



***Federal Housing Finance Board
Office of Supervision***

Date: February 14, 2001

To: Federal Home Loan Bank Directors, Presidents, Directors of Internal Audit, and Community Investment Officers

From: Mitchell Berns, Director
Office of Supervision

Subject: Conflicts of Interest

Background: Circumstances that could lead to potential conflicts of interest involving Federal Home Loan Bank (Bank) directors or staff merit conscientious scrutiny. Due to the cooperative nature of the System, directors are often associated with Bank customers or potential AHP grant or subsidy recipients, which gives rise to potential conflicts. Clear conflict of interest policies and codes of conduct combined with diligent monitoring are essential components of Banks' systems of internal control.

Federal Housing Finance Board (Finance Board) rules and regulations require the Banks to adopt written conflict of interest policies. Section 915.11 requires a Bank director conflict of interest policy. Section 951.3(c) requires a conflict of interest policy for directors and Bank staff with respect to the Affordable Housing Program (AHP). Both regulations set forth prohibitions on director and Bank staff actions under certain circumstances where conflicts of interest may arise. Section 917.7 also establishes independence requirements for director membership on the Bank's audit committee.

Guidance: Banks should review their conflict of interest policies to ensure compliance with applicable regulations and to determine whether their policies provide clear and adequate guidance to directors and Bank staff regarding situations in which actual or apparent conflicts may arise. In establishing conflict policies, Banks should consider authoritative industry guidance and guidance provided by other bank regulators as well as Finance Board regulations. One source for such guidance is the Office of the Comptroller of the Currency's publication *The Director's Book-The Role of a National Bank Director*, published in 1997. Chapter 3 of this publication provides guidance on insider transactions. Chapter 4 provides guidance on directors' individual responsibility. This publication is available online at <http://www.occ.treas.gov/toolkit.htm>.

Particular diligence is warranted regarding AHP projects and applications involving entities in which Bank directors or staff have financial interests, or of which the director or staff person is a director, officer or employee. Banks should review their AHP project application, approval and monitoring procedures to ensure that these procedures adequately address the identification, disclosure, and management of potential and actual conflicts of interest.

Banks should specify a contact person for questions regarding conflicts of interest and should communicate this to Bank staff and directors. Banks should consider designating this person as the



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Bank's Ethics Officer. Directors and staff should be urged to bring conflict of interest questions to this contact person for guidance, preferably before entering into situations that might create an actual or apparent conflict of interest.

Banks should adopt and follow insider transaction policies for both directors and staff that establish guidelines for the following:

- Conducting insider transactions at arm's length;
- Disclosure of actual and potential conflicts of interest;
- Handling confidential information;
- Prohibition of the use of insider information; and
- Restrictions on gifts from persons doing business with the Bank.

Directors should consider the following guidance involving the Bank:

- Avoid even the appearance of a conflict of interest;
- Consult with legal counsel or the Bank's ethics contact person before entering into or approving transactions involving the Bank and an entity of which the director is a director, officer or employee or in which the director has a financial interest;
- Fully document transactions with the Bank, including obtaining independent appraisals to support fair values for real estate transfers;
- Fully disclose actual or apparent conflicts of interest to the board before decisions are made;
- Recuse oneself from any involvement in the discussion or resolution of any issue involving an actual or apparent conflict of interest; and
- Observe the rule that the Bank's interests must be paramount in any transaction or AHP decision involving a director or an entity of which the director is a director, officer or employee or in which the director has a financial interest.

Transactions and relationships involving directors and Bank staff that create actual or apparent conflicts of interests can lead to unacceptable reputation, compliance, business, and operational risks. Effective conflict of interest policies and codes of conduct combined with diligent monitoring by a Bank's board of directors and staff are essential to identify and manage situations that present actual and potential conflicts of interest.