



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

NEWS RELEASE

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(Due to events of Sept. 11, 2001 release was delayed)

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OFHEO RELEASES THREE REGULATIONS UNDER REGULATORY INFRASTRUCTURE PROJECT

Attached: Language that appeared in the *Federal Register* Sept. 12

WASHINGTON, D.C. – **Armando Falcon, Jr.**, Director of the Office of Federal Housing Enterprise Oversight (OFHEO), financial safety and soundness regulator of Fannie Mae and Freddie Mac (the Enterprises), has sent to the *Federal Register* one final and two proposed regulations under OFHEO's infrastructure project initiated in July 2000. The regulations are Executive Compensation, Corporate Governance and Flood Insurance. The infrastructure project seeks to codify and make transparent OFHEO's actions and processes in supervising the Enterprises.

OFHEO's regulatory project is comprised of four areas: OFHEO Organization, Enterprise Corporate Governance, Safety and Soundness Issues and Compliance Matters.

OFHEO has sent the following **final rule** to the *Federal Register*:

1. Executive compensation. Effective 45 days after publication; this regulation proposed in December 2000 codifies much of the Office's current practice related to its ability to oversee compensation and termination benefits provided by the Enterprises to their executive officers. The **final rule** clarifies statutory requirements and provides specifics as to the timing and informational requirements of the law. OFHEO made several modifications to the rule in response to comments received.

OFHEO has sent the following **proposed rules** to the *Federal Register*:

2. Corporate Governance. A **proposed rule** with a 60-day comment period; this regulation addresses minimum standards for corporate behavior. The rule was previously proposed in April 2001 but was withdrawn to permit new presidential appointments to be made to the Boards of the Enterprises. Such appointments have been largely completed. Corporate governance is a specific category of risk and risk management evaluated by OFHEO through its examination process. The proposed standards are significantly similar to those required by Federal banking agencies for regulated depository institutions.

3. Flood Insurance. A **proposed rule** with a 30-day comment period; this proposed rule addresses OFHEO's responsibility in examining the Enterprises to ensure they have a program in place to comply with requirements of the National Flood Insurance Reform Act of 1994, administered by the Federal Emergency Management Agency (FEMA).

OFHEO **currently** examines the Enterprises in the areas of executive compensation, corporate governance and flood insurance practices.

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Federal Register

**Wednesday,
September 12, 2001**

Part III

**Department of
Housing and Urban
Development**

**Office of Federal Housing and Enterprise
Oversight**

**12 CFR Parts 1710 et al.
Executive Compensation, Corporate
Governance and Flood Insurance; Final
Rule and Proposed Rules**

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**Office of Federal Housing Enterprise Oversight****12 CFR Part 1770**

RIN 2550-AA13

Executive Compensation**AGENCY:** Office of Federal Housing Enterprise Oversight, HUD.**ACTION:** Final regulation.

SUMMARY: The Office of Federal Housing Enterprise Oversight ("OFHEO") is issuing a final regulation that clarifies the procedures OFHEO employs in overseeing compensation provided by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (collectively, "the Enterprises") to their executive officers. The final regulation formalizes processes by which OFHEO performs its separate reviews of executive compensation and termination benefits. The processes require the submission of relevant information by the Enterprises on a timely basis to enable OFHEO to efficiently carry out its executive compensation functions.

EFFECTIVE DATE: The effective date of this regulation is October 29, 2001.

FOR FURTHER INFORMATION CONTACT: David W. Roderer, Deputy General Counsel, telephone (202) 414-3804; Christine C. Dion, Associate General Counsel, telephone (202) 414-3838 (not a toll-free number); or Brian M. Doherty, Senior Policy Analyst, telephone (202) 414-8922, 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:**I. Background**

Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, entitled the "Federal Housing Enterprises Financial Safety and Soundness Act of 1992" (the "Act"),¹ established the Office of Federal Housing Enterprise Oversight ("OFHEO") as an independent office within the Department of Housing and Urban Development. OFHEO is the safety and soundness regulator of two of the nation's largest housing-related government sponsored enterprises: the Federal National Mortgage Association ("Fannie Mae") and the Federal Home

Loan Mortgage Corporation ("Freddie Mac") (collectively, the "Enterprises"). In addition to establishing OFHEO, the Act made amendments to the Enterprises' enabling statutes (collectively, the "charter acts"),² in part to accommodate OFHEO's statutory supervisory powers.

Included in the supervisory responsibilities of the Director of OFHEO (the "Director") is oversight of compensation provided by the Enterprises to their respective executive officers. Briefly, the Director's statutory oversight of executive compensation involves two statutory mandates: (1) The prohibition of excessive compensation, as required by the Act; and (2) the prior review of termination benefits, as required by the charter acts. Notably, the differing statutes use similar but not identical terms in delineating the standards and identifying the different comparator groups to be used in these matters.

Specifically, the Act requires the Director to prohibit the Enterprises from providing compensation to any executive officer that is not reasonable and comparable with that paid by similar businesses to executives doing similar work. Businesses used for comparison purposes include publicly held financial institutions or major financial services companies.³

The charter acts were amended by the Act to similarly provide that an Enterprise may only pay compensation that it determines is reasonable and comparable with compensation for employment in other similar businesses, and that the Enterprise must report annually to Congress on the comparability of the compensation policies for their employees with the compensation policies of other similar businesses.⁴ The Enterprises have the general power to select the individuals who will work for them and to set their specific compensation. The Act explicitly provides that OFHEO may not prescribe or set a specific level or range of compensation for executive officers of the Enterprises.⁵

To effectuate OFHEO's charge to prohibit excessive compensation, the Act requires OFHEO to take such actions and perform such functions as the Director determines to be

necessary.⁶ OFHEO may also require an Enterprise to submit reports and special reports as deemed appropriate and in such form as the Director may require.⁷ Moreover, OFHEO has express statutory authority to retain any consultant that the Director determines is necessary to assist in such matters.⁸ The Act also grants OFHEO a wide array of enforcement powers. Thus, without regard to the capital condition of an Enterprise, the Director can undertake enforcement actions, both formal and informal, including the issuance of a notice of charges, for conduct in violation of the compensation provisions of the Act, the charter acts or this regulation.⁹ The Director can require an Enterprise, or any executive officer or member of the board of directors ("Board") to correct or remedy any violation in such manner as the Director determines to be appropriate.¹⁰

In addition to prohibiting the payment of excessive executive compensation, OFHEO is required to review termination benefits provided by the Enterprises to their executive officers. The respective charter acts of the Enterprises were identically amended by the Act to provide that an Enterprise may not enter into an agreement or contract to provide for payment of money or other thing of current or potential value in connection with the termination of employment of an executive officer unless the agreement or contract is approved in advance by OFHEO.¹¹ The Act further amended the charter acts to prohibit the Director from approving termination benefits that are not comparable to such benefits provided by other public or private entities involved in financial services and housing interests to executives with comparable duties and responsibilities.

These amendments to the charter acts were effective after October 28, 1992. Therefore, agreements to provide termination payments to executives that were entered into before that date are not subjected to retroactive review for approval or disapproval by OFHEO. However, the amended charter acts provide that any subsequent renegotiation, amendment or change to any such agreement entered into on or

⁶ Section 1313(8) (12 U.S.C. 4513(8)).⁷ Section 1314(a) (12 U.S.C. 4514(a)).⁸ Section 1315(e) (12 U.S.C. 4515(e)).⁹ Section 1371(a)(3) (12 U.S.C. 4631) and section 1372 (12 U.S.C. 4632).¹⁰ Section 1371(d)(7) (12 U.S.C. 4631(d)(7)).¹¹ Section 310(d)(3)(B) of Federal National Mortgage Association Charter Act (12 U.S.C. 1723a(d)(3)(B)), and section 303(h)(2) of Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(h)(2)).² Federal National Mortgage Association Charter Act (12 U.S.C. 1716-1723i) and Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451-1459).³ Section 1318(a) (12 U.S.C. 4518(a)).⁴ Section 309(d)(2) and (3) of Federal National Mortgage Association Charter Act (12 U.S.C. 1723a(d)(2) and (3)) and section 303(c) and (h) of Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(c) and (h)).⁵ Section 1318(b) (12 U.S.C. 4518(b)).¹ 12 U.S.C. 4501 *et seq.*

before October 28, 1992, is to be considered as entering into an agreement subject to approval by OFHEO. An extension of such an agreement is deemed to constitute a change subject to OFHEO's prior approval. OFHEO's approval is required regardless of how such an extension is structured, *e.g.*, by a written agreement or by a resolution adopted by the Board of the Enterprise.

OFHEO published a notice of proposed rulemaking for public comment relating to its executive compensation oversight responsibilities.¹² Comments on the proposed regulation were received only from the two Enterprises. Those comments were carefully considered in developing this final regulation. A discussion of those comments and OFHEO's response to those comments follows.

II. Comments on the Proposed Executive Compensation Regulation

General Comments

OFHEO's Role and Authority

Both Enterprises commented that OFHEO has a narrow and precisely defined role with regard to executive compensation oversight. They described OFHEO's role as reviewing Board-established executive compensation decisions to determine whether they meet the comparability standards contained in the Enterprises' charter acts. One Enterprise stated that OFHEO cannot regulate what an Enterprise's Board chooses to pay senior executives or the Board's choice of a compensation structure. The Enterprise suggested that such regulation by OFHEO would interfere with management prerogatives; would amount to an undue regulatory interference; and would be contrary to a balance intended by Congress between regulatory action and the Enterprises' independence.

Both Enterprises noted other constraints on their executive compensation in addition to OFHEO's review. They stated that their executive compensation practices are subject to public disclosure under ERISA and other benefit laws and regulations. One Enterprise commented that extensive public disclosure also results from conformance with federal securities laws and stock exchange rules, responsiveness to market discipline, and compliance with reporting requirements to Congress.

OFHEO agrees that it has a defined role with regard to oversight of Enterprise executive compensation

practices. Under the Act, OFHEO is required to prohibit executive compensation that exceeds certain standards. Under the charter acts, OFHEO cannot approve termination benefits provided by an Enterprise to an executive officer that are not comparable to the requisite standards. In the event that OFHEO determines that compensation is excessive or that termination benefits are not similar, the Enterprise would have to revise the executive officer's compensation in order to render it reasonable and comparable. In fulfilling its congressionally defined role, OFHEO does not set executive salaries or dictate an Enterprise's choice of a compensation structure. OFHEO seeks to carry out its responsibilities in this area in the most efficient and least burdensome manner. The regulation sets forth clear processes designed to meet OFHEO's oversight needs, including the submission by the Enterprises of relevant information on a timely basis.

Safety and Soundness Issues

Both Enterprises asserted that OFHEO's executive compensation authority is separate and distinct from its safety and soundness authority. One Enterprise referred to the legislative history of OFHEO's enabling statute, suggesting that Congress was not concerned that excessive compensation practices pose a financial threat to the Enterprises, *i.e.*, asserting that such practices do not present a safety and soundness concern. The other Enterprise stated that, unlike the federal bank regulators, OFHEO's executive compensation oversight is not tied to the regulated entities' financial condition.

One Enterprise argued that OFHEO does not have broad authority under its executive compensation oversight authorities and that OFHEO's rulemaking should not take the same approach to remedial and corrective actions employed to address safety and soundness concerns, *i.e.*, remedies that address a threat to the financial integrity or stability of a regulated institution.

OFHEO disagrees. The executive compensation practices of corporations are widely acknowledged to reflect the integrity of management and soundness of corporate governance practices, as indicators of safe and sound operation. OFHEO recognizes that in addition to its broad authority to oversee the safety and soundness of the Enterprises policies and practices, including executive compensation matters, the agency has specific responsibilities unlike those of the banking agencies to review

compensation and termination benefits of the Enterprises' executive officers. OFHEO may use its full range of preventative and remedial tools to address problems in this area, including rescission agreements and recovery. OFHEO has modified the language of the final rule to clarify the special nature of executive compensation under the statute and the range of supervisory tools it may employ, both formal and informal.

Confidentiality Concerns

One Enterprise stated that inadvertent release of nonpublic executive compensation information may cause competitive and economic harm. The Enterprise suggested that such information only be subject to on-site review.

OFHEO recognizes the sensitive, nonpublic nature of certain information submitted by the Enterprises regarding their executive compensation practices and OFHEO has established appropriate safeguards under its internal procedures and regulations and in line with applicable federal law. Restricted review of executive compensation information at an Enterprise would be contrary to past and current practice. The suggested restriction would result in a less effective and inefficient implementation of OFHEO's oversight responsibilities and could delay timely reviews sought by the Enterprises. The final regulation continues to require the timely submission of all relevant information by the Enterprises to OFHEO in the manner and format specified by OFHEO.

Section Comments

Definitions (§ 1770.3(g))

Both Enterprises made several suggestions to narrow the definition of the term "executive officer" in the proposed regulation. The proposed definition of the term "executive officer" included the chairman of the Board, chief executive officer, chief financial officer, president, vice chairman and any executive vice president, and added the position of chief operating officer, and any individual who performs functions similar to such positions whether or not the individual has an official title. Additionally, the proposed definition of term "executive officer" covered any senior vice president ("SVP") or other individual with similar responsibilities, without regard to title, who is in charge of a principal business unit, division or function, or who reports directly to the Enterprise's chairman of the Board, vice

¹² 65 FR 81771 (December 27, 2000).

chairman, president or chief operating officer.

One Enterprise argued that the proposed definition of executive officer is inconsistent with the plain language and intent of the Act and suggested a narrower definition. The Enterprise objected to defining the term "executive officer" by reference to job function and including consideration of individuals performing "similar responsibilities, without regard to title." The Enterprise suggested that the definition of "executive officer" be confined to those titled SVPs in charge of a principal business unit, division or function; and that all other provisions in the proposed definition should be deleted. It further stated that the statutory language "in charge of" should be read narrowly to mean managerial and policymaking authority and responsibilities; and that "principal" business means of "highest importance," similar to the term's definition as used in accounting.

Both Enterprises noted the past use by OFHEO of a reporting function to define the term "executive officer." They suggested that, if OFHEO determines to use a broad standard, OFHEO should look to the Enterprises' principal lines of business to identify officers who play a key role in management and policymaking decisions. They asserted that an approach limiting review to officers managing key business units would avoid unnecessary reviews of officers engaged in support or subsidiary functions.

After consideration of the comments, OFHEO has determined to retain the definition of the term "executive officer" set forth in the proposed regulation, with one modification. The final regulation adds a provision that the Director shall inform the Enterprises of those officers covered by the definition. This is intended to allow continued discussion between OFHEO and the Enterprises as to the appropriate coverage of particular officers under the regulation.

OFHEO has retained from the proposed regulation the determination that, under the Enterprises' current organizational structure, any officer who reports directly to the chairman of the Board, vice chairman, president or chief operating officer is deemed to be in charge of a principal business unit, division, or function and has an important policymaking role, regardless of his or her title. The Director of OFHEO has discretion to define coverage of SVPs under the term "executive officer" whenever warranted by changes in either Enterprise's organizational structure, position responsibilities or other relevant factors.

In response to one Enterprise's request for clarification, it is noted here that administrative and support staff, such as secretaries and special assistants who report directly to the chairman, vice chairman, *etc.*, are not considered to be executive officers for purposes of this regulation.

Submissions Requirements (§ 1770.4) Categories of Information Relating to Prohibition of Excessive Compensation (§ 1770.4(b))

Both Enterprises commented that § 1770.4(b)(1) and (2) of the proposed regulation appear to require the submission of committee and board minutes within a week after the meeting of either. The Enterprises recommended that OFHEO amend both paragraphs to require the submission of minutes only after they are finalized, that is, after the adoption of minutes at the next board or committee meeting.

For purposes of clarification, paragraph (b) has been amended in this final regulation to provide that information on actions relating to compensation by the board of directors or the committee of the board responsible for compensation that are *effective immediately* upon board or committee action should be submitted to OFHEO within a week (along with supporting materials). Otherwise, OFHEO expects information regarding compensation to be submitted within a week of adoption of minutes by the board or the committee responsible for compensation, as this is the normal effective date for board or committee actions, usually taken at the next meeting of these bodies.

In response to one Enterprise's request for clarification, the term "supporting materials" as used in § 1770.4(b)(1) and (2) of the proposed regulation is defined here to mean copies of compensation documents that are referenced in or are incorporated by reference in the board or in committee resolutions, *e.g.*, human resources documents and benefit plans of the Enterprise. Continuing existing OFHEO practice, the regulation exempts individual performance ratings from its submission requirements.

Both Enterprises objected to proposed paragraph (b)(8) of § 1770.4, which requires submission to OFHEO of information regarding the hiring and payment of compensation to an executive for whom a contract remains under negotiation. One Enterprise suggested that proposed paragraph (b)(8) is not consistent with § 1770.5(a), which authorizes employment contracts to be entered into prior to OFHEO approval, provided they contain notice of the

approval requirement. The Enterprise recommended that paragraph (b)(8) be deleted.

OFHEO agrees that paragraph (b)(8) is unnecessary and has deleted the paragraph from the final regulation. The requirements contained in § 1770.5(a) will govern any contract negotiated and entered into prior to OFHEO's approval.

Revisions to paragraph (b) in this final regulation include the following: materials required for submission under paragraphs (b)(1) and (2) of the proposed regulation are now contained in paragraphs (b)(1) through (3) of the final regulation, and paragraphs (b)(3) through (7) of the proposed regulation are redesignated as paragraphs (b)(4) through (8) in the final regulation.

Timing of Submissions Related to Prior Approval of Termination Benefits (§ 1770.4(c))

Both Enterprises made extensive comment regarding paragraph (c) of § 1770.4. The paragraph sets out when information relevant to the Director's prior approval of termination benefits should be submitted by an Enterprise to OFHEO. As proposed, the paragraph requires that the relevant information be provided to OFHEO when the Enterprise: (1) Enters into any agreement or contract with a new or existing executive officer that includes termination benefits; (2) makes any extension or other amendment to such an agreement or contract; (3) takes any other action to provide termination benefits to a specific executive officer, regardless of how effected; (4) makes any changes in post-employment benefit programs affecting multiple executive officers; or (5) changes the termination provisions of other compensation programs affecting multiple executive officers.

One Enterprise recommended the deletion of the requirement in § 1770.4(c)(1) that requires submission of information on an agreement between an Enterprise and a new or existing officer because, assertedly, most executive officers "are not terminated," but rather leave voluntarily. The commenter suggested that this would save OFHEO from reviewing hypothetical terminations. The Enterprise noted that it could choose to submit a termination agreement for a current executive officer for review by OFHEO at any time.

OFHEO disagrees with this argument. Prior approval by OFHEO is mandatory whenever an Enterprise enters into or changes an agreement or contract with a new or existing executive that contains provisions providing termination benefits. The legislative

history of the Act contains no indication that the term "termination" is limited to involuntary situations. OFHEO considers the specific benefits to which an officer would be entitled under those provisions at the end of his or her employment term and compares those termination benefits to the applicable standard. This determination includes consideration of the effect on termination benefits if the executive departs prior to the expiration of the employment term, either on a voluntary or an involuntary basis. The proposed submission requirements of § 1770.4(c)(1) are therefore retained in the final regulation.

Both Enterprises objected to the language of paragraphs (c)(4) and (5) of § 1770.4 relating to changes in post-employment programs and in the termination provisions of other compensation programs affecting multiple executive officers. They noted that, as drafted, the provisions suggest that OFHEO has prior approval authority over changes in any compensation or benefit plan or program provided to all officers or corporate-wide. The Enterprises requested clarification that the provisions cover only individual termination packages that provide special benefits to an executive officer under so-called "top hat" plans, as opposed to benefits provided to multiple officers under general welfare and benefit plans. One Enterprise further stated that prior approval by OFHEO is not required for executive compensation generally available to similarly situated executives which is received as part of annual compensation, even if it is to be paid post-employment, *e.g.*, pensions, deferred compensation, stock option plans, and retirees' health benefits. It recommended deleting reporting requirements for general welfare and benefit plans and relocating provisions (4) and (5) from paragraph (c) to paragraph (b), which addresses review of "excessive" compensation. The Enterprise also recommended that only "material" changes to covered plans and programs be submitted to OFHEO.

OFHEO has made several clarifications and modifications to the submissions section of the final regulation. Section 1770.4(c), addressing timing of submissions of information for review of termination benefits, has been revised. The revisions indicate that, except as provided under § 1770.5(a), an Enterprise must submit certain delineated information before entering into agreements, making amendments or taking other actions on termination benefits and when changes to

termination benefits are made that affect multiple executive officers. Paragraph (d) of § 1770.4 has been revised to make clear that such submissions need not include information on benefit plans of general applicability, as the statute only contemplates review of "golden parachute" and similar contracts or grants.

Further, for purposes of clarification, OFHEO notes that information submissions under paragraph (c), at the times stated under provisions (1) through (4)—paragraphs (4) and (5) being consolidated in the final regulation—enable OFHEO to determine an individual executive officer's termination benefits. The total payment or value derived from all such termination benefits are included in OFHEO's consideration of compensation. The final regulation makes clear that, while OFHEO has access to benefit plans of general applicability under its oversight authorities, they are not required to be submitted for purposes of prior approval under the consideration of termination benefits. As noted earlier, the intent of the statute and the regulation is to focus on so-called "top hat plans," golden parachutes and similar arrangements. Any change in such benefits may alter the value of the total termination benefits package. Notably, if a change in termination benefits affects an executive officer, the Enterprise may request OFHEO's consideration of the change in officer termination benefits, in the context of previously-granted termination benefits, either at that time or when the officer leaves the Enterprise.

Additionally, both Enterprises expressed concern that the language of paragraphs (c)(4) and (5) appears to suggest that OFHEO can review an officer's compensation twice (under the "excessive" standard in the Act and under the standard for prior approval of termination benefits in the charter acts). One Enterprise stated that such review could result in retroactive disapproval of previously awarded compensation, creating recruitment, retention, and constitutional issues. The other Enterprise asserted that reviewing twice would be contrary to congressional intent.

OFHEO's review authority extends both to the "compensation" and to the individualized termination benefits package provided to an executive officer by an Enterprise. The term "compensation" is broadly defined to include benefits to an executive officer that are derived from post-employment benefit plans or programs and other compensatory benefit arrangements

containing termination benefits, which affect the executive officer individually or as part of a group. As a result, OFHEO reviews the value of benefits provided under such plans, programs and arrangements on an ongoing basis in exercising its dual review authorities. OFHEO aggregates the benefits provided under such plans, programs and arrangements with all other payments of money or any other thing of current or potential value to determine whether an officer's overall "compensation" is excessive.

OFHEO also reviews termination benefits provided by such plans, programs and arrangements in exercising its prior approval authority. Such a review is performed when any agreement that includes termination benefits is entered into, as well as at the time the executive officer leaves his or her employment with an Enterprise, if there have been benefit enhancements or modifications since the time the package was agreed upon. Upon determining that an officer's termination benefits package, as previously approved by OFHEO, has not changed in structure or terms, such package will not be subject to subsequent review or disapproval.

Specific Information to Calculate Termination Benefits (§ 1770.4(d))

Paragraph (d) of § 1770.4 of the proposed regulation specifies what information the Enterprise is to submit and when in order for OFHEO to calculate an executive officer's termination benefits package. Both Enterprises commented that paragraph (d) seems to prevent them from entering into an agreement with a new or departing officer prior to OFHEO approval if that agreement contains individualized termination provisions. They suggested that this would be a departure from current practice and would impede their ability to hire expeditiously. They also asserted that such a requirement would be inconsistent with proposed § 1770.5(a), which authorizes employment contracts to be entered into prior to OFHEO approval, provided they contain notice of the approval requirement.

As noted above in response to the Enterprises' comments on proposed § 1770.4(b)(8), an employment agreement subject to OFHEO's prior approval may be entered into prior to that approval, provided that such agreement satisfies the notice requirements set forth in § 1770.5(a).

One Enterprise requested clarification on paragraph (d)(1), which requires submission of details of a program change before entering into an

agreement containing termination provisions. The Enterprise suggested that the requirement not apply to programmatic benefits available to executives as part of their total compensation, but to "individualized departures" from programmatic termination benefits.

As noted above, in response to the Enterprises' comments on proposed § 1770.4(c)(4) and (5), paragraph (d) has been clarified in the final regulation to provide that submissions need not include information on benefit plans of general applicability, such as so-called 401(k) plans or general health plans.

Compliance (§ 1770.5)

One Enterprise requested deletion of proposed § 1770.5(b), which would require the Enterprises to adopt written procedures implementing the regulation's submission requirements, as unwarranted "micro-management" of the Enterprises' internal procedures. It further asserted that the regulation's force of law and the enforcement remedies of paragraph (d) are sufficient to ensure compliance without the need for written procedures.

OFHEO agrees that the regulation need not require written procedures implementing the submission requirements contained in § 1770.4. Therefore, paragraph (b) has been deleted from this final regulation. Paragraphs (c) and (d) have been consolidated and redesignated as paragraph (b) in the final regulation. Failure by an Enterprise to comply with the requirements of this regulation may warrant remedial action. OFHEO has broad formal and informal authorities to remedy problems and to enforce its determinations, including rescission agreements and recovery.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

This regulation is not classified as a significant rule under Executive Order 12866 because it will 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 and this final regulation has not been submitted to the

Office of Management and Budget for review.

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 this final regulation under the Regulatory Flexibility Act. The General Counsel of OFHEO certifies that the rule, as herein adopted, is not likely to have a significant economic impact on a substantial number of small business entities because the regulation only affects the Enterprises.

Paperwork Reduction Act

This final regulation does not contain any information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

Unfunded Mandates Reform Act of 1995

This final regulation does not require the preparation of an assessment statement in accordance with the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1531. Assessment statements are not required for regulations that incorporate requirements specifically set forth in law. As explained in the preamble, this regulation implements specific statutory requirements. In addition, this regulation does not include a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year.

List of Subjects in 12 CFR Part 1770

Administrative practice and procedure, Confidential business information, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, OFHEO adds 12 CFR part 1770 to subchapter C to read as follows:

PART 1770—EXECUTIVE COMPENSATION

Sec.

- 1770.1 Authority and scope.
- 1770.2 Purpose.
- 1770.3 Definitions.
- 1770.4 Submission requirements.
- 1770.5 Compliance.

Authority: 12 U.S.C. 1452(h)(2), 1723a(d)(3)(B), 4501(6), 4502(3), 4502(7), 4513, 4514, 4517, 4518(a), 4631, 4632, 4636, 4641.

§ 1770.1 Authority and scope.

(a) *Authority.* Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, entitled the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("the Act") (12 U.S.C. 4501 *et seq.*), established the Office of Federal Housing Enterprise Oversight ("OFHEO") as an independent office within the Department of Housing and Urban Development. In general, OFHEO is the safety and soundness regulator of two housing-related government sponsored enterprises: the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the Enterprises"). The supervisory responsibilities of the Director of OFHEO (the "Director") include oversight of compensation provided by the Enterprises to their executive officers.

(b) *Scope.* The procedures set forth in this part apply to OFHEO's oversight of executive compensation under the following two statutory mandates:

(1) *Prohibition of excessive compensation.* The Act requires the Director to prohibit an Enterprise from providing compensation to any executive officer that is not reasonable and comparable with that paid by other similar businesses to executives doing similar work, *i.e.*, having similar duties and responsibilities. Businesses used for comparison purposes include publicly held financial institutions or major financial services companies. (12 U.S.C. 4518(a)). To effectuate this compensation oversight responsibility, the Act provides that the Director has full authority to take such actions as the Director determines are necessary. (12 U.S.C. 4513(8)). However, the Director may not prescribe or set a specific level or range of compensation for executive officers of the Enterprises. (12 U.S.C. 4518(b)).

(2) *Prior approval of termination benefits.* The Enterprises' enabling statutes ("charter acts") similarly provide that an Enterprise may not enter into any agreement or contract to provide any payment of money or other

thing of current or potential value in connection with the termination of employment of an executive officer unless the agreement or contract is approved in advance by the Director. The Director may only approve termination benefits that are comparable to benefits provided by other public or private entities involved in financial services and housing interests to executives with comparable duties and responsibilities. Agreements or contracts that provide for termination payments to executives that were entered into before October 28, 1992 are not retroactively subject to approval or disapproval by the Director. However, a renegotiation, amendment or change to such an agreement or contract entered into on or before October 28, 1992 shall be considered as entering into an agreement or contract that is subject to approval by the Director. (Section 309(d)(3)(B); 12 U.S.C. 1723a(d)(3)(B) of Fannie Mae's Charter Act; Section 303(h)(2); 12 U.S.C. 1452(h)(2) of Freddie Mac's Corporation Act)

§ 1770.2 Purpose.

In exercising responsibilities related to executive compensation, the Director has established a structured process for the submission of relevant information by each Enterprise. This part codifies those procedures and clarifies the terms used therein in order to facilitate and enhance the efficiency of OFHEO's oversight.

§ 1770.3 Definitions.

The following definitions apply to the terms used in this part:

(a) *The Act* is Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, Oct. 28, 1992, 106 Stat. 3672, 3941 through 4012 (1993), 12 U.S.C. 4501 *et seq.*, separately entitled the "Federal Housing Enterprises Financial Safety and Soundness Act of 1992."

(b) *Affiliate* means, except as provided by the Director, any entity that controls, is controlled by, or is under common control with, an Enterprise.

(c) *Charter 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.

(d) *Compensation* means any payment of money or the provision of any other thing of current or potential value in connection with employment. Compensation includes all direct and indirect payments of benefits, both cash and non-cash, granted to or for the benefit of any executive officer,

including, but not limited to, payments and benefits derived from an employment contract compensation or benefit agreement, fee arrangement, perquisite, stock option plan, post employment benefit or other compensatory arrangement.

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

(f) *Enterprise* means the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation and, except as provided by the Director, any affiliate thereof.

(g)(1) *Executive officer* means, with respect to an Enterprise:

(i) The chairman of the board of directors, chief executive officer, chief financial officer, chief operating officer, president, vice chairman, any executive vice president, and any individual who performs functions similar to such positions whether or not the individual has an official title; and

(ii) Any senior vice president (SVP) or other individual with similar responsibilities, without regard to title:

(A) Who is in charge of a principal business unit, division or function, or

(B) Who reports directly to the Enterprise's chairman of the board of directors, vice chairman, president or chief operating officer.

(2) The Director shall inform the Enterprises of those officers covered by this definition.

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

§ 1770.4 Submission requirements.

(a) *Submission of information to OFHEO.* All information required to be filed for purposes of this part is to be provided in a timely fashion by each Enterprise to OFHEO's Associate Director of the Office of Policy Analysis and Research, as specified in this section, or as designated by the Director.

(b) *Categories of information relating to prohibition of excessive compensation.* The following materials, unless otherwise specified, shall be provided by each Enterprise to OFHEO for review within one week after the specified action or event:

(1) Resolutions, including supporting materials and related reports, from meetings of the Enterprise's committee responsible for compensation when the committee takes any action regarding a compensation matter that under the committee's authority is effective without further action by the committee or the board of directors;

(2) Resolutions, including supporting materials and related reports (not otherwise provided to OFHEO under paragraph (b)(1) of this section), from meetings of the board of directors

relating to executive compensation when the board of directors takes any action regarding a compensation matter that is effective without any further action by the board of directors;

(3) Minutes, including supporting materials and related reports, when adopted by the committee responsible for compensation and those portions of minutes of the board of directors, including supporting materials and related reports, related to compensation matters (except for materials previously provided under paragraphs (b)(1) or (2) of this section);

(4) General benefit plans applicable to executive officers when adopted or amended;

(5) Any study conducted by or on behalf of an Enterprise with respect to compensation of executive officers;

(6) The Enterprise's annual compensation report to Congress when submitted;

(7) A current organizational chart when changes occur affecting the status of executive officers under this part;

(8) Proxy statements when issued; and,

(9) Such other information as deemed appropriate by the Director, except that submissions required under this paragraph shall not include materials related to the performance of specific individuals.

(c) *Timing of submissions related to prior approval of termination benefits.* All relevant information, except as provided under § 1770.5(a), should be provided to OFHEO, unless already provided under paragraph (b) of this section:

(1) Before an Enterprise enters into any agreement or contract with a new or existing executive officer that includes termination benefits;

(2) Before an Enterprise makes any extension or other amendment to such an agreement or contract;

(3) Before an Enterprise takes any other action to provide termination benefits to a specific executive officer, regardless of how effected; or

(4) When an Enterprise makes any changes to the termination provisions of any compensation or benefit program affecting multiple executive officers.

(d) *Specific information required for calculation of termination benefits.* For submissions under paragraph (c) of this section, an Enterprise shall submit to OFHEO the following materials:

(1) The details of the agreement or program change, e.g., employment agreements, termination agreements, severance agreements, and portions of minutes of the board of directors relating to executive compensation and minutes and supporting materials of the

compensation Committee of the board of directors;

(2) All information, data, assumptions and calculations for the potential total dollar value or range of values of the benefits provided, such as but not limited to salary, bonus opportunity, short-term incentives, long-term incentives, special incentives and pension provisions or related contract or benefit terms; and

(3) Such other information deemed appropriate by the Director, except that information required to be submitted under paragraph (c) of this section or under this paragraph shall not include information on benefit plans of general applicability.

§ 1770.5 Compliance.

(a) An employment agreement or contract subject to the Director's prior approval, as set forth in § 1770.1(b)(2), may be entered into prior to that approval, *provided that* such agreement or contract specifically provides that termination benefits under the agreement or contract shall not be effective and no payments shall be made thereunder unless and until approved by OFHEO. Such notice should make clear that alteration of benefit plans subsequent to OFHEO approval under this section, that affect final termination benefits of an executive officer, requires review at the time of the individual's termination from the Enterprise and prior to the payment of any benefits.

(b) Failure by an Enterprise to comply with the requirements this regulation

may warrant remedial action by OFHEO. Such action may be taken in the form determined appropriate by the Director and may be taken separately from, in conjunction with, or in addition to any other corrective or remedial action, including an enforcement action to require an individual to make restitution to or reimbursement to the Enterprise of excessive compensation or inappropriately paid termination benefits.

Dated: September 4, 2001.

Armando Falcon, Jr.,

Director, Office of Federal Housing Enterprise Oversight.

[FR Doc. 01-22926 Filed 9-11-01; 8:45 am]

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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:** Proposed 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 proposing a regulation to set forth minimum requirements with respect to corporate governance practices and procedures of the Enterprises.

DATES: Written comments on the proposed regulation must be received by November 13, 2001.

ADDRESSES: Send written comments concerning the proposed regulation to Alfred M. Pollard, General Counsel, Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. Written comments may also be sent to Mr. Pollard by electronic mail at RegComments@OFHEO.gov. OFHEO requests that written comments submitted in hard copy also be accompanied by the electronic version in MS Word© or in portable document format (PDF) on 3.5" disk.

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:**Comments**

OFHEO invites comments on all aspects of the proposed regulation, including legal and policy considerations, and will take all comments into consideration before issuing the final regulation. Copies of all comments will be posted on the OFHEO Internet web site at <http://www.ofheo.gov>. In addition, copies of

all comments received will be available for examination by the public at the Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

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 (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 and the Federal Home Loan Mortgage Corporation (collectively, the Enterprises) are adequately capitalized and operate safely and in compliance with applicable laws, rules, and regulations.

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 the means of attaining those objectives and monitoring performance. In recent years, regulators, investor organizations, stock exchanges, and corporations themselves have increased their focus on the importance of good corporate governance practices and procedures to ensure the long-term success of corporations.

OFHEO recognizes that good corporate governance practices and procedures are essential to the safe and sound operations of the Enterprises and accomplishment of their public policy purposes. Thus, corporate governance is one category of risk and risk management that is examined by OFHEO under its annual risk-based examination program. The proposed regulation builds upon the annual risk-based examination program in that it sets forth basic safety and soundness standards for corporate governance with which the Enterprises are required to comply. The proposed corporate governance practices and procedures are substantively similar to those required by Federal banking agencies with respect to the regulated financial institutions. To a large extent, the corporate governance requirements set forth in the proposed regulation reflect the current practices of the Enterprises and the supervisory standards of OFHEO. The Enterprises must be able to continue to attract and retain the highest caliber of board members and executive officers.

Section-by-Section Analysis*Subpart A—General**Section 1710.1 Purpose*

OFHEO is responsible under the Act for ensuring the safety and soundness of the Enterprises. In furtherance of that responsibility, proposed § 1710.1 provides that the purpose of the proposed regulation is to set forth minimum requirements with respect to the corporate governance practices and procedures of the Enterprises.

Section 1710.2 Definitions

Proposed § 1710.2 sets forth the definitions of terms used in the proposed regulation. The term:

Act is proposed to mean 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.*).

Agent is proposed to mean any person, other than a board member, executive officer, or employee of an Enterprise, who acts on behalf or for the benefit of an Enterprise, such as representing an Enterprise in contacts with third parties or providing professional services to an Enterprise.

Board member is proposed to mean a member of the board of directors; and, for purposes of subpart D, "board member" is proposed to include a current or former board member.

Board of directors is proposed to mean the board of directors of an Enterprise.

Chartering acts is proposed to 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.

Compensation is proposed to mean any payment of money or the provision of any other thing of current or potential value in connection with employment. The term "compensation" is also proposed to include 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.

Conflict of interest is proposed to mean 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.

Director means the Director of OFHEO or his or her designee.

Employee is proposed to mean a salaried individual, other than an executive officer, who works part-time, full-time, or temporarily for an Enterprise.

Enterprise is proposed to mean the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation; and the term "Enterprises" is proposed to mean, collectively, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Entity is proposed to mean a corporation, company, association, firm, joint venture, general or limited partnership, society, joint stock company, fund, or other organization or institution.

Executive officer is proposed to mean any senior executive officer and any senior vice president or individual with similar responsibilities, without regard to title, who is in charge of a principal business unit, division, or function, or who reports directly to the chairperson, vice chairperson, chief operating officer, or president; and, for purposes of subpart D, "executive officer" is proposed to include a current or former executive officer.

Independent board member is proposed to mean a board member who meets the criteria for independence under the NYSE rules for audit committee members, regardless of the committee(s) on which the board member serves.

Legal expenses is proposed to mean, with respect to a claim, proceeding, or action, the amount of legal or other professional fees and expenses, and the amount of, and any cost incurred in connection with a penalty, fine, assessment, judgment, or settlement.

NYSE means the New York Stock Exchange.

OFHEO means the Office of Federal Housing Enterprise Oversight.

Payment, for purposes of subpart D of this part, is proposed to mean:

- (1) Direct or indirect transfer of funds or assets;
- (2) Forgiveness of a debt or other obligation;
- (3) Conferment of a benefit, including but not limited to stock options and stock appreciation rights; and
- (4) Segregation of funds or assets, establishment or funding of a trust, or purchase of or arrangement for a letter of credit or other instrument, for the purpose of making, or pursuant to an agreement to make, a payment on or after the date on which such funds or

assets are segregated, such trust is established, or such letter of credit or other instrument is made available, without regard to whether the obligation to make such payment is contingent on the determination, after such date, of the liability for the payment of such amount or the liquidation of the amount of such payment.

Person is proposed to mean an individual or entity.

Senior executive officer is 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.

Sections 1710.3–1710.9

Sections 1710.3 through 1710.9 are proposed to be reserved.

Subpart B—Corporate Practices and Procedures

Section 1710.10 Applicable Law

Congress established the Enterprises as privately owned corporations, imbued with private and public purposes, to be managed by their respective boards of directors. To dispel any legal uncertainty as to whether and to what extent State or Federal law applies to corporate governance practices and procedures of the Enterprises, proposed § 1710.10 would require that each Enterprise elect to follow and be bound by a specified body of corporate governance law to the extent such law is not inconsistent with applicable Federal law, rules, or regulations, including the standards proposed here. Specifically, the proposal requires the Enterprise to elect either the law of the jurisdiction in which its principal office is located, Delaware General Corporation Law, or the Model Business Corporation Act. The Enterprise is required to specify its election in its bylaws.

The proposed approach provides the Enterprises with flexibility in structuring their corporate governance practices and procedures while at the same time providing shareholders and other interested parties with certainty as to the body of corporate law applicable to each Enterprise.

OFHEO requests comments as to whether the choice of law to be elected should be narrower or broader than proposed. More particularly, should the law of the jurisdiction where the principal office of the Enterprise is located be the applicable law? Should the Delaware General Corporation Law

and the Model Business Corporation Act be permissible alternatives? Should Federal law or agency-promulgated standards be the sole legal basis for corporate governance practices and procedures of the Enterprises?

Section 1710.11 Committees of Board of Directors

Proposed § 1710.11 provides that an Enterprise may establish committees of the board of directors, in addition to the minimally required audit and compensation committees. No committee is to have the authority of the board of directors to amend the bylaws and no committee is to operate to relieve the board of directors or any board member of any responsibility imposed by applicable laws, rules, and regulations. In addition, proposed § 1710.11 requires that each Enterprise provide in its bylaws for the establishment of audit and compensation committees, however styled.¹

The proposed section requires that the audit committee comply with all NYSE rules with respect to the audit committee, including charter, independence, composition, and expertise requirements.² The NYSE rules are adequate to ensure an effective and independent audit committee without further supplementation by OFHEO. Furthermore, since both Enterprises are listed with the NYSE, the Enterprises should not need to make changes to their respective audit committees to comply with the requirements of proposed § 1710.11.

The compensation committee is proposed to be comprised of at least three independent board members. The proposed duties of the compensation committee include ensuring that compensation plans for executive officers and employees comply with applicable laws, rules, and regulations and approving the compensation of senior executive officers.

OFHEO specifically requests comments as to whether the definition of the term "independent board member" in proposed § 1710.2 is appropriate to use with respect to the

¹ The importance of an independent audit committee has received increased attention by recent publications, including the *Recommendation of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, sponsored by the NYSE and the National Association of Securities Dealers, which can be accessed at <http://www.nyse.com> or <http://www.nasd.com>.

² The NYSE rules applicable to audit committees are in sections 303.01 and 303.02 of the NYSE Listed Company Manual, which can be accessed at <http://www.nyse.com>.

independence of board members of the compensation committee.

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

Proposed § 1710.12 requires that the compensation of board members, executive officers, and employees be reasonable and commensurate with their duties and responsibilities and comply with applicable laws, rules, and regulations.³

Section 1710.13 Quorum of Board of Directors; Proxies Not Permissible

Proposed § 1710.13 requires 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.

Section 1710.14 Conflict-of-Interest Standards

Proposed § 1710.14 requires that each Enterprise establish and administer written conflict-of-interest standards that will provide reasonable assurance that the board members, executive officers, employees, and agents of the Enterprise discharge their responsibilities in an objective and impartial manner.

Sections 1710.15–1710.19

Sections 1710.15 through 1710.19 are proposed to be reserved.

Subpart C—Responsibilities of Board of Directors

Section 1710.20 Conduct of Board Members

Proposed § 1710.20 sets forth the standards that board members must follow in conducting the business of the Enterprise. In addition to devoting sufficient time to his or her duties and responsibilities, each board member 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 acts of the Enterprises and other applicable laws, rules, and regulations.

This proposed section is based on current legal standards embodied in State law and the Model Business Corporation Act.

Section 1710.21 Responsibilities of Board of Directors

Proposed § 1710.21 sets forth the responsibilities of the board of directors. 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, including, at a minimum:

- (1) Reviewing and overseeing corporate strategy, major plans of action, and risk policy as well as monitoring corporate performance;
- (2) Hiring and retaining qualified senior executive officers and overseeing succession planning for such senior executive officers;
- (3) Ensuring that compensation plans for executive officers and employees comply with applicable law, rules, and regulations and approving the compensation of board members and senior executive officers.

(4) Ensuring the integrity of the accounting and financial reporting systems of the Enterprise, including independent audits, and that appropriate systems of control are in place to identify and monitor risk and compliance with the chartering acts of the Enterprises and other applicable laws, rules, and regulations;

(5) Remaining informed of the condition, activities, and operations of the Enterprise;

(6) Overseeing the process and adequacy of reporting, disclosures, and communications to shareholders, investors, and potential investors; and

(7) Ensuring the 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.

The proposed section also notes that the board of directors should refer to publications of and formal pronouncements by OFHEO for guidance on the responsibilities of the board of directors.⁴ The proposed section is based on current OFHEO supervisory standards as well as State laws and the Model Business Corporation Act.

Sections 1710.22–1710.29

Sections 1710.22 through 1710.29 are proposed to be reserved.

Subpart D—Indemnification Payments
§ 1710.30 Permitted Indemnification Payments

Proposed § 1710.30 delineates the circumstances under which an Enterprise may make or agree to make indemnification payments. In proposing this section, OFHEO has considered the likely effect of such delineation on the ability of the Enterprises to attract and retain competent board members, executive officers, employees, and agents, and defers to applicable law in connection with actions not initiated or undertaken by OFHEO.

OFHEO considers an administrative proceeding to be initiated or undertaken by the issuance of a notice of charges. With respect to administrative proceedings initiated or undertaken by OFHEO, the proposed section permits an Enterprise to make or to agree to make indemnification payments, which are not prohibited under proposed § 1710.31, to a board member or executive officer, if the following two criteria are met:

(1) The board of directors of the Enterprise, in good faith, determines in writing after due investigation and consideration that the board member or executive officer acted in good faith and in a manner he or she believed to be in the best interests of the Enterprise and that the indemnification payment will not materially adversely affect the safety and soundness of the Enterprise; and

(2) The board member or executive officer agrees in writing to reimburse the Enterprise, to the extent the Enterprise is not covered by a commercial insurance policy or similar coverage, for that portion of any indemnification payment that subsequently becomes a prohibited indemnification payment under proposed § 1710.31.

In connection with an administrative proceeding initiated or undertaken by OFHEO, proposed § 1710.30 provides that the board member or executive officer requesting an indemnification payment is not to participate in any way in the discussion of the board of directors and approval of such payment. It does, however, provide that the board member or executive officer may present the request for indemnification to the board of directors and respond to any inquiries from the board of directors concerning his or her involvement in the circumstances giving rise to the administrative proceeding.

If a majority of board members are named as respondents in an administrative proceeding initiated or undertaken by OFHEO and request indemnification, proposed § 1710.30 provides that the remaining board

³OFHEO has issued a proposed regulation with respect to the compensation of executive officers at 65 FR 81771 (Dec. 27, 2000).

⁴For example, the *OFHEO Examination Handbook*, published at <http://www.ofheo.gov>, provides information and sets forth the examination criteria with respect to responsibilities of the board of directors.

members may authorize independent legal counsel to review the indemnification request and provide the remaining board members with a written opinion of counsel as to whether the two criteria for payment, noted above, are met. If the opinion of counsel concludes that the criteria have been met, the remaining board members may rely on the opinion in authorizing the requested indemnification.

Likewise, if all of the board members are named as respondents in an administrative proceeding and request indemnification, proposed § 1710.30 provides that the board of directors is to authorize independent legal counsel to review the indemnification request and provide the board of directors with a written opinion of counsel as to whether the two criteria have been met. If the opinion of counsel concludes that the criteria have been met, the board of directors may rely on such opinion in authorizing the requested indemnification.

These proposed procedures address the conflicts inherent in situations where the majority or all of the board members are subjects of an administrative proceeding. The use of independent legal counsel provides for an unbiased review of the two criteria necessary to approve indemnification and does not impose an undue hardship on the Enterprise. The board members may, of course, decline to approve the indemnification request despite a favorable opinion of legal counsel. OFHEO would consider legal counsel to be independent for purposes of the proposed section if the legal counsel is not a member of the legal staff of the Enterprise, does not have a recent or ongoing relationship with the Enterprise or any of its board members or senior executive officers, and has no other conflict of interest.

In a civil action or an administrative proceeding not initiated or undertaken by OFHEO, the proposed section authorizes an Enterprise to provide for payment to any board member, executive officer, employee, or agent of the Enterprise of legal expenses, in accordance with applicable law, provided that such payment is consistent with the safe and sound operations of the Enterprise.

Section 1710.31 Prohibited Indemnification Payments

Proposed § 1710.31 addresses when indemnification is prohibited in connection with an administrative proceeding that OFHEO initiates or undertakes. Thus, the proposed section does not permit an Enterprise or any affiliate of an Enterprise to make or

agree to make, with certain exceptions, any payment to indemnify a board member or executive officer for any legal expense incurred in connection with an administrative proceeding initiated or undertaken by OFHEO that results in a final order or settlement pursuant to which such 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.

The proposed exceptions to this prohibition are that an Enterprise may make a reasonable payment that:

(1) Is used to purchase a commercial insurance policy or similar coverage; provided, that such insurance policy or similar coverage is not used to indemnify a board member or executive officer for the cost of any civil money penalty assessed against him or her in an administrative proceeding initiated or undertaken by OFHEO, but may be used to pay other legal expenses incurred in connection with such administrative proceeding or the amount of any restitution to the Enterprise; or

(2) Represents partial indemnification for legal expenses specifically attributable to particular charges for which there has been a formal and final adjudication or finding in connection with a settlement that the board member or executive officer has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty.

With respect to the second exception noted above, OFHEO recognizes that the appropriate amount of any partial indemnification may be difficult to ascertain with certainty. OFHEO, nevertheless, is of the opinion that the permissibility of partial indemnification is more equitable than an all or nothing approach.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

The proposed regulation is not classified as a 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 and this proposed regulation has not been submitted to the Office of Management and Budget for review.

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 proposed regulation under the Regulatory Flexibility Act. The General Counsel of OFHEO certifies that the proposed regulation, if adopted, is not likely to have a significant economic impact on a substantial number of small business entities because the regulation 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 proposes to add subchapter B to 12 CFR chapter XVII as follows:

Subchapter B—Corporate Governance

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 Applicable law.

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.

1710.15–1710.19 [Reserved]

Subpart C—Responsibilities of Board of Directors

1710.20 Conduct of board members.

1710.21 Responsibilities of board of directors.

1710.22–1710.29 [Reserved]

Subpart D—Indemnification Payments

1710.30 Permitted indemnification payments.

1710.31 Prohibited indemnification payments.

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

Subpart A—General**§ 1710.1 Purpose.**

OFHEO is responsible under the Act for ensuring the safety and soundness of the Enterprises. In furtherance of that responsibility, this part sets forth minimum requirements 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) *Agent* means any person, other than a board member, executive officer, or employee of an Enterprise, who acts on behalf or for the benefit of an Enterprise, such as representing an Enterprise in contacts with third parties or providing professional services to an Enterprise.

(c) *Board member* means a member of the board of directors; and, for purposes of subpart D of this part, the term “board member” includes a current or former board member.

(d) *Board of directors* means the board of directors of an Enterprise.

(e) *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.

(f) *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.

(g) *Conflict of interest* means 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.

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

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

(j) *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.

(k) *Entity* means a corporation, company, association, firm, joint venture, general or limited partnership, society, joint stock company, fund, or other organization or institution.

(l) *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; and, for purposes of subpart D of this part, the term “executive officer” includes a current or former executive officer.

(m) *Independent board member* means a board member who meets the criteria for independence under the NYSE rules for audit committee members, regardless of the committee(s) on which the board member serves.

(n) *Legal expenses* means, with respect to a claim, proceeding, or action, the amount of legal or other professional fees and expenses, and the amount of, and any cost incurred in connection with a penalty, fine, assessment, judgment, or settlement.

(o) *NYSE* means the New York Stock Exchange.

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

(q) *Payment*, for purposes of subpart D of this part, means:

(1) Direct or indirect transfer of funds or assets;

(2) Forgiveness of a debt or other obligation;

(3) Conferment of a benefit, including but not limited to stock options and stock appreciation rights; and

(4) Segregation of funds or assets, establishment or funding of a trust, or purchase of or arrangement for a letter of credit or other instrument, for the purpose of making, or pursuant to an agreement to make, a payment on or after the date such funds or assets are segregated, such trust is established, or such letter of credit or such other

instrument is made available, without regard to whether the obligation to make such payment is contingent on the determination, after such date, of the liability for such payment or the liquidation of the amount of such payment.

(r) *Person* means an individual or entity.

(s) *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 Applicable law.**

(a) *Election.* Each Enterprise shall elect to follow and be bound by the corporate governance practices and procedures of one of the following bodies of law, to the extent such procedures are not inconsistent with safety and soundness and applicable Federal law, rules, and regulations:

(1) Law of the jurisdiction in which the principal office of the Enterprise is located;

(2) Delaware General Corporation Law, Del. Code Ann. tit. 8, as amended; or

(3) Model Business Corporation Act, as amended.

(b) *Designation.* Each Enterprise shall designate in its bylaws the body of law elected pursuant to paragraph (a) of this section within 90 calendar days from the effective date of this part.

§ 1710.11 Committees of board of directors.

(a) *Committees.* An Enterprise may provide in its bylaws for the establishment of committees of the board of directors, in addition to the audit and compensation committees required under paragraph (b) of this section. 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 any responsibility imposed by applicable laws, rules, and regulations.

(b) *Audit and compensation committees.* Each Enterprise shall provide in its bylaws, within 90 calendar days after the effective date of this part, for the establishment of the following committees, however styled:

(1) 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.

(2) A compensation committee, comprised of at least three independent board members, whose duties include, at a minimum, ensuring that compensation plans for executive officers and employees comply with applicable laws, rules, and regulations 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 the effective date of this part, 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.

§ 1710.14 Conflict-of-interest standards.

Each Enterprise shall establish and administer written conflict-of-interest standards that will provide reasonable assurance that the board members, executive officers, employees, and agents of the Enterprise discharge their responsibilities in an objective and impartial manner.

§§ 1710.15–1710.19 [Reserved]

Subpart C—Responsibilities of Board of Directors

§ 1710.20 Conduct of board members.

(a) *Actions.* Each member of the board of directors of an Enterprise, in conducting the business of the Enterprise, shall 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.

(b) *Time.* Each board member of an Enterprise shall devote sufficient time and attention to his or her responsibilities in conducting the business of the Enterprise.

§ 1710.21 Responsibilities of board of directors.

(a) *Responsibilities.* 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, including, at a minimum:

(1) Reviewing and overseeing corporate strategy, major plans of action, risk policy, as well as monitoring corporate performance;

(2) Hiring and retaining qualified senior executive officers and overseeing succession planning for such senior executive officers;

(3) Ensuring that compensation plans for executive officers and employees comply with applicable law, rules, and regulations and approving the compensation of board members and senior executive officers;

(4) Ensuring the integrity of the accounting and financial reporting systems of the Enterprise, including independent audits, and that appropriate systems of control are in place to identify and monitor risk and compliance with the chartering act of the Enterprise and other applicable laws, rules, and regulations;

(5) Remaining informed of the condition, activities, and operations of the Enterprise;

(6) Overseeing the process and adequacy of reporting, disclosures, and communications to shareholders, investors, and potential investors; and

(7) Ensuring the 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.

(b) *Additional guidance.* The board of directors should refer to publications of and formal pronouncements of OFHEO for guidance on the responsibilities of the board of directors.

§§ 1710.22–1710.29 [Reserved]

Subpart D—Indemnification Payments

§ 1710.30 Permitted indemnification payments.

(a) *OFHEO administrative proceedings.* (1) Except as provided in § 1710.31, an Enterprise may make or agree to make indemnification payments to a board member or executive officer of the Enterprise with respect to legal expenses incurred in connection with an administrative proceeding initiated or undertaken by OFHEO, if:

(i) The board of directors of the Enterprise, in good faith, determines in writing after due investigation and consideration that the board member or executive officer acted in good faith and

in a manner he or she believed to be in the best interests of the Enterprise and that the indemnification payment will not materially adversely affect the safety and soundness of the Enterprise; and

(ii) The board member or executive officer agrees in writing to reimburse the Enterprise, to the extent the Enterprise is not covered by any commercial insurance policy or similar coverage, for that portion of an indemnification payment that subsequently becomes a prohibited indemnification payment under § 1710.31.

(2) In connection with an administrative proceeding initiated or undertaken by OFHEO:

(i) The board member or executive officer requesting an indemnification payment shall not participate in any way in the discussion of the board of directors and approval of such payment; provided, however, that such board member or executive officer may present the request for indemnification to the board of directors and respond to any inquiries from the board of directors concerning his or her involvement in the circumstances giving rise to the administrative proceeding.

(ii) In the event that a majority of the board members are named as respondents, the remaining board members may authorize independent legal counsel to review the indemnification request and provide the remaining board members with a written opinion of counsel as to whether the conditions delineated in paragraph (a)(1) of this section have been met. If the opinion of counsel concludes that such conditions have been met, the remaining members of the board of directors may rely on the opinion in authorizing the requested indemnification.

(iii) In the event that all of the board members are named as respondents, the board of directors shall authorize independent legal counsel to review the indemnification request and provide the board with a written opinion of counsel as to whether the conditions delineated in paragraph (a)(1) of this section have been met. If the opinion of counsel concludes that such conditions have been met, the board of directors may rely on the opinion in authorizing the requested indemnification.

(b) *Other civil actions or administrative proceedings.* In cases involving a civil action or an administrative proceeding not initiated or undertaken by OFHEO, an Enterprise may provide for payment to any board member, executive officer, employee, or agent of the Enterprise of legal expenses in accordance with applicable law, provided that such payment will not

materially adversely affect the safety and soundness of the Enterprise.

§ 1710.31 Prohibited indemnification payments.

(a) *Prohibited indemnification payments.* An Enterprise or any affiliate of an Enterprise may not make, except as provided in paragraph (b) of this section, any payment to indemnify any board member or executive officer for any legal expense incurred in connection with an administrative proceeding initiated or undertaken by OFHEO that results 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.

(b) *Exceptions.* An Enterprise may make a reasonable payment that:

(1) Is used to purchase any commercial insurance policy or similar coverage; provided, however, that such insurance policy or similar coverage shall not be used to indemnify a board member or executive officer for the cost of any civil money penalty assessed against him or her in an administrative proceeding initiated or undertaken by OFHEO, but may be used to pay other legal expenses incurred in connection with such administrative proceeding or to pay the amount of any restitution to the Enterprise; or

(2) Represents partial indemnification for legal expenses specifically attributable to particular charges for which there has been a formal and final adjudication or a finding in connection with a settlement that the board member or executive officer has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty.

Dated: September 4, 2001.

Armando Falcon, Jr.,

Director, Office of Federal Housing Enterprise Oversight.

[FR Doc. 01-22925 Filed 9-11-01; 8:45 am]

BILLING CODE 4220-01-U

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

12 CFR Part 1773

RIN 2550-AA21

Flood Insurance

AGENCY Office of Federal Housing Enterprise Oversight, HUD.

ACTION: Proposed regulation.

SUMMARY: The Office of Federal Housing Enterprise Oversight (“OFHEO”) is proposing a regulation to codify the authority and responsibility of OFHEO to oversee and enforce the statutory requirements affecting the operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation under the National Flood Insurance Reform Act of 1994, and to effect congressionally mandated adjustments to the civil money penalties applicable to violations of that law.

DATES: Comments regarding this notice of proposed rulemaking must be received in writing on or before October 12, 2001.

ADDRESSES: Send written comments to Alfred M. Pollard, General Counsel, Office of General Counsel, Office of Federal Housing Enterprise Oversight, 1700 G Street, NW., Fourth Floor, Washington, DC 20552. Written comments may also be sent by electronic mail at RegComments@ofheo.gov. OFHEO requests that written comments submitted in hard copy also be accompanied by the electronic version in MS Word or in portable document format (pdf) on 3.5” disk.

FOR FURTHER INFORMATION CONTACT: David A. Felt, Associate General Counsel, Office of General Counsel, Office of Federal Housing Enterprise Oversight, 1700 G Street, NW., Fourth Floor, Washington, DC 20552, telephone (202) 414-3750 (not a toll-free number). The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

Comments

OFHEO invites comments on all aspects of the proposed regulation, including legal and policy considerations, and will take all comments into consideration before issuing the final regulation. Copies of all comments will be posted on the OFHEO Internet web site at <http://www.ofheo.gov>. In addition, copies of all comments received will be available for examination by the public at the Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

I. Statutory Framework

Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, entitled the “Federal Housing Enterprises Financial Safety and Soundness Act of 1992” (the

“Act”),¹ established the Office of Federal Housing Enterprise Oversight (“OFHEO”) as an independent office within the Department of Housing and Urban Development. OFHEO is the financial safety and soundness regulator of the nation’s two largest housing-related Government-sponsored enterprises: the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively, the “Enterprises”). In addition to establishing OFHEO, the Act made amendments to the Enterprises’ enabling statutes (collectively, “the Charter Acts”)² among other things, accommodate the restructured regulatory regime under the Act.

The National Flood Insurance Act of 1968 (“NFIA”)³ and the Flood Disaster Protection Act of 1973 (“FDPA”),⁴ as amended by the National Flood Insurance Reform Act of 1994 (“NFIRA”),⁵ together create a comprehensive National Flood Insurance Program (“NFIP”) that includes various provisions designed to ensure that structures built in flood plains are covered by statutory minimum amounts of flood insurance. NFIRA added specific requirements explicitly applicable to the Enterprises,⁶ designated OFHEO as the Federal agency responsible for determining compliance of the Enterprises’ flood insurance responsibilities, required OFHEO to report their compliance in the agency’s 1996, 1998 and 2000 annual reports,⁷ and provided OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA.⁸ NFIRA also authorized OFHEO to impose civil money penalties upon an Enterprise that fails to implement procedures reasonably designed to ensure that the loans it purchases comply with the mandatory flood insurance purchase requirements.⁹

More specifically, NFIRA requires that the Enterprises each implement procedures reasonably designed to ensure that any mortgage loan that is purchased and is secured by property located in a designated flood hazard

¹ 12 U.S.C. 4501 *et seq.*

² Federal National Mortgage Association Charter Act (12 U.S.C. 1716-1723i) and Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451-1459).

³ Codified at 42 U.S.C. 4001 *et seq.* and other scattered sections of 42 U.S.C.

⁴ Codified at 42 U.S.C. 4002 *et seq.* and other scattered sections of 42 U.S.C.

⁵ Pub. L. No. 103-325 (Sept. 23, 1994) (codified, as amended, at 42 U.S.C. 4001-4129).

⁶ 42 U.S.C. 4012a(b)(3).

⁷ 12 U.S.C. 4521(a)(4).

⁸ 42 U.S.C. 4001 note.

⁹ 42 U.S.C. 4012a(f)(c).

materially adversely affect the safety and soundness of the Enterprise.

§ 1710.31 Prohibited indemnification payments.

(a) *Prohibited indemnification payments.* An Enterprise or any affiliate of an Enterprise may not make, except as provided in paragraph (b) of this section, any payment to indemnify any board member or executive officer for any legal expense incurred in connection with an administrative proceeding initiated or undertaken by OFHEO that results 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.

(b) *Exceptions.* An Enterprise may make a reasonable payment that:

(1) Is used to purchase any commercial insurance policy or similar coverage; provided, however, that such insurance policy or similar coverage shall not be used to indemnify a board member or executive officer for the cost of any civil money penalty assessed against him or her in an administrative proceeding initiated or undertaken by OFHEO, but may be used to pay other legal expenses incurred in connection with such administrative proceeding or to pay the amount of any restitution to the Enterprise; or

(2) Represents partial indemnification for legal expenses specifically attributable to particular charges for which there has been a formal and final adjudication or a finding in connection with a settlement that the board member or executive officer has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty.

Dated: September 4, 2001.

Armando Falcon, Jr.,

Director, Office of Federal Housing Enterprise Oversight.

[FR Doc. 01-22925 Filed 9-11-01; 8:45 am]

BILLING CODE 4220-01-U

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

12 CFR Part 1773

RIN 2550-AA21

Flood Insurance

AGENCY Office of Federal Housing Enterprise Oversight, HUD.

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The National Flood Insurance Act of 1968 (“NFIA”)³ and the Flood Disaster Protection Act of 1973 (“FDPA”),⁴ as amended by the National Flood Insurance Reform Act of 1994 (“NFIRA”),⁵ together create a comprehensive National Flood Insurance Program (“NFIP”) that includes various provisions designed to ensure that structures built in flood plains are covered by statutory minimum amounts of flood insurance. NFIRA added specific requirements explicitly applicable to the Enterprises,⁶ designated OFHEO as the Federal agency responsible for determining compliance of the Enterprises’ flood insurance responsibilities, required OFHEO to report their compliance in the agency’s 1996, 1998 and 2000 annual reports,⁷ and provided OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA.⁸ NFIRA also authorized OFHEO to impose civil money penalties upon an Enterprise that fails to implement procedures reasonably designed to ensure that the loans it purchases comply with the mandatory flood insurance purchase requirements.⁹

More specifically, NFIRA requires that the Enterprises each implement procedures reasonably designed to ensure that any mortgage loan that is purchased and is secured by property located in a designated flood hazard

¹ 12 U.S.C. 4501 *et seq.*

² Federal National Mortgage Association Charter Act (12 U.S.C. 1716-1723i) and Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451-1459).

³ Codified at 42 U.S.C. 4001 *et seq.* and other scattered sections of 42 U.S.C.

⁴ Codified at 42 U.S.C. 4002 *et seq.* and other scattered sections of 42 U.S.C.

⁵ Pub. L. No. 103-325 (Sept. 23, 1994) (codified, as amended, at 42 U.S.C. 4001-4129).

⁶ 42 U.S.C. 4012a(b)(3).

⁷ 12 U.S.C. 4521(a)(4).

⁸ 42 U.S.C. 4001 note.

⁹ 42 U.S.C. 4012a(f)(c).

area is covered for the term of the loan by flood insurance in an amount at least equal to the lesser of (1) the outstanding principal balance of the loan or (2) the maximum limit of coverage made available for that type of property under the NFIP. OFHEO is authorized under NFIRA to levy a civil money penalty of \$350 per violation, not to exceed \$100,000 per year, against an Enterprise that it finds to have engaged in a pattern or practice of purchasing loans in violation of the procedures.¹⁰

II. Background

The Enterprises have a key role in the implementation of the Federal Government's flood insurance program, particularly with regard to lenders that are not subject to direct supervision by a Federal regulatory agency. The Enterprises use their seller/servicer guidelines and other quality control review procedures to ensure that lenders with whom they contract comply with the applicable flood insurance laws. The Enterprises are required to establish procedures designed to prevent their purchase of loans that do not comply with these laws. NFIRA tasks OFHEO with reviewing the adequacy of such procedures as well as the Enterprises' compliance with them.

A primary purpose of the proposed regulation is to reiterate the relevant statutory provisions specifically applicable to the Enterprises and to OFHEO and to codify them in OFHEO's regulations. The proposed regulation is intended to provide guidance as to the procedures to be applied if an enforcement action were to be required, to add statutory civil money penalty amounts for infractions of the flood insurance requirements to the schedule of penalties in OFHEO's regulations and to adjust such penalty amounts as contemplated by law for inflation.

The Inflation Adjustment Act

The Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996 (the Inflation Adjustment Act),¹¹ requires Federal agencies with the authority to issue civil money penalties, to adopt regulations to adjust each civil money penalty authorized by law that the agency has jurisdiction to administer. The purpose of these adjustments is to maintain the deterrent effect of civil money penalties and promote compliance with the law. The Inflation Adjustment Act requires agencies to make an initial adjustment

of their civil money penalties upon the statute's enactment, and to make additional adjustments on an ongoing basis, at least once every four years following the initial adjustment.

Under the Inflation Adjustment Act, the inflation adjustment for each applicable civil money penalty is determined by increasing the maximum civil money penalty amount by a cost-of-living adjustment. As is described in detail below, the Inflation Adjustment Act provides that this cost-of-living adjustment is to reflect the percentage increase in the Consumer Price Index since the civil money penalties were last adjusted or established.

NFIRA sets forth the procedures under which the Director of OFHEO could impose civil money penalties against an Enterprise and the amounts of these civil money penalties. In this rulemaking, the amounts of these civil money penalties are being adjusted in accordance with the requirements of the Inflation Adjustment Act. The increases in maximum civil money penalty amounts contained in this proposed rule do not mandate the amount of any civil money penalty that OFHEO may seek for a particular violation; OFHEO would determine each civil money penalty on a case-by-case basis in light of the circumstances of the case.

The Inflation Adjustment Act directs Federal agencies to calculate each civil money penalty adjustment as the percentage by which the CPI-U for June of the calendar year preceding the adjustment exceeds the CPI-U for June of the calendar year in which the amount of such civil money penalty was last set or adjusted pursuant to law. OFHEO has not previously adjusted these CMP amounts, so the base period is 1994, the year in which the CMPs were enacted into law by NFIRA. Because OFHEO is making these adjustments in calendar year 2001, and NFIRA was enacted in 1994, the inflation adjustment amount for each civil money penalty was calculated by comparing the CPI-U for June 1994 (148.0) with the CPI-U for June 2000 (172.4), resulting in an inflation adjustment of 16.5 percent. For each civil money penalty, the product of this inflation adjustment and the previous maximum penalty amount was then rounded in accordance with the specific requirements of the Inflation Adjustment Act,¹² then added to the

previous maximum penalty amount to determine the new adjusted maximum penalty amount. However, the Inflation Adjustment Act further specifies that the first adjustment of any CMP pursuant to such Act may not exceed ten percent of the penalty. Accordingly, the original civil money penalty maximum of \$350 under NFIRA is increased to \$385 for each violation and the civil money penalty maximum of \$100,000 is increased to \$110,000 for the total assessed penalties against any Enterprise during any calendar year.

Section-By-Section Analysis

Section 1773.1 Authority and Scope

Section 1773.1 sets forth the authority upon which this proposed regulation is based, namely the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended by the National Flood Insurance Reform Act of 1994. The National Flood Insurance Reform Act of 1994 requires OFHEO to examine the Enterprises to ascertain their compliance with these statutes and to report to Congress on their compliance, and provides OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA. OFHEO is authorized to impose civil money penalties on an Enterprise for violation of procedures established pursuant to the National Flood Insurance Act of 1968, as amended, or rules or regulations adopted pursuant thereto.¹³

Section 1773.2 Requirements

Section 1773.2(a) sets forth the requirement that each Enterprise is to implement procedures reasonably designed to ensure that the properties securing particular loans described in paragraph (a) are properly insured in accordance with the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended by the National Flood Insurance Reform Act of 1994. This requirement applies to any loan purchased by an Enterprise that is secured by improved real estate or a mobile home located in an area that has been identified, at the time of the origination of the loan or at any time during the term of the loan, by the Director of the Federal Emergency Management Agency as an area having special flood hazards and in which

penalties greater than \$10,000 but less than or equal to \$100,000; \$10,000 in the case of penalties greater than \$100,000 but less than or equal to \$200,000; and \$5,000 in the case of penalties greater than \$200,000.

¹³ 42 U.S.C. 4012a(f)(3).

¹² The statute's rounding rules require that each increase be rounded to the nearest multiple as follows: \$10 in the case of penalties less than or equal to \$100; \$100 in the case of penalties greater than \$100 but less than or equal to \$1,000; \$1,000 in the case of penalties greater than \$1,000 but less than or equal to \$10,000; \$5,000 in the case of

¹⁰ 42 U.S.C. 4012a(f)(3)(5).

¹¹ 28 U.S.C. 2461 note.

flood insurance is available under the National Flood Insurance Program. As explained in paragraph (a), the Enterprise is required to ensure that a building or mobile home, and any personal property securing such loan are covered for the term of the loan by flood insurance in an amount at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage made available with respect to the particular type of property under the National Flood Insurance Program.

Section 1773.2(b) proposes that the procedures in paragraph (a) need apply only to loans made, increased, extended, or renewed after September 22, 1995. It further provides that paragraph (a) does not apply to any loan having an original outstanding principal balance of \$5,000 or less and a repayment term of one year or less.

Section 1773.3 Civil Money Penalties

Section 1773.3 sets forth procedures under this proposed section under which the Director of OFHEO may impose civil money penalties against an Enterprise. Section 1773.3(a) sets forth that the Director of OFHEO may assess a civil money penalty against an Enterprise determined by the Director to have engaged in a pattern or practice of purchasing loans in violation of the procedures established pursuant to § 1773.2.

Section 1773.3(b) sets forth notice and hearing requirements prior to the imposition of civil money penalties under this section. A civil money penalty may be issued only after notice and an opportunity for a hearing on the record has been provided under 12 CFR part 1780.

Section 1773.3(c) sets forth the maximum amount of civil money penalties that may be imposed on an Enterprise under this section. A civil money penalty under this section may not exceed the adjusted statutory amount of \$385 for each violation and the total amount of penalties assessed under this section against an Enterprise during any calendar year may not exceed the adjusted statutory cap of \$110,000 for such total penalties.

Section 1773.3(d) sets forth procedures for the deposit of civil money penalties. Any civil money penalties collected under this section shall be paid into the National Flood Mitigation Fund in accordance with 42 U.S.C. 4104d.

Section 1773.3(e) provides that any civil money penalty under this section shall be in addition to any civil remedy or criminal penalty otherwise available.

Section 1773.3(f) provides that no penalty may be imposed under this section after the expiration of the four-year period beginning on the date of the occurrence of the violation for which the penalty is authorized.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

This proposed rule is not deemed to be a significant rule under Executive Order 12866 because it will not result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) 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 and this proposed rule has not been submitted to the Office of Management and Budget for review.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a rule 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 this proposed rule under the Regulatory Flexibility Act. The General Counsel certifies that this proposed rule will not have a significant economic impact on a substantial number of small business entities.

Paperwork Reduction Act

This proposed rule does not contain any information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

Unfunded Mandates Reform Act of 1995

This proposed rule does not require the preparation of an assessment statement in accordance with the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1531. Assessment statements are not required for regulations that incorporate

requirements specifically set forth in law. As explained in the preamble, this rule implements specific statutory requirements. In addition, this rule does not include a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year.

List of Subjects in 12 CFR Part 1773

Administrative practice and procedure, Flood insurance, Penalties, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, OFHEO proposes to add 12 CFR part 1773 to subchapter C of chapter XVII as follows:

PART 1773—FLOOD INSURANCE

Sec.

1773.1 Authority and scope.

1773.2 Requirements.

1773.3 Civil money penalties.

Authority: 12 U.S.C. 4521(a)(4); 42 U.S.C. 4001 note; 28 U.S.C. 2461 note; 42 U.S.C. 4012a(f)(3), (4), (8), (9), (10).

§ 1773.1 Authority and scope.

(a) *Authority.* The National Flood Insurance Act of 1968, title XII of Pub. L. No. 90-448, Aug. 1, 1968, 42 U.S.C. 4002 *et seq.*, and the Flood Disaster Protection Act of 1973, 42 U.S.C. 4002 *et seq.*, as amended by the National Flood Insurance Reform Act of 1994 ("NFIRA"), Pub. L. No. 103-325, Sept. 23, 1994, 42 U.S.C. 4001-4129, together create the National Flood Insurance Program ("NFIP") which established specific requirements applicable to the Enterprises. NFIRA designates OFHEO as the Federal agency responsible for determining compliance by the Enterprises with these statutes and with reporting to Congress biannually for six years on the Enterprises' compliance. OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA. OFHEO is also charged with enforcing the requirements of NFIRA as to the Enterprises and provides for the assessment of civil money penalties for violations of the procedures established by the Enterprises pursuant to the law or implementing regulations.

(b) *Scope.* This part sets forth the responsibilities of the Enterprises under NFIRA and the procedures to be used in any proceeding to assess civil money penalties against an Enterprise under NFIRA.

§ 1773.2 Requirements.

(a) *Procedures.* Each Enterprise shall implement procedures reasonably

designed to ensure for any loan that is secured by improved real estate or a mobile home located in an area that has been identified, at the time of the origination of the loan or at any time during the term of the loan, by the Director of the Federal Emergency Management Agency as an area having special flood hazards and in which flood insurance is available under the NFIP, and purchased by such entity, the building or mobile home and any personal property securing the loan is covered for the term of the loan by flood insurance in an amount at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage made available with respect to the particular type of property under the NFIP.

(b) *Applicability.* (1) Paragraph (a) of this section shall apply only with respect to any loan made, increased, extended, or renewed after September 22, 1995.

(2) Paragraph (a) of this section shall not apply to any loan having an original

outstanding balance of \$5,000 or less and a repayment term of one year or less.

§ 1773.3 Civil money penalties.

(a) *In general.* If an Enterprise is determined by the Director of OFHEO to have engaged in a pattern or practice of purchasing loans in violation of the procedures established pursuant to the NFIA, as amended, or to § 1773.2, the Director may assess civil money penalties against such Enterprise in such amount or amounts as deemed to be appropriate under paragraph (c) of this section.

(b) *Notice and hearing.* A civil money penalty under this section may be assessed only after notice and an opportunity for a hearing on the record has been provided under 12 CFR part 1780.

(c) *Amount.* A civil money penalty under this section may not exceed \$385 for each violation. The total amount of penalties assessed under this section

against an Enterprise during any calendar year may not exceed \$110,000.

(d) *Deposit of penalties.* Any penalties collected under this section shall be paid into the National Flood Mitigation Fund in accordance with 42 U.S.C. 4104d.

(e) *Additional penalties.* Any penalty under this section shall be in addition to, and shall not preclude, any civil remedy or criminal penalty otherwise available.

(f) *Statute of limitations.* No civil money penalty may be imposed under this section after the expiration of the four-year period beginning on the date of the occurrence of the violation for which the penalty is authorized under this section.

Dated: September 4, 2001.

Armando Falcon, Jr.,

Director, Office of Federal Housing Enterprise Oversight.

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