See* 12 CFR 932.41(a) (January 1, 1996 revision) (amended 61 FR 2 (Jan. 4, 1997)); Bd. Res. No. 91–565 (as amended). Under the Compensation Plan, the boards of directors of the individual Banks were authorized to set the base salaries of the Bank Presidents, subject to Finance Board approval, within ranges established by the Finance Board. Under the Compensation Plan, the Banks also were authorized to make incentive payments to their Presidents in amounts up to a maximum percentage of base salary, as determined by the Finance Board. The Finance Board's Compensation regulation did not contain specific standards governing the base salaries or incentive payments for Bank employees other than the Presidents. On January 2, 1997, after providing the public with opportunity for notice and comment, the Finance Board published a new Compensation regulation, which, among other things, superseded the Compensation Plan and provided new standards governing the base salaries and incentive payments for Bank Presidents and other Bank employees. *See* 61 FR 2 (Jan. 4, 1997). The 1997 revisions to the Compensation regulation eliminated the use of Finance Board-established salary ranges and now permit each Bank to set its President's base salary, subject to a cap to be published annually by the Finance Board. *See* 12 CFR 932.41(b)(1)(i). The 1997 revisions also established a dollar limit on a Bank President's total cash compensation payable in salary and incentive payments of 125 percent of the amount of the base salary cap established by the Finance Board for that Bank. Thus, a Bank President's maximum incentive payment allowable under the Compensation regulation is the difference between the President's annual base salary approved by the Bank and 125 percent of the annual base salary cap for the Bank. *See id.* § 932.41(c)(2)(i).

In establishing a base salary cap and the 125 percent limit on total cash compensation for Bank Presidents, the Finance Board explicitly intended to permit the Banks to choose incentive compensation levels for their Presidents higher than 25 percent of the Presidents' base salaries. Specifically, under the Compensation regulation, the further a Bank set its President's base salary below the cap, the higher the President's potential incentive payment opportunity. The Finance Board believes that incentive compensation is an important and useful management tool, and it made the regulatory change described above in response to comments from the Banks and others that the industry trend in setting compensation for chief executives and other employees of financial institutions was to allocate increasingly higher percentages of total cash compensation to incentive compensation rather than base salary.

While the Compensation regulation now permits the Banks to make this kind of adjustment in the way they compensate their Presidents, most of the Banks have not taken advantage of this flexibility. Most of the Banks have set their Presidents' base salaries at or near the cap established by the Finance Board. Consequently, the Presidents receive the bulk of their cash compensation in base salary. Eight of the Banks have established incentive payment opportunities for their Presidents ranging from 25 to 27.8 percent of base salary. Under the Compensation regulation, the maximum incentive payment opportunity for a Bank employee other than the President is linked to the incentive payment opportunity of the President. Section 932.41(c)(3)(ii) of the Compensation regulation provides that the total incentive payment opportunity, expressed as a percentage of base salary, for an employee other than the Bank President shall not exceed the total incentive payment opportunity, expressed as a percentage of base salary, allowable for the Bank President. *See id.* § 932.41(c)(3)(ii). In addition, § 932.41(b)(2) of the Compensation regulation provides that no employee's base salary may exceed the base salary of the Bank President.

The purpose of linking the maximum incentive payment opportunities of the Bank Presidents and other Bank employees was to ensure a measure of consistency between the President and other employees regarding the allocation of compensation between base salary and incentive pay. Specifically, in providing the Banks with flexibility to allocate compensation between base salary and incentive pay, the Finance Board wished to prevent a Bank from paying a large percentage of total cash compensation to employees other than the President in the contingent form of incentive pay, while paying the President mostly in the form of guaranteed base salary.

Because most of the Banks have set the base salaries of their Presidents at or near the caps published by the Finance Board, and thereby limited the Presidents' maximum incentive payment opportunities to the minimum percentage of base salary available under the regulation, these Banks are unable to provide increased incentive payment opportunities to their other employees, due to the limitation in § 932.41(c)(3)(ii) of the Compensation regulation. As further discussed below, several of the Banks have voiced concerns that this is impairing their ability to hire and retain key personnel below the level of President. As discussed above, these Banks have the option to address this situation by reducing their Presidents' base salaries and increasing their Presidents' incentive payment opportunities, which would allow the Banks to increase incentive payment opportunities for their other employees. However, the Banks have not viewed reducing their Presidents' base salaries as a viable alternative, and the Finance Board does not wish to make this the Banks' sole option. Therefore, the Finance Board is eliminating the link between the maximum base salaries and incentive payment opportunities of the Bank Presidents and other Bank employees, and establishing instead an overall dollar limit on cash compensation for a Bank's employees other than the President equal to 125 percent of the base salary cap established by the Finance Board for the Bank President.

B. Payment of Bonuses

Section 932.41(f) of the Compensation regulation provides that a Bank shall not pay any employee or other person a bonus. *See id.* § 932.41(f). A bonus is defined in the Compensation regulation as ''a payment to an employee, other than base salary and benefits, that is not based on performance.'' *Id.* § 932.41(a). As further discussed below, the Finance Board is eliminating the provisions of the Compensation regulation governing bonuses because they have proved confusing and duplicative with the provisions of the regulation governing incentive payments for Bank employees. *See id.* §§ 932.41(a), (c)(3)(iii).

C. Conflicts of Interest

Section 12(a) of the Bank Act provides that each Bank may select and employ such officers, employees, attorneys, and agents as shall be necessary for the transaction of its business, subject to the approval of the Finance Board. *See* 12 U.S.C. 1432(a). The Finance Board's Conflicts regulation, set forth at 12 CFR 932.40(d), provides that a Bank employee shall not also be employed by, or otherwise act in any capacity for, a member or an institution eligible to make application to become a member. *See* 12 CFR 932.40(d).

Several of the Banks maintain item processing operations in which they employ non-exempt hourly employees who also have full- or part-time positions with financial institutions that are, or are eligible to make application to become, members of the Bank. The Finance Board has determined that based upon the nature of the work performed by these Bank employees, it is unlikely that any conflict of interest between the Bank and a Bank member or an institution eligible to make application to become a member would be created as a result of concurrent employment by a Bank and such institution. Consequently, the Conflicts regulation, as currently stated, unnecessarily impedes a Bank's ability to hire qualified employees for its item processing operations. *See* Bd. Res. 98–06 (Feb. 18, 1998). On this basis, the Finance Board has waived the Conflicts regulation, as applied to the non-exempt hourly employees working in the item processing operations of the Topeka, Pittsburgh and Indianapolis Banks. *See id.*

The Finance Board believes that the rationale for waiving application of the Conflicts regulation to non-exempt hourly employees working in a Bank's item processing operations applies with equal force for all non-exempt hourly Bank employees. Therefore, the final rule adds a specific exception to the Conflicts regulation for all non-exempt hourly employees of the Banks, so that such employees may be employed concurrently by a Bank and a member or an institution eligible to make application to become a member.

II. Analysis of the Final Rule

A. Base Salary and Incentive Payments for Employees Other than the Bank President

As discussed above, several of the Banks have raised concerns that the limit on incentive payment opportunities for employees other than the President set forth in § 932.41(c)(3)(ii) of the Compensation regulation constrains the Banks' ability to attract and retain experienced and highly qualified personnel in key areas of Bank operations, such as auditing, asset/liability management, investments, risk analysis, and accounting. In addition, this poses an immediate problem for the Banks in attracting and retaining qualified personnel to assist in Year 2000 information systems conversion processes.

While there is no concern that the Banks' ability to attract key personnel has had any negative impact on the safety and soundness of their operations to date, the Finance Board believes that there is a credible risk that, in the future, the Banks may be placed in a non-competitive position relative to other employers of financial and banking professionals. The Finance Board wishes to prevent a situation in which the Banks' ability to compete for the highest quality personnel is unduly limited.

For these reasons, the Finance Board is making the following changes to the provisions of the Compensation regulation governing base salary and incentive payments of Bank employees other than the Presidents. First, the final rule eliminates the limitation in § 932.41(c)(3)(ii) on incentive payment opportunities for Bank employees other than the President. Consequently, such employees may have incentive payment opportunities in excess of that of a Bank's President. However, incentive payments for employees other than the President will continue to be subject to the requirement in § 932.41(c)(3)(i) of the Compensation regulation that such payments be reasonable and comparable with incentive payments made to employees of the other Banks and other similar businesses (including financial institutions) with similar duties and responsibilities. *See id.* § 932.41(c)(3)(i).

Second, in order to give the Banks maximum flexibility in allocating total cash compensation for employees other than the President between base salary and incentive pay, the final rule eliminates the requirement in § 932.41(b)(2) of the Compensation regulation that no Bank employee may have a base salary higher than that of the President. *See id.* § 932.41(b)(2).

Third, the final rule establishes an overall limit on total cash compensation for a Bank's employees other than the President equal to 125 percent of the base salary cap established by the Finance Board for the Bank's President. This limit is the same as under the existing Compensation regulation; however under the existing regulation, it is embodied in two separate limits on base salary and incentive payments for Bank employees other than the President, which, as discussed above, are eliminated by this final rule.

The Finance Board is hopeful that the Banks will use this new flexibility in structuring cash compensation for employees other than the President to enhance their strategic plans for mission achievement, which are under consideration at the Banks. The Finance Board will look at the degree to which the Banks have tied incentive compensation for employees other than the President to mission-related goals, similar to the those that form the basis the Bank Presidents' incentive payments, in deciding whether further regulatory action in this area is warranted.

The final rule adds a new § 932.41(c)(3)(iv) to the Compensation regulation, requiring all Bank incentive compensation plans in effect on May 1, 1998, to be submitted to the Finance Board no later than June 1, 1998. This section further provides that any subsequent amendments to such plans shall not become effective until submitted to the Finance Board. The effect of this provision is to make the effectiveness of any changes a Bank may adopt to its incentive programs for employees other than the President contingent upon the submission of such changes to the Finance Board, but does not contemplate any action to approve or disapprove the submissions. Of course, these policies and their implementation are subject to compliance review as part of the regular examination process.

B. Payment of Bonuses

The Compensation regulation, as revised in 1997, carried forward an existing regulatory provision prohibiting the payment of bonuses to Bank employees. *See id.* § 932.41(f). The 1997 revisions also for the first time adopted a regulatory definition of ''bonus'' as ''a payment to an employee, other than base salary and benefits, that is not based on performance.'' *Id.* § 932.41(a).

The Banks have questioned whether the new definition of ''bonus'' prevents an employee from receiving incentive payments based on the achievement of Bank-wide performance targets. For many years, several Banks have maintained incentive programs for employees under which incentive payments are based, in part, on the extent to which the Bank achieves certain corporate performance targets. Several Banks have requested confirmation that such programs remain permissible in light of the new definition of ''bonus.''

The 1997 revisions were not intended to preclude the Banks from maintaining existing or establishing new employee incentive programs linked to Bank performance. Under § 932.41(c)(3)(iii) of the Compensation regulation, the Banks may make incentive payments to employees other than the Bank President based on the extent to which an employee meets objective performance targets related to criteria established by the Bank's board of directors. *See id.* § 932.41(c)(3)(iii). The Compensation regulation defines ''incentive payment'' as ''a direct or indirect transfer of funds by a Bank to a Bank employee, in addition to base salary, based on the employee's on-the-job-performance.'' *Id.* § 932.41(a).

The Finance Board believes that the achievement of Bank-wide performance targets may be the basis for employee incentive payments as long as there is a reasonable nexus between the job performance of the employee and the achievement of the performance target. The extent to which a Bank achieves its corporate performance targets may be considered a reflection of the on-the-job performance of each of the Bank's employees. The regulatory changes discussed above regarding incentive payments for employees other than the Presidents provide the Banks with the opportunity to integrate Bank-wide goals related to mission achievement into the incentive payment plans of employees whose jobs may not be directly related to the mission of the Bank, but whose support is crucial to the Bank's overall performance, such as the Chief Financial Officer.

The definition of ''bonus'' was added in 1997 to carve out non-performance related incentive payments from the category of permissible incentive payments. However, the Finance Board believes, and it is the Finance Board's intention, that the definition of ''incentive payment'' in § 932.41(a), coupled with § 932.41(e)(1), which prohibits a Bank from making any payment to a Bank employee except as provided in the Compensation regulation, *see id.* § 932.41(e)(1), preclude a Bank from making non-performance related incentive payments to Bank employees. Therefore, removal of the prohibition in § 932.41(f) on the payment of bonuses and the definition of ''bonus'' would clarify the provisions of the Compensation regulation governing employee incentive payments without substantively changing the prohibition on non-performance related incentive payments. Based on the foregoing, and in light of the confusion caused by the provisions on employee bonuses, the Finance Board is eliminating § 932.41(f) and the definition of ''bonus'' in § 932.41(a).

C. Conflicts of Interest

For the reasons discussed in the Statutory and Regulatory Background section, the final rule adds a specific exception to the Conflicts regulation for all non-exempt hourly employees of the Banks.

III. Procedural Requirements

The Finance Board has determined that the rule shall be effective upon publication in the **Federal Register**, for the reasons discussed below.

The Administrative Procedure Act (APA) does not require adherence to notice-and-comment procedures when an agency ''for good cause finds * * * that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.'' 5 U.S.C. 553(b)(3)(B). In addition, the 30-day delay in the effective date of a rule ordinarily required by section 553 of the APA will not apply where the rule relieves a restriction or upon a showing of good cause by the agency adopting the rule. *See id.* § 553(d)(3).

The Finance Board finds good cause to forgo notice-and-comment procedures as unnecessary in connection with lifting the limitations on allocating the base salary and incentive payment components of the total cash compensation for Bank employees other than the President because this regulatory action imposes no new requirements on the Banks or their employees. Furthermore, engaging in notice-and-comment procedures would be contrary to the public interest, because it would prolong existing conditions under which the Banks may be at a competitive disadvantage in attracting and retaining highly experienced and qualified personnel, due to the existing limits on incentive payments for such employees. The longer these conditions persist, the greater the potential risk that there will be a negative impact on the operations of the Banks. Furthermore, the Finance Board believes that the Banks should be free to take immediate action to adjust their compensation programs in order to attract and retain personnel involved in preparing their information systems for 2000. Therefore, the Finance Board finds good cause to forgo a delayed effective date for this change. In addition, the 30-day delay of effective date is not mandated under the APA, because this change relieves a restriction on the Banks' authority to set employee compensation.

Elimination of the provisions of the Compensation regulation governing employee bonuses will not have a substantive effect on the Banks, because they are duplicative of existing provisions governing the Banks' employee incentive payments. Therefore, the Finance Board has determined that notice-and-comment procedures and a delay in the rule's effective date are unnecessary with regard to this change.

As discussed above, the Finance Board has determined that, based upon the nature of the work performed by non-exempt hourly Bank employees, it is unlikely that any conflict of interest between the Bank and a Bank member or an institution eligible to make application to become a member would be created as a result of concurrent employment by a Bank and such institution. Furthermore, the Finance Board previously has permitted such dual employment through the granting of waivers for three Banks. Consequently, the Finance Board has determined that notice-and-comment procedures are unnecessary in connection with amendment to the Conflicts regulation set forth above. The 30-day delay of effective date is not mandated under the APA for this change, because it relieves a restriction on the Banks' authority to select and employ personnel.

IV. Regulatory Flexibility Act

The Finance Board is adopting these regulatory amendments in the form of an final rule. Therefore, the provisions of the Regulatory Flexibility Act do not apply. *See* 5 U.S.C. 601(2), 603(a).

List of Subjects in 12 CFR Part 932

Conflict of interests, Federal home loan banks.

Accordingly, the Federal Housing Finance Board hereby amends title 12, chapter IX, subchapter B, part 932 of the Code of Federal Regulations as follows:

SUBCHAPTER B—FEDERAL HOME LOAN BANK SYSTEM

PART 932—ORGANIZATION OF THE BANKS

1. The authority citation for part 932 continues to read as follows:

Authority: 12 U.S.C. 1422a, 1422b, 1426, 1427, 1432; 42 U.S.C. 8101 *et seq.*

2. Amend § 932.40 by revising paragraph (d) to read as follows:

§ 932.40 Selection.

* * * * *

(d) *Conflicts of interest.* A Bank employee shall not also be employed by, or otherwise act in any capacity for, a member or an institution eligible to make application to become a member. The restriction on employment set forth in the preceding sentence shall not apply to non-exempt hourly employees of a Bank.

3. Amend § 932.41 by removing the definition of ''*Bonus*'' from paragraph (a), removing paragraph (f) and redesignating paragraph (g) as paragraph (f), revising paragraphs (b)(2) and (c)(3)(ii), and adding a new paragraph (c)(3)(iv) to read as follows:

§ 932.41 Compensation.

* * * * *

(b) * * *

(2) *Other Bank employees.* Each Bank shall establish base salaries for employees other than the President that are reasonable and comparable with the base salaries of employees of the other Banks and other similar businesses (including financial institutions) with similar duties and responsibilities.

* * * * *

(c) * * *

(3) * * *

(ii) The sum of annual base salary and all incentive payments received in a single calendar year by an employee other than the Bank President shall not exceed 125 percent of the annual base salary cap for the Bank President, as published by the Finance Board.

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(iv) All Bank incentive compensation plans in effect on May 1, 1998, shall be submitted to the Finance Board no later than June 1, 1998. Any subsequent amendments to such plans shall not become effective until submitted to the Finance Board.

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

Dated: May 13, 1998.

Bruce A. Morrison,

Chairman.

[FR Doc. 98–14970 Filed 6–4–98; 8:45 am]

BILLING CODE 6725–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 98–CE–15–AD; Amendment 39–10567; AD 98–12–11]

RIN 2120–AA64

Airworthiness Directives; British Aerospace Jetstream Model 3101 Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment adopts a new airworthiness directive (AD) that applies to certain British Aerospace Jetstream Model 3101 airplanes. This AD requires modifying the emergency hydraulic hand-pump by increasing the length of the access aperture. This AD is the result of mandatory continuing airworthiness information (MCAI) issued by the airworthiness authority for the United Kingdom. The actions specified by this AD are intended to prevent difficulty accessing the emergency hydraulic hand-pump because of the current design, which, in the event of a hydraulic system failure, could result in the inability to operate the flaps and landing gear.

DATES: Effective July 24, 1998.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of July 24, 1998.

ADDRESSES: Service information that applies to this AD may be obtained from British Aerospace Regional Aircraft, Prestwick International Airport, Ayrshire, KA9 2RW, Scotland; telephone: (01292) 479888; facsimile: (01292) 479703. This information may also be examined at the Federal Aviation Administration (FAA), Central Region, Office of the Regional Counsel, Attention: Rules Docket No. 98–CE–15–AD, Room 1558, 601 E. 12th Street, Kansas City, Missouri 64106; or at the Office of the Federal Register, 800 North Capitol Street, NW, suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mr. S.M. Nagarajan, Aerospace Engineer, Small Airplane Directorate, Aircraft Certification Service, 1201 Walnut, suite 900, Kansas City, Missouri 64106; telephone: (816) 426-6934; facsimile: (816) 426–2169.

SUPPLEMENTARY INFORMATION:

Events Leading to the Issuance of This AD

A proposal to amend part 39 of the Federal Aviation Regulations (14 CFR part 39) to include an AD that would apply to certain British Aerospace Jetstream Model 3101 airplanes was published in the **Federal Register** as a notice of proposed rulemaking (NPRM) on March 19, 1998 (63 FR 13378). The NPRM proposed to require modifying the emergency hydraulic hand-pump by increasing the length of the access aperture. Accomplishment of the proposed action as specified in the NPRM would be in accordance with British Aerospace Jetstream Service Bulletin 29–JM 7360, Revision No. 1, dated January 3, 1991.

The NPRM was the result of mandatory continuing airworthiness information (MCAI) issued by the airworthiness authority for the United Kingdom.

Interested persons have been afforded an opportunity to participate in the making of this amendment. No comments were received on the proposed rule or the FAA's determination of the cost to the public.

The FAA's Determination

After careful review of all available information related to the subject