OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

NEWS RELEASE

FOR IMMEDIATE RELEASE
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OFHEO ANNOUNCES CORPORATE GOVERNANCE REGULATION FOR FANNIE MAE AND FREDDIE MAC

Text of rule attached

WASHINGTON, D.C. — Armando Falcon, Jr., Director of the Office of Federal Housing Enterprise Oversight (OFHEO), safety and soundness regulator for Fannie Mae and Freddie Mac (the Enterprises), announced a final rule on corporate governance that enhances the transparency of regulatory standards for the executives and boards of directors of the Enterprises.

"This rule represents a solid foundation for corporate governance that OFHEO will continue to build upon," said Director Falcon.

The final rule requires the Enterprises to:

-Elect to follow the corporate governance practices and procedures of either the jurisdiction in which the Enterprise is located, Delaware law or the Model Business Corporation Act.

-Establish and maintain audit and compensation committees of their boards of directors.

-Ensure compensation of board members, executive officers and employees is not excessive, unreasonable or otherwise inconsistent with legal standards.

-Implement minimum quorum and voting requirements for board actions.

-Establish and maintain written conflict of interest standards.

-Comply with specific minimum standards for the conduct and responsibilities of the Enterprises' boards of directors.

(more)

The final regulation also states the broad authority of OFHEO to prohibit indemnification of an Enterprise's board members and executives, including the indemnification of activities involving intentional misconduct or recklessness.

The rule becomes effective 60 days after publication in the *Federal Register.* Publication is expected tomorrow, June 4. The corporate governance regulation was proposed Sept. 12, 2001 by OFHEO and cleared by the Office of Management and Budget (OMB) May 29, 2002. The rule is part of OFHEO's regulatory infrastructure project that aims to provide a strong foundation for OFHEO's supervisory programs.

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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

12 CFR Part 1710

RIN 2550-AA20

Corporate Governance

AGENCY: Office of Federal Housing Enterprise Oversight, HUD.

ACTION: Final regulation.

SUMMARY: The Office of Federal Housing Enterprise Oversight (OFHEO) is responsible for ensuring the safety and soundness of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (Enterprises). In furtherance of that responsibility, OFHEO is issuing a final regulation to set forth minimum standards with respect to corporate governance practices and procedures of the Enterprises.

EFFECTIVE DATE: [insert date 60 days after date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: David W. Roderer, Deputy General Counsel, telephone (202) 414-3804 (not a toll-free number); or Isabella W. Sammons, Associate General Counsel, telephone (202) 414-3790 (not a toll-free number); Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION

Background

Title XIII of the Housing and Community Development Act of 1992, Pub. L. 102-550, titled the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Act) (12 U.S.C. 4501 et seq.) established OFHEO as an independent office within the Department of Housing and Urban Development to ensure that the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises) are adequately capitalized and operate safely and in compliance with applicable laws, rules, and regulations.

The Enterprises were established and operate under the authority of their respective Federal chartering acts as government-sponsored, privately owned corporations, to be directed by their respective boards of directors to fulfill the public purpose of providing a stable secondary market for residential mortgages.[1]

Corporate Governance

Corporate governance involves the relationships between an Enterprise, its management, board of directors, shareholders, regulators, and other stakeholders. It provides the structure through which the business objectives and strategies of the Enterprises are set as well as delineating the means of attaining those objectives and monitoring business performance. The chartering acts contain several provisions related

[1] Consistent with the purposes of the chartering acts, the Enterprises are authorized, among other things, to provide stability in the secondary market for residential mortgages; respond appropriately to the private capital market; provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and promote access to mortgage credit throughout the United States (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing. See 12 U.S.C. 1716, with respect to Fannie Mae, and 12 U.S.C. note to 1451, with respect to Freddie Mac.

to matters of corporate governance. For example, Congress therein provided for establishing principal offices, board member composition and qualifications, board of director powers, compensation of executive officers and employees, and common and preferred stock. The chartering acts, however, are silent with respect to other corporate governance provisions that are commonly addressed for state-chartered corporations under State law.

In recent years, regulators, investor organizations, stock exchanges, and corporations themselves have increased their focus on the importance of sound corporate governance practices and procedures to ensure the long-term success of corporations. Sound corporate governance practices and procedures are essential to the safe and sound operations of the Enterprises and accomplishment of their public policy purposes. As one Enterprise noted in its comments to the proposed regulation, "[a] well-qualified and effective board of directors is one of the most important elements in maintaining the safety and soundness of a financial institution." Thus, corporate governance is one category of risk and risk management that is examined by OFHEO under its annual risk-based examination program and the subject of additional policy guidance.

Examination and Guidance with Respect to Corporate Governance

In furtherance of its safety and soundness supervisory responsibilities, OFHEO routinely conducts risk-based examinations of each Enterprise in four categories: credit, market risk, operations, and corporate governance. As described in the Examination Handbook (Dec. 1998),[2] the corporate governance category is comprised of four programs: (1) The Board Governance Program, which assesses the manner in which the Board of Directors discharges its duties and responsibilities in governing the Enterprise;

[2] Examination Handbook (Dec. 1998), available at http://www.ofheo.gov.

(2) the Management Processes Program, which assesses the processes used to drive behaviors to support the defined corporate goals, standards, and risk tolerances of the Enterprise; (3) the Audit Program, which assesses the appropriateness of reliance of the Board of Directors management on internal or external audits; and lastly, (4) the Management Information Program, which assesses the effectiveness, accuracy, and completeness of information and reports. The factors and criteria used to assess and evaluate the four program areas are set forth in Risk-based Examinations – Evaluation Criteria (Evaluation Criteria).[3]

In addition to safety and soundness standards contained in the Examination Handbook and the Evaluation Criteria, OFHEO has issued safety and soundness policy guidelines. To date, the guidelines address minimum safety and soundness requirements and safety and soundness standards for information. The policy guideline, titled Minimum Safety and Soundness Requirements, sets forth in broad terms various minimum board and management responsibilities and functions.[4]

Corporate Governance Regulation

To further support the supervisory scheme with respect to corporate governance, OFHEO issued a proposed corporate governance regulation, published in the Federal Register on September 12, 2001.[5] The proposed regulation builds upon and reinforces the annual risk-based examination and supervisory program in that it restates and amplifies upon the minimum safety and soundness standards affecting the corporate governance policies and practices of the Enterprises.

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[3] Risk-based Examinations – Evaluation Criteria, EG-98-01 (Dec. 31, 1998), available at http://www.ofheo.gov.
[4] Minimum Safety and Soundness Requirements, PG-00-001 (Dec. 19, 2000), available at http://www.ofheo.gov.
[5] 66 FR 47557 (Sept. 12, 2001).

To a large extent, the minimum corporate governance standards set forth in the proposed regulation reflect the current practices of the Enterprises and the current supervisory standards of OFHEO. OFHEO conducts a comprehensive program of review of corporate governance at each Enterprise. Supervisory and examination policies provide for oversight of all facets of board and senior management attention to their responsibilities. OFHEO has had a significant portion of its examination function focused on corporate governance and conducts a vigorous review of all areas determined to be of importance. OFHEO has reported in annual examination reports to Congress that each Enterprise has met and exceeded its safety and soundness standards.

Response to Comments

OFHEO received eleven comment letters on the proposed regulation. Comment letters were received from (1) Fannie Mae; (2) Freddie Mac; (3) the Board Members of Fannie Mae; (4) the Presidential appointees to the board of Fannie Mae; (5) a former Board Member of Fannie Mae; (6) a lawyer with Gibson, Dunn & Crutcher LLP, who is the Chairman of the American Bar Association's Committee on Corporate Governance, on behalf of Fannie Mae; (7) a Widener University professor, on behalf of Freddie Mac; (8) a Georgetown University Law Center professor, on behalf of Freddie Mac; (9) the National Association of Corporate Directors, an educational, publishing, and consulting organization on board leadership; (10) FM Watch, a coalition of eight trade associations; and (11) Consumer Mortgage Coalition, an association of national residential mortgage lenders and servicers.

General Comments

Many of the comments addressed general issues with the overall regulation as proposed. Several of the comments described the proposed regulation as confusing. Some comments insisted that the proposed regulation should be withdrawn, alleging lack of legal authority for OFHEO to issue a regulation relating to the corporate governance of the Enterprises, inconsistency with prevailing corporate governance principles, lack of necessity in light of supervisory examinations conducted by OFHEO, and likely detrimental effect on the ability of the Enterprises to attract and retain quality board members and senior management. Conversely, other commenters offered that the proposed regulation is a good starting point, but that OFHEO should strengthen the proposal in various recommended ways so as not to limit the supervisory authority of the agency. Other comments objected to certain provisions as having no counterpart in the regulatory schemes of the bank regulatory agencies, or not being appropriate to the Enterprises. Yet others recommended the adoption of additional and more stringent provisions that would be similar to the regulations or guidelines of bank regulatory agencies.

As explained above, OFHEO is responsible under the Act for ensuring the safety and soundness of the Enterprises. Congress charged OFHEO with express statutory authority to do so and to issue regulations to implement and support its statutory responsibilities. The proposed corporate governance regulation was published in furtherance of that authority and to support the risk-based examination process of the agency. The OFHEO regulation neither supplants nor displaces traditional standards of corporate governance as commonly defined by State laws regarding the relationships of

corporate board members and management to shareholders and other stakeholders. Indeed, § 1710.10 of the final regulation explicitly clarifies the applicability of such standards to the Enterprises. In contrast, the regulation in largest part sets minimum standards pertaining to the safe and sound operations of the Enterprises under the Act and the respective chartering acts of the Enterprises.

Notably, the comments of both Enterprises and others reflect recognition of the examination program and supervisory process of OFHEO, including the appropriate supervisory role of the agency in relation to the corporate governance practices and procedures of the Enterprises. Indeed, both Enterprises highlighted that the results of recent examinations indicate that OFHEO has determined that they met or exceeded the examination standards in regard to such matters. That is, no commenter asserted that OFHEO lacks statutory authority to oversee and examine the corporate governance program of the Enterprises.

In order to carry out its statutory role and responsibilities, OFHEO is broadly empowered to determine the manner in which it oversees the safe and sound operation of the Enterprises and how it conducts examinations and the scope of such examinations. As set forth in the Examination Handbook, OFHEO reviews corporate governance matters as an area of risk appropriately subject to examination and oversight to ensure the safety and soundness of the Enterprises.

The proposed corporate governance regulation, however, differs from the regulatory scheme adopted by the bank regulatory agencies. As several comments noted, the Enterprises are not banks or thrift institutions, inasmuch as the Enterprises do not engage in deposit taking or origination of commercial or consumer loans. Most

significantly, the Enterprises have no federal deposit insurance. The Enterprises, however, do enjoy a special status under their federally granted charters. OFHEO, therefore, has fashioned standards to reflect the nature of the Enterprises that generally employ as models the regulatory regimes of bank regulatory agencies without imposing the numerous transaction-related limits and constraints that affect insured banks and thrift institutions. The bank regulatory scheme also imposes stringent conflict-of-interest requirements with respect to insider relationships and transactions beyond the management and corporate governance standards applicable to other companies that are not subject to specific requirements under this regulation.

Assertions that the regulation will engender confusion and be detrimental to the ability of the Enterprises to attract and retain qualified board members and senior management, and those contrary assertions that the regulation should go further are addressed below. In responding to the specific comments, OFHEO is guided primarily by pragmatic objectives for which the comments themselves call, that is, to clarify the relationship of the board of directors with management; to support the examination function by providing both greater transparency and enforceability to supervisory standards; and to ensure clarity of the regulation without narrowing the supervisory prerogatives of OFHEO. These objectives guide the changes to the proposed regulation that OFHEO is adopting in the final regulation.

Specific Comments

Section 1710.1 Purpose

Proposed § 1710.1 reiterates that OFHEO is responsible under the Act for ensuring the safety and soundness of the Enterprises and that, in furtherance thereof, the

regulation sets forth certain minimum standards with respect to the corporate governance practices and procedures of the Enterprises. As explained above, the corporate governance regulation establishes a regulatory framework for the performance of the safety and soundness and supervisory responsibilities of OFHEO under the Act. OFHEO received no comments specific to this proposed section and adopts it as proposed with no substantive change.

Section 1710.2 Definitions

As described below, OFHEO received comments with respect to the definitions of several of the defined terms and adopts them as proposed and deletes a few and adopts others as modified to conform to changes elsewhere in the regulation.

Agent, entity, and person. The definitions of these terms are deleted as they are not needed in connection with proposed § 1710.14, discussed below.

Board member. The term was proposed to mean a member of the board of directors; and, for purposes of subpart D of this part, the term "board member" included a current or former board member. The definition has been modified by deleting the reference to subpart D and to current or former board members to conform with changes to proposed §§ 1710.30 and 1710.31, discussed below.

Conflict of interest. The definition of this term is deleted as it is not needed in connection with proposed § 1710.14, discussed below.

Executive officer and senior executive officer. The term “executive officer,” was proposed to mean any senior executive officer and any senior vice president of an Enterprise and any individual with similar responsibilities, without regard to title, who is in charge of a principal business unit, division, or function of an Enterprise, or who

reports directly to the chairperson, vice chairperson, chief operating officer, or president of an Enterprise; and, for purposes of subpart D (the indemnification provisions), the term "executive officer" included a current or former executive officer. The term “senior executive officer,” was proposed to mean the chairperson of the board of directors, chief executive officer, chief financial officer, chief operating officer, president, vice chairperson, any executive vice president of an Enterprise, and any individual, without regard to title, who has similar responsibilities.

Two commenters noted that the definition of these terms differ from the combined definition of “executive officer” adopted by OFHEO in the executive compensation regulation.[6] The comments recommended that the proposed definition be conformed to the definition set forth in the executive compensation regulation, including the provision that OFHEO will identify the officers who are covered by the definition.

OFHEO has determined not to make the recommended changes. The proposed definitions are essentially similar to the definitions in the executive compensation regulation and do not warrant modification. In addition, the provision that OFHEO will identify the officers covered by the specific requirements of 12 CFR part 1770 is not relevant to the corporate governance regulation and will thus not be incorporated into the final regulation. Also see the discussion below under proposed § 1710.12. The definition has been modified by deleting the reference to subpart D and to current or former board members to conform with changes to proposed §§ 1710.30 and 1710.31, discussed below.

Independent board member. The definition of this term is deleted as unnecessary. See the discussion below under proposed § 1710.11.

[6] 12 CFR part 1770, 66 FR 47550 (Sept. 12, 2001).

Legal expenses and payment. In conformance with changes to proposed §§ 1710.30 and 1710.31, discussed below, the separate definitions of these terms are unnecessary and are deleted.

Section 1710.10 Applicable Law

The proposed section required each Enterprise to elect to follow the corporate governance practices and procedures of one of the following bodies of law, to the extent such provisions are not inconsistent with applicable Federal law, rules, and regulations: the law of the jurisdiction in which the principal office of the Enterprise is located; Delaware General Corporation Law, Del. Code Ann. tit. 8, as amended; or Revised Model Business Corporation Act (RMBCA), as amended. The proposed section also would have required each Enterprise to designate in its bylaws the body of law elected within 90 calendar days from the effective date of the regulation.

Section 1710.10 was proposed to dispel any legal uncertainty as to whether and to what extent standards and procedures of State law apply to corporate governance of the Enterprises. The intent of the proposed approach is to provide the Enterprises with flexibility in structuring their corporate governance practices and procedures while at the same time providing certainty to shareholders and other stakeholders as to the body of corporate law applicable to each Enterprise. The body of law elected by the Enterprises, and legal precedents thereunder, to the extent not inconsistent with applicable Federal standards, set forth the standards of conduct of board members with respect to shareholders.

Two commenters objected to permitting the Enterprises to elect a body of State law or the RMBCA as an inappropriate delegation of the fundamental responsibility of

the Federal government for establishing the legal underpinnings of the Enterprises. The comments alleged that the laws applicable to traditional private companies are not fully appropriate for guiding the governance of federally chartered institutions, such as the Enterprises, which were created by Congress to meet specific public purposes. The comments recommended that OFHEO clearly state that the chartering acts and other applicable Federal law are the sole source of the powers of the Enterprises.

OFHEO agrees that the Enterprises are not simply private companies chartered under State law. They were established by Congress and operate under the authority of their respective Federal chartering acts, as government-sponsored, privately-owned corporations, to be directed by their respective board of directors, in compliance with law and regulation and to fulfill particular public purposes.[7] The chartering acts contain various specific corporate governance provisions that are clearly within the realm of the congressionally mandated oversight by OFHEO of the safe and sound operations of the Enterprises. In addition, OFHEO has broad supervisory authority over the corporate behavior of the Enterprises from a safety and soundness perspective. The regulation does not delegate authority to the States, does not in any manner abrogate Federal authority, and does not expand the lawful powers and activities of the Enterprises under their respective chartering acts.

Moreover, the section requiring the election of a specific body of law establishes, in effect, a "safe harbor" for an Enterprise that undertakes a corporate governance program conforming to corporate practices and procedures of State law or the RMBCA. An Enterprise and its officers and board members may reasonably assume that corporate

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[7] OFHEO recognizes that the chartering acts provide a mixture of private control and management along with Federal oversight, as has been done, to a greater or lesser degree, with other companies.

practices, procedures, and behaviors that conform to those standards shall be deemed to be safe and sound unless inconsistent with the chartering act or other applicable Federal law, rule, or regulation, or other guidance or directive from OFHEO.[8] In order to underscore that neither State corporate law nor the RMBCA is incorporated wholesale by the election of such a body of law by an Enterprise, OFHEO has revised proposed § 1710.10.

Fannie Mae specifically recommended that the election of law provision be expanded to allow the choice of either the District of Columbia or Virginia, the two jurisdictions in which the Enterprise has significant operations. OFHEO believes the location of the corporate headquarters provides a reasonable nexus for choice of law. The additional options of either Delaware State law or the RMBCA allow for a choice of laws that are well developed by the courts. No further expansion of choice of law is appropriate at this time.

Finally, one commenter requested that the time period to implement the designation in the bylaws of the body of law elected be lengthened to provide sufficient time for the drafting, review and adoption of the requisite amendment to the bylaws. OFHEO has determined not to increase the time period for implementation in light of the 60-day delayed effective date, which, when added to the 90-day implementation period, provides the Enterprises sufficient time.

Section 1710.11 Committees of Board of Directors

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[8] For example, although the RMBCA and Virginia and Delaware corporate law would permit a quorum to be one-third of the board of directors under certain circumstances, such a practice would be inconsistent with the requirement under this regulation that a quorum constitutes at least a majority of the board. Bank regulatory agencies, likewise, provide for a higher quorum requirement. See, for example, the requirements of the Comptroller of the Currency at 12 CFR 7.2009, and those of the Office of Thrift Supervision at 12 CFR 552.6-1. It should be noted that the “safe harbor” here is limited; judgment must be exercised in combination with regulatory consultation.

Paragraph (a) of the proposed section required that an Enterprise provide in its bylaws for the establishment of committees of the board of directors. It also provided that no committee of the board of directors shall have the authority of the board of directors to amend the bylaws and no committee shall operate to relieve the board of directors or any board member of a responsibility imposed by applicable law, rule, or regulation.

Paragraph (b) of the proposed section required that each Enterprise provide in its bylaws, within 90 calendar days after the effective date of this regulation, for the establishment of two committees, however styled: an audit committee that is in compliance with the charter, independence, composition, expertise, and all other requirements of the audit committee rules of the NYSE; and a compensation committee, to include at least three independent board members, the duties of which include, at a minimum, ascertaining that compensation plans for executive officers and employees comply with applicable laws, rules, and regulations and approving the compensation of senior executive officers.

The Enterprises asserted that paragraph (a) is unnecessary in that State law and the RMBCA already provide that board of directors may establish committees and that the board of directors may rely on reports from such board committees in directing the corporation. OFHEO agrees and has modified the final section accordingly. Although board members may rely on reports of various committees, it must be emphasized, however, that the ultimate responsibility for the direction of the Enterprises rests with the entire board of directors.

The Enterprises also objected to the requirement for the establishment of audit and compensation committees as unnecessary because (1) neither the Code of Virginia,

District of Columbia Code, the General Delaware Corporation Law, nor the RMBCA require audit or compensation committees; and (2) the Enterprises have established such committees and are required to establish an audit committee by the NYSE listing agreement. Another commenter recommended that OFHEO not adopt the definition of "independent board member" as defined by the NYSE, but rather establish rules specifically adapted to the special circumstances of the Enterprises to ensure that the board members are truly independent.

Audit and compensation committees play important roles in the safe and sound operations of the Enterprises and OFHEO has determined, therefore, to retain the requirement for both committees. With respect to the audit committee, OFHEO has determined to retain the reference to the rules of the NYSE, but with the addition of the proviso "or as otherwise provided by OFHEO," clarifying that OFHEO may issue subsequent guidance with respect to the audit committee's composition in the event that an Enterprise is no longer listed with the NYSE or that the NYSE audit committee rules are no longer found to be adequate.

OFHEO has determined to delete the definition of "independent board member" that was proposed in § 1710.2. What constitutes independence of board members is adequately defined under the NYSE rules, unless OFHEO determines additional guidance is needed.

Section 1710.12 Compensation of Board Members, Executive Officers, and Employees

Proposed § 1710.12 provided that the compensation of board members, executive officers, and employees is not to be in excess of that which is reasonable and commensurate with their duties and responsibilities and comply with applicable laws,

rules, and regulations. The Enterprises asserted that the proposed section exceeds the statutory authority of OFHEO under Section 1318 of the Act[9], which purportedly limits OFHEO to prohibiting an Enterprise from providing compensation to an executive officer that is not reasonable and comparable with compensation for employment in other similar businesses involving similar duties and responsibilities.

Section 1318 specifically charges OFHEO to prohibit excessive compensation with respect to certain executive officers. A regulation to implement that provision of the Act was adopted on September 12, 2001.[10] Section 1318, however, does not address the separate and primary authority of OFHEO to ensure the safe and sound operations of the Enterprises, under which authority § 1710.12 is issued. That authority is founded in Sections 1302(6) and 1313 of the Act.[11]

Congress has made clear that safety and soundness encompasses regulatory action regarding excessive compensation.[12] The bank regulatory agencies explicitly prohibit compensation that is unreasonable or disproportionate to the services performed by an executive officer, employee, or board member, or that could lead to a material financial loss to an institution. See the Interagency Guidelines Establishing Standards for Safety and Soundness, for the Office of the Comptroller of the Currency, 12 CFR part 30; for the Board of Governors of the Federal Reserve System, 12 CFR part 263; for the Federal Deposit Insurance Corporation, 12 CFR part 308, subpart R; and for the Office of Thrift Supervision, 12 CFR part 570.

[9] 12 U.S.C. 4518.
[10] 12 CFR part 1770, 66 FR 47550 (Sept. 12, 2001).
[11] 12 U.S.C. 4501(6) and 4513, respectively.
[12] Section 39 of the Federal Deposit Insurance Act, 12 U.S.C. 1831p-1(c).

Section 1710.12 provides for OFHEO to review the adequacy of compensation polices and procedures used by each Enterprise under the obligatory oversight of the board of directors.[13] Section 1710.12 reflects OFHEO examination guidelines used to ensure that policies and practices established by the Enterprises avoid compensation that creates perverse incentives for board members, executive officers, and employees.

The Enterprises also suggested that proposed § 1710.12 is essentially an attempt by OFHEO to set salaries at the Enterprises. OFHEO disagrees. Routine practice under similar Federal standards has not demonstrated any "setting" of compensation by Federal regulators.

Two other commenters recommended that OFHEO impose an explicit requirement that the compensation structure of an Enterprise consider the extent to which the individual officer or employee contributes to the fulfillment of the public purpose of the Enterprise. OFHEO has determined that there is no need to reiterate such an expectation in the regulation.

Section 1710.13 Quorum of Board of Directors; Proxies Not Permissible

Proposed § 1710.13 required that each Enterprise provide in its bylaws that, for the transaction of business, a quorum of the board of directors is a majority of the entire board of directors and that a board member may not vote by proxy.

Freddie Mac suggested that the proposed section would unnecessarily and inappropriately supplant otherwise applicable State law and override a Virginia State law

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[13] The boards of directors of both Enterprises, as charged by their respective chartering acts, are required to cause the Enterprise to pay such compensation to "officers, attorneys, employees, and agents" as the board of directors "determines reasonable and comparable with compensation for employment in other similar businesses (including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities . . . ." See 12 U.S.C. 1723a(d)(2) (Fannie Mae) and 12 U.S.C. 1452(c)(9) (Freddie Mac).

provision, which Freddie Mac follows, that permits a company's articles of incorporation or bylaws to adjust the quorum requirement either upward or downward. Freddie Mac asserted that although its bylaws are in compliance with the proposed section, there is no reason for OFHEO to restrict its flexibility.

The Code of Virginia (VA Section 13.1-689), the Delaware General Corporation Law (Section 141), the RMBCA (Section 8.24) include quorum requirements that permit a quorum of no less than one-third of the total number of the members of the board; the District of Columbia Code is silent. None of those bodies of law address proxy requirements. The proposed quorum and proxy requirements are appropriate minimum standards for Federal safety and soundness purposes necessary to ensure the participation of board members in the deliberative processes of the Enterprises. OFHEO has determined, therefore, to retain the requirements. The proposed language is revised, however, to clarify that the Enterprise may increase the quorum requirement upward when deemed by the Enterprise to be appropriate.

Section 1710.14 Conflict-of-Interest Standards

Section 1710.14, as proposed, required that each Enterprise establish and administer written conflict-of-interest standards that would provide reasonable assurance that board members, executive officers, employees, and agents of the Enterprise discharge their responsibilities in an objective and impartial manner. As proposed, the term "conflict of interest" would be defined in § 1710.2(g) as an interest in a transaction, relationship, or activity that might affect adversely, or appear to affect adversely, the ability to perform duties and responsibilities on behalf of the Enterprise in an objective and impartial manner.

In conducting the risk-based examination of the Enterprises with respect to corporate governance, OFHEO assesses whether the board of directors ensures that executive management appropriately defines the operating parameters and risk tolerances of the Enterprise consistent with, among other things, ethical standards. The evaluation criteria for this assessment factor include: (1) Is there an appropriate Code of Conduct? (2) Does the board receive periodic reports on compliance with the Code of Conduct?[14] OFHEO also assesses whether management effectively conveys an appropriate message of integrity and ethical values.[15] In addition, one of the criteria used to determine if the Enterprise has effective programs for recruiting competent staff, is whether employee retention and promotion criteria are aligned with codes of conducts and other behavioral guidelines of the Enterprise.[16]

One commenter suggested that the definition of the term “conflict of interest” be revised so that it does not refer to a person’s ability to perform duties and responsibilities “in an objective and impartial” manner. The commenter suggested that any conflict of interest provision should do no more than require the Enterprises to establish and administer written standards that are designed to preclude situations in which board members, executive officers, and employees face a conflict of interest when discharging their responsibilities on behalf of the Enterprise. Another commenter recommended

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[14] EG-98-01, supra note 3, at 28.
[15] The evaluation criteria for this assessment factor include the following: (1) Ascertain if codes of conduct are comprehensive, addressing conflicts of interest, illegal or other improper payments and are periodically acknowledged; (2) Verify the establishment of the tone at the top including explicit moral guidance about what is right and wrong; (3) Determine if everyday dealings with employees, investors, customers, creditors, insurers, competitors, and auditors are based on honesty and fairness; determine if management responds to violations of behavioral standards; (4) Determine if management has stringent policies towards overriding established internal controls; (5) Ascertain that deviations from policies are investigated and documented; ascertain that there are no conditions, such as extreme incentives or temptations, that exist that can unnecessarily and unfairly test people’s adherence to ethical values; (6) Determine if controls are in place to reduce temptations that might otherwise exist. Id., at 27.
[16] Id., at 26.

defining a conflict of interest as a situation in which an actual or apparent question of loyalty arises between a board member's personal interest (financial or otherwise) and his or her responsibilities to the Enterprise.

OFHEO has determined not to adopt these recommendations, but has revised § 1710.14 to clarify that the discharge of duties and responsibilities is on behalf of the Enterprise. In addition, the definition of conflict of interest has been deleted because the examination guidance provided in the Evaluation Criteria is adequate and the concept of conflict of interest is a fundamental concept widely understood under traditional precepts of corporate law. OFHEO will continue to review conflict-of-interest standards of the Enterprises and will take action as necessary to ensure that such standards are adequate.

Objections were raised to the use of the term "assurance" with respect to the phrase "standards that will provide reasonable assurance." It is not possible for the Enterprises, the commenters explain, to guarantee the state of mind of the affected individuals. Section 1710.14, as proposed, does not require that the conflict-of-interest standards "guarantee" that board members, executive officers, employees, and agents will always act in an objective and impartial manner. Rather, § 1710.14 is intended to require that the conflict-of-interest standards be so crafted and implemented so as to ensure that compliance with them will provide reasonable assurance that the affected individuals are to act in an objective and impartial manner on behalf of the Enterprise. To clarify this intent, the language of § 1710.14 has been revised to provide that the written conflict-of-interest standards be "reasonably designed to assure" the appropriate conduct.

Objections were also raised to the proposal that the conflict-of-interest standards be required of agents of the Enterprises. Inasmuch as the principal purpose of the

regulation is to provide greater transparency as to the respective roles and responsibilities of the board of directors and management, the practices and policies of agents of the Enterprises are beyond the immediate focus of the regulation. Such matters appropriately remain as a matter of course within the proper scope of review by management of each Enterprise in effecting the routine management of its business operations. Therefore, that portion of proposed § 1710.14 related to the inclusion of agents within the conflict-of-interest standards has been deleted. If, at a later time, OFHEO finds it necessary to revisit such matters, it will do so in an appropriate manner. OFHEO expects each Enterprise to ascertain and address any potential or perceived conflict-of-interest an agent may present as a matter of routine business practice.

Two commenters also recommended that OFHEO expand § 1710.14, as proposed, (1) to specifically prohibit an Enterprises from retaliating against an individual or entity that advocates a public policy position adverse to that of the Enterprise, and (2) to require each Enterprise to disclose, at least annually, a list of all employees whose total annual compensation exceeds $100,000 and employees who have been employed, or whose spouse or immediate family member has been employed, by the Federal government, including the Congress, in the last five years. Both recommendations, however, are rejected as being beyond the scope of the proposed regulation.

Section 1710.20 Conduct of Board Members, and Section 1710.21 Responsibilities of Board of Directors

Proposed § 1710.20 would have explicitly required that each board member, in conducting the business of the Enterprise, is to act: (1) on a fully informed, impartial, objective, and independent basis; (2) in good faith and with due diligence, care, and

loyalty; (3) in the best interests of the shareholders and the Enterprise; and (4) in compliance with the chartering act of the Enterprise and other applicable laws, rules, and regulations. Furthermore, the proposed section would have required that each board member of an Enterprise is to devote sufficient time and attention to his or her responsibilities in conducting the business of the Enterprise.

Proposed § 1720.21 provided that the board of directors is responsible for managing the conduct and affairs of the Enterprise to ensure that the Enterprise is operated in a safe and sound manner. It included responsibilities such as hiring qualified senior executive officers; ensuring the integrity of the accounting and financial reporting systems of the Enterprise, including independent audits; and remaining informed of the condition, activities, and operations of the Enterprise.

Several commenters objected to proposed §§ 1710.20 and 1710.21 inasmuch as they allegedly depart from prevailing State law by making so-called "aspirational standards" enforceable standards, with the potential threat of civil penalties for nonobservance. That is, the proposed regulation would effectively expose board members to a standard of liability arguably stricter than that of the traditional business judgment rule under State law. The commenters argued that the proposed section could cause a well-advised person not to choose a board position at one of the Enterprises when he or she has attractive opportunities to serve elsewhere in a lower risk environment. In addition, the commenters asserted that the proposed provision would cause confusion when compared to the duty of care standards provided under State law and the RMBCA. The commenters asserted that the potential liability of board members should be limited under the business judgment rule, so that, absent self-dealing or bad faith, a board

member would not be held liable for what in hindsight might be determined by the agency to have been unreasonable conduct.

OFHEO agrees that it would be inappropriate for OFHEO to alter the liability standard of the business judgment rule with respect to a board member's potential exposure to shareholder actions against an Enterprise. Neither proposed § 1710.20 nor proposed § 1710.21 does so; neither section addresses nor impinges on the business judgment rule, shareholder rights, or board member accountability to shareholders. Rather, proposed section § 1710.20 would set forth minimum standards of board member conduct and proposed § 1710.21 would enumerate certain of the minimum responsibilities of the board of directors deemed to be integral to the safe and sound operation of the Enterprise for Federal supervisory purposes.[17] OFHEO enforces compliance with minimum standards in furtherance of the congressionally-mandated supervisory responsibilities of OFHEO. OFHEO has revised § 1710.21 and expressly states that the section is not intended to affect the potential exposure of board members to shareholder actions under applicable standards of State law.

The arguments that OFHEO, in proposed §§ 1710.20 and 1710.21, would undo State corporate governance law are not only incorrect, but are contrary to the purpose and intentions of § 1710.10, which would require each Enterprise to elect a body of State law or the RMBCA. The regulation would require that a body of law be selected. OFHEO also addresses its supervisory obligations under Federal law to oversee the safe and sound operations of the Enterprises. The obligations of OFHEO are separate and apart from

[17] As noted above, OFHEO conducts risk-based examinations of each Enterprise with respect to, among other areas, corporate governance. The responsibilities listed in proposed § 1710.21 reflect the current corporate governance examination of the Enterprises and further provide the Enterprises with notice of those minimum responsibilities of the board of directors that OFHEO deems essential to the safe and sound operation of the Enterprises.

traditional matters of State law. While the comments made on this topic were instructive on the history, progression, and direction of State corporate governance law, they bear little or no relevance here. OFHEO has been consistent in the proposed rule — election of a State law or the RMBCA is directed, in line with the need to protect shareholders and promote corporate purposes; adherence to Federal standards for safe and sound operations pursuant to a separate and distinct regulatory regime are set forth as well. This is not inconsistent, but rather is the nature of Federal and State relations across a broad range of federal regulatory regimes where private companies operating under State laws (whether or not federally charted) are subject to Federal standards based on the exercise by Congress of its constitutional authorities. In all of these regimes, companies and their boards operate with an eye toward both Federal and State law and regulation.

Several commenters objected to the use of the term "ensure" with respect to board of director responsibilities and the relationship of the responsibilities of management with that of the board of directors. OFHEO has revised the final section to clarify its intent that OFHEO is not requiring the board of directors to "guarantee" outcomes.

Another commenter recommended that proposed §1710.20 include a specific reference to the obligation of the board of directors to ensure that the activities of the Enterprise are consistent with the authorities under its chartering act and a specific reference to the oversight of internal controls. OFHEO makes no changes in response to these recommendations; references, however, to the chartering acts and internal controls are retained in the revised section.

Two commenters recommended that the list of responsibilities in proposed § 1710.21 specifically require that presidential appointees to the board are to ensure that the

Enterprise fulfills its public mission. They also recommended that the regulation require each Enterprise to establish a separate committee composed of presidential appointees with specific responsibility to publish periodic reports on the Enterprise's fulfillment of its public purposes. OFHEO rejects these recommendations inasmuch as each board member, whether elected by shareholders or appointed by the President, is responsible for overseeing the operation and direction of the Enterprise in accordance with its chartering act and the public purposes set forth therein. The chartering acts do not differentiate between elected and appointed board members with respect to their duties and responsibilities.

Two commenters recommended that OFHEO establish rules, modeled after the Interagency Guidelines Establishing Standards for Safety and Soundness (Interagency Guidelines) of the bank regulatory agencies, that require review by the board of directors and senior management of areas such as internal controls and information systems, internal audits, external audits, credit underwriting policies and procedures, asset quality and asset growth, and privacy and security safeguards. OFHEO has, however, already published examination and other guidance that addresses those areas and does not deem it necessary to include such explicit requirements in this regulation.

Upon review, OFHEO has determined to revise §§ 1710.20 and 1710.21 to ensure that those provisions best complement the supervisory and examination policies of OFHEO. The new § 1710.15, titled Conduct and responsibilities of board of directors, contains general principles while more specific guidance may be found in OFHEO's examination materials. The revised section clarifies that board members are not required to guarantee the successful outcomes of their decisions and deliberations. As discussed

above, OFHEO routinely conducts risk-based examinations of the corporate governance operations of the Enterprises, which include regular assessments of the effectiveness with which the board of directors discharges its duties and responsibilities in governing the Enterprise. In doing so, OFHEO may assess individual board member performance, as well as the conduct of the board as a whole.[18] The body of law and legal precedents thereunder elected by the Enterprises pursuant to § 1710.10, to the extent not inconsistent with applicable Federal rules, set forth standards of conduct of board members with respect to shareholders.

Certain revisions and technical modifications, as discussed above, are appropriate to the proposed regulation. These changes are merited because they continue to support the examination program and standards of OFHEO; they do not diminish the flexibility of OFHEO to review corporate behavior and to determine if safe and sound operations are threatened or a violation of law, rule, or regulation has occurred; and they clarify the intent of OFHEO not to alter the relationship of the board to senior management in day-to-day operations. The board of directors remains responsible for seeing that management adopts policies and procedures that adequately address areas of corporate practice and concern. On this last point, the revised regulation maintains the current strong framework for safe and sound operations and supports the continued ability of the Enterprises to retain and attract the strongest board of directors.

Section 1710.30 Permitted Indemnification Payments, and Section 1710.31 Prohibited Indemnification Payments

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[18] For example, OFHEO examiners assess whether board members are able to devote sufficient, well-organized time to carry out their responsibilities, which is evaluated by, among other criteria, how many other boards the individual Enterprise board members sit on simultaneously. EG-98-01 at 29. Furthermore, formal and informal administrative enforcement actions against individual board members are supervisory tools available to OFHEO as authorized by Congress.

Proposed § 1710.30 generally permitted indemnification payments to a board member or executive officer of an Enterprise, in civil actions or administrative proceedings not initiated or undertaken by OFHEO, provided that such payment would not materially adversely affect the safe and sound operations of the Enterprise. Proposed § 1710.31 would have prohibited indemnification payments in connection with administrative proceedings initiated or undertaken by OFHEO that result in a final order or settlement pursuant to which the board member or executive officer is assessed a civil money penalty or is required to cease and desist from or take any affirmative action with respect to the Enterprise.[19]

Several commenters strongly objected to the proposed prohibitions against indemnification in certain enforcement actions initiated by the agency. These commenters asserted that the statutory prohibition in section 1376(g)[20] of the Act (subsection (g)), which expressly prohibits an Enterprise from reimbursing or indemnifying certain individuals for so-called "third tier" civil money penalties under section 1376(b)(3),[21] impliedly constrains the authority of OFHEO to impose such sanctions against corporate insiders in any other circumstances such as in "second tier" situations. The commenters also asserted that the expression of broad authority in proposed § 1710.31 of OFHEO to prohibit indemnification other than in connection with third-tier civil money penalties would make it difficult for the Enterprises to attract and retain qualified board members and executive officers.

[19] The proposed indemnification sections were drawn from elements founded in the indemnification regulations of the bank regulatory agencies.
[20] 12 U.S.C. 4636(g).
[21] 12 U.S.C. 4636(b)(3).

OFHEO disagrees with the assertion that it has no authority beyond that contained in subsection (g) to address indemnification.[22] Neither that subsection nor other provisions of the Act explicitly nor implicitly purports to constrain the discretion of the agency to fashion remedies as appropriate in varying circumstances consistent with OFHEO's safety and soundness authorities under the Act.

The commenters also assert that subsection (g) is a penal statute because it defines when individuals must bear the full practical consequence of financial sanctions. According to one commenter, the Act must be construed strictly to prohibit OFHEO from denying indemnification for other than third tier civil money penalties. The explicit language of subsection (g), however, relates only to the inability of an Enterprise to indemnify corporate insiders in certain circumstances; it does not purport to in any way

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[22] The authority of OFHEO to preclude indemnification of a wrongdoer in connection with an administrative enforcement proceeding by the agency flows from its statutory enforcement and supervisory authorities to ensure the safe and sound operations of the Enterprises and to issue regulations in furtherance of the responsibilities of the agency. OFHEO previously has issued rules of practice and procedure that recount the enforcement powers and their legal foundations that set forth the procedures for the exercise thereof. 12 CFR part 1780.

Under the statutory and regulatory enforcement scheme, OFHEO is afforded broad enforcement powers by Congress to fashion remedies deemed appropriate to the circumstances against board members and executive officers, as well as an Enterprise, including permanent and temporary cease-and-desist orders, sections 1371 and 1372 of the Act (12 U.S.C. 4631 and 4632, respectively) and civil money penalties, section 1376 of the Act (12 U.S.C. 4636). With respect to civil money penalties, which are the narrow focus of the comments from Fannie Mae, the Director may impose such penalties against an Enterprise, board member, or executive officer who (1) violates a provision of the Act, the chartering acts, or any order, rule, or regulation under the Act (with certain exceptions); (2) violates a final or temporary cease-and-desist order; (3) violates a written agreement between the Enterprise and OFHEO or (4) engages in conduct that causes or is likely to cause a loss to the Enterprise. (Section 1376(a) of the Act; 12 U.S.C. 4636(a)) The amounts of the civil money penalties are denominated "tiers." The first tier civil money penalty amount is applicable under the terms of the Act to the Enterprises only.

With respect to executive officers and board members, second tier civil money penalties may be imposed in an amount not to exceed $10,000 for each day that a violation or conduct continues, if the Director finds that the violation or conduct is a part of a pattern of misconduct; or involved recklessness and caused or would be likely to cause a material loss to the Enterprise. Third tier civil money penalties may be imposed on such persons in an amount not to exceed $100,000 for each day that a violation or conduct described above continues, if the Director finds that the violation or conduct was knowing and caused or would be likely to cause a substantial loss to the Enterprise. (Section 1376(b) of the Act; 12 U.S.C. 4636(b)). In subsection (g), Congress fashioned an absolute bar that "[a]n enterprise may not reimburse or indemnify any individual for any penalty imposed under subsection (b)(3) [third tier civil money penalty]."

address the discretionary remedial authority of OFHEO.[23] Furthermore, the canon cited by the commenter that penal statutes are to be construed strictly is not to be applied so as to defeat the purpose of all other rules of statutory construction.[24]

One commenter would apply the canon of statutory construction known as, expressio unius est exclusio alterius, i.e, the expression of one thing excludes others not expressed, to read subsection (g) to preclude impliedly the denial of indemnification in other circumstances. That is, asserting to apply the canon here, the commenter would interpret the law to mean that because subsection (g) explicitly prohibits the Enterprises from indemnifying for third tier civil money penalties, it impliedly also prohibits OFHEO from denying indemnification in other proceedings. Such an interpretation goes beyond the logical application of the canon, is inconsistent with the limited use of the canon by the courts, and is inappropriate in the context at hand.[25] Indeed, the courts have recognized "an equally pertinent canon of interpretation" that:

> [A] congressional decision to prohibit certain activities does not imply an intent to disable the relevant administrative body from taking similar action with respect to activities that pose a similar danger. . . . . Indeed, a congressional prohibition of particular conduct may actually support the view that the administrative entity can exercise its authority to eliminate a similar danger.[26]

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[23] See Mourning v. Family Publications Service, Inc., 411 U.S. 356, 375 (1973) (Every section of an act establishing a broad regulatory scheme need not be construed as a penal provision merely because a few sections of the act provide for civil and criminal penalties.)

[24] See NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION § 59:8 (6th ed. 2001).

[25] See, e.g., Herman & MacLean v. Huddleston, 459 U.S. 375, 387 (1983); U.S. Dept. Of Labor v. Bethlehem Mines, et al., 669 F.2d 187, 197 (4th Cir. 1982); Mobile Communications Corp. of America v. FCC, 77 F.3d 1399, 1404 (D.D.C. 1996); Texas Rural Legal Aid, Inc. v. Legal Services Corporation, 940 F.2d 685, 694 (D.D.C. 1991); Cheney Railroad Co., Inc. v. ICC, 902 F.2d 66, 69 (D.D.C. 1990); National Petroleum Refiners Ass'n v. FTC, 482 F.2d 672, 676 (D.D.C. 1973). Its application also is inappropriate when, as here, a nonexclusive reading better serves the purposes for which the statute was enacted or allows the exercise of incidental authority necessary to an expressed power or right. Bailey v. Federal Intermediate Credit Bank of St. Louis, 788 F.2d 498, 500 (8th Cir. 1986) cert. denied, 479 U.S. 915 (1986).

[26] Texas Rural Legal Aid, Inc., at 694 (emphasis in original, citations omitted). Thus, the congressional decision to prohibit the Enterprises from indemnifying board members and executive officers in connection with third tier civil money penalties does not imply congressional intent to disable OFHEO from prohibiting indemnification in connection with other agency actions.

Further, OFHEO remains cognizant of the canon of statutory construction known as the "whole statute" interpretation.[27] Because a statute is passed as a whole and not in parts or sections, this canon requires that each section should be construed in connection with every other part or section so as to produce a harmonious whole.[28] Statutes must be construed to further the statutory scheme; "a statutory subsection may not be considered in a vacuum."[29] Here, the Director is broadly empowered under various sections of the Act to fashion appropriate sanctions and remedies to address varying circumstances of misconduct, such as that resulting from recklessness or fraud, by corporate officials, including officers and directors of an Enterprise. This occurs without regard to other provisions of the Act that curtail the authority of an Enterprise to indemnify such persons in certain extraordinary circumstances.

The commenters also asserted that its restrictive interpretation of subsection (g) is supported by the argument that if Congress had wanted to prohibit indemnification for second tier civil money penalties, it knew how to do so in light of congressional amendment of section 18(k) of the Federal Deposit Insurance Act (FDI Act).[30] More particularly, that law explicitly authorizes the Federal Deposit Insurance Corporation to prohibit indemnification payments to institution-affiliated parties, including board members and executive officers of federally insured banks and thrifts, for penalties and

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[27] See SINGER, supra note 24, at § 46:05.
[28] Id.
[29] Id. and FDA v. Brown & Williamson Tobacco Corp., et al., 529 U.S. 120, 132 - 133 (2000) ("It is a 'fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.' A court must therefore interpret the statute 'as a symmetrical and coherent regulatory scheme.' " [citations omitted]). The authority of OFHEO in connection with administrative enforcement proceedings is derived from its statutory enforcement and supervisory responsibilities. It would be wholly inconsistent with the congressional scheme to read subsection (g) so as to constrain the essential flexibility of OFHEO to fashion differing remedies to address particular circumstances.
[30] 12 U.S.C. 1828(k).

related legal expenses in view of such factors as the agency spells out by regulation. But Congress did not address indemnification in the Act affecting the Enterprises in the same manner as it did for insured banks and thrift institutions under the FDI Act. Logic supports the position that the different statutory formulations of the Act and the FDI Act evidence that Congress knew how to prohibit expressly OFHEO from denying indemnification, but did not do so.

OFHEO rejects the assertion that it has no authority beyond subsection (g) to address indemnification. In order to minimize misunderstanding and to clarify the authority of the agency to fashion appropriate remedies on a case-by-case basis, proposed §§ 1710.30 and 1710.31 have been revised and renumbered as § 1710.20 to require each Enterprise to adopt written policies and procedures concerning indemnification and to recount the authority of OFHEO to fashion appropriate remedies, including indemnification pursuant to its inchoate enforcement authority under various sections of the Act as set forth at 12 CFR part 1780.

Under § 1710.20, the body of law elected by an Enterprise pursuant to § 1710.10 will provide the basis for indemnification by the Enterprise. The Enterprises are authorized to operate under the indemnification requirements set forth by the elected body of State law or the RMBCA. The revisions to the indemnification provision are designed to preclude any misunderstanding as to the applicability of State law or RMBCA provisions that may mandate or provide for indemnification in certain circumstances. Thus, the revised indemnification provisions should not detract from the efforts of the Enterprises to continue to attract and retain qualified board members and executive officers.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

The final regulation is not classified as an economically significant rule under Executive Order 12866 because it would not result in an annual effect on the economy of $100 million or more or a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or have significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or foreign markets. Accordingly, no regulatory impact assessment is required. The final regulation was reviewed by the Office of Management and Budget under other provisions of Executive Order 12866.

Executive Order 13132, Federalism

Executive Order 13132 requires that Executive departments and agencies identify regulatory actions that have significant federalism implications. A regulation has federalism implications if it has substantial direct effects on the States, on the relationship or distribution of power between the Federal Government and the States, or on the distribution of power and responsibilities among various levels of Government. The Enterprises are federally chartered corporations supervised by OFHEO. The final regulation sets forth minimum corporate governance standards with which the Enterprises must comply for Federal supervisory purposes. The final regulation requires that each Enterprise elect a body of State corporate law or the Revised Model Corporation Act to follow in terms of its corporate practices and procedures. The final regulation does not affect in any manner the powers and authorities of any State with respect to the

Enterprises or alter the distribution of power and responsibilities between State and Federal levels of government. Therefore, OFHEO has determined that the final regulation has no federalism implications that warrant the preparation of a Federalism Assessment in accordance with Executive Order 13132.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). OFHEO has considered the impact of the final regulation under the Regulatory Flexibility Act. The General Counsel of OFHEO certifies that the final regulation, if adopted, is not likely to have a significant economic impact on a substantial number of small business entities because it is applicable only to the Enterprises, which are not small entities for purposes of the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 1710

Administrative practice and procedure, Government Sponsored Enterprises.

Accordingly, for the reasons stated in the preamble, OFHEO adds part 1710 to subchapter C of 12 CFR chapter XXVII to read as follows:

PART 1710 — CORPORATE GOVERNANCE

Subpart A—General

Sec.

1710.1 Purpose.

1710.2 Definitions.

1710.3 — 1710.9 [Reserved]

Subpart B—Corporate Practices and Procedures

1710.10 Law applicable to corporate governance.

1710.11 Committees of board of directors.

1710.12 Compensation of board members, executive officers, and employees.

1710.13 Quorum of board of directors; proxies not permissible.

1710.14 Conflict-of-interest standards.

1710.15 Conduct and responsibilities of board of directors.

1710.16 — 1710.19 [Reserved]

Subpart C—Indemnification

1710.20 Indemnification.

Authority: 12 U.S.C. 4513(a) and 4513(b)(1).

Subpart A—General

§ 1710.1 Purpose.

OFHEO is responsible under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, 12 U.S.C. 4501 et seq., for ensuring the safety and soundness of the Enterprises. In furtherance of that responsibility, this part sets forth minimum standards with respect to the corporate governance practices and procedures of the Enterprises.

§ 1710.2 Definitions.

For purposes of this part, the term:

(a) Act means the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Title XIII of the Housing and Community Development Act of 1992, Pub. L. 102-550, section 1301, Oct. 28, 1992, 106 Stat. 3672, 3941 through 4012 (1993) (12 U.S.C. 4501 et seq.).

(b) Board member means a member of the board of directors.

(c) Board of directors means the board of directors of an Enterprise.

(d) Chartering acts mean the Federal National Mortgage Association Charter Act and the Federal Home Loan Mortgage Corporation Act, which are codified at 12 U.S.C. 1716 through 1723i and 12 U.S.C. 1451 through 1459, respectively.

(e) Compensation means any payment of money or the provision of any other thing of current or potential value in connection with employment. The term "compensation" includes all direct and indirect payments of benefits, both cash and non-cash, including, but not limited to, payments and benefits derived from compensation or benefit agreements, fee arrangements, perquisites, stock option plans, post employment benefits, or other compensatory arrangements.

(f) Director means the Director of OFHEO or his or her designee.

(g) Employee means a salaried individual, other than an executive officer, who works part-time, full-time, or temporarily for an Enterprise.

(h) Enterprise means the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation; and the term "Enterprises" means, collectively, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

(i) Executive officer means any senior executive officer and any senior vice president of an Enterprise and any individual with similar responsibilities, without regard to title, who is in charge of a principal business unit, division, or function of an Enterprise, or who reports directly to the chairperson, vice chairperson, chief operating officer, or president of an Enterprise.

(j) NYSE means the New York Stock Exchange.

(k) OFHEO means the Office of Federal Housing Enterprise Oversight.

(l) Senior executive officer means the chairperson of the board of directors, chief executive officer, chief financial officer, chief operating officer, president, vice chairperson, any executive vice president of an Enterprise, and any individual, without regard to title, who has similar responsibilities.

§§ 1710.3 — 1710.9 [Reserved]

Subpart B—Corporate Practices and Procedures

§ 1710.10 Law applicable to corporate governance.

(a) General. The corporate governance practices and procedures of each Enterprise shall comply with applicable chartering acts and other Federal law, rules, and regulations, and shall be consistent with the safe and sound operations of the Enterprise.

(b) Election and designation of body of law. (1) To the extent not inconsistent with paragraph (a) of this section, each Enterprise shall follow the corporate governance practices and procedures of the law of the jurisdiction in which the principal office of the Enterprise is located, as amended; Delaware General Corporation Law, Del. Code Ann. tit. 8, as amended; or the Revised Model Business Corporation Act, as amended.

(2) Each Enterprise shall designate in its bylaws the body of law elected for its corporate governance practices and procedures pursuant to this paragraph within 90 calendar days from **[insert date 60 days after date of publication in the Federal Register]**.

§ 1710.11 Committees of board of directors.

(a) General. The board of directors may rely, in directing the Enterprise, on reports from committees of the board of directors, provided, however, that no committee of the board of directors shall have the authority of the board of directors to amend the bylaws and no committee shall operate to relieve the board of directors or any board member of a responsibility imposed by applicable law, rule, or regulation.

(b) Audit and compensation committees. Each Enterprise shall provide in its bylaws, within 90 calendar days from **[insert date 60 days after date of publication in the Federal Register]** for the establishment of, however styled:

(1) An audit committee that is in compliance with the charter, independence, composition, expertise, and other requirements of the audit committee rules of the NYSE, as from time to time amended, unless otherwise provided by OFHEO; and

(2) A compensation committee, the membership of which is to include at least three independent board members and the duties of which include, at a minimum, oversight of compensation policies and plans for executive officers and employees and approving the compensation of senior executive officers.

§ 1710.12 Compensation of board members, executive officers, and employees.

Compensation of board members, executive officers, and employees shall not be in excess of that which is reasonable and commensurate with their duties and responsibilities and comply with applicable laws, rules, and regulations.

§ 1710.13 Quorum of board of directors; proxies not permissible.

Each Enterprise shall provide in its bylaws, within 90 calendar days from **[insert date 60 days after date of publication in the Federal Register]**, that, for the transaction of business, a quorum of the board of directors is at least a majority of the entire board of directors and that a board member may not vote by proxy.

§ 1710.14 Conflict-of-interest standards.

Each Enterprise shall establish and administer written conflict-of-interest standards that are reasonably designed to assure the ability of board members, executive officers, and employees of the Enterprise to discharge their duties and responsibilities, on behalf of the Enterprise, in an objective and impartial manner.

§ 1710.15 Conduct and responsibilities of board of directors.

(a) Purpose. The purpose of this section, and of this subpart, is to set forth minimum standards of the conduct and responsibilities of the board of directors in furtherance of the safe and sound operations of each Enterprise. The provisions of this section neither provide shareholders of an Enterprise with additional rights nor impose liability on any board member under State law.

(b) Conduct and responsibilities. The board of directors is responsible for directing the conduct and affairs of the Enterprise in furtherance of the safe and sound operation of the Enterprise and must remain reasonably informed of the condition, activities, and operations of the Enterprise. The responsibilities of the board of directors

include having in place adequate policies and procedures to assure its oversight of, among other matters, the following:

(1) Corporate strategy, major plans of action, risk policy, and corporate performance;

(2) Hiring and retention of qualified senior executive officers and succession planning for such senior executive officers;

(3) Compensation programs of the Enterprise;

(4) Integrity of accounting and financial reporting systems of the Enterprise, including independent audits and systems of internal control;

(5) Process and adequacy of reporting, disclosures, and communications to shareholders, investors, and potential investors; and

(6) Responsiveness of executive officers in providing accurate and timely reports to Federal regulators and in addressing the supervisory concerns of Federal regulators in a timely and appropriate manner.

(c) Guidance. The board of directors should refer to the body of law elected under § 1710.10 and to publications and other pronouncements of OFHEO for additional guidance on conduct and responsibilities of the board of directors.

§§ 1710.16 — 1710.19 [Reserved]

Subpart C—Indemnification

§ 1710.20 Indemnification.

(a) Safety and soundness authority. OFHEO has the authority, under the Act, to prohibit or restrict reimbursement or indemnification of any current or former board

member or any current or former executive officer by an Enterprise or by any affiliate of an Enterprise in furtherance of the safe and sound operations of the Enterprise.

(b) Policies and procedures. Each Enterprise shall have in place policies and procedures consistent with this part for indemnification, including the approval or denial by the board of directors of indemnification of current and former board members and current or former executive officers. Such policies and procedures should address, among other matters, standards relating to indemnification, investigation by the board of directors, and review by independent counsel.

____ __________________

Signature Date

Armando Falcon, Jr.
Director,
Office of Federal Housing Enterprise Oversight.

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