

concerning our proposed information collection and recordkeeping requirements. These comments will help us:

(1) Evaluate whether the proposed information collection is necessary for the proper performance of our agency's functions, including whether the information will have practical utility;

(2) Evaluate the accuracy of our estimate of the burden of the proposed information collection, including the validity of the methodology and assumptions used;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the information collection on those who are to respond (such as through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses).

*Estimate of burden:* Public reporting burden for this collection of information is estimated to average 0.78 hours per response.

*Respondents:* Foreign government, importers and growers of bananas from the Philippines.

*Estimated annual number of respondents:* 46.

*Estimated annual number of responses per respondent:* 5.34.

*Estimated annual number of responses:* 246.

*Estimated total annual burden on respondents:* 192 hours. (Due to averaging, the total annual burden hours may not equal the product of the annual number of responses multiplied by the reporting burden per response.)

Copies of this information collection can be obtained from Mrs. Celeste Sickles, APHIS' Information Collection Coordinator, at (301) 851-2908.

#### E-Government Act Compliance

The Animal and Plant Health Inspection Service is committed to compliance with the E-Government Act to promote the use of the Internet and other information technologies, to provide increased opportunities for citizen access to Government information and services, and for other purposes. For information pertinent to E-Government Act compliance related to this proposed rule, please contact Mrs. Celeste Sickles, APHIS' Information Collection Coordinator, at (301) 851-2908.

#### List of Subjects in 7 CFR Part 319

Coffee, Cotton, Fruits, Imports, Logs, Nursery stock, Plant diseases and pests, Quarantine, Reporting and

recordkeeping requirements, Rice, Vegetables.

Accordingly, we propose to amend 7 CFR part 319 as follows:

#### PART 319—FOREIGN QUARANTINE NOTICES

■ 1. The authority citation for part 319 continues to read as follows:

**Authority:** 7 U.S.C. 450, 7701-7772, and 7781-7786; 21 U.S.C. 136 and 136a; 7 CFR 2.22, 2.80, and 371.3.

■ 2. Section 319.56-58 is amended as follows:

■ a. The introductory text is revised;

■ b. In paragraph (c), the date, "February 9, 2015" is removed and the date "[date 2 years after the effective date of final rule]" is added in its place;

■ c. In paragraph (h)(2), in the second sentence, the words "introductory text of this section" are removed and the words "operational workplan required by paragraph (a)(1) of this section" are added in their place.

The revision reads as follows:

#### § 319.56-58 Bananas from the Philippines.

Bananas (*Musa* spp., which include *M. acuminata* cultivars and *M. acuminata* x *M. balbisiana* hybrids) may be imported into the continental United States, Guam, Hawaii, and the Northern Mariana Islands from the Philippines only under the conditions described in this section.

\* \* \* \* \*

Done in Washington, DC, this 23rd day of January 2014.

**Kevin Shea,**

*Administrator, Animal and Plant Health Inspection Service.*

[FR Doc. 2014-01581 Filed 1-27-14; 8:45 am]

**BILLING CODE 3410-34-P**

#### FEDERAL HOUSING FINANCE BOARD

#### 12 CFR Parts 914 and 917

#### FEDERAL HOUSING FINANCE AGENCY

#### 12 CFR Parts 1236 and 1239

#### DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

#### Office of Federal Housing Enterprise Oversight

#### 12 CFR Parts 1710 and 1720

RIN 2590-AA59

#### Responsibilities of Boards of Directors, Corporate Practices and Corporate Governance Matters

**AGENCIES:** Federal Housing Finance Board; Federal Housing Finance Agency; Office of Federal Housing Enterprise Oversight.

**ACTION:** Proposed rule; with request for comments.

**SUMMARY:** The Federal Housing Finance Agency (FHFA) is proposing to amend its regulations by relocating and consolidating certain Federal Housing Finance Board (Finance Board) and Office of Federal Housing Enterprise Oversight (OFHEO) regulations that pertain to the responsibilities of boards of directors, corporate practices, and corporate governance matters. The OFHEO regulations address corporate governance matters at the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (Enterprises), while the Finance Board regulations address the powers and responsibilities of the boards of directors and management of the Federal Home Loan Banks (Banks). The proposed rule would consolidate most of those existing regulations into a new FHFA regulation, parts of which would apply to both the Banks and the Enterprises (together, regulated entities), and parts of which would apply only to the Banks or only to the Enterprises. Most of the content of the new regulation has been derived from the existing regulations, with such modifications as are necessary to apply certain provisions to all regulated entities. The proposal also would include a new provision on risk management and a new definition of "credit risk," which is a term that is used only within the proposed risk management provision. Those provisions would apply to both the Banks and the Enterprises. FHFA also is proposing to amend a definition within

its Prudential Management and Operations Standards (Prudential Standards) regulations and the introductory language to the standards themselves. Together, those amendments would explicitly include certain introductory language—pertaining to the general responsibilities of senior management and boards of directors—as part of the standards. The proposed rule also would repeal a separate provision of the OFHEO regulations that relate to minimum safety and soundness requirements.

**DATES:** Written comments on the proposed rule must be received on or before March 31, 2014. For additional information, see **SUPPLEMENTARY INFORMATION**.

**ADDRESSES:** You may submit your comments on the proposed rule, identified by regulatory information number “RIN 2590-AA59,” by any of the following methods:

- **Email:** Comments to Alfred M. Pollard, General Counsel, may be sent by email to [RegComments@FHFA.gov](mailto:RegComments@FHFA.gov). Please include “RIN 2590-AA59” in the subject line of the message.
- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the *Federal eRulemaking Portal*, please also send it by email to FHFA at [RegComments@FHFA.gov](mailto:RegComments@FHFA.gov) to ensure timely receipt by the agency. Include the following information in the subject line of your submission: Comments/RIN 2590-AA59.

- **U.S. Mail, United Parcel Post, Federal Express, or Other Mail Service:** The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA59, Federal Housing Finance Agency, Constitution Center, Eighth Floor (OGC), 400 7th Street SW., Washington, DC 20024.

- **Hand Delivered/Courier:** The hand delivery address is: Alfred M. Pollard, General Counsel; Attention: Comments/RIN 2590-AA59, Federal Housing Finance Agency, Constitution Center, Eighth Floor (OGC), 400 7th Street SW., Washington, DC 20024. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.

**FOR FURTHER INFORMATION CONTACT:** Amy Bogdon, [Amy.Bogdon@fhfa.gov](mailto:Amy.Bogdon@fhfa.gov), (202) 649-3320, Associate Director, Division of Federal Home Loan Bank Regulation; or Michou Nguyen, [Michou.Nguyen@fhfa.gov](mailto:Michou.Nguyen@fhfa.gov), (202) 649-3081 (not toll-free numbers), Assistant General Counsel, Office of General Counsel, Federal Housing Finance

Agency, Constitution Center, Eighth Floor (OGC), 400 7th Street SW., Washington, DC 20024. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

#### **SUPPLEMENTARY INFORMATION:**

##### **I. Comments**

FHFA invites comments on all aspects of the proposed rule in addition to requesting comments in response to specific questions that appear throughout this document. FHFA will take all comments into consideration before issuing a final regulation. All comments received will be posted without change on the FHFA Web site at <http://www.fhfa.gov>, and will include any personal information you provide, such as your name, address (mailing and email), and telephone numbers. In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Eighth Floor, 400 7th Street SW., Washington, DC 20024. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 649-3804.

##### **II. Background**

###### *A. Purpose of the Proposed Rule*

This proposed rule is the next phase in FHFA’s effort to repeal or relocate all remaining OFHEO and Finance Board regulations. Both of the predecessor agencies had adopted regulations addressing director responsibilities, corporate practices, and corporate governance matters. Pursuant to the Housing and Economic Recovery Act of 2008 (HERA), Public Law 110-289, 122 Stat. 2654, those regulations remain in effect until they are superseded by regulations issued by FHFA. *See id.* at sections 1301, 1302, 1311, 1312, 122 Stat. 2794-95, 2797-98. The intent of this proposed rule is to consolidate or relocate certain of the existing regulations into a new set of FHFA regulations that would address those same matters. FHFA would expand the scope of certain of the existing regulations to both the Enterprises and the Banks. Those provisions address matters of general corporate governance or corporate practices that are common to all the regulated entities. For certain other provisions of the existing regulations, FHFA would continue to apply them only to the Banks or only to the Enterprises, as they address topics that are unique to the particular entity, as permitted by statute. The proposed rule would carry over most of those

provisions without change. The proposed rule is not intended to address conservatorship matters. Rather, the proposal addresses matters of corporate practice and governance, as well as compliance and risk management practices, nearly all of which currently apply to the Enterprises through the OFHEO regulations and all of which remain relevant to their safe and sound operation.

The regulations of the predecessor agencies that would be relocated by this rulemaking are located at parts 914, 917, and 1710 of title 12 of the Code of Federal Regulations (CFR). The Finance Board regulations at part 914 address regulatory reporting for the Banks. FHFA is proposing to relocate that provision without substantive change and apply it to all of the regulated entities. All of the relocated regulations would be adopted as a new part, 12 CFR 1239 (part 1239), in the FHFA section of title 12 of the CFR. Any regulations of the predecessor agencies that are not being adopted as FHFA regulations would be repealed.

As part of this rulemaking, FHFA is also proposing to amend one of the definitions within its Prudential Standards regulations, as well as one aspect of the Prudential Standards themselves. Together, those amendments would explicitly provide that the introductory language within the Prudential Standards, which appears immediately before the enumerated 10 standards, is considered a part of the standards and is to be treated in the same manner as the 10 enumerated standards. The introductory section of the Prudential Standards recites general concepts of corporate governance and responsibilities, as they relate to the subject matter of the individual standards, that are a part of the typical responsibilities of the board of directors and senior management of any financial institution. FHFA believes that it would be more appropriate to include those paragraphs as explicitly part of the standards, and having the same substantive effect under the Prudential Standards regime. Lastly, FHFA is proposing to repeal in its entirety part 1720 of the OFHEO regulations, which established certain safety and soundness standards for the Enterprises. Because many of the matters addressed by part 1720 are also addressed by the Prudential Standards and by parts of this proposed rule, FHFA has determined that the repeal of part 1720 will not change the standards applicable to the Enterprises. The following sections briefly describe each of the provisions in proposed part 1239 and its origin.

Also with respect to the Prudential Standards, FHFA acknowledges that there is substantial overlap between some of these proposed regulations and the Prudential Standards, and requests comment on appropriate modifications to the regulations to harmonize them with the Prudential Standards to create a unified set of corporate governance requirements with appropriate levels of specificity and appropriate enforcement mechanisms.

#### *B. Overview of Part 1239*

Part 1239 of the proposed rule would be structured into a subpart (A) for definitions and four substantive subparts (B through E). Subpart B would consist of regulations relating to core corporate governance principles, which would apply to both the Banks and the Enterprises. Subpart C would include regulations addressing codes of conduct, risk management, compliance programs, and regulatory reports, which also would apply to both the Banks and the Enterprises. Subpart D would consist of regulations that address matters specific to the Banks (such as those relating to a Bank's member product policy) and to the Enterprises (such as those relating to the Enterprise boards), respectively.

Much of the content of part 1239, with the exception of the provision on risk management, has been derived from the current Finance Board and OFHEO regulations, with modifications as necessary to apply certain of the provisions to all regulated entities and to clarify, update, or supplement the existing regulations, as appropriate. FHFA believes that the current Finance Board risk management regulation would benefit from updates. Accordingly, FHFA has rewritten this provision in its entirety and is proposing to apply the revised provision to the Enterprises as well as to the Banks. FHFA believes that the Finance Board regulations dealing with audit committees and internal controls could be similarly updated and extended to the Enterprises, but is soliciting comment on how best to do that, rather than proposing revised language for those provisions, as discussed in more detail in part III.E. (Bank Specific Requirements).

#### *C. Considerations of Differences Between the Banks and the Enterprises*

When promulgating regulations or taking other actions that relate to the Banks, section 1313(f) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act), as amended by section 1201 of HERA, requires the Director to consider the differences between the

Banks and the Enterprises with respect to the Banks' cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability. 12 U.S.C. 4513(f). In preparing the proposed rule, the Director has considered the differences between the Banks and the Enterprises as they relate to the above factors and has determined that none of the statutory factors would be adversely affected by the proposed rule. The Director is requesting comments from the public about whether differences related to these factors should result in a revision of the proposed rule as it relates to the Banks.

### **III. Part 1239**

#### *A. Subpart A—General*

##### *Definitions (1239.2)*

The definitions section of the proposed rule consists of definitions from parts 914, 917, and 1710, most of which are being relocated without any substantive change, apart from conforming changes that are necessary to make certain of the defined terms applicable to both the Banks and the Enterprises. The proposed rule would substantively amend certain of the existing definitions, as described below. First, the proposed rule would replace the term "reportable conditions" (which currently appears only in the Finance Board regulation on audit committees) with the term "significant deficiency." That revision would better align the concept with current accounting and financial reporting standards. Second, the proposed rule would amend the definition of "credit risk," which currently appears only in the Finance Board provision pertaining to risk management. The proposed definition would define credit risk as the potential that a borrower or counterparty will fail to meet its financial obligations in accordance with the agreed terms. FHFA believes that is a better definition than the current provision, which focuses on the decline in value of an obligation as a result of a deterioration in creditworthiness. Third, the proposal would revise the definition of "operational risk" to follow the definition used by the other federal banking regulators in their risk-based capital regulations, which also is consistent with the definition of the term from the Basel Committee on Banking Supervision.<sup>1</sup> Fourth, the

<sup>1</sup> See Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version*, Section V (Operational Risk), paragraph 644, Basel, June 2006.

proposed rule would delete the definition of "senior executive officer" but add the substance of that definition into the definition of "executive officer." The term "senior executive officer" is not used in any of the substantive provisions of the proposed regulations, and appears only within the definition of "executive officer." Rather than retain a definition of a term that appears only within another defined term, FHFA believes it is more appropriate to relocate the operative language from the definition of "senior executive officer" into the definition of "executive officer." A number of terms that will no longer be used in the proposed regulations will not be carried forward into the proposed rule, nor will any terms that FHFA has defined in the general definitions section of its regulations, 12 CFR part 1201.

#### *B. Subpart B—Corporate Practices and Procedures Applicable to All Regulated Entities*

Subpart B includes three provisions that address certain core principles of corporate practices or governance that FHFA believes should be applied to both the Enterprises and the Banks. The topics addressed by this part of the proposed rule are choice of law, duties of directors, and committees of the boards of directors, and nearly all of those provisions are derived from the Finance Board or OFHEO regulations.

##### *Choice of Law (1239.3)*

Section 1239.3 of the proposed rule would require each regulated entity to designate a body of law to follow with respect to its corporate governance and indemnification practices. This requirement already applies to the Enterprises and the Office of Finance, pursuant to 12 CFR 1710.10 of the OFHEO regulations and 12 CFR 1273.7(i)(2) of the FHFA regulations, respectively, but would be new for the Banks. Under this provision, a regulated entity would be required to designate in its bylaws one of the following for its corporate governance practices and procedures: (1) The law of the jurisdiction in which the entity maintains its principal office; (2) the Delaware General Corporation Law; or (3) the Revised Model Business Corporation Act. Technically, those laws would not apply to, nor be binding on, the Banks or Enterprises, because they are not state-chartered corporations. Rather, FHFA intends that the entities would look to their chosen body of law to address any governance or indemnification issues that may arise and for which no federal laws control.

The proposed regulation also includes a provision dealing with indemnification, which is derived from FHFA's regulations governing the Office of Finance, 12 CFR 1273.7(i)(3), and from the OFHEO indemnification provisions at 12 CFR 1710.20. The proposed provision would state that a regulated entity shall indemnify its directors, officers, and employees under terms and conditions to be determined by the board, subject to any limitations in federal law or the law of the jurisdiction designated for an entity's corporate governance practices. The proposal further requires each entity to have policies and procedures regarding the indemnification of its directors, officers, and employees, which must address how the board of directors is to decide on requests for indemnification, and must include standards relating to indemnification, investigations by the board of directors, and review by independent counsel. The proposal also authorizes FHFA to review an entity's indemnification policies, procedures, and practices, and carries over a provision of the OFHEO regulation that authorized it to limit or prohibit indemnification payments for reasons of safety and soundness. Under that latter provision, FHFA could limit or prohibit indemnification payments to any person found to have violated any law or regulation, breached any material elements of the entity's bylaws or code of conduct, or engaged in grossly negligent actions.

FHFA is proposing to make these provisions applicable to the Banks because there are benefits to having all regulated entities follow the same regulatory standard with respect to their corporate governance and indemnification practices, and because there currently is no definitive guidance for the Banks on this matter. The indemnification provision explicitly states that it is subject to the other provisions of the regulation, one of which provides that the corporate governance and indemnification practices must comply with the authorizing statutes and any other applicable federal statutes or regulations. That means that a regulated entity's ability to indemnify its directors, officers, and employees will be subject to any limitations that FHFA imposes through its separate indemnification regulations or through this provision, regardless of what the chosen state law may provide.

#### Duties and Responsibilities of Board Members (1239.4)

Section 1293.4 of the proposed rule would set forth certain basic duties and

responsibilities of directors of a regulated entity. This provision states that the ultimate responsibility for managing a regulated entity lies with the board of directors. It also requires directors to, among other things: (1) Act in good faith and with due care, in the best interest of the regulated entity, and in a fair and impartial manner; (2) direct the affairs of an entity in a manner consistent with applicable statutes and regulations; (3) have a working familiarity with basic finance and accounting practices; and (4) adopt bylaws governing the manner in which the regulated entity administers its affairs. Directors must also put in place policies relating to the board's oversight of risk management, compensation, financial reporting, and responsiveness to FHFA supervisory concerns.

The text of the proposed regulation consists mostly of provisions carried over from Finance Board regulation (§ 917.2) and, to a lesser extent, OFHEO regulation (§ 1710.15). The proposed rule would carry over nearly all of the provisions of (§ 917.2) of the Finance Board regulations, and the substance of the existing OFHEO regulations located at 12 CFR 1710.15(b)(3), (5), and (7). Those OFHEO provisions require the boards of directors to have policies in place to assure their oversight of compensation programs, disclosures to shareholders and investors, and responsiveness to regulatory inquiries. The proposed rule would add a provision requiring the boards to have policies in place to assure their oversight of risk management, in light of the importance of risk management policies and controls to the safe and sound operation of the entities. FHFA is proposing not to carry over certain other OFHEO regulations that require the boards to have in place policies to assure their oversight of corporate strategy, hiring and retention of qualified senior executive officers, integrity of financial reporting, and extensions of credit to board members. See 12 CFR 1710.15(b)(1)–(2), (4), and (6). FHFA believes that these topics are covered adequately elsewhere. The proposed rule also would repeal 1710.15(a) and (c), which state the purpose of those OFHEO regulations and direct Enterprise board members to their chosen body of corporate law, as well as to OFHEO pronouncements, for additional guidance on these topics. FHFA believes that these matters need not be explicitly stated in the regulation.

#### Board Committees (1239.5)

The last section in subpart B deals with committees of the board of directors, and is derived principally

from § 1710.12 of the OFHEO regulations. The proposed regulation would require each regulated entity to have certain specified committees of the board of directors and would authorize the entities to establish any other committees they deem appropriate. Each entity would be required to have committees of the board of directors that are responsible for each of the following matters: (1) Risk management; (2) audit; (3) compensation; and (4) corporate governance. The rule would not require the entities to establish committees with those specific names, only that they establish committees that are responsible for overseeing those matters. The proposed rule also would provide that the risk management committee and the audit committee cannot be combined with any of the other committees. The proposal would further require that each committee have a formal written charter and that it meet with sufficient frequency to carry out its responsibilities. The regulation retains, for the Enterprises only, an OFHEO provision requiring Enterprise audit committees to comply with certain provisions of section 301 of the Sarbanes-Oxley Act (SOA), which relates to audit committees of public companies, and that the audit committee and other Enterprise committees also comply with applicable provisions of the rules of the New York Stock Exchange (NYSE). That is the only provision in this proposed regulation that would not apply to the Banks. Because the Federal Home Loan Bank Act (Bank Act) mandates that a majority of a Bank's board of directors be officers or directors of the Bank's members, these directors may not meet the independence criteria in both of the relevant SOA and NYSE provisions for audit committee members. Indeed, nine of the Banks have disclosed in their federal securities law filings that the member directors who serve on the Banks' audit committees did not meet the NYSE independence requirement because the member had a "material relationship" with the Bank or failed the NYSE's revenue test.<sup>2</sup>

<sup>2</sup> Under NYSE rules, an employee of a Bank member would not be considered independent for purposes of serving on the audit committee if: (1) The member has made interest payments to the Bank exceeding the greater of \$1 million or 2 percent of the Bank's gross annual revenue in any of the past three fiscal years; or (2) if the Bank has purchased loans from the member in an amount exceeding the greater of \$1 million or 2 percent of the member's gross annual revenue in any of the past three fiscal years. In addition, an officer of a Bank member is not considered independent if the member has a "material relationship" with the Bank. The rules list a banking relationship as an example of a type of relationship that can constitute

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The substance of the proposed rule differs slightly from OFHEO regulation § 1710.12 in that it requires each board to have a committee dealing with risk management. The OFHEO rule mandates that the Enterprises have the other three committees mentioned above. There is no equivalent Finance Board regulation. FHFA believes that, consistent with current best practices, it is appropriate to add the risk management committee to the list of required committees and to make this regulation applicable to the Banks as these four areas are crucial to the safe and sound operation of all regulated entities.

FHFA also has considered whether the proposed rule should require the board of directors of each regulated entity to have an executive committee, in addition to the other four committees that would be required by the proposed rule. FHFA requests comments on whether it would be appropriate for the regulations to require the establishment of executive committees as a matter of course and, if so, what powers should be delegated to those committees. An executive committee that is authorized to exercise the powers of the full board of directors could enhance the efficiency of the board's operations, particularly at Banks that have large boards of directors. FHFA also requests comment on whether the need for an executive committee, or the benefits from having such a committee, would be any greater in the case of a Bank that results from the merger of two other Banks. In such cases, statutory provisions that cause the resulting Bank to have a very large board of directors also may make board operations more

a material relationship. The board of directors of the Bank is responsible for determining whether a relationship is "material" after "broadly" considering all relevant facts and circumstances. See NYSE Listed Company Manual Sect. 303A.02 and 303A.07(a).

Under SOA section 301, an audit committee director is not considered independent if the director is an "affiliated person" of the Bank. The Securities Exchange Act of 1934 defines "affiliated person" as a person who owns, directly or indirectly, or controls 5% of the voting securities of the Bank. A member director does not directly own voting securities of a Bank but may be deemed to indirectly own or control the securities under certain scenarios (e.g., if the member director owns 25% of the voting securities of the member). See 15 U.S.C. 78c(a)(19) and 78j-1. Under SEC rule 10A-3, promulgated pursuant to SOA section 301, an audit committee director is considered "affiliated" if the director directly or indirectly "controls" the Bank. Under rule 10A-3, a person will be deemed not to have "control" if the person, directly or indirectly, owns 10% or less of the voting securities of the Bank. See 17 CFR 240.10A-3. Nine of the Banks have stated in their federal securities laws filings that all members of their audit committees have satisfied the independence requirements under SEC rule 10A-3.

cumbersome and thus less efficient. To the extent that an executive committee may address matters that otherwise would have been addressed by the full board, FHFA requests comments on what limitations might be appropriate to ensure that the ability of those directors who are not on the executive committee to exercise their own fiduciary duties is not compromised.

#### *C. Subpart C—Other Requirements Applicable to All Regulated Entities*

Subpart C includes four provisions that relate to certain other matters that FHFA believes should apply to all of the regulated entities, but are not the type of governance provisions that are included in Subpart B. These provisions address: (1) Code of conduct; (2) risk management; (3) compliance programs; and (4) regulatory reports. The substance of these provisions is derived from parts 914, 917, and 1710 of the Finance Board and OFHEO regulations, respectively, except for the risk management provision, which has been rewritten in its entirety to better align it with supervisory expectations for sound risk management.

#### *Code of Conduct (1239.10)*

The first regulation in Subpart C requires each regulated entity to establish a written code of conduct for directors, executive officers, and employees that is designed to ensure that they discharge their duties in an objective and impartial manner. The code of conduct must include standards set forth in section 406 of the SOA, which address promoting: (1) Honest and ethical conduct, including the handling of conflicts of interest between personal and professional relationships; (2) full, fair, accurate, timely, and understandable disclosures in periodic reports filed with the Securities and Exchange Commission (SEC); and (3) compliance with applicable rules and regulations. In addition, each regulated entity must review the code at least once every three years and make any necessary revisions. The requirements of proposed § 1239.10 are being relocated from OFHEO regulation § 1710.14 without any substantive changes, and are being made applicable to the Banks as well as the Enterprises. FHFA believes that a code of conduct is an important tool to ensure the safe and sound operation of a regulated entity and therefore is proposing to extend the requirements of this provision to the Banks.

#### *Risk Management (1239.11)*

Both the Finance Board and OFHEO regulations include provisions dealing

with the issue of risk management responsibilities of the boards of directors. See 12 CFR 917.3 and § 1710.19(b). In reviewing both of those provisions, FHFA determined that they may no longer reflect the current best risk management practices and concepts. Based in part on more recent proposals of the Federal Reserve Board,<sup>3</sup> FHFA is proposing to adopt a new risk management regulation for all of the regulated entities, which would supplant the existing Finance Board and OFHEO regulations. The proposed risk management provision would require a regulated entity to adopt an enterprise-wide risk management program that aligns the entity's overall risk profile with its strategic plan and mission objectives. The regulation also would require that the risk management program address the regulated entity's risk profile and risk exposure. The program also would have to include appropriate risk limitations, risk management practices, and compliance monitoring provisions, while specifying management's authority and independence to carry out its risk management responsibilities.

The proposed rule would require each regulated entity to have a risk committee and that it be established pursuant to a written charter approved by the full board of directors. The risk committee also would have to be chaired by a director that does not serve in a management capacity. That provision would effectively apply only to the Enterprises because the boards of the Banks do not have any management representatives. The committee must have at least one member with risk management expertise and all members must have an understanding of risk management principles and experience developing and applying risk management practices, identifying risks, and monitoring risk controls for financial services organizations. The proposal would require the committee to meet regularly and report directly to the board of directors, and would provide that the committee is responsible for documenting and overseeing the risk management policies and practices, reviewing and approving the risk management program, and reviewing regular reports from the chief risk officer (CRO).

The proposed rule would require each regulated entity to appoint a CRO, who would be responsible for the risk management function. The proposed

<sup>3</sup> See Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, Board of Governors of the Federal Reserve System, 77 FR 594 (Jan. 5, 2012).

rule would specify certain responsibilities of the CRO, which would include: (1) Allocating delegated risk limits; (2) establishing appropriate policies, processes, and systems to identify and report risks; (3) managing risk exposures and controls; and (4) reporting risk management issues directly and regularly to the risk committee and the chief executive officer. The CRO also must have risk management expertise commensurate with the regulated entity's capital structure, risk profile, complexity, activities, and size. The board would be required to structure the CRO's compensation in such a manner as to provide for an objective and independent assessment of the risks taken by the regulated entity.

#### Compliance Program (1239.12)

This provision of the proposed rule would require the regulated entities to establish a compliance program headed by a compliance officer and would set forth criteria for the program. These provisions would be carried over, with modest conforming changes, from OFHEO regulation § 1710.19, and thus would be new only for the Banks. The compliance program to be established under this provision must be reasonably designed to ensure that the regulated entity complies with applicable laws, rules, regulations, and internal controls. In addition to reporting directly to the chief executive officer, the compliance officer must report regularly to the entity's board of directors (or a committee thereof) on the adequacy of the entity's compliance policies and procedures, and must recommend any appropriate adjustments to those policies or procedures. Other provisions of the OFHEO regulation, at § 1710.19(b) and (c), which deal with risk management and registration of Enterprise stock under the federal securities laws, would be repealed as either being addressed elsewhere or no longer being relevant.

#### Regulatory Reports (1239.13)

The last section of Subpart C would require each regulated entity to provide FHFA with such regulatory reports as are necessary for it to evaluate the condition of a regulated entity, or compliance with applicable law, and to do so in accordance with the forms and instructions issued by FHFA from time to time. This provision would be relocated, with only minor non-substantive changes, from the Finance Board regulations at 12 CFR 914.1 and 914.2. FHFA has the statutory authority to compel all regulated entities to submit the reports described in

§ 1239.13. 12 U.S.C. 4514. Therefore, applying this provision to all regulated entities would not impose any new burdens on the Enterprises, but would serve to highlight the importance of timely and accurate data reporting.

#### *D. Enterprise-Specific Requirements (Subpart D)*

Subpart D of the proposed rule would carry over two OFHEO regulations relating to: (1) Eligibility requirements for the board of directors of the Enterprises and conduct of their board meetings; and (2) compensation for Enterprise directors. The first provision is substantively identical to the current OFHEO regulation § 1710.11, while the second provision is based on § 1710.13, with minor changes that eliminate portions relating to compensation of executive officers and employees, which are no longer necessary. Neither of these two provisions would be applied to the Banks because section 7 of the Bank Act, 12 U.S.C. 1427, already establishes eligibility requirements and mandates a specific composition of Bank boards between member directors and independent directors, and because section 7 and 12 CFR part 1261 of the FHFA regulations already include provisions governing compensation for directors of the Banks.

#### Enterprise Board of Director Requirements (1239.20)

The first provision of Subpart D addresses age and term limits for individual Enterprise board members and requires that a majority of the directors be independent, as defined under the rules of the NYSE. It also addresses the frequency of Enterprise board meetings, quorum requirements, and voting by directors. These provisions are being carried over from § 1710.11 without substantive change and would apply only to the Enterprises. In addition, proposed § 1239.20 includes a new provision that would prohibit the chief executive officer (CEO) of an Enterprise from also serving as the chairman of the board of directors. FHFA is proposing to add this requirement in order to promote the board of directors' oversight of senior management. By separating the two positions, FHFA intends to preclude the possibility that a CEO would have an opportunity to unduly influence the full board of directors by virtue of holding the chairman's position.

#### Compensation of Enterprise Board Members (1239.21)

The second provision of Subpart D states that Enterprise director compensation must be reasonable and

appropriate for the time required for the performance of their duties. This provision is based on § 1710.13 of the OFHEO regulations, which addresses compensation of Enterprise board members, as well as Enterprise officers and employees. The proposed rule would differ from the OFHEO rule in that it would apply only to compensation paid to the directors of an Enterprise. Because FHFA has recently adopted an interim rule addressing executive compensation matters for the Banks and the Enterprises, there is no longer any need to address the matter of executive compensation in these provisions. As for non-executive employees, FHFA believes that a separate regulation is not necessary as those salaries will be set by an entity's executives, whose compensation is subject to FHFA review.

#### *E. Subpart E—Bank-Specific Requirements*

Subpart E of the proposed rule would carry over from the Finance Board regulations five provisions that address a Bank's: (1) Member products policy; (2) strategic business plan; (3) internal control system; (4) audit committee; and (5) dividends. The proposed provisions derive from current Finance Board regulations on these topics, which will be relocated to subpart E with only minor and conforming changes. As discussed in more detail below, FHFA believes that three of these provisions—regarding the member products policy, business plan, and dividends—are unique to the Banks and thus should not be applied to the Enterprises. Although FHFA is proposing to include the Finance Board provisions on internal controls and audit committees in the "Bank specific" portion of the rule, it also is requesting comment on whether it would be appropriate to revise those provisions so that they could be applied to both the Banks and the Enterprises.

#### Bank Member Product Policy (1239.30)

Finance Board regulations require each Bank to have a member products policy that addresses the Bank's management of products offered to members and housing associates. See 12 CFR 917.4. Under that provision, a Bank's board of directors must review the policy annually, amend it as appropriate, and readopt it at least every three years. The policy must address certain specified topics, which are: (1) Credit underwriting criteria; (2) levels of collateralization; (3) fees and product pricing; (4) maintenance of appropriate systems, procedures, and internal controls; and (5) maintenance of appropriate operational and personnel

capacity. The proposed rule would simply relocate the existing Finance Board regulations without substantive change.

#### Strategic Business Plan (1239.31)

Finance Board regulations also require each Bank's board of directors to adopt a strategic business plan that describes how each Bank will achieve its housing finance mission, and how each Bank establishes goals and objectives for each of its business activities. *See* 12 CFR § 917.5. The plan must also: (1) Discuss how a Bank will address credit needs and market opportunities; (2) establish quantitative performance goals for Bank products related to multi-family housing, small business, small farm, and small agri-business lending; (3) describe proposed new business activities; and (4) be supported by appropriate research and analysis of market developments and member demand for products. Each Bank's board of directors must review the plan at least annually, readopt it at least every three years, and establish management reporting requirements and monitor implementation. The proposed rule would simply relocate this regulation without substantive change to the FHFA regulations. FHFA is not proposing to extend it to the Enterprises because their strategic objectives are subject to FHFA control as a result of the conservatorships.

#### Internal Control System (1239.32)

The proposed rule would carry over, without substantive change, the Finance Board regulation dealing with internal control systems at the Banks. *See* 12 CFR 917.6. The current Finance Board regulation requires each Bank to establish and maintain an effective internal control system that addresses: (1) The efficiency and effectiveness of Bank activities; (2) the safeguarding of Bank assets; (3) the reliability, completeness, and timely reporting of financial and management information; and (4) compliance with applicable laws, regulations, policies, and management and board directives. The regulation sets forth detailed responsibilities of senior management and the board of directors with respect to internal controls. This regulation would not apply to the Enterprises, as many of the detailed requirements in the provision are specific to the Banks and reflect their unique structure.

Nonetheless, the topic of internal controls is one that is relevant to both the Banks and the Enterprises, and FHFA is considering whether it should adopt a regulation on internal controls that would apply to all of the regulated

entities. Accordingly, FHFA specifically requests public comment on the following questions:

1. In what manner should FHFA revise the content of § 917.6 so that it could be applied to all regulated entities, and what specific revisions to the regulatory text would be needed to accomplish that objective?

2. What regulatory approach would be best suited for addressing the topic of internal controls at the Banks and Enterprises, one based on general principles, or one that includes detailed requirements that prescribe particular steps that an entity should take in creating and operating a system of internal controls?

3. If FHFA were to adopt a more prescriptive approach to a regulation on internal controls, is the current approach, which separately addresses the requirements of an internal control system, the responsibilities of the board, and the responsibilities of management, appropriate?

4. If FHFA were to adopt a more principles-based approach to internal controls, what principles would be necessary to assure that regulated entities would establish and maintain an effective system of internal controls?

5. What amendments to the regulation or the Prudential Standards would be most appropriate to ensure that they complement each other with respect to the entities' internal control systems?

6. Should the proposed § 1239.32(a)(iv) retain the requirement that the internal control system must ensure that the entity complies with all applicable laws and regulations if the proposed rule will separately require that the entities establish a compliance program to address that same topic?

7. Are there any types of internal control requirements that would be unique to either the Banks or the Enterprises and could not readily be applied to the other entities?

#### Audit Committee (1239.33)

The proposed rule also would carry over without substantive change the provisions of the Finance Board regulations dealing with Bank audit committees. *See* 12 CFR 917.7. Those provisions would set forth requirements relating to the composition of the audit committee and the content of the audit committee charter. They would also require that the audit committee members be independent and establish certain independence criteria. The proposal would retain the provision requiring the audit committee to include a balance of representatives of community financial institutions and other members, as well as independent

directors and member directors. The audit committee would be required to have a charter that covers the selection and retention of the internal auditor and reporting channels for the auditor. The regulation also lists numerous duties of the audit committee, including: (1) Directing senior management to maintain the reliability and integrity of the accounting policies; (2) reviewing the basis for the Bank's financial statements and the external auditor's opinion; (3) overseeing the audit function; and (4) conducting or authorizing investigations.

The Finance Board regulation on Bank audit committees reflects the unique structure of the Banks as member-owned cooperatives whose boards of directors include a majority of member directors that also serve as officers or directors of their member institutions. Because the board structure of the Banks is unique and differs so much from that of the Enterprises, FHFA believes that it is appropriate to retain the Bank-specific regulations for the Banks' audit committees. FHFA is not proposing to impose these requirements on the Enterprises because of those differences and because the Enterprises are separately required (by the OFHEO regulations and by this proposed rule) to comply with the audit committee requirements of section 301 of the SOA and the rules of the NYSE.

Nonetheless, the topic of audit committees is one that is relevant to both the Banks and the Enterprises, and FHFA requests comments on the following questions:

1. By carrying over the existing Finance Board and OFHEO regulations, the proposed rule would effectively retain the two distinct regulatory approaches embodied in the current rules, *i.e.*, OFHEO's approach of using a cross-reference to the SOA audit committee provisions and the Finance Board's approach of using the considerably more detailed regulatory provisions to address audit committee responsibilities. FHFA requests comment on whether it should continue this arrangement or whether it should develop one rule on audit committees that would apply to both the Banks and the Enterprises. FHFA also requests comment on how a single rule should be structured, *i.e.*, whether it should adopt the approach of the current OFHEO regulations, the approach of the Finance Board regulations, or some other approach.

2. If FHFA were to retain the substance of the current Finance Board rule for Bank audit committees (either for the Banks or for the Banks and the Enterprises), FHFA requests comments

on how it could modify the provisions of that rule (which would be located at § 1239.33 of this proposal) to make them more streamlined while also providing sufficient guidance to the regulated entities to ensure that the audit committees function in an independent and efficient manner.

3. With respect to the independence requirement of the current Finance Board regulation, FHFA requests comments on whether it should add a new provision that would deem a member director to not be “independent” for audit committee purposes if the member institution at which that director is employed were to have more than a specified percentage of the Bank’s outstanding capital stock or the Bank’s total advances. FHFA also requests comments regarding the level at which a member’s Bank stock or advances could be considered to be too high for that member’s representative to be deemed sufficiently independent to serve on the Bank’s audit committee.<sup>4</sup>

4. With respect to the composition of Bank audit committees, which must include a balance of representatives from community financial institutions and other members, and of independent and member directors, FHFA requests comment on whether that provision remains optimal or whether the regulation should require any other requirements relating to audit committee composition, such as requiring a majority of the committee members to be independent directors.

5. With respect to the relationship between the audit committee regulations and the Prudential Standards, FHFA requests comment on how best to coordinate the audit committee regulations with the provisions of Standard 2, which also addresses audit committees, whether FHFA should address audit committee requirements entirely within either the regulations or the standards, and what matters would be more appropriately addressed in a regulation or in the Prudential Standards.

#### Bank Dividends (1239.34)

The last regulation in Subpart E would carry over with only modest

revisions a Finance Board regulation addressing Bank dividends. *See* 12 CFR 917.9. Among other things, that provision prohibits a Bank’s board of directors from declaring or paying a dividend based on projected or anticipated earnings or if the par value of the Bank’s stock is impaired, or would become impaired as a result of paying the dividend. The proposed rule would not carry over two provisions from § 917.9 whose content either is addressed in another regulation or relates to statutory provisions that are no longer in effect. FHFA is proposing not to apply this provision to the Enterprises, in part because it carries out provisions of the Bank Act that apply only to the Banks and in part because Enterprise dividends during conservatorship are governed by the senior preferred stock purchase agreements.

#### F. Provisions To Be Repealed

As noted above, there are several portions of 12 CFR part 917 and 12 CFR part 1710 that have become obsolete or are no longer necessary, and FHFA is proposing to repeal them as part of this rulemaking. The repealed provisions consist of: (1) Several OFHEO regulations that impose requirements substantively identical to those found in the SOA; (2) an OFHEO regulation that reserves the right of FHFA to amend its regulations; (3) an OFHEO regulation that states that FHFA has the authority under the Safety and Soundness Act to prohibit or restrict indemnification of board members and executives of the Enterprises; (4) portions of the OFHEO regulation relating to the responsibilities of boards of directors that address matters that are covered by the Prudential Standards; and (5) a Finance Board regulation that requires Banks to prepare annual budgets.

#### SOA Provisions

OFHEO regulations at § 1710.13(b), § 1710.16, § 1710.17, § 1710.18, and § 1710.19(c) are substantively identical to requirements found in the SOA, which apply to the Banks and Enterprises as registered issuers under the federal securities laws.<sup>5</sup> These regulations address reimbursement of compensation paid to an Enterprise CEO or CFO in cases of accounting restatements due to material noncompliance with financial reporting requirements, prohibitions on extensions of credit to Enterprise board

members and executives, certification of quarterly and annual financial statements by the CEO and CFO, audit partner rotation, and registration and deregistration of securities. Because the Enterprises and the Banks are subject to the corresponding SOA statutory provisions, there is no need to repeat those requirements in the FHFA regulations.

#### Board of Directors

As noted previously, § 1710.15 of the OFHEO regulations addresses the conduct and responsibilities of Enterprise directors, and FHFA is proposing to carry over certain of those provisions into § 1239.4 of the proposed rule. FHFA also is proposing to repeal the remaining portions of § 1710.15, which include the introductory language, language requiring directors to refer to state law and OFHEO pronouncements for additional guidance, several provisions requiring the board to have policies for overseeing corporate strategy, hiring of qualified senior executives, financial reporting, and extensions of credit to board members. FHFA believes that these matters are adequately addressed in other provisions of the proposed rule or in the Prudential Standards, and need not be adopted as FHFA regulations.

#### Budget Preparation

Finance Board regulation § 917.8 requires Banks to adopt an operating and a capital expenditures budget annually. FHFA believes that the adoption of a budget is a basic duty already encompassed in a director’s duty to act in good faith and with care in overseeing the affairs of a Bank. Therefore, FHFA is not proposing to carry this Finance Board provision over into the FHFA regulations.

#### Part 1720

As noted previously, FHFA is proposing to repeal 12 CFR part 1720 of the OFHEO regulations, which established certain safety and soundness standards for the Enterprises, because those matters are addressed by the Prudential Standards and by certain parts of this proposed rule.

### IV. Prudential Standards

The introductory section of the Prudential Standards, which appears immediately before the enumerated 10 standards, recites general responsibilities of the boards of directors and senior management of the regulated entities, as they relate to the matters addressed by the individual standards. FHFA is proposing to explicitly state that this introductory

<sup>4</sup> For example, the Federal Deposit Insurance Corporation prohibits “large customers” from serving on the audit committee of a regulated institution that has total assets of more than \$3 billion at the beginning of the fiscal year. “Large customer” is defined as “any individual or entity (including a controlling person of any such entity) which, in the determination of the board of directors, has such significant direct or indirect credit or other relationships with the institution, the termination of which likely would materially and adversely affect the institution’s financial condition or results of operations . . .” *See* 12 CFR § 363.5(b) and Appendix A to 12 CFR 363.

<sup>5</sup> Section 1112 of HERA requires the Banks to maintain registration of their common stock with the SEC and states that equity securities of the Enterprises are not exempt from SEC registration requirements.

section is part of the standards, which means that the introductory provisions would have the same effect and could be enforced in the same manner as the 10 enumerated standards. To do this, FHFA is proposing to amend the definition of the term “standards,” which appears in 12 CFR 1236.2, by adding an explicit statement that the Prudential Standards consist of both the introductory section and the existing enumerated standards. FHFA is also proposing to revise the Prudential Standards by relocating a sentence that appears immediately after the introductory language and immediately before the 10 enumerated standards, that reads as follows: “The following provisions constitute the prudential management and operations standards established pursuant to 12 U.S.C. 4513b(a).” FHFA would relocate this sentence to the beginning of the Prudential Standards and immediately before the existing introductory language regarding director and senior management responsibilities. FHFA is proposing these amendments to ensure that it can use the remedial provisions of the Prudential Standards to address corporate governance deficiencies at the regulated entities, as they may relate to the individual standards, should FHFA believe that those provisions will be more effective than its other administrative enforcement authorities.

#### *Harmonization of the Prudential Standards and FHFA Regulations*

The Prudential Standards address certain topics that also are covered by the existing regulations and would continue to be covered by the proposed regulations, which results in a degree of regulatory overlap. Despite that overlap, there are meaningful differences between the two provisions, some of which may be appropriate to preserve. One key difference is that because the Prudential Standards have been adopted as guidance, they do not have the force and effect of law, as do the regulations addressing the same topics. For that reason, the Prudential Standards may be enforced only by the remedial authorities in the Prudential Standards statute, and not through the agency’s administrative enforcement powers, which can be used to enforce regulations, unless a regulated entity’s failure to meet a prudential standard rises to the level of an unsafe or unsound practice. FHFA is not proposing to address in this regulation all of the potential areas of overlap between the Prudential Standards and the regulations, but does intend to initiate a separate project to identify any regulations that address topics that are

also covered by the Prudential Standards, or would more appropriately be covered by a Prudential Standard. To aid it in that undertaking, FHFA is requesting comments on how it may best integrate and harmonize its regulations and the Prudential Standards, particularly with respect to the seven topics described below.

*General Duties of Boards of Directors.* To certain degrees, both the Prudential Standards and the regulations address the general responsibilities of the boards of directors of the regulated entities. Within the Standards, the first three principles of the introductory section address certain director responsibilities, as they relate to the subject matter of each of the Prudential Standards, such as adopting business strategies and policies, overseeing management, and remaining informed about the operations and condition of a regulated entity. The proposed regulation, at § 1239.4, also would address the duties and responsibilities of the boards of directors, albeit in a more global sense, *i.e.*, not simply in relation to the subject matter of the 10 prudential standards.

*Board Briefings.* Principles seven and eight of the introductory section of the Prudential Standards require management to provide the board of directors with periodic reports on the entity’s condition and performance. This is similar to proposed § 1239.20(b)(4), which would apply only to the Enterprise and requires management to provide boards with information that is necessary to allow the directors to fulfill their fiduciary duties.

*Audit Committee Responsibilities.* Several provisions of the Prudential Standards, paragraphs 2.1, 2.3–2.7, and 2.9–2.10, address audit committee responsibilities, including establishing policies for and overseeing the internal audit function, evaluating the effectiveness of the internal audit function, addressing internal audit issues, and ensuring that audit department personnel are competent and properly trained. Section 1239.33 of the proposed rule, which is based on a Finance Board regulation and would apply only to the Banks, also addresses certain of these same topics.

*Risk Management.* Although the Prudential Standards do not address specific duties of the risk committee or the CRO, Standards 8.2, 8.4–8.5, 8.7, 8.9–8.10, and principles nine and 10 of the introductory section do require a regulated entity to have a risk management program that is capable of addressing a number of the topics. Certain of those topics are also addressed in § 1239.11 of the proposed

rule. In addition, both § 1239.11 and the Prudential Standards provide that the CRO should report to the CEO and the risk committee.

*Internal Controls.* Prudential Standards 1.1, 1.3–1.8, 1.10, and 1.14–1.15 require regulated entities to have an adequate and effective system of internal controls, including a board-approved organizational structure that clearly assigns responsibilities and reporting relationships. Under those provisions, a regulated entity also must establish and monitor appropriate internal control policies. These same topics and related concepts are also addressed in § 1239.32, which is based on an existing Finance Board regulation and would apply only to the Banks.

*Code of Conduct.* Principle nine of the introductory section of the Prudential Standards states that board members and senior management of a regulated entity should conduct themselves in a manner to promote high ethical standards and establish a culture of compliance throughout the organization. Section 1239.10, which would apply to all regulated entities, also addresses the topic of codes of conduct and ethics.

*Compliance with Laws and Regulations.* Prudential Standards 1–5 and 8–10 each contain a paragraph that states that, with respect to the subject matter addressed by that standard, a regulated entity should comply with all applicable laws, regulations, and supervisory guidance. The subject of regulatory compliance is also addressed in § 1239.12, which requires each entity to have a compliance program.

With respect to each of those topics described above, FHFA requests comments on whether there are any direct conflicts between the regulations and the standards, *i.e.*, situations in which an entity cannot practicably comply with both the regulation and the standard. FHFA also requests comments on how it should strike the balance for each of those topics with respect to what issues should be addressed by regulation and what issues should be addressed by the Prudential Standards. FHFA further requests comments on the content of the particular regulations and standards, *i.e.*, whether the current content remains appropriate, as well as the structure of the regulations or standards, *i.e.*, whether they should address the underlying subject matter through a principles-based approach or through the more prescriptive approach reflected in the current Finance Board regulations.

## V. Paperwork Reduction Act

The proposed regulation does not contain any information collection requirement that requires the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

## VI. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires an agency to analyze a proposed regulation's impact on small entities if the final rule is expected to have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of this regulation and determined that it is not likely to have a significant economic impact on a substantial number of small entities because it applies only to the regulated entities, which are not small entities for purposes of the Regulatory Flexibility Act.

### List of Subjects

#### 12 CFR Part 914

Federal Home Loan Banks, Reporting and recordkeeping requirements.

#### 12 CFR Part 917

Federal Home Loan Banks.

#### 12 CFR Part 1236

Administrative practice and procedure, Federal Home Loan Banks, Government-Sponsored Enterprises, Reporting and recordkeeping requirements.

#### 12 CFR Part 1239

Administrative practice and procedure, Federal Home Loan Banks, Government-Sponsored Enterprises, Reporting and recordkeeping requirements.

#### 12 CFR Part 1710

Administrative practice and procedure, Mortgages.

#### 12 CFR Part 1720

Administrative practice and procedure, Mortgages.

Accordingly, for reasons stated in the Supplementary Information and under the authority of 12 U.S.C. 1426, 1427, 1432(a), 1436(a), 1440, 4511(b), 4513(a), 4513(b), and 4526, FHFA hereby proposes to amend subchapter C of chapter IX, subchapter B of chapter XII, and subchapter C of chapter XVII of title 12 of the Code of Federal Regulations as follows:

## CHAPTER IX—FEDERAL HOUSING FINANCE BOARD

### Subchapter C—[Removed and Reserved]

- 1. Subchapter C, consisting of parts 914 and 917, is removed and reserved.

## CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY

### Subchapter B—Entity Regulations

## PART 1236—PRUDENTIAL MANAGEMENT AND OPERATIONS STANDARDS

- 2. The authority citation for part 1236 continues to read as follows:

**Authority:** 12 U.S.C. 4511, 4513(a) and (f), 4513b, and 4526.

- 3. Amend § 1236.2 by revising the definition of “Standards” to read as follows:

### § 1236.2 Definitions.

\* \* \* \* \*

*Standards* means any one or more of the prudential management and operations standards established by the Director pursuant to 12 U.S.C. 4513b(a), as modified from time to time pursuant to § 1236.3(b), including the introductory statement of general responsibilities of boards of directors and senior management of the regulated entities.

### Appendix to Part 1236 [Amended]

- 4. Amend the appendix to part 1236 by removing the undesignated paragraph “The following provisions constitute the prudential management and operations standards established pursuant to 12 U.S.C. 4513b(a).” following paragraph 10 under “Responsibilities of the Board of Directors and Senior Management” and adding it as introductory text to the appendix.

- 5. Part 1239 is added to read as follows:

## PART 1239—RESPONSIBILITIES OF BOARDS OF DIRECTORS, CORPORATE PRACTICES, AND CORPORATE GOVERNANCE

### Subpart A—General

Sec.

1239.1 Purpose.

1239.2 Definitions.

### Subpart B—Corporate Practices and Procedures Applicable to All Regulated Entities

1239.3 Law applicable to corporate governance and indemnification practices.

1239.4 Duties and responsibilities of directors.

1239.5 Board committees.

### Subpart C—Other Requirements Applicable to All Regulated Entities

1239.10 Code of conduct and ethics.

1239.11 Risk management.

1239.12 Compliance program.

1239.13 Regulatory reports.

### Subpart D—Enterprise Specific Requirements

1239.20 Board of directors of the Enterprises.

1239.21 Compensation of Enterprise board members.

### Subpart E—Bank Specific Requirements

1239.30 Bank member product policy.

1239.31 Strategic business plan.

1239.32 Internal control system.

1239.33 Audit committee.

1239.34 Dividends.

**Authority:** 12 U.S.C. 1426, 1427, 1432(a), 1436(a), 1440, 4511(b), 4513(a), 4513(b), and 4526.

### Subpart A—General

#### § 1239.1 Purpose.

FHFA is responsible for supervising and ensuring the safety and soundness of the regulated entities. In furtherance of those responsibilities, this part sets forth minimum standards with respect to responsibilities of boards of directors, corporate practices, and corporate governance matters of the regulated entities.

#### § 1239.2 Definitions.

As used in this part (or, as otherwise noted):

*Authorizing statutes* 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, or the Bank Act, as applicable.

*Board member* means a member of the board of directors of a regulated entity.

*Board of directors* means the board of directors of a regulated entity.

*Business risk* means the risk of an adverse impact on a regulated entity's profitability resulting from external factors as may occur in both the short and long run.

*Community financial institution* has the meaning set forth in § 1263.1 of this chapter.

*Compensation* means any payment of money or the provision of any other thing of current or potential value in connection with employment or service as a director.

*Credit risk* is the potential that a borrower or counterparty will fail to meet its financial obligations in accordance with agreed terms.

*Employee* means an individual, other than an executive officer, who works

part-time, full-time, or temporarily for a regulated entity.

*Executive officer* means the chairperson or vice chairperson of the board of directors of an Enterprise; and, with respect to any regulated entity, the chief executive officer, chief financial officer, chief operating officer, president, any executive vice president, any senior vice president, and any 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 chief executive officer or president of a regulated entity.

*Immediate family member* means a parent, sibling, spouse, child, dependent, or any relative sharing the same residence.

*Internal auditor* means the individual responsible for the internal audit function at a regulated entity.

*Liquidity risk* means the risk that a regulated entity will be unable to meet its financial obligations as they come due or meet the credit needs of its members and associates in a timely and cost-efficient manner.

*Market risk* means the risk that the market value, or estimated fair value if market value is not available, of a regulated entity's portfolio will decline as a result of changes in interest rates, foreign exchange rates, or equity or commodity prices.

*NYSE* means the New York Stock Exchange.

*Operational risk* means the risk of loss resulting from inadequate or failed internal processes, people, or systems, or from external events (including legal risk but excluding strategic and reputational risk).

*Significant deficiency* means a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

*SOA* means the Sarbanes Oxley Act, Pub. L. 107–204 (2002).

## **Subpart B—Corporate Practices and Procedures Applicable to All Regulated Entities**

### **§ 1239.3 Law applicable to corporate governance and indemnification practices.**

(a) *General.* The corporate governance practices and procedures of each regulated entity, and practices and procedures relating to indemnification (including advancement of expenses), shall comply with and be subject to the applicable authorizing statutes and other Federal law, rules, and regulations, and shall be consistent with

the safe and sound operations of the regulated entities.

(b) *Election and designation of body of law.* (1) To the extent not inconsistent with paragraph (a) of this section, each regulated entity shall elect to follow the corporate governance and indemnification practices and procedures set forth in one of the following:

(i) The law of the jurisdiction in which the principal office of the regulated entity is located;

(ii) The Delaware General Corporation Law (Del. Code Ann. Title 8); or

(iii) The Revised Model Business Corporation Act.

(2) Each regulated entity shall designate in its bylaws the body of law elected for its corporate governance and indemnification practices and procedures pursuant to this paragraph.

(c) *Indemnification.* (1) Subject to paragraphs (a) and (b) of this section, to the extent applicable, a regulated entity shall indemnify (and advance the expenses of) its directors, officers, and employees under such terms and conditions as are determined by its board of directors. The regulated entity is authorized to maintain insurance for its directors and any other officer or employee.

(2) Each regulated entity shall have in place policies and procedures consistent with this section for indemnification of its directors, officers, and employees. Such policies and procedures shall address how the board of directors is to approve or deny requests for indemnification from current and former directors, officers, and employees, and shall include standards relating to indemnification, investigations by the board of directors, and review by independent counsel.

(3) Nothing in this paragraph shall affect any rights to indemnification (including the advancement of expenses) that a director or any other officer or employee had with respect to any actions, omissions, transactions, or facts occurring prior to the effective date of this paragraph.

(4) FHFA has the authority under the Safety and Soundness Act to review a regulated entity's indemnification policies, procedures, and practices, and may limit or prohibit indemnification payments in furtherance of the safe and sound operations of the regulated entity.

### **§ 1239.4 Duties and responsibilities of directors.**

(a) *Management of a regulated entity.*

The management of each regulated entity shall be vested in its board of directors. While boards of directors may delegate the execution of operational

functions to officers and employees of the regulated entity, the ultimate responsibility of each entity's board of directors for that entity's management is non-delegable. The board of directors of a regulated entity is responsible for directing the conduct and affairs of the entity in furtherance of the safe and sound operation of the entity and shall remain reasonably informed of the condition, activities, and operations of the entity.

(b) *Duties of directors.* Each director of a regulated entity shall have the duty to:

(1) Carry out his or her duties as director in good faith, in a manner such director believes to be in the best interests of the regulated entity, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances;

(2) Administer the affairs of the regulated entity fairly and impartially and, for Bank directors, without discrimination in favor of or against any member institution;

(3) At the time of election, or within a reasonable time thereafter, have a working familiarity with basic finance and accounting practices, including the ability to read and understand the regulated entity's balance sheet and income statement and to ask substantive questions of management and the internal and external auditors;

(4) Direct the operations of the regulated entity in conformity with the requirements set forth in the authorizing statutes, Safety and Soundness Act, and this chapter; and

(5) Adopt and maintain in effect at all times bylaws governing the manner in which the regulated entity administers its affairs. Such bylaws shall be consistent with applicable laws and regulations administered by FHFA, and with the body of law designated for the entity's corporate governance practices and procedures.

(c) *Director responsibilities.* The responsibilities of the board of directors include having in place adequate policies and procedures to assure its oversight of, among other matters, the following:

(1) The risk management and compensation programs of the regulated entity;

(2) The processes for providing accurate financial reporting and other disclosures, and communications with stockholders; and

(3) The responsiveness of executive officers in providing accurate and timely reports to FHFA and in addressing all supervisory concerns of

FHFA in a timely and appropriate manner.

(d) *Authority regarding staff and outside consultants.* (1) In carrying out its duties and responsibilities under the authorizing statutes, the Safety and Soundness Act, and this chapter, each regulated entity's board of directors and all committees thereof shall have authority to retain staff and outside counsel, independent accountants, or other outside consultants at the expense of the regulated entity.

(2) The board of directors and its committees may require that staff of the regulated entity that provides services to the board or any committee under paragraph (d)(1) of this section report directly to the board or such committee, as appropriate.

#### **§ 1239.5 Board committees.**

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

(b) *Required committees.* The board of directors of each regulated entity shall have committees, however styled, that address each of the following areas of responsibility: Risk management, audit, compensation, and corporate governance (in the case of the Banks, including the nomination of independent board of director candidates, and, in the case of the Enterprises, including the nomination of all board of director candidates). The risk management committee and the audit committee shall not be combined with any other committees. The board of directors may establish any other committees that it deems necessary or useful to carrying out its responsibilities, subject to the provisions of this section. In the case of the Enterprises, board committees shall comply with the charter, independence, composition, expertise, duties, responsibilities, and other requirements set forth under rules issued by the NYSE, and the audit committees shall also comply with the requirements set forth under section 301 of the SOA.

(c) *Charter.* Each committee shall adopt, and the board of directors of each regulated entity shall approve, a formal written charter that specifies the scope of a committee's powers and responsibilities, as well as the committee's structure, processes, and membership requirements.

(d) *Frequency of meetings.* Each committee of the board of directors shall meet regularly and with sufficient frequency to carry out its obligations and duties under applicable laws, rules, regulations, and guidelines. Such a committee shall also meet with sufficient timeliness as necessary in light of relevant conditions and circumstances to fulfill its obligations and duties.

### **Subpart C—Other Requirements Applicable to All Regulated Entities**

#### **§ 1239.10 Code of conduct and ethics.**

(a) *General.* A regulated entity shall establish and administer a written code of conduct and ethics that is reasonably designed to assure the ability of board members, executive officers, and employees of the regulated entity to discharge their duties and responsibilities, on behalf of the regulated entity, in an objective and impartial manner, and that includes standards required under section 406 of the SOA, as amended from time to time, and other applicable laws, rules, and regulations.

(b) *Review.* Not less often than once every three years, a regulated entity shall review the adequacy of its code of conduct and ethics for consistency with practices appropriate to the entity and make any appropriate revisions to such code.

#### **§ 1239.11 Risk management.**

(a) *Risk management program—(1) Adoption.* Each regulated entity's board of directors shall have in effect at all times an enterprise-wide risk management program that establishes the regulated entity's risk profile, aligns the risk profile with the regulated entity's strategies and objectives, and addresses the regulated entity's exposure to credit risk, market risk, liquidity risk, business risk and operational risks and complies with the requirements of this part and with all applicable FHFA regulations and policies.

(2) *Risk profile.* The board of directors and senior management shall ensure that the risk management program aligns the regulated entity's overall risk profile with its mission objectives.

(b) *Risk committee.* The board of each regulated entity shall establish and maintain a risk committee of the board of directors that is responsible for oversight of enterprise-wide risk management practices of the regulated entity.

(c) *Risk committee structure and requirements.* (1) The risk management program shall include:

(i) Risk limitations appropriate to each business line of the regulated entity;

(ii) Appropriate policies and procedures relating to risk management governance, risk management practices, and risk control infrastructure, and processes and systems for identifying and reporting risks, including emerging risks;

(iii) Provisions for monitoring compliance with the regulated entity's risk limit structure and policies and procedures relating to risk management governance, practices, risk controls, and effective and timely implementation of corrective actions; and

(iv) Provisions specifying management's authority and independence to carry out risk management responsibilities, and the integration of risk management and control objectives in management goals and compensation structure.

(2) The risk committee shall:

(i) Be chaired by a director not serving in a management capacity of the regulated entity;

(ii) Have at least one member with risk management expertise that is commensurate with the regulated entity's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors;

(iii) Have committee members with an understanding of risk management principles and practices relevant to the regulated entity;

(iv) Have members with experience developing and applying risk management practices and procedures, measuring and identifying risks, and monitoring the testing risk controls with respect to financial services organizations;

(v) Fully document and maintain records of its meetings, including its risk management decisions and recommendations; and

(vi) Report directly to the board and not as part of, or combined with, another committee.

(d) *Risk committee responsibilities.* The risk committee shall:

(1) Be responsible for documenting and overseeing the enterprise-wide risk management policies and practices of the regulated entity;

(2) Review and approve an appropriate risk management program that is commensurate with the regulated entity's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors; and

(3) Receive and review regular reports from the regulated entity's chief risk officer.

(e) *Chief Risk Officer—(1)*

*Appointment of a chief risk officer*

(CRO). Each regulated entity shall appoint a CRO to implement and maintain appropriate enterprise-wide risk management practices for the regulated entity.

(2) *Organizational structure of the risk management function.* The CRO shall oversee an independent risk management function, or unit, and shall report directly to the risk committee and to the chief executive officer.

(3) *Responsibilities of the CRO.* The CRO shall be responsible for oversight of:

(i) Allocating delegated risk limits and monitoring compliance with such limits;

(ii) Establishing appropriate policies and procedures relating to risk management governance, practices, and risk controls, and developing appropriate processes and systems for identifying and reporting risks, including emerging risks;

(iii) Monitoring risk exposures and risk controls, including testing risk controls and verifying risk measures; and

(iv) Reporting risk management issues and emerging risks, and ensuring that risk management issues are effectively resolved in a timely manner.

(4) The CRO shall execute the responsibilities enumerated in paragraph (e)(3) of this section on an enterprise-wide basis.

(5) The CRO should have risk management expertise that is commensurate with the regulated entity's capital structure, risk profile, complexity, activities, size, and other appropriate risk related factors.

(6) The CRO shall report regularly to the risk committee and to the chief executive officer on the entity's compliance with, and the adequacy of, its current risk management policies and procedures, and shall recommend any adjustments to such policies and procedures that he or she considers necessary or appropriate.

(7) The compensation of a regulated entity's CRO shall be appropriately structured to provide for an objective and independent assessment of the risks taken by the regulated entity.

#### **§ 1239.12 Compliance program.**

A regulated entity shall establish and maintain a compliance program that is reasonably designed to assure that the regulated entity complies with applicable laws, rules, regulations, and internal controls. The compliance program shall be headed by a compliance officer, however styled, who reports directly to the chief executive officer. The compliance officer also shall report regularly to the board of

directors, or an appropriate committee thereof, on the adequacy of the entity's compliance policies and procedures, including the entity's compliance with them, and shall recommend any revisions to such policies and procedures that he or she considers necessary or appropriate.

#### **§ 1239.13 Regulatory reports.**

(a) *Reports.* Each regulated entity shall file Regulatory Reports with FHFA in accordance with the forms, instructions, and schedules issued by FHFA from time to time. If no regularly scheduled reporting dates are established, Regulatory Reports shall be filed as requested by FHFA.

(b) *Definition.* For purposes of this section, the term *Regulatory Report* means any report to FHFA of information or raw or summary data needed to evaluate the safe and sound condition or operations of a regulated entity, or to determine compliance with any:

(1) Provision in the Bank Act, Safety and Soundness Act, or other law, order, rule, or regulation;

(2) Condition imposed in writing by FHFA in connection with the granting of any application or other request by a regulated entity; or

(3) Written agreement entered into between FHFA and a regulated entity.

#### **Subpart D—Enterprise Specific Requirements**

##### **§ 1239.20 Board of directors of the Enterprises.**

(a) *Membership*—(1) *Limits on service of board members*—(i) *General requirement.* No board member of an Enterprise may serve on the board of directors for more than 10 years or past the age of 72, whichever comes first; provided, however, a board member may serve his or her full term if he or she has served less than 10 years or is 72 years on the date of his or her election or appointment to the board; and

(ii) *Waiver.* Upon written request of an Enterprise, the Director may waive, in his or her sole discretion and for good cause, the limits on the service of a board member under paragraph (a)(1)(i) of this section.

(2) *Independence of board members.* A majority of seated members of the board of directors of an Enterprise shall be independent board members, as defined under rules set forth by the NYSE, as amended from time to time.

(3) *Segregation of duties.* The position of chairperson of the board of directors shall be filled by a person other than the chief executive officer, who shall also be

a director of the Enterprise that is independent, as defined under the rules set forth by the NYSE, as amended from time to time.

(b) *Meetings, quorum and proxies, information, and annual review*—(1) *Frequency of meetings.* The board of directors of an Enterprise shall meet at least eight times a year and no less than once a calendar quarter to carry out its obligations and duties under applicable laws, rules, regulations, and guidelines.

(2) *Non-management board member meetings.* Non-management directors of an Enterprise shall meet at regularly scheduled executive sessions without management participation.

(3) *Quorum of board of directors; proxies not permissible.* For the transaction of business, a quorum of the board of directors of an Enterprise is at least a majority of the seated board of directors and a board member may not vote by proxy.

(4) *Information.* Management of an Enterprise shall provide a board member of the Enterprise with such adequate and appropriate information that a reasonable board member would find important to the fulfillment of his or her fiduciary duties and obligations.

(5) *Annual review.* At least annually, the board of directors of an Enterprise shall review, with appropriate professional assistance, the requirements of laws, rules, regulations, and guidelines that are applicable to its activities and duties.

##### **§ 1239.21 Compensation of Enterprise board members.**

Each Enterprise may pay its directors reasonable and appropriate compensation for the time required of them, and their necessary and reasonable expenses, in the performance of their duties.

#### **Subpart E—Bank Specific Requirements**

##### **§ 1239.30 Bank member products policy.**

(a) *Adoption and review of member products policy*—(1) *Adoption.* Each Bank's board of directors shall have in effect at all times a policy that addresses the Bank's management of products offered by the Bank to members and housing associates, including but not limited to advances, standby letters of credit, and acquired member assets, consistent with the requirements of the Bank Act, paragraph (b) of this section, and all applicable FHFA regulations and policies.

(2) *Review and compliance.* Each Bank's board of directors shall:

(i) Review the Bank's member products policy annually;

(ii) Amend the member products policy as appropriate; and

(iii) Re-adopt the member products policy, including interim amendments, not less often than every three years.

(b) *Member products policy requirements.* In addition to meeting any other requirements set forth in this chapter, each Bank's member products policy shall:

(1) Address credit underwriting criteria to be applied in evaluating applications for advances, standby letters of credit, and renewals;

(2) Address appropriate levels of collateralization, valuation of collateral and discounts applied to collateral values for advances, and standby letters of credit;

(3) Address advances-related fees to be charged by each Bank, including any schedules or formulas pertaining to such fees;

(4) Address standards and criteria for pricing member products, including differential pricing of advances pursuant to § 1266.5(b)(2) of this chapter, and criteria regarding the pricing of standby letters of credit, including any special pricing provisions for standby letters of credit that facilitate the financing of projects that are eligible for any of the Banks' CICA programs under part 1292 of this chapter;

(5) Provide that, for any draw made by a beneficiary under a standby letter of credit, the member will be charged a processing fee calculated in accordance with the requirements of § 1271.6(b) of this chapter;

(6) Address the maintenance of appropriate systems, procedures and internal controls; and

(7) Address the maintenance of appropriate operational and personnel capacity.

#### § 1239.31 Strategic business plan.

(a) *Adoption of strategic business plan.* Each Bank's board of directors shall have in effect at all times a strategic business plan that describes how the business activities of the Bank will achieve the mission of the Bank consistent with part 1265 of this chapter. Specifically, each Bank's strategic business plan shall:

(1) Enumerate operating goals and objectives for each major business activity and for all new business activities, which must include plans for maximizing activities that further the Bank's housing finance and community lending mission, consistent with part 1265 of this chapter;

(2) Discuss how the Bank will address credit needs and market opportunities identified through ongoing market

research and consultations with members, associates, and public and private organizations;

(3) Establish quantitative performance goals for Bank products related to multi-family housing, small business, small farm and small agri-business lending;

(4) Describe any proposed new business activities or enhancements of existing activities; and

(5) Be supported by appropriate and timely research and analysis of relevant market developments and member and associate demand for Bank products and services.

(b) *Review and monitoring.* Each Bank's board of directors shall:

(1) Review the Bank's strategic business plan at least annually;

(2) Re-adopt the Bank's strategic business plan, including interim amendments, not less often than every three years; and

(3) Establish management reporting requirements and monitor implementation of the strategic business plan and the operating goals and objectives contained therein.

(c) *Report to FHFA.* Each Bank shall submit to FHFA annually a report analyzing and describing the Bank's performance in achieving the goals described in paragraph (a)(3) of this section.

#### § 1239.32 Internal control system.

(a) *Establishment and maintenance.*

(1) Each Bank shall establish and maintain an effective internal control system that addresses:

(i) The efficiency and effectiveness of Bank activities;

(ii) The safeguarding of Bank assets;

(iii) The reliability, completeness, and timely reporting of financial and management information, and transparency of such information to the Bank's board of directors and to FHFA; and

(iv) Compliance with applicable laws, regulations, policies, supervisory determinations, and directives of the Bank's board of directors and senior management.

(2) Ongoing internal control activities necessary to maintain the internal control system required under paragraph (a)(1) of this section shall include, but are not limited to:

(i) Top level reviews by the Bank's board of directors and senior management, including review of financial presentations and performance reports;

(ii) Activity controls, including review of standard performance and exception reports by department-level management on an appropriate periodic basis;

(iii) Physical and procedural controls to safeguard, and prevent the unauthorized use of, assets;

(iv) Monitoring for compliance with the risk tolerance limits set forth in the Bank's risk management policy;

(v) Any required approvals and authorizations for specific activities; and

(vi) Any required verifications and reconciliations for specific activities.

(b) *Internal control responsibilities of Banks' boards of directors.* Each Bank's board of directors shall ensure that the internal control system required under paragraph (a)(1) of this section is established and maintained, and shall oversee senior management's implementation of such a system on an ongoing basis, by:

(1) Conducting periodic discussions with senior management regarding the effectiveness of the internal control system;

(2) Ensuring that an internal audit of the internal control system is performed annually and that such annual audit is reasonably designed to be effective and comprehensive;

(3) Requiring that internal control deficiencies be reported to the Bank's board of directors in a timely manner and that such deficiencies are addressed promptly;

(4) Conducting a timely review of evaluations of the effectiveness of the internal control system made by internal auditors, external auditors, and FHFA examiners;

(5) Directing senior management to address promptly and effectively recommendations and concerns expressed by internal auditors, external auditors, and FHFA examiners regarding weaknesses in the internal control system;

(6) Reporting any internal control deficiencies found, and the corrective action taken, to FHFA in a timely manner;

(7) Establishing, documenting, and communicating an organizational structure that clearly shows lines of authority within the Bank, provides for effective communication throughout the Bank, and ensures that there are no gaps in the lines of authority;

(8) Reviewing all delegations of authority to specific personnel or committees and requiring that such delegations state the extent of the authority and responsibilities delegated; and

(9) Establishing reporting requirements, including specifying the nature and frequency of reports it receives.

(c) *Internal control responsibilities of Banks' senior management.* Each Bank's

senior management shall be responsible for carrying out the directives of the Bank's board of directors, including the establishment, implementation, and maintenance of the internal control system required under paragraph (a)(1) of this section, by:

(1) Establishing, implementing, and effectively communicating to Bank personnel policies and procedures that are adequate to ensure that internal control activities necessary to maintain an effective internal control system, including the activities enumerated in paragraph (a)(2) of this section, are an integral part of the daily functions of all Bank personnel;

(2) Ensuring that all Bank personnel fully understand and comply with all policies, procedures, and legal requirements applicable to their positions and responsibilities;

(3) Ensuring that there is appropriate segregation of duties among Bank personnel and that personnel are not assigned conflicting responsibilities;

(4) Establishing effective paths of communication upward, downward, and across the organization in order to ensure that Bank personnel receive necessary and appropriate information, including:

(i) Information relating to the operational policies and procedures of the Bank;

(ii) Information relating to the actual operational performance of the Bank;

(iii) Adequate and comprehensive internal financial, operational, and compliance data; and

(iv) External market information about events and conditions that are relevant to decision making;

(5) Developing and implementing procedures that translate the major business strategies and policies established by the Bank's board of directors into operating standards;

(6) Ensuring adherence to the lines of authority and responsibility established by the Bank's board of directors;

(7) Overseeing the implementation and maintenance of management information and other systems;

(8) Establishing and implementing an effective system to track internal control weaknesses and the actions taken to correct them; and

(9) Monitoring and reporting to the Bank's board of directors the effectiveness of the internal control system on an ongoing basis.

#### § 1239.33 Audit committee.

(a) *Establishment.* The audit committee of each Bank established as required by § 1239.5(b) of this chapter, shall be consistent with the requirements set forth in this section.

(b) *Composition.* (1) The audit committee shall comprise five or more persons drawn from the Bank's board of directors, each of whom shall meet the criteria of independence set forth in paragraph (c) of this section.

(2) The audit committee shall include a balance of representatives of:

(i) Community financial institutions and other members; and

(ii) Independent and member directors of the Bank.

(3) The terms of audit committee members shall be appropriately staggered so as to provide for continuity of service.

(4) At least one member of the audit committee shall have extensive accounting or related financial management experience.

(c) *Independence.* Any member of the Bank's board of directors shall be considered to be sufficiently independent to serve as a member of the audit committee if that director does not have a disqualifying relationship with the Bank or its management that would interfere with the exercise of that director's independent judgment. Such disqualifying relationships include, but are not limited to:

(1) Being employed by the Bank in the current year or any of the past five years;

(2) Accepting any compensation from the Bank other than compensation for service as a board director;

(3) Serving or having served in any of the past five years as a consultant, advisor, promoter, underwriter, or legal counsel of or to the Bank; or

(4) Being an immediate family member of an individual who is, or has been in any of the past five years, employed by the Bank as an executive officer.

(d) *Charter.* (1) The audit committee and the board of directors of each Bank shall:

(i) Review, and assess the adequacy of, the Bank's audit committee charter on an annual basis;

(ii) Amend the audit committee charter as appropriate; and

(iii) Re-adopt and re-approve, respectively, the Bank's audit committee charter not less often than every three years.

(2) Each Bank's audit committee charter shall:

(i) Provide that the audit committee has the responsibility to select, evaluate and, where appropriate, replace the internal auditor and that the internal auditor may be removed only with the approval of the audit committee;

(ii) Provide that the internal auditor shall report directly to the audit committee on substantive matters and

that the internal auditor is ultimately accountable to the audit committee and board of directors; and

(iii) Provide that both the internal auditor and the external auditor shall have unrestricted access to the audit committee without the need for any prior management knowledge or approval.

(e) *Duties.* Each Bank's audit committee shall have the duty to:

(1) Direct senior management to maintain the reliability and integrity of the accounting policies and financial reporting and disclosure practices of the Bank;

(2) Review the basis for the Bank's financial statements and the external auditor's opinion rendered with respect to such financial statements (including the nature and extent of any significant changes in accounting principles or the application therein) and ensure that policies are in place that are reasonably designed to achieve disclosure and transparency regarding the Bank's true financial performance and governance practices;

(3) Oversee the internal audit function by:

(i) Reviewing the scope of audit services required, significant accounting policies, significant risks and exposures, audit activities, and audit findings;

(ii) Assessing the performance and determining the compensation of the internal auditor; and

(iii) Reviewing and approving the internal auditor's work plan.

(4) Oversee the external audit function by:

(i) Approving the external auditor's annual engagement letter;

(ii) Reviewing the performance of the external auditor; and

(iii) Making recommendations to the Bank's board of directors regarding the appointment, renewal, or termination of the external auditor;

(5) Provide an independent, direct channel of communication between the Bank's board of directors and the internal and external auditors;

(6) Conduct or authorize investigations into any matters within the audit committee's scope of responsibilities;

(7) Ensure that senior management has established and is maintaining an adequate internal control system within the Bank by:

(i) Reviewing the Bank's internal control system and the resolution of identified material weaknesses and significant deficiencies in the internal control system, including the prevention or detection of management override or compromise of the internal control system; and

(ii) Reviewing the programs and policies of the Bank designed to ensure compliance with applicable laws, regulations and policies, and monitoring the results of these compliance efforts;

(8) Review the policies and procedures established by senior management to assess and monitor implementation of the Bank's strategic business plan and the operating goals and objectives contained therein; and

(9) Report periodically its findings to the Bank's board of directors.

(f) *Meetings*. The audit committee shall prepare written minutes of each audit committee meeting.

#### **§ 1239.34 Dividends.**

A Bank's board of directors may not declare or pay a dividend based on projected or anticipated earnings and may not declare or pay a dividend if the par value of the Bank's stock is impaired or is projected to become impaired after paying such dividend.

### **CHAPTER XVII—OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

#### **Subchapter C—Safety and Soundness**

#### **PART 1710—[REMOVED]**

■ 6. Remove part 1710.

#### **PART 1720—[REMOVED]**

■ 7. Remove part 1720.

Dated: January 15, 2014.

**Melvin L. Watt,**

*Director, Federal Housing Finance Agency.*

[FR Doc. 2014-01173 Filed 1-27-14; 8:45 am]

**BILLING CODE 8070-01-P**

### **DEPARTMENT OF JUSTICE**

#### **Drug Enforcement Administration**

#### **21 CFR Part 1308**

[Docket No. DEA-386]

#### **Schedules of Controlled Substances: Temporary Placement of 10 Synthetic Cathinones into Schedule I**

**AGENCY:** Drug Enforcement Administration, Department of Justice.

**ACTION:** Notice of Intent.

**SUMMARY:** The Deputy Administrator of the Drug Enforcement Administration (DEA) is issuing this notice of intent to temporarily schedule 10 synthetic cathinones into schedule I pursuant to the temporary scheduling provisions of the Controlled Substances Act (CSA). The 10 substances are: (1) 4-methyl-N-ethylcathinone ("4-MEC"); (2) 4-methyl-

alpha-pyrrolidinopropiophenone ("4-MePPP"); (3) alpha-pyrrolidinopentiophenone ("α-PVP"); (4) 1-(1,3-benzodioxol-5-yl)-2-(methylamino)butan-1-one ("butylone"); (5) 2-(methylamino)-1-phenylpentan-1-one ("pentedrone"); (6) 1-(1,3-benzodioxol-5-yl)-2-(methylamino)pentan-1-one ("pentylone"); (7) 4-fluoro-N-methylcathinone ("4-FMC"); (8) 3-fluoro-N-methylcathinone ("3-FMC"); (9) 1-(naphthalen-2-yl)-2-(pyrrolidin-1-yl)pentan-1-one ("naphyrone"); and (10) alpha-pyrrolidinobutiophenone ("α-PBP"). This action is based on a finding by the Deputy Administrator that the placement of these synthetic cathinones into schedule I of the CSA is necessary to avoid an imminent hazard to the public safety. Any final order will be published in the **Federal Register** and may not be effective prior to February 27, 2014. Any final order will impose the administrative, civil, and criminal sanctions and regulatory controls applicable to schedule I substances under the CSA on the manufacture, distribution, possession, importation, exportation, research, and conduct of instructional activities of these synthetic cathinones.

**DATES:** January 28, 2014.

#### **FOR FURTHER INFORMATION CONTACT:**

Ruth A. Carter, Acting Chief, Policy Evaluation and Analysis Section, Office of Diversion Control, Drug Enforcement Administration; Mailing Address: 8701 Morrisette Drive, Springfield, Virginia 22152, Telephone (202) 598-6812.

#### **SUPPLEMENTARY INFORMATION:**

#### **Background**

Section 201 of the CSA, 21 U.S.C. 811, provides the Attorney General with the authority to temporarily place a substance into schedule I of the CSA for two years without regard to the requirements of 21 U.S.C. 811(b) if he finds that such action is necessary to avoid imminent hazard to the public safety. 21 U.S.C. 811(h). In addition, if proceedings to control a substance are initiated under 21 U.S.C. 811(a)(1), the Attorney General may extend the temporary scheduling for up to one year. 21 U.S.C. 811(h)(2).

Where the necessary findings are made, a substance may be temporarily scheduled if it is not listed in any other schedule under section 202 of the CSA, 21 U.S.C. 812, or if there is no exemption or approval in effect for the substance under section 505 of the Federal Food, Drug, and Cosmetic Act (FDCA), 21 U.S.C. 355. 21 U.S.C. 811(h)(1); 21 CFR part 1308. The Attorney General has delegated his

authority under 21 U.S.C. 811 to the Administrator of the DEA, who in turn has delegated her authority to the Deputy Administrator of the DEA. 28 CFR 0.100, 0.104, Appendix to Subpart R of Part 0, Sec. 12.

Section 201(h)(4) of the CSA (21 U.S.C. 811(h)(4)) requires the Deputy Administrator to notify the Secretary of the Department of Health and Human Services (HHS) of his intention to temporarily place a substance into schedule I of the CSA.<sup>1</sup> As 4-MEC, 4-MePPP, α-PVP, butylone, pentadone, pentylone, 4-FMC, 3-FMC, naphyrone, and α-PBP are not currently listed in any schedule under the CSA, the DEA believes that the conditions of 21 U.S.C. 811(h)(1) have been satisfied. Any comments submitted by the Assistant Secretary in response to the notice transmitted to the Assistant Secretary on November 7, 2013, shall be taken into consideration before a final order is published. 21 U.S.C. 811(h)(4).

To make a finding that placing a substance temporarily into schedule I of the CSA is necessary to avoid an imminent hazard to the public safety, the Deputy Administrator is required to consider three of the eight factors set forth in section 201(c) of the CSA, 21 U.S.C. 811(c): the substance's history and current pattern of abuse; the scope, duration, and significance of abuse; and what, if any, risk there is to the public health. 21 U.S.C. 811(h)(3). Consideration of these factors includes actual abuse, diversion from legitimate channels, and clandestine importation, manufacture, or distribution. 21 U.S.C. 811(h)(3).

A substance meeting the statutory requirements for temporary scheduling may only be placed in schedule I. 21 U.S.C. 811(h)(1). Substances in schedule I are those that have a high potential for abuse, no currently accepted medical use in treatment in the United States, and a lack of accepted safety for use under medical supervision. 21 U.S.C. 812(b)(1). Available data and information for 4-MEC, 4-MePPP, α-PVP, butylone, pentadone, pentylone, 4-FMC, 3-FMC, naphyrone, and α-PBP indicate that these 10 synthetic

<sup>1</sup> Because the Secretary of the HHS has delegated to the Assistant Secretary for Health of the HHS the authority to make domestic drug scheduling recommendations, for purposes of this Notice of Intent, all subsequent references to "Secretary" have been replaced with "Assistant Secretary." As set forth in a memorandum of understanding entered into by HHS, the Food and Drug Administration (FDA), and the National Institute on Drug Abuse (NIDA), FDA acts as the lead agency within HHS in carrying out the Assistant Secretary's scheduling responsibilities under the CSA, with the concurrence of NIDA. 50 FR 9518, Mar. 8, 1985.