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Part II

Federal Housing Finance Board

12 CFR Parts 900, 910 and 941
Reorganization of the Office of Finance;
Authority To Issue Consolidated
Obligations on Which the Federal Home
Loan Banks Are Jointly and Severally
Liable; Proposed Changes to the Financial
Management Policy of the Federal Home
Loan Bank System; Proposed Rule and
Notice

FEDERAL HOUSING FINANCE BOARD**12 CFR Parts 900, 910 and 941**

[No. 99-61]

RIN 3069-AA88

Reorganization of the Office of Finance; Authority To Issue Consolidated Obligations on Which the Federal Home Loan Banks Are Jointly and Severally Liable**AGENCY:** Federal Housing Finance Board.**ACTION:** Proposed rule.

SUMMARY: The Federal Housing Finance Board (Finance Board) is proposing to amend its regulations regarding the Office of Finance (OF), a joint office of the Federal Home Loan Banks (Bank or Banks). The proposed rule would reorganize the OF and broaden its duties, functions and responsibilities in two key respects: the OF would perform consolidated obligation (CO) issuance functions, including preparation of combined financial reports, for the Banks; and the OF would serve as a vehicle for the Banks to carry out joint activities in a way that promotes operating efficiency and effectiveness in achieving the mission of the Banks.

With respect to the issuance of COs, *i.e.*, bonds, notes or debentures, the proposed rule would make the Banks, rather than the Finance Board, the issuers of COs under section 11 of the Federal Home Loan Bank Act (Act). As proposed, this action would not have a substantive effect on the debt issuance process or on the joint and several obligation of the Banks on the COs, but it would make the Banks responsible for accessing the capital markets through the OF to fund their own operations. This is consistent with devolutionary actions taken by Congress to give the Banks greater autonomy over the management of their business and to remove the Finance Board from involvement in Bank management functions.

The proposed rule also is intended to provide the powers, operational independence, and flexibility the OF needs to be available for the Banks' use as a central management facility with respect to all joint Bank asset activities, and to facilitate the issuance of COs by the Banks or the Finance Board under section 11 of the Bank Act.

The Finance Board is also proposing to make certain conforming amendments to its policy statement entitled "Financial Management Policy of the Federal Home Loan Bank System" (FMP). A Notice describing the

proposed FMP changes in detail is published elsewhere in this issue of the **Federal Register**.

DATES: The Finance Board will accept comments on the proposed rule in writing on or before March 6, 2000.

ADDRESSES: Send comments to Elaine L. Baker, Secretary to the Board, by electronic mail at bakere@fhfb.gov, or by regular mail at the Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006. Comments will be available for public inspection at this address.

FOR FURTHER INFORMATION CONTACT: Joseph A. McKenzie, Deputy Chief Economist, Office of Policy, Research and Analysis, 202/408-2845, mckenziej@fhfb.gov, Charlotte A. Reid, Special Counsel, Office of General Counsel, 202/408-2510, reidc@fhfb.gov, or Eric E. Berg, Senior Attorney, Office of General Counsel, 202/408-2589, berge@fhfb.gov. Staff also can be reached by regular mail at the Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006.

SUPPLEMENTARY INFORMATION:**I. Overview of Proposal**

The proposed rule would establish a new structure for the OF to accommodate additional functions proposed to address new challenges faced by the Bank System. With respect to the issuance of COs, the proposed rule would authorize the Banks, rather than the Finance Board, to issue COs, as discussed more completely below. This action is consistent with the Finance Board's ongoing efforts to remove itself as much as it can legally do from involvement in the management of the Banks, and with devolutionary actions taken by Congress to give the Banks greater autonomy over the management of their business.

Notwithstanding the fact that the members of the Bank System know their communities and customers' needs best, the mortgage market is no longer the fragmented, localized market that it was when Congress created the Bank System in 1932. Driven by technological improvements, the mortgage market's delivery systems have become more national in scope, and the mortgage market now plays a central role in the national economy. The need for "an appropriate vehicle for coordination of System-wide business issues," such as a central facility to assist the Banks in managing various aspects of their operations, including mortgage-related assets, has grown in the ten years since Congress confirmed the OF as a joint office of the Banks in the Financial

Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).¹

The Finance Board believes that the market has created an incentive and a business need for a facility controlled by the Banks and their members to provide economies and efficiencies of scale, as it has done for the issuance of COs by the Finance Board, by giving the Banks the flexibility to centralize certain of their common business functions. The Finance Board anticipates that this need will become even more critical as the Banks develop asset activities such as Member Mortgage Assets as part of their core business.² Not only would such a facility provide operational benefits, it also would enhance the safety and soundness of the operations by providing both expertise and a mechanism for achieving risk management, and geographic diversity on a joint asset portfolio basis. In light of the recent enactment of Title VI of the Gramm-Leach-Bliley Act, the Federal Home Loan Bank System Modernization Act of 1999,³ the Finance Board is taking this opportunity to propose a reorganization of the OF that will allow this joint office of the Banks to function in this way at the request of the Banks and facilitate growth in the Bank System's business as the Banks seek to provide their members with new credit products and respond to changes in the marketplace and congressional mandates. The Finance Board believes having the OF serve these functions is particularly important because the OF is the only statutorily acknowledged and sanctioned joint office for the Banks,

¹ See Pub. L. 101-73, tit. VII, sec. 702, 103 Stat. 183 (Aug. 9, 1989). A General Accounting Office (GAO) report commissioned by Congress in section 1393 of the Housing and Community Development Act of 1992, which was issued on December 8, 1993 (GAO/GGD-94-38) (GAO Report), noted that FIRREA made "many changes" to the Bank System that "introduced significant cultural changes for the Banks and their members." GAO Report at 19-20. Principally, after FIRREA, the Banks were no longer involved in the oversight and supervision of their members. The members henceforth only would view the Banks as a credit facility, and this change would promote the cooperative nature of the Bank System. GAO concluded, however, that to attract new, voluntary members and retain members, the Banks "must provide sufficient value—through the products and services offered and the dividends paid—to warrant the required stock investment for membership." *Id.* at 21. The GAO Report noted the need for coordination of System-wide business issues. *Id.* at 117.

² Indeed, GAO foresaw this need, stating that "there may be a need for a central coordinating mechanism * * * [that] should reside in the [Bank] System itself." See GAO Report at 113. The GAO Report observed that there were certain positive goals that could be attained by relieving the Finance Board of certain Bank System governance functions, including enhanced cost control and the centralization of "certain business functions." *Id.* at 114.

³ Pub. L. 106-102, 113 Stat. 1338 (Nov. 12, 1999).

and the legal authority for the Banks to establish other joint entities is in question.⁴

A. Issuance of Consolidated Obligations

Since 1946, the operations of the Banks and member demand for advances have been financed principally with the proceeds from COs issued pursuant to section 11(c) of the Bank Act by the Finance Board, or its predecessor agencies. See 12 U.S.C. 1431(c). The Banks, individually and collectively, are the sole obligors on COs issued by the Finance Board under section 11(c) of the Bank Act.⁵ The issuance of COs by the Finance Board under section 11(c) of the Bank Act is governed by Finance Board regulations set forth in 12 CFR parts 910 and 941, the FMP and an annual debt authorization. The Finance Board is proposing to achieve the goal of continuing to give the Banks the autonomy to manage and run their own businesses by authorizing the Banks to issue joint debt pursuant to section 11(a) of the Bank Act through the OF as agent for the Banks, which would still be called COs, on which the Banks would be jointly and severally liable. See 12 U.S.C. 1422a(a)(3)(B)(iii), 1431(a) and (d). Section 11(a) of the Bank Act provides that the Banks may issue bonds, debentures or other obligations "upon such terms and conditions" as the Finance Board may approve and "subject to the rules and regulations prescribed by" the Finance Board. See *id.* 1431(a). Under the proposed rule, the same rules governing the apportionment of joint-and-several liability with respect to COs issued by the Finance Board through the OF as agent pursuant to section 11(c) of the Bank Act would apply to COs issued by the Banks through the OF as agent pursuant to section 11(a) of the Bank Act.⁶ To eliminate the potential for

conflicts to the Finance Board in its role as regulator of the OF and the Banks, the Finance Board is removing itself from its role as issuer of the COs, and instead allowing the Banks to raise funds in the capital markets to fund their operations, a management function tied directly to member demand. While the Finance Board has long been uncomfortable serving in both of these capacities, the process, while awkward, has worked quite successfully. However, the Finance Board's discomfort turned to concern over potential liability for the United States as a result of litigation arising from the bankruptcy of the County of Orange, California.

In the course of the Orange County litigation, (which has since been settled with respect to the Banks, the OF and the United States), the United States District Court for the Central District of California held that Orange County had stated a claim for relief based on its contention that the United States had violated the federal securities laws in the issuance of certain COs. The District Court also found that Orange County's claim for "restitution" against the United States under the provisions of the Administrative Procedure Act was not barred by the doctrine of sovereign immunity. The Finance Board does not endorse these holdings, but has determined it is prudent to limit any further risk to the United States from such suits. By taking the proposed action, the Finance Board can accomplish this goal as well as that of making the Banks responsible in name for this most central aspect of their business.

As a natural and necessary adjunct to the issuance of COs, the Banks also should be responsible for the preparation of the disclosure documents that facilitate CO issuance and for the periodic combined financial statements for the Bank System. Logic dictates that the OF, as the only joint Bank System office and existing agent for CO issuance, is the most appropriate entity to perform that function. The OF already prepares the offering documents used in the sale of the Bank System's COs, services the Bank System's debt, and possesses knowledge of the Bank System's financial statements, operations and condition. The Finance Board believes that transferring the function of preparing combined Bank

System annual and quarterly financial reports to the OF is entirely appropriate and a provision making the transfer is included in the proposed rule.

The proposed rule will codify the disclosure standards set forth in the Finance Board's "Statement of Policy: Disclosures in the Combined Annual and Quarterly Financial Reports of the FHLBank System" (Policy Statement). See 63 FR 39872 (July 24, 1998). These standards generally require the combined annual and quarterly financial reports of the Bank System to be prepared in a manner that is, in the judgement of the Finance Board, consistent with the disclosure requirements promulgated by the Securities and Exchange Commission (SEC). While securities issued by the Finance Board or the Banks are exempt from the registration and reporting requirements of the Securities Exchange Act of 1934, 15 U.S.C. 77c(a)42 (1934 Act), the Finance Board believes that the disclosure requirements promulgated by the SEC pursuant to the federal securities laws represent best practice, and that financial and other disclosure concerning the Bank System should conform to this standard to the greatest extent practicable. However, having determined that certain areas of disclosure are either inapplicable or inappropriate for the Bank System, the Finance Board has provided a list of exceptions to the general standard in the Appendix to the proposed rule. Preparation of combined Bank System annual and quarterly financial reports should be greatly simplified by the codification of uniform disclosure standards.

In the area of compensation disclosure, the Finance Board notes that Item C of the proposed Appendix requires disclosure of compensation information only for the 12 Bank presidents and the CEO of the OF, whereas the SEC's regulations require that information for the CEO, the 4 other most highly compensated executive officers who held such offices during the last completed fiscal year, and up to 2 additional individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year. This exception was adopted when the Finance Board regulated the compensation of Bank employees, and was intended to avoid the volume of disclosure that would result from applying the SEC standard to twelve Banks and the OF. However, now that Bank employee compensation has been deregulated, the Finance Board seeks comment on whether it should (1)

⁴ See, e.g., section 304(a) of the Government Corporation Control Act, *codified* at 31 U.S.C.A. § 9102 (West 1994).

⁵ *Id.* 1431(b)-(d). The Bank Act makes clear that obligations of the Banks issued with the approval of the Finance Board are not the obligations of, and are not guaranteed by, the United States. See *id.* 1435. Congress underscored this precept in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which provides in pertinent part that none of the housing government-sponsored enterprises' obligations or securities are backed by the full faith and credit of the United States. See Pub. L. 102-550, tit. XIII, sec. 1304, 106 Stat. 3944 (Oct. 28, 1992) (*codified* at 12 U.S.C. 4503).

⁶ On October 12, 1999, the Finance Board published a final rule clarifying for the Banks how their joint-and-several liability on COs would operate, and elucidating for bondholders how they benefit from the Banks' joint-and-several liability. See 64 FR 55125 (Oct. 12, 1999). The Bank System has been and remains financially strong. As of

September 30, 1999, there were over \$477 billion in COs outstanding. In the history of the Bank System, no Bank has ever been delinquent or defaulted on a principal or interest payment on any CO issued by the Finance Board or its predecessor agencies. The joint-and-several liability of the Banks on the COs is an integral part of investor confidence in Bank System debt.

expand the number of individuals for whom the required compensation information would be provided and (2) change the triggering criteria for compensation disclosure from title/position to income level, or from individual Banks to the Bank System overall.

While the Finance Board is proposing that the OF prepare the Bank System's annual and quarterly financial reports, the Finance Board will continue to be responsible for oversight of the combined Bank System financial reports' compliance with the applicable disclosure standards. Accordingly, the proposed rule provides that the Finance Board in its sole discretion will determine whether or not a combined annual or quarterly report prepared by the OF meets the prescribed regulatory standards. The proposed rule requires the OF to promptly comply with any directive the Finance Board issues regarding the preparation, filing, amendment or distribution of the combined annual or quarterly financial reports.

B. Restructuring of the Office of Finance

The Finance Board long has recognized the importance of an organizational structure for the OF that reflects its duties and responsibilities. The Finance Board has re-evaluated the appropriate organizational structure of the OF in light of the changes proposed herein, with two key goals in mind. First, the Finance Board wants to build on the governance model in the Bank Act, particularly after enactment of the Gramm-Leach-Bliley Act, whereby the Banks should have the autonomy to manage and run their own businesses. Second, the Finance Board wants to give all of the Banks representation on the OF Board of Directors to best achieve their operational goals. Additionally, the Finance Board has considered that the members of the OF Board of Directors should possess experience and qualifications to enable the Board to be most effective in exercising business judgment in its policy-making and decision-making roles. The proposed reorganization is designed to provide the structure, additional functions and operational capacity the OF must possess in order to accommodate the evolving business needs of the Banks.

The Finance Board proposes to significantly alter both the size and composition of the OF Board of Directors. Based on the considerations described above, particularly the increased role being proposed for the OF, the Finance Board believes that the Bank System would best be served by an OF Board of Directors that includes

representatives from each Bank, members of the Bank System, and the general community. Accordingly, the proposed rule would expand the OF Board of Directors to a total of 24 members, 12 of whom would be appointed by the Banks, 6 of whom would be elected by Bank System members, and 6 of whom would be appointed by the Finance Board. However, recognizing that this number of directors may be unwieldy, the Finance Board invites comments addressing alternative board structures for the OF that would preserve an appropriate balance of representation by the Banks, the members and the public, as discussed more completely below.

II. Statutory and Regulatory Background

A. The Office of Finance

The OF was one of a number of joint Bank offices established by regulation of the former Federal Home Loan Bank Board (FHLBB), predecessor agency to the Finance Board. Over time, the OF has evolved to support the Banks in responding to changes in the financial markets and Bank System member funding requirements. As originally enacted in 1932, the Bank Act permitted the Banks to issue bonds and debentures, and established a trust registrar, which was the genesis of the OF. From 1934 to 1948, the FHLBB directed the Banks collectively to employ a fiscal agent to issue and sell consolidated obligations.⁷ In 1948, the FHLBB promulgated a regulation that created the Office of the Fiscal Agent of the Banks within the Bank System to facilitate the issuance of COs.⁸

In 1972, the FHLBB promulgated a regulation that merged the Office of System Finance with the Office of Fiscal Agent and created the OF as a Joint Bank System office. See 37 FR 16864 (Aug. 22, 1972) (codified at 12 CFR

⁷ In 1934, Section 503 of the National Housing Act of 1934 amended section 11 of the Bank Act to provide authority to the FHLBB to issue COs on which the Banks are jointly and severally liable under sections 11(b) and (c) of the Bank Act (12 U.S.C. 1431(b) and (c)). See H.R. 9680, 73rd Cong., 2d Sess. (Pub. No. 479) (enacted). The contractual duties of the Fiscal Agent expanded to include managing the Banks' investment portfolios.

⁸ See 13 FR 7447 and 8269 (1948) (codified at 24 CFR 122.80 (1949)) (repealed). The regulation provided for the appointment of the Fiscal Agent, and expanded the duties of the Fiscal Agent to include the sale and purchase of Bank System securities. After the Federal Home Loan Mortgage Corporation (Freddie Mac) was created in 1970, the FHLBB created an Office of System Finance (as a separate Bank System office) to manage Freddie Mac's investment portfolios and reserves with those of the Federal Savings and Loan Insurance Corporation (FSLIC) in coordination with the Office of Fiscal Agent. The Banks since had ceased having the OF perform investment services on their behalf.

522.80–82) (repealed). The regulation provided for the OF to perform any "function, duty or authority" previously vested in the Fiscal Agent. In addition to issuing COs under the delegated authority of the FHLBB and servicing the debt as a fiscal agent of the Banks, the OF was required to perform other duties as requested by a Bank or Banks, or the FHLBB. During the 1980's, those duties included purchasing investment securities on behalf of the Banks, researching alternative investment vehicles and strategies and managing assets acquired by the FSLIC.

As a part of the amendments to the Bank Act made by FIRREA, the existing joint or collective offices of the Bank System other than the OF were abolished, and the FHLBB regulation governing the OF was transferred to the Finance Board's regulations. See 12 U.S.C. 1422b(b)(2); 12 CFR 932.56(a)(3) (repealed). The Finance Board reorganized the OF as fiscal agent of the Finance Board in issuing COs under section 11(c) of the Bank Act. See 57 FR 2832 (Jan. 24, 1992); 57 FR 11429 (Apr. 3, 1992) (codified at 12 CFR 941.9(b)(1)). The rule instituted a three-member Board of Directors for the oversight of the management of the OF, executing daily operations and implementing the Board of Directors plans and policies.⁹

B. Consolidated Obligations

The Bank Act always has authorized the Banks to issue debt, and empowered the regulator to issue rules, regulations and orders governing virtually every aspect of a Bank's debt issuance.¹⁰ Under the original statutory scheme, the Banks were jointly and severally liable for the debt of any Bank.¹¹ In 1934,

⁹ From 1972 to 1992, the OF was headed by a Director. See 12 CFR 932.55 (1992) (repealed). Following the reorganization, the OF Board of Directors consists of two Bank presidents and one private citizen, all appointed by the Finance Board.

¹⁰ As originally enacted in 1932, section 11(a) permitted the Banks to issue debt. It provided that "Each Federal Home Loan Bank shall have power, subject to the approval of the Board, * * * to issue bonds and debentures having such maturities as may be determined by the board, secured by the transfer of eligible obligations of borrowing institutions on advances made by the bank to borrowing institutions and by the deposit of home mortgages." Sec. 11, c. 522, 47 Stat. 733 (July 22, 1932).

¹¹ Section 11(f) mandated that "the Federal Home Loan Banks shall be jointly and severally liable for the payment when due of all bonds and debentures, and of notes and other obligations issued by any Federal Home Loan Bank." Various provisions in section 11 required the Board to prescribe rules and regulations governing the issuance and security for the bonds, notes or debentures, and set requirements for the security for the Banks' debt. Section 11(f) also specified that the Banks were permitted to make agreements to ensure the payment of such obligations, so long as the agreements did not restrict in any way the Banks'

section 503 of the National Housing Act¹² amended section 11 of the Bank Act (1934 amendments) to give the Bank System more ready access to the capital markets, and authorized the FHLBB to issue consolidated obligations on which the Banks would be jointly and severally liable. 12 U.S.C. 1431(b) and (c). Certain constraints on the Banks' power to issue debt were eliminated by the 1934 amendments: the requirement that security deposits be not less than 190 percent of any consolidated issue was replaced by provisions limiting consolidated debentures issued by the FHLBB under section 11(b) to 5 times paid in capital. The 1934 amendments also replaced the requirement in section 11(f) that all Banks would be jointly and severally liable for obligations issued by any Bank, as well as the proviso, with the more broadly drawn requirements in section (a), that the Banks' power to issue debt "upon such terms and conditions as the Board may approve" is "subject to the rules and regulations prescribed by the Board." Thus, the 1934 revisions to section 11 of the Bank Act gave broad authority to the Banks' regulator to determine the terms and conditions for the issuance of obligations on which the Banks would be liable.

In 1989, Congress authorized the Finance Board to maintain the OF, a joint office of the Banks, and to delegate to the OF the ministerial functions associated with issuance of COs. See 12 U.S.C. 1422b(b)(1) and (2). Accordingly, the Finance Board delegated to the OF the authority to issue COs under section 11 of the Bank Act subject to Finance Board regulations, resolutions or policies. See 12 CFR 900.30.

The issuance of COs is governed by part 910 of the Finance Board's regulations (12 CFR part 910), the FMP and an annual debt authorization. The operations of the OF are governed by part 941 of the Finance Board's regulations (12 CFR part 941). The Finance Board's regulations and the FMP provide for a leverage limit on the issuance COs. Section 910.1(b) prohibits the issuance of senior bonds where immediately following such issuance the aggregate amount of senior bonds and unsecured senior liabilities would exceed 20 times the total paid-in capital stock, retained earnings and reserves (exclusive of loss and deposit reserves

joint and several liability. Section 11(f), however, contained a limited proviso permitting a Bank independently to borrow "temporarily," if the Bank clearly disclosed that the liability was limited to it as the sole issuer, and obtained the express approval of the FHLBB. See id.

¹² Pub. L. 479, c. 847, sec. 503, 48 Stat. 1261 (Jun. 27, 1934).

required pursuant to section 1431(g) of all of the Banks). See 12 CFR 910.1(b).¹³ Additionally, Finance Board regulations require the Banks to maintain certain assets at all times free of lien or pledge (the negative pledge requirement) to ensure sufficient collateralization of the consolidated obligations.¹⁴

C. FMP

The FMP generally provides a framework within which the Banks may implement their financial management strategies in a prudent and responsible manner. Specifically, the FMP identifies the types of investments the Banks may purchase pursuant to their statutory investment authority. The FMP also includes a series of guidelines relating to the funding and hedging practices of the Banks, as well as to the management of their credit, interest-rate and liquidity risks, and establishes liquidity requirements in addition to those required by statute, as noted above. See FMP secs. III-IV.

The FMP evolved from a series of policies and guidelines initially adopted by the FHLBB in the 1970s and revised a number of times thereafter. The Finance Board adopted the FMP in 1991, consolidating into one document the previously separate policies on funds management, hedging and interest rate swap, and adding new guidelines on management of unsecured credit and interest-rate risks.

¹³ The following definitions apply to the leverage limit provisions: "(b) 'consolidated bonds' means bonds or notes issued on behalf of all Banks;" "(c) 'senior bonds' means consolidated bonds issued pursuant to 12 U.S.C. 1431 and this part and not defeased, other than bonds specifically subordinated to any then outstanding consolidated bonds;" "(d) 'unsecured, senior liabilities' means all obligations of the Banks recognized as a liability under Generally Accepted Accounting Principles, except (1) liabilities that are covered by a perfected security interest; (2) consolidated bonds; (3) bonds issued pursuant to 12 U.S.C. 1431(a); and (4) allowances for losses for off-balance sheet obligations." 12 CFR 910.0(b)-(d) (1999).

¹⁴ The "negative pledge requirement" is the regulatory requirement that the Banks maintain certain types of unpledged assets in an amount equal to the amount of the Bank's senior bonds outstanding. See 12 CFR 910.1(c) (1999). Section 910.1(c) provides in pertinent part:

The Banks shall at all times maintain assets of the following types, free from any lien or pledge, in a total amount at least equal to the amount of senior bonds outstanding: (1) Cash; (2) Obligations of or fully guaranteed by the United States; (3) Secured advances; (4) Mortgages as to which one or more Banks have any guaranty or insurance, or commitment thereof, by the United States or any agency thereof; (5) Investments described in section 16(a) of the Bank Act, as amended (12 U.S.C. 1436(a)); and (6) Other securities which have been assigned a rating or assessment by a major nationally recognized securities rating agency that is equivalent to or higher than the rating or assessment assigned by such agency or senior bonds outstanding. (Proviso omitted).

III. Analysis of Proposed Rule

A. Overview

The proposed rule would amend parts 910 and 941 of the Finance Board's regulations governing operation of the OF and issuance of COs, to enable the OF to issue debt on behalf of the Banks pursuant to section 11(a) of the Bank Act, require the OF to prepare the quarterly and annual combined financial reports of the Bank System, and provide services at the request of two or more Banks related to joint asset activities undertaken by the requesting Banks, including the administration of Member Mortgage Asset programs and liquidity management. With the additional functions and operational capacity established for the OF under the proposed rule, the Banks will have the ability to make the most efficient use of the OF and its services and thereby to maximize mission achievement as they develop new joint asset activities.

B. Amendments to 12 CFR 900.30

The proposed rule would amend § 900.30 of the Finance Board regulations to provide for the termination as of December 31, 2000, of the OF's authority to act as agent for the Finance Board in the issuance of COs under section 11(c) of the Bank Act. By this provision, the Finance Board intends to transition itself out of, and the Banks into, the debt issuance function under the provisions of section 11(a) of the Bank Act as soon as practicable.

C. CO Issuance—Proposed Amendments to Part 910

1. Definitions

The proposed rule would delete §§ 910.0(a) and (b), the definitions of the terms "Board" and "Bank," which have been proposed to be defined for all Finance Board regulations in a previous rulemaking, see 64 FR 52148 (Sept. 27, 1999), and the definition of the term "unsecured senior liabilities" in § 910.0(d). The proposed rule would amend the definition of the term "consolidated obligation" to clarify that it includes bonds, notes or debentures issued by the Banks through the OF under section 11(a) of the Bank Act. The proposed rule also would add a new § 910.1(b) to define the term "Nationally Recognized Statistical Rating Organizations."

2. Section 910.2

Proposed § 910.2(a) sets forth the types of liabilities authorized for Bank business operations. It is intended to be an exclusive list and the Banks' sole liability authority, replacing the

Funding Guidelines section of the FMP. The Funding Guidelines of the FMP, which set forth the parameters for the use by the Banks of alternative sources and structures in funding their activities, are proposed to be deleted in a separate notice published elsewhere in this **Federal Register**. See FMP sec. IV. The Funding Guidelines differentiate between Bank specific liabilities and COs, which are the joint-and-several liabilities of the Banks. See *id.* at secs. IV.B. and C.

Under the FMP, authorized Bank specific liabilities generally include: (1) Deposits from members, from any institution for which a Bank is providing correspondent services, from another Bank, and from other instrumentalities of the United States; (2) federal funds purchased from any financial institution that participates in the federal funds market; and (3) repurchase agreements, with the provision that those requiring the delivery of collateral by a Bank may be only with Federal Reserve Banks, U.S. government sponsored agencies and instrumentalities, primary dealers recognized by the Federal Reserve Bank of New York, eligible financial institutions,¹⁵ and states and municipalities with a Moody's Investment Grade rating of 1 or 2.

The FMP also prohibits a Bank from directly placing COs with another Bank. See *id.* at sec. IV.C.4.

The proposed rule would incorporate certain provisions of section IV of the FMP into regulation. Proposed § 910.2(a)(1) sets forth each Bank's authority to act as a joint-and-several obligor with other Banks on COs, as authorized under part 910. Proposed § 910.2(a)(2) continues each Bank's authority to accept deposits from members, other Banks and instrumentalities of the United States, but provides that the deposit transaction may not be conducted in such a way as to result in the offer or sale of a security in a public offering as those terms are used in 15 U.S.C. 77b(3). In addition, recognizing the importance of federal funds and repurchase agreements for the Banks' liquidity management, proposed § 910.2(a)(3) allows a Bank to purchase federal funds and enter into repurchase

agreements, but only in order to satisfy the Banks' short-term liquidity needs.

Proposed § 910.2(b) would retain the substance of existing § 910.1(a) concerning COs to be issued by the Finance Board through the OF, but would expressly provide that the Finance Board may terminate the delegation of authority to the OF to issue COs on behalf of the Finance Board pursuant to section 11(c) of the Bank Act. Proposed § 910.2(b) and (c) continue the existing prohibition on directly placing COs with another Bank. It is the opinion of the Finance Board that such placements do not further the mission of the Bank System. Proposed § 910.2(c) would expressly authorize the OF to undertake the issuance of joint Bank debt pursuant to section 11(a) of the Bank Act as COs on which all of the Banks are jointly and severally liable subject to § 910.8, which governs the joint-and-several liability of the Banks on COs issued under section 11(c) of the Bank Act.

The proposed rule does not include the 20-to-1 leverage limit from § 910.1(b) of the existing regulations, or the 20-to-1 leverage limit on each Bank contained in the FMP. Instead, as discussed in detail in the Notice published elsewhere in this issue of the **Federal Register**, the Finance Board is proposing to amend the FMP to require each Bank to have and maintain total capital in an amount equal to at least 4.76 percent of the Bank's total assets.

Neither the elimination of the System-wide leverage limit from the Finance Board's regulations, nor the proposed revision to the leverage limit contained in the FMP, would have any practical effect on the Bank System or its bondholders. The Finance Board, as the regulator of the Banks, would continue to monitor each Bank for compliance with the individual leverage limit included in the FMP. The current FMP prohibits a Bank from participating in COs if such transactions would cause the Bank's liabilities to exceed 20 times the Bank's total capital. The proposed revision to the FMP establishes an equivalent leverage standard, stated as a percentage of assets, which would require each Bank to maintain capital of at least 4.76 percent of its total assets. The imposition of this standard on each Bank will ensure that the Bank System itself stays within the leverage limit, rendering any retention of a Bank System-wide leverage limit unnecessary. Further, the Finance Board notes that with the recent passage of the Gramm-Leach-Bliley Act, Banks will be subject to statutory leverage limits and risk-based capital requirements. When implemented, the new risk-based capital

regime will provide an additional safeguard to the Bank System and its bondholders by requiring Banks to hold capital in proportion to the risks they assume.

As discussed above, the Finance Board, by incorporating COs issued by the Banks under section 11(a) of the Bank Act into the definition of the term "consolidated obligations" in part 910, intends that the provisions of § 910.8 pertaining to the joint-and-several liability of the Banks on COs shall apply to such debt because it enhances investor confidence in Bank System debt, and promotes the liquidity of the bonds.

Proposed § 910.2(d) amends existing § 910.1(c), the negative pledge requirement, by requiring each Bank to at all times maintain the assets listed in an amount at least equal to the Bank's pro rata share of the outstanding COs issued by the OF on behalf of the Finance Board under section 11(c) and the COs issued by the OF on behalf of the Banks under section 11(a) in which the Bank participated for purposes of the negative pledge requirement. The proposed rule retains the negative pledge requirement for debt previously issued by the OF on behalf of the Finance Board under section 11(c), and expressly requires each Bank to maintain the specified assets free of pledge in an amount equal to the Bank's pro rata share in COs issued by the OF on behalf of the Banks under section 11(a) in which the Bank participated. In connection with these proposed amendments, it is the intention of the Finance Board to preserve the existence of the special asset accounts at the Banks established when the leverage limit in current part 910 was raised in 1992 from 12-to-1 to 20-to-1. See Finance Board Res. No. 92-751 (Dec. 21, 1992). The Finance Board has maintained these requirements in the proposal to cause the least amount of change possible to the current structure and thereby avoid disruptions of the market. The Finance Board invites comment on this provision.

3. Sections 910.3 Through 910.7

Sections 910.3 through 910.6 are retained, as amended, by substituting "Finance Board" for "Board," "Bank" for "Federal home Loan Bank," and "consolidated obligation" for "consolidated bond." Current § 910.6(b)(2), which purports to impose limitations on the Finance Board's ability to change the leverage limit provision in current § 910.6(b), provides that current § 910.1(b) may be changed by the Finance Board if the Finance Board receives either: (1) Written

¹⁵ Eligible financial institutions include banks and Federal Deposit Insurance Corporation (FDIC) insured financial institutions, including U.S. subsidiaries of foreign commercial banks, whose most recently published financial statements exhibit at least \$100 million of Tier I (or tangible) capital if the institution is a member of the investing Bank or at least \$250 million of tangible capital for all other FDIC-insured institutions, and which have been rated at least a level III institution as defined in section VI.C of the FMP.

evidence from at least one major nationally recognized securities rating agency that the proposed change will not result in the lowering of that rating agency's then-current rating or assessment on senior bonds outstanding or next to be issued; or (2) a written opinion from an investment banking firm that the proposed change would not have a materially adverse effect on the creditworthiness of senior bonds outstanding or next to be issued. While the Finance Board will continue to consult with the ratings agencies to preserve the triple-A rating of Bank System COs, this provision is proposed to be deleted along with the rest of the existing § 910.6.

Proposed § 910.7 provides the conditions under which the OF Board of Directors may authorize the issuance of COs: the OF Board of Directors shall authorize the offering for current and forward settlement (not to exceed 12 months) or the reopening of COs as necessary and authorize the maturities, rates of interest, terms and conditions (subject to the provisions of 31 U.S.C. 9108) under certain conditions, including the restriction that COs may be offered for sale only to the extent that the Banks are committed to take the proceeds, the OF Board of Directors shall implement investor suitability standards and adopt a policy addressing the relationship between the Banks and their members as debt issuers.

D. Powers, Duties, Responsibilities and Functions of the OF—Amendments to Part 941

1. Section 941.1—Definitions

The definitions in § 941.1 are proposed to be revised as follows: the term "Office of Finance" becomes "OF" in the heading and is added as a defined term; the term "OF Board of Directors" is revised to mean the 24 member administrative body responsible for the oversight of management of the OF; the terms "Chief Executive Officer" and "OF Operations Imprest Fund" are added as new defined terms. The definition of the term "consolidated obligation" is made consistent with the proposed definition in § 910.1(a). The definitions of the terms "Finance Board," "Bank," and "Bank Act" which have been proposed to be defined for all Finance Board regulations in a previous rulemaking, *see* 64 FR 52148 (Sept. 27, 1999), and the definition of the term "Director" are deleted.

2. Section 941.2—Powers and Responsibilities of the OF

Proposed § 941.2(a) states that the OF is a joint office of the Banks under

section 2B of the Bank Act. *See* 12 U.S.C. 1422b(b)(2). Proposed § 941.2(b) sets out the broadened purpose of the OF: to facilitate the accomplishment of the mission of the Banks as set forth in section 2A of the Bank Act. *Id.* 1422a(3)(A)(ii) and (iii). As a part of its purpose to further the mission of the Banks, proposed § 941.2(b)(1) expressly provides that the OF shall issue COs on which the Banks shall be jointly and severally liable, on behalf of the Banks and the Finance Board under sections 11(a) and 11(c) of the Bank Act, respectively. *Id.* 1431(a) and (c). The second prong of the OF's purpose is to support the Banks upon the request of two or more Banks undertaking joint asset activities that the Banks are otherwise authorized by law to undertake individually.

Proposed § 941.2(c) sets out the functions the OF is authorized to undertake in support of the issuance of debt and the support to be provided to Banks engaged in joint asset activities. Proposed § 941.2(c)(1) contains the specific parameters related to issuance and servicing of COs: conducting negotiations relating to the offering and sale of COs and other obligations of the Banks, and promoting market discipline and making timely payments on the COs. Proposed § 941.2(c)(1)(iii) requires the OF to offer, issue and service COs effectively and at the lowest all-in funding costs over time, with due regard for prudent risk-management practices, prudential debt parameters, short-and long-term market conditions, the cooperative nature of the Bank System, and the Banks' role as government-sponsored enterprises. The proposed rule further provides that such debt shall be issued consistent with maintaining reliable access to the short-term and long-term capital markets, by positioning the issuance of debt to take advantage of current and future capital market opportunities, and requires the OF to define and maintain appropriate investor suitability standards. In considering the cooperative nature of the Bank System, the OF specifically must take into account the relationship between the Banks as debt issuers, and the members of the Bank System as retail issuers of debt, such as certificates of deposit, and the potential for competition between the Banks and their members.

As discussed, the OF currently issues debt on behalf of the Finance Board. The Finance Board annually adopts a debt-issuance authorization to the OF that includes parameters to which the debt must conform. If the Banks are authorized to issue joint debt under section 11(a) of the Bank Act, as

proposed, the annual Finance Board authorization, including the parameters to which debt must conform, would no longer be required. However, the Finance Board continues to be responsible for ensuring that the Banks are able to raise funds in the capital markets. *See* 12 U.S.C. 1422a(a)(3)(B)(iii). Accordingly, the proposed rule requires the OF Board of Directors to implement policies to access debt markets according to an efficient and managed process that establishes prudent debt parameters and risk-management practices. In particular, this will involve establishing policies that may temporarily prevent a Bank from accessing the capital markets or prevent a Bank from issuing a specific type of security. In addition, the proposed rule requires the OF to adopt, implement and maintain investor suitability standards.

As a part of its CO issuance function, proposed § 941.2(c) would assign to the OF the function of preparing the combined Bank System annual and quarterly financial reports (financial reports). Proposed § 941.2(c)(1)(iv) would codify current Finance Board policy (Finance Board Res. No. 98-27 (June 24, 1998)) and set forth the standards under which the OF must prepare the financial reports, including requiring that the scope, form and content of the disclosure contained in such financial reports generally be consistent with the requirements of the SEC's Regulations S-K (specific narrative disclosure requirements) and S-X (accounting and financial statement disclosure requirements) (17 CFR parts 229 and 210) and be presented in accordance with the Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" (FAS 131). While the FAS 131 standard only applies to public business enterprises, and not, therefore, to a government-sponsored enterprise such as the Bank System, the Finance Board continues to believe that presentations resulting from compliance with FAS 131, with each Bank presented as a separate segment, provide useful information to bondholders and Bank members.

Proposed § 941.2(c)(1)(iv)(C) references an Appendix to the proposed rule that lists exceptions to the standards set forth in § 941.2(c)(1)(iv)(A) and (B). These exceptions stem from the Finance Board's belief that the general standards may include disclosure requirements that are inapplicable to, or inappropriate for, the Bank System. The list of exceptions is similar to that contained in the Finance Board's Policy

Statement, and includes certain disclosures concerning related-party transactions, biographical information, compensation, submission of matters to a vote of shareholders, exhibits, per-share information and beneficial ownership. Exceptions relating to derivatives and the filing schedule for financial reports that are included in the Finance Board's Policy Statement have been omitted from the Appendix since the Finance Board intends the SEC standard to be met in each case. The Appendix also expands the list of persons required to provide biographical information to include members of the OF Board of Directors, in recognition of the increased role assigned to that body by the proposed reorganization of the OF.

References to the "managing director of the OF" in the Policy Statement have been changed to the "Chief Financial Officer of the OF" in the Appendix.

Proposed § 941.2(c)(1)(iv)(D) provides that the OF will file and distribute combined Bank System financial reports according to a schedule that mirrors the filing requirements applicable to corporate registrants under the 1934 Act (*i.e.*, annual reports within 90 days after the end of the fiscal year and quarterly reports within 45 days after the end of each of the first three fiscal quarters). The Finance Board believes that, just as disclosure concerning the Bank System should conform to industry standards, so too should the Bank System provide that information to interested parties within the timeframes applicable in the industry. Proposed § 941.2(c)(1)(iv)(D) would require the OF to distribute financial reports to each Bank member according to the same schedule to ensure prompt dissemination of relevant information. Proposed § 941.2(c)(1)(iv)(E) expressly confirms the Finance Board's sole authority to determine compliance with the standards of part 941, while proposed § 941.2(c)(1)(iv)(F) provides an explicit compliance mechanism by requiring the OF to promptly comply with any Finance Board directive pertaining to the preparation, filing, amendment or distribution of financial reports.

Proposed §§ 941.2(c)(1)(v), (vi) and (vii) obligate the OF to stay informed on issues and developments relating to capital markets and COs, and to pass relevant information along to the Banks. Proposed § 941.2(c)(1)(v) expressly requires the OF to provide capital markets information concerning debt to the Banks. Proposed § 941.2(c)(1)(vi) provides that the OF shall manage relationships with Nationally Recognized Statistical Rating Organizations (NRSROs) in connection

with the NRSRO's ratings of COs, while § 941.2(c)(1)(vii) allows the OF to conduct research reasonably related to the issuance or servicing of COs. These functions are intended to allow the OF to serve as a centralized repository for information supporting the issuance of COs for the benefit of the Bank System.

3. Joint Asset Activity Management

The Finance Board has determined that the Banks have incidental and investment authority to undertake certain lending programs with their members whereby a Bank may purchase or fund mortgages originated by members, subject to certain conditions. On October 4, 1999, the Finance Board adopted Resolution Number 99-50, which authorized the Banks to "establish and operate Member Mortgage Assets programs, a generic designation for programs that efficiently allocate mortgage risks so as to best use the core competencies of the entities involved, provide appropriate capital treatment to the participating financial institution members, and provide capital market funding and risk management alternatives, all for the ultimate benefit of consumers." See Finance Board Res. No. 99-50 (Oct. 4, 1999); *see also* 64 FR 60448 (Nov. 5, 1999). Finance Board Resolution Number 99-50 also includes the terms and conditions applicable to the operation of member mortgage assets programs. See Finance Board Res. No. 99-50 at 2.

These are not the only potential joint asset activities that the Banks may choose to conduct. Certain advance participation programs or investments, liquidity management and investments in housing finance agency bonds present potential for joint activity among the Banks.

Any joint asset activities in which the Banks may engage may be most efficiently administered on a joint basis through a central facility. Administering joint assets through a centralized facility offers the added safety and soundness benefits of better risk-management capabilities and geographic diversity in the portfolio. The latter is particularly important given the national nature of the mortgage markets. This is an issue the Finance Board will continue to study as this product develops and business therein increases.

Proposed § 941.2(c)(2) is intended to authorize the OF, as the only statutorily recognized joint office of the Banks, to operate in the above capacity. It provides that, to the extent requested by two or more Banks pursuant to any agreement or contract, the OF shall facilitate or provide services to the

Banks in connection with any Bank joint asset activities authorized by law. With regard to the joint asset activities of the Banks, the OF would be required to provide administrative and technical support for the origination, purchase, management, servicing or sale of any asset owned by one or more Banks pursuant to any contract, including member mortgage assets; provide market information to the Banks concerning member mortgage assets and other assets or investments of the Banks; conduct and provide research on such assets and investments; develop effective systems to monitor credit exposure and manage counter-party risk; adopt procedures to assist the Banks in managing their liquidity; and adopt procedures to facilitate the inter-Bank sale of participation interests in advances and investments. This section does not require the Banks to make use of the OF in this capacity, but it does require the OF to provide the services outlined if two or more Banks wish the OF to do so. The OF may, of course, establish a reasonable fee structure or charge for its services by contract or otherwise. It also may mediate among competing Bank demands, in accordance with its specified duties and responsibilities.

Proposed § 941.2(c)(3) provides that, in accordance with policies and procedures established by the OF Board of Directors, the OF shall perform such duties and responsibilities for the Financing Corporation (FICO) or the Resolution Funding Corporation (REFCorp) on behalf of the Banks, as may be required. This section preserves a current function of the OF as set forth in § 941.5(b).

Proposed § 941.2(d) provides that the OF may contract with a Bank or Banks for the use of Bank facilities or personnel in order to perform its functions, which is currently set forth in § 941.7(b).

4. Finance Board Oversight

Proposed § 941.3 provides that the Finance Board shall retain the same regulatory oversight authority and enforcement powers over the OF, the OF Board of Directors, the directors, officers, employees, agents, attorneys, accountants or other OF staff, as it has over a Bank and its respective board members, officers, employees, attorneys, accountants, agents or other staff, which is broader than the existing provision. The proposed rule deletes § 941.3(a), which states that the activities of the OF are subject to the approval of the Finance Board. The Finance Board believes that § 941.3 should be amended to expressly state the Finance Board's

supervisory role in the proposed expanded functions of the OF. Additionally, the proposed rule states that, pursuant to Section 20 of the Bank Act, 12 U.S.C. 1440, the Finance Board shall examine the OF, all funds and accounts that may be established pursuant to this part, and the operations and activities of the OF, as provided for in the Bank Act or any regulations promulgated pursuant thereto. This is somewhat broader in scope than the provisions of existing § 941.3.

E. Organizational Structure— Amendments to Part 941

1. Section 941.4—the OF Board of Directors

Current § 941.7(c) establishes an OF board of directors composed of three members, two Bank presidents and one private citizen with demonstrated expertise in financial markets, all appointed by the Finance Board. This structure has served the OF and the Bank System while the OF's only functions have been to issue COs on behalf of the Finance Board and make CO principal and interest payments when due on behalf of the Banks. The proposed rule contemplates that the OF will undertake additional, varied responsibilities that would require broader oversight by a board of directors possessing a wide range of financial sector credentials. Accordingly, proposed § 941.4(a) would change the size and composition of the OF Board of Directors to reflect the proposed expanded duties and functions of the OF. As revised, the OF Board of Directors would consist of 24 individuals, 6 of whom would be appointed by the Finance Board, 6 of whom would be elected by Bank System members, and 12 of whom would be appointed by the Banks. The Finance Board acknowledges that the size of the proposed OF Board of Directors may seem unwieldy to some. The ratio and balance among Bank representatives, System representatives and representatives of the public is the principle most important to the Finance Board in this provision. The quest to achieve the proper balance while providing every Bank a seat and a role for members and the public on the OF Board of Directors, leads to the number proposed. The Finance Board seeks comment on and suggestions for alternative structures that might be more workable in terms of number that that would still maintain the appropriate mix and balance of representation on the OF Board of Directors. For instance, if less than 12 Banks were to be represented on the OF Board of

Directors at any one time, the regulation could provide for rotating Bank representation, or the elimination of the requirement for an Executive Committee.

Under proposed § 941.4(a)(1), directors appointed by the Finance Board would have to be U.S. citizens with demonstrated experience in financial markets or asset management, and could not be affiliated with any Bank or broker-dealer under contract with the OF. The proposed rule establishes no other eligibility criteria for Finance Board appointees to the OF Board. This differs from the appointment standards for public interest directors of the Banks, which require that two out of six Finance Board appointees represent consumer or community interest organizations, and prohibit any Finance Board appointee from serving as an officer of a Bank, or as an officer or director of any member of a Bank, or from holding shares or any other financial interest in any member, during his or her tenure as a Bank director. *See* 12 U.S.C. 1427(a). The absence of such restrictions for OF Board appointees in the proposed rule is intended to provide the Finance Board with maximum flexibility in selecting persons it believes would best assist the OF in fulfilling its mission. However, the Finance Board seeks comment on whether the qualifications and restrictions applicable to appointed Bank directors, or any others, should be included in the proposed rule for Finance Board appointees to the OF Board.

Under proposed § 941.4(a)(2), a director appointed by a Bank must be an officer, employee, or director of the Bank. Pursuant to proposed § 941.4(a)(3), Bank System members would elect six directors (two each year) through annual elections conducted by the OF. Under proposed § 941.4(a)(3)(i), to be eligible for a directorship, nominees of members would have to be U.S. citizens with demonstrated experience in financial markets or asset management, and could not be associated with a broker-dealer under contract with the OF. A Bank System member and its affiliates could not have more than one representative on the OF Board of Directors at any time.

Proposed § 941.4(a)(3)(ii) provides that each member of the Bank System is entitled to nominate an eligible person for service on the OF Board in each annual election. From such nominees, two member-elected directorships would be filled each year by a plurality vote of Bank System members. Each member would be permitted to cast a number of votes equal to the number of

shares of stock in such Bank the member held at the end of the calendar year preceding the election, without any limitation, including limits that would apply to voting in director elections under section 7(b) of the Bank Act. *See* 12 U.S.C. 1427(b). Under proposed § 941.4(a)(3)(iii), the OF would prepare nomination forms and transmit them to Bank System members no later than March 1st of the election year. The nomination forms would state the director eligibility requirements and restrictions. Members would have not less than 30 calendar days to submit the nomination forms to the OF, which would create acceptance and certification of eligibility forms and provide them to the nominees no later than May 1st of the election year. The nominees would have 30 days to accept or decline the nomination and provide the written eligibility certification to the OF.

Under proposed § 941.4(a)(3)(iv), the OF would prepare a ballot for the OF Board of Directors election to be used in each Bank district based on the acceptance and certification forms, and provide the ballot to the Banks not later than July 1st of the election year. The Banks would be required to transmit the ballot to their members with the election ballots for the election of the Banks' respective boards of directors. Bank System members would have a minimum of 30 days to vote and return the OF Board of Directors election ballot to the OF. The OF would tabulate the ballots and announce the slate of the OF Board of Directors no later than November 1st of the election year.

Proposed § 941.4(b) provides that the directors' terms would be three years, and that initial terms would be staggered so that $\frac{1}{3}$ of the terms expire each year. Under proposed § 941.4(c), appointed directorship vacancies would be filled in the manner in which the appointment was originally made, while elected directorship vacancies would be filled by majority vote of the remaining OF Board of Directors. A director appointed or elected to fill a vacancy would serve the remainder of the original term. Proposed § 941.4(d), which sets forth the means of selection and duties of the Chair and Vice Chair of the OF Board of Directors, contains all of the substantive provisions of current § 941.7(e).

Proposed § 941.4(e), "Compensation," replaces the multiple provisions of current § 941.7(f) with a single standard that permits members of the OF Board of Directors to receive compensation and reimbursement for expenses incurred as a result of their service on the OF Board of Directors.

Proposed § 941.4(f) is a new section that requires the OF Board of Directors to establish an audit committee consistent with the requirements set forth in part 917 (which is being proposed in a separate notice of proposed rulemaking); an executive committee comprised of member-elected directors, Bank-appointed directors, and Finance Board-appointed directors, each represented in the same proportions as they are on the full OF Board of Directors; and a committee to coordinate the issuance and servicing of COs under part 910. The proposed rule provides authority for the OF Board of Directors to establish additional committees as necessary and appropriate to carry out the Board's duties and responsibilities. Additionally, the OF Board of Directors is required to promulgate policies and define respective roles and duties of any committees so established, which shall be binding upon such committees.

Proposed § 941.4(g) is a new section that sets the quorum requirement for meetings of the OF Board of Directors and meetings of committees of the OF Board of Directors at a simple majority of the total directorships on the OF Board of Directors or the committee.

2. Section 941.5—Powers of the OF Board of Directors

Proposed § 941.5, "Powers of the OF board of directors," incorporates and revises the provisions of current § 941.8. As is true in § 941.8(a) of the current rule, proposed § 941.5(a) provides that the OF Board of Directors shall have the incidental powers under section 12(a) of the Bank Act as are necessary, convenient and proper to accomplish the efficient operation and management of the OF. Also, as is true under § 941.8(b) of the current rule, proposed § 941.5(b) expressly empowers the OF Board of Directors to act as the agent of the Finance Board in issuing COs pursuant to section 11(c) of the Bank Act. It also empowers the OF Board of Directors to act as agent for the Banks in issuing COs pursuant to section 11(a) of the Bank Act and in making principal and interest payments on COs issued by either entity.

Proposed § 941.5(c) preserves the authority of the OF Board of Directors to delegate powers to OF staff to carry out OF functions, and proposed § 941.5(d) retains the indemnification powers currently provided in § 941.8(d).

3. Section 941.6—Duties of the OF Board of Directors

Proposed § 941.6, "Duties of the OF board of directors" would substantially revise the provisions of current § 941.9.

Proposed § 941.6(a) retains intact the provisions of current § 941.9(a), which provides that the OF Board of Directors shall adopt bylaws, consistent with applicable laws and regulations as administered by the Finance Board, governing its operation and issue such guidance or instruction as will promote the efficient operation of the OF and that the OF Board of Directors shall conduct its business by majority vote of its members convened at a meeting in accordance with its bylaws.

Proposed § 941.6(b) enumerates the oversight responsibilities of the OF Board of Directors. Importantly, proposed § 941.6(b)(2) requires the OF Board of Directors to set policies for management of the OF, in particular a policy in connection with the issuance of debt that would take into account the cooperative nature of the Bank System, and the relationship of the Banks as issuers of debt to their members as issuers of debt. Proposed § 941.6(b) also requires the OF Board of Directors to be responsible for the conduct and performance of all duties, functions, operations and activities of the OF and for its efficient and effective operation; approve a strategic business plan for the OF and monitor the progress of its operations under such plan; review, adopt, and monitor the annual operating budget of the OF including any supplemental expenditure thereto; provide oversight for the OF Board of Directors committee charged with directing the issuance of COs; develop and implement the pricing mechanism by which the OF will make private or public offerings of COs, subject to the requirements of part 910; select, employ and define the duties of a Chief Executive Officer of the OF (CEO), provided that the CEO, or his designee, shall be the Fiscal Agent of the Banks, a member of the Directorate of the Financing Corporation, pursuant to section 21(b)(1)(A) of the Bank Act, 12 U.S.C. 1441(b)(1)(A), and a member of the Directorate of the Resolution Funding Corporation, pursuant to section 21B(c)(1)(A) of the Bank Act, 12 U.S.C. 1441b(c)(1)(A). Additionally, the OF Board of Directors would be required to approve all contracts of the OF, and assume any other responsibilities that may from time to time be delegated to it by the Finance Board. The proposed rule also expressly provides that the OF Board of Directors would be subject to and required to operate in accordance with Finance Board policies and regulations applicable to the boards of directors of the Banks, including proposed part 917.

Proposed § 941.7 incorporates and revises the provisions of current

§ 941.11. It retains the requirement of current § 941.11(f) that the Banks are responsible for jointly funding the OF. Under the proposed rule, at the direction of and pursuant to policies and procedures adopted by the OF Board of Directors, the Banks are required periodically to reimburse the OF Operations Imprest Fund to maintain in such fund an amount approved by the OF Board of Directors sufficient to fund the operations of the OF under a budget approved by the OF Board of Directors. Each Bank's respective *pro rata* share of the reimbursement must be based on the ratio of the total paid-in value of its capital stock relative to the total paid-in value of all capital stock in the Bank System. The proposed rule provides new authority for the OF Board of Directors, with the prior approval of the Finance Board, to devise an alternative formula for determining each Bank's respective share of the OF expenses or, by contract with a Bank or Banks, may choose to be reimbursed through a fee structure in lieu of or in addition to assessment, for services provided to the Bank or Banks for the issuance or servicing of COs or the management and administration of joint asset activities.

Proposed § 941.8 retains the savings clause contained in current § 941.12, which provides that all actions taken by the OF as it existed prior to these amendments will continue to be valid as regards the Finance Board and the Bank System. The rest of the provisions of current § 941.12 are not included in the proposed rule as they are obsolete and no longer necessary.

IV. Regulatory Flexibility Act

The proposed rule applies only to the Banks, which do not come within the meaning of small entities as defined in the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Therefore, in accordance with section 605(b) of the RFA, 5 U.S.C. 605(b), the Finance Board hereby certifies that this proposed rule, if promulgated as a final rule, will not have significant economic impact on a substantial number of small entities.

V. Paperwork Reduction Act

This proposed rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995. See 33 U.S.C. 3501 *et seq.* Therefore, the Finance Board has not submitted any information to the Office of Management and Budget for review.

List of Subjects*12 CFR Part 900*

Organization and functions
(Government agencies).

12 CFR Part 910

Banks, Consolidated bonds and
debentures, Federal home loan banks,
Securities.

12 CFR Part 941

Consolidated bonds and debentures,
Federal home loan banks, Organization
and functions (Government agencies),
Securities.

For the reasons stated in the
preamble, the Finance Board proposes
to amend 12 CFR parts 900, 910 and 941
as follows:

PART 900—DESCRIPTION OF ORGANIZATION AND FUNCTIONS

1. The authority citation for part 900
continues to read as follows:

Authority: 5 U.S.C. 552; 12 U.S.C. 1422b(a)
and 1423.

2. Amend § 900.30 to add a new
paragraph (a)(3) to read as follows:

§ 900.30 Office of Finance Board of Directors.

(a) * * *

(3) The authority delegated under
paragraphs (a)(1) and (2) of this section
expires on December 31, 2000, unless
otherwise extended or modified by the
Finance Board.

* * * * *

3. Revise part 910 to read as follows:

PART 910—CONSOLIDATED OBLIGATIONS

Sec.

910.1 Definitions.

910.2 Authorized liabilities; Issuance of
consolidated obligations.

910.3 Form of consolidated obligations.

910.4 Transactions in consolidated
obligations.

910.5 Lost, stolen, destroyed, mutilated or
defaced consolidated obligations.

910.6 Administrative provision.

910.7 Conditions for issuance of
consolidated obligations.

910.8 Joint and several liability.

Authority: 12 U.S.C. 1422a, 1422b and
1431.

§ 910.1 Definitions.

For purposes of this part:

(a) *Consolidated obligations* or *CO*
means any bond, debenture, or note
issued jointly by the Banks pursuant to
section 11(a) of the Federal Home Loan
Bank Act (Act), as amended (12 U.S.C.
1431(a)), or any bond or note issued by
the Finance Board on behalf of all Banks
pursuant to section 11(c) of the Act (12

U.S.C. 1431(c)), on which the Banks are
by statute or regulation jointly and
severally liable.

(b) *NRSRO* means a credit rating
organization regarded as a Nationally
Recognized Statistical Rating
Organization by the Securities and
Exchange Commission.

(c) *Senior bonds* means COs issued
pursuant to section 11 of the Act and
this part and not defeased, other than
bonds specifically subordinated to any
then outstanding COs.

§ 910.2 Authorized liabilities; Issuance of consolidated obligations.

(a) *Authorized liabilities.* As a source
of funds for business operations, each
Bank is authorized to incur liabilities
only by:

(1) Acting as joint and several obligor
with other Banks on consolidated
obligations, as authorized under this
part;

(2) Accepting time or demand
deposits from members or any
institution for which the Bank is
providing correspondent services, other
Banks, and instrumentalities of the
United States, so long as the deposit
transaction is not conducted in such a
way as to result in the offer or sale of
a security in a public offering as those
terms are used in 15 U.S.C. 77b(3); or

(3) Solely in order to satisfy the
Bank's short-term liquidity needs, by:
(i) Purchasing federal funds; and
(ii) Entering into repurchase
agreements.

(b) *Consolidated obligations issued by
the Finance Board.* The Finance Board
may issue consolidated obligations
under section 11(c) of the Act (12 U.S.C.
1431(c)), including the determination of
the dates of issue, maturities, rates of
interest, terms and conditions thereof,
and the manner in which such
consolidated obligations shall be issued,
subject to the provisions of 31 U.S.C.
9108. The Finance Board in its
discretion may delegate this
responsibility, or terminate such
delegation. Consolidated obligations
issued under this paragraph shall not be
directly placed with any Bank.

(c) *Consolidated obligations issued by
the Banks.* (1) Pursuant to the Banks'
housing finance mission set forth in
section 2A(a)(3)(B)(ii) of the Act (12
U.S.C. 1422a(a)(3)(B)(ii)), pursuant to
the Finance Board's duty to ensure that
the Banks carry out that mission and
remain adequately capitalized and able
to raise funds in the capital markets
under section 2A(a)(3)(B)(ii) and (iii) of
the Act (12 U.S.C. 1422a(a)(3)(B)(ii) and
(iii)), and subject to such rules,
regulations, terms and conditions as the
Finance Board may prescribe, the Banks

are authorized to issue joint debt under
section 11(a) of the Act (12 U.S.C.
1431(a)), which shall be called
consolidated obligations and on which
the Banks shall be jointly and severally
liable under § 910.7.

(2) Consolidated obligations shall be
issued through the Office of Finance, as
agent of the Banks pursuant to this part
910.

(3) Consolidated obligations issued
under this paragraph (c) shall not be
directly placed with any Bank.

(d) *Negative pledge requirement.* Each
Bank shall at all times maintain assets
described in paragraphs (d)(1) through
(d)(6) of this section free from any lien
or pledge, in an amount at least equal
to a pro rata share of the total amount
of currently outstanding consolidated
obligations jointly issued by the Banks
pursuant to section 11(a) of the Act (12
U.S.C. 1431(a)) and by the Finance
Board pursuant to section 11(c) of the
Act (12 U.S.C. 1431(c)) equal to such
Bank's participation in all such COs
outstanding provided that any assets
that are subject to a lien or pledge for
the benefit of the holders of any issue
of consolidated obligations shall be
treated as if they were assets free from
any lien or pledge for purposes of
compliance with this paragraph (d).
Eligible assets are:

- (1) Cash;
- (2) Obligations of or fully guaranteed
by the United States;
- (3) Secured advances;
- (4) Mortgages as to which one or more
Banks have any guaranty or insurance,
or commitment therefore, by the United
States or any agency thereof;
- (5) Investments described in section
16(a) of the Act (12 U.S.C. 1436(a)); and
- (6) Other securities that have been
assigned a rating or assessment by an
NRSRO that is equivalent to or higher
than the rating or assessment assigned
by an NRSRO to consolidated
obligations outstanding.

§ 910.3 Form of consolidated obligations.

Consolidated obligations shall be
issued in series and all consolidated
obligations of the same series shall be of
like date, tenor, and effect except as to
denominations, which shall be in such
amounts as may be authorized by the
Finance Board. The Finance Board shall
prescribe the form of each consolidated
obligation. Consolidated obligations
issued with maturities of one year or
less may be designated consolidated
notes.

§ 910.4 Transactions in consolidated obligations.

The general regulations of the
Department of Treasury now or

hereafter in force governing transactions in United States securities, except 31 CFR part 357 regarding book-entry procedure, are hereby incorporated into this part 910, so far as applicable and as necessarily modified to relate to consolidated obligations, as the regulations of the Finance Board for similar transactions on consolidated obligations. The book-entry procedure for consolidated obligations is contained in part 912 of this subchapter.

§ 910.5 Lost, stolen, destroyed, mutilated or defaced consolidated obligations.

United States statutes and regulations of the Department of Treasury now or hereafter in force governing relief on account of the loss, theft, destruction, mutilation, or defacement of United States securities, so far as applicable and as necessarily modified to relate to consolidated obligations, are hereby adopted as the regulations of the Finance Board for the issuance of substitute consolidated obligations or the payment of lost, stolen, destroyed, mutilated or defaced consolidated obligations.

§ 910.6 Administrative provision.

The Secretary of the Treasury or the Acting Secretary of the Treasury is hereby authorized and empowered, as the agent of the Finance Board and the Banks to administer §§ 910.4 and 910.5, and to delegate such authority at their discretion to other officers, employees, and agents of the Department of Treasury. Any such regulations may be waived on behalf of the Finance Board and the Banks by the Secretary of the Treasury or the Acting Secretary of the Treasury or by an officer of the Department of Treasury authorized to waive similar regulations with respect to United States securities, but only in any particular case in which a similar regulation with respect to United States securities would be waived. The terms "securities" and "bonds" as used in this section shall, unless the context otherwise requires, include and apply to coupons and interim certificates.

§ 910.7 Conditions for issuance of consolidated obligations.

The OF Board of Directors shall authorize the offering for current and forward settlement (up to 12 months) or the reopening of COs, as necessary, and authorize the maturities, rates of interest, terms and conditions thereof, subject to the provisions of 31 U.S.C. 9801 and the following conditions:

(a) COs may be offered for sale only to the extent that Banks are committed to take the proceeds;

(b) The OF Board of Directors shall implement investor suitability standards; and

(c) COs may be offered for sale only pursuant to a policy adopted by the OF Board of Directors that addresses the relationship between the Banks as issuers of debt and their members as issuers of debt.

§ 910.8 Joint and several liability.

(a) *In general.* (1) Each and every Bank, individually and collectively, has an obligation to make full and timely payment of all principal and interest on consolidated obligations when due.

(2) Each and every Bank, individually and collectively, shall ensure that the timely payment of principal and interest on all consolidated obligations is given priority over, and is paid in full in advance of, any payment to or redemption of shares from any shareholder.

(3) The provisions of this part shall not limit, restrict or otherwise diminish, in any manner, the joint and several liability of all of the Banks on all of the consolidated obligations issued by the Finance Board pursuant to section 11(c) of the Bank Act (12 U.S.C. 1431(c) and by one or more Banks pursuant to section 11(a) of the Bank Act (12 U.S.C. 1431(a)).

(b) *Certification and reporting.* (1) Before the end of each calendar quarter, and before declaring or paying any dividend for that quarter, the President of each Bank shall certify in writing to the Finance Board that, based on known current facts and financial information, the Bank will remain in compliance with the liquidity requirements set forth in section 11(g) of the Act (12 U.S.C. 1431(g)), and the Finance Board's Financial Management Policy or any regulations, (as the same may be amended, modified or replaced), and will remain capable of making full and timely payment of all of its current obligations, including direct obligations, coming due during the next quarter.

(2) A Bank shall immediately provide written notice to the Finance Board if at any time the Bank:

(i) Is unable to provide the certification required by paragraph (b)(1) of this section;

(ii) Projects at any time that it will fail to comply with statutory or regulatory liquidity requirements, or will be unable to timely and fully meet all of its current obligations, including direct obligations, due during the quarter;

(iii) Actually fails to comply with statutory or regulatory liquidity requirements or to timely and fully meet all of its current obligations, including

direct obligations, due during the quarter; or

(iv) Negotiates to enter or enters into an agreement with one or more other Banks to obtain financial assistance to meet its current obligations, including direct obligations, due during the quarter; the notice of which shall be accompanied by a copy of the agreement, which shall be subject to the approval of the Finance Board.

(c) *Consolidated obligation payment plans.* (1) A Bank promptly shall file a consolidated obligation payment plan for Finance Board approval:

(i) If the Bank becomes a non-complying Bank as a result of failing to provide the certification required in paragraph (b)(1) of this section;

(ii) If the Bank becomes a non-complying Bank as a result of being required to provide the notice required pursuant to paragraph (b)(2) of this section, except in the event that a failure to make a principal or interest payment on a consolidated obligation when due was caused solely by a temporary interruption in the Bank's debt servicing operations resulting from an external event such as a natural disaster or a power failure; or

(iii) If the Finance Board determines that the Bank will cease to be in compliance with the statutory or regulatory liquidity requirements, or will lack the capacity to timely and fully meet all of its current obligations, including direct obligations, due during the quarter.

(2) A consolidated obligation payment plan shall specify the measures the non-complying Bank will undertake to make full and timely payments of all of its current obligations, including direct obligations, due during the applicable quarter.

(3) A non-complying Bank may continue to incur and pay normal operating expenses incurred in the regular course of business (including salaries, benefits, or costs of office space, equipment and related expenses), but shall not incur or pay any extraordinary expenses, or declare, or pay dividends, or redeem any capital stock, until such time as the Finance Board has approved the Bank's consolidated obligation payment plan or inter-Bank assistance agreement, or ordered another remedy, and all of the non-complying Bank's direct obligations have been paid.

(d) *Finance Board payment orders; Obligation to reimburse.* (1) The Finance Board, in its discretion and notwithstanding any other provision in this section, may at any time order any Bank to make any principal or interest

payment due on any consolidated obligation.

(2) To the extent that a Bank makes any payment on any consolidated obligation on behalf of another Bank, the paying Bank shall be entitled to reimbursement from the non-complying Bank, which shall have a corresponding obligation to reimburse the Bank providing assistance, to the extent of such payment and other associated costs (including interest to be determined by the Finance Board).

(e) *Adjustment of equities.* (1) Any non-complying Bank shall apply its assets to fulfill its direct obligations.

(2) If a Bank is required to meet, or otherwise meets, the direct obligations of another Bank due to a temporary interruption in the latter Bank's debt servicing operations (e.g., in the event of a natural disaster or power failure), the assisting Bank shall have the same right to reimbursement set forth in paragraph (d)(2) of this section.

(3) If the Finance Board determines that the assets of a non-complying Bank are insufficient to satisfy all of its direct obligations as set forth in paragraph (e)(1) of this section, then the Finance Board may allocate the outstanding liability among the remaining Banks on a *pro rata* basis in proportion to each Bank's participation in all consolidated obligations outstanding as of the end of the most recent month for which the Finance Board has data, or otherwise as the Finance Board may prescribe.

(f) *Reservation of authority.* Nothing in this section shall affect the Finance Board's authority to adjust equities between the Banks in a manner different than the manner described in paragraph (e) of this section, or to take enforcement or other action against any Bank pursuant to the Finance Board's authority under the Act or otherwise to supervise the Banks and ensure that they are operated in a safe and sound manner.

(g) *No rights created.* (1) Nothing in this section shall create or be deemed to create any rights in any third party.

(2) Payments made by a Bank toward the direct obligations of another Bank are made for the sole purpose of discharging the joint and several liability of the Banks on consolidated obligations.

(3) Compliance, or the failure to comply, with any provision in this section shall not be deemed a default under the terms and conditions of the consolidated obligations.

4. Revise part 941 to read as follows:

PART 941—OPERATIONS OF THE OFFICE OF FINANCE

Sec.

- 941.1 Definitions.
- 941.2 Powers and responsibilities of the OF.
- 941.3 Finance Board oversight.
- 941.4 The OF board of directors.
- 941.5 Powers of the OF board of directors.
- 941.6 Duties of the OF board of directors.
- 941.7 Funding of the OF.
- 941.8 Savings clause.

Appendix A to Part 941—Exceptions to the General Disclosure Standards

Authority: 12 U.S.C. 1422b(a) and 1431.

§ 941.1 Definitions.

For purposes of this part:

(a) *Bank System* means the 12 Banks and the OF.

(b) *Chair* means the Chairperson of the OF Board of Directors.

(c) *Chief Executive Officer* or *CEO* means the Chief Executive Officer of the OF.

(d) *OF* means the Office of Finance.

(e) *OF Board of Directors* means the 24 member administrative body responsible for management of the OF.

(f) *OF Operations Imprest Fund* means the checking account established in a financial depository institution approved by the OF Board of Directors to fund OF operations.

§ 941.2 Powers and responsibilities of the OF.

(a) *Joint office.* The OF is a joint office of the Banks pursuant to section 2B of the Act (12 U.S.C. 1422b(b)(2)).

(b) *Purpose.* The role of the OF is to facilitate the accomplishment of the mission of the Banks set forth in section 2A of the Act (12 U.S.C. 1422a(3)(A)(ii) and (iii)) by:

(1) Exclusively offering, issuing, and servicing consolidated obligations on behalf of the Finance Board pursuant to section 11(c) of the Act (12 U.S.C. 1431(c)) and the Banks pursuant to section 11(a) of the Act (12 U.S.C. 1431(a)), on which the Banks are jointly and severally liable; and

(2) At the request of two or more Banks, by undertaking on a joint basis activities the requesting Banks are authorized by law to undertake individually.

(c) *Functions.* The OF shall have the following functions:

(1) Subject to part 910 of this chapter, with respect to consolidated obligations, the OF shall:

(i) Conduct or facilitate negotiations relating to the public or private offering and sale of consolidated obligations in such a manner as to promote the cooperative nature of the Bank System and assure that suitability standards are met;

(ii) Issue and service (including making timely payments on principal and interest due, subject to § 910.7 of this chapter) consolidated obligations pursuant to and in accordance with the policies and procedures established by the OF Board of Directors under this part, which shall govern the frequency and timing of issuance, issue size, minimum denomination, bond concessions, underwriter qualifications, currency of issuance, interest-rate change or conversion features, call features, principal indexing features, selection and retention of outside counsel, selection of clearing organizations, and the selection and compensation of underwriters for consolidated obligations, and shall be in accordance with the mission of the OF as set forth in § 941.2 and the requirements and limitations set forth in paragraph (c)(1)(iii) of this section;

(iii) Discharge the function described in paragraphs (c)(1)(i) and (ii) of this section effectively and at the lowest all-in funding costs over time, with due regard for prudent risk-management practices, prudential debt parameters, short and long-term market conditions, the cooperative nature of the Bank System, and the Banks' role as government-sponsored enterprises, and, consistent with:

(A) Maintaining reliable access to the short-term and long-term capital markets;

(B) Positioning the issuance of debt to take advantage of current and future capital market opportunities; and

(C) Defining and maintaining appropriate investor suitability standards.

(iv) Prepare and issue the combined annual and quarterly financial reports for the Bank System in accordance with the following requirements:

(A) The scope, form and content of the disclosure generally shall be consistent with the requirements of the Securities and Exchange Commission's Regulations S-K and S-X (17 CFR parts 229 and 210);

(B) Information about each Bank shall be presented as a segment of the Bank System as if Statement of Financial Accounting Standards No. 131, titled "Disclosures about Segments of an Enterprise and Related Information" (FASB 131) applied to the combined annual and quarterly financial reports of the Bank System.

(C) The standards set forth in paragraphs (c)(1)(iv)(A) and (B) of this section are subject to the exceptions set forth in the Appendix to this part 941.

(D) The OF shall file with the Finance Board and distribute to each Bank and Bank member the combined Bank

System annual report within 90 days after the end of the fiscal year, and the combined Bank System quarterly report within 45 days after the end of the first three fiscal quarters of each fiscal year.

(E) The Finance Board in its sole discretion shall determine whether or not a combined Bank System annual or quarterly financial report prepared by the OF pursuant to § 941.8 complies with the standards of this part 941.

(F) The OF shall promptly comply with any directive of the Finance Board regarding the preparation, filing, amendment or distribution of the combined Bank System annual or quarterly financial reports.

(v) Provide capital markets information concerning debt to the Banks;

(vi) Manage relationships with the Nationally Recognized Statistical Rating Organizations in connection with their rating of consolidated obligations;

(vii) Conduct research reasonably related to the issuance or servicing of consolidated obligations.

(2) The OF shall, to the extent requested by two or more Banks pursuant to any agreement or contract, facilitate or provide services for the management and administration of joint asset activities of the Banks otherwise authorized by law and in accordance with this part, including without limitation:

(i) Providing administrative and technical support for the origination, purchase, management, servicing, or sale of any assets acquired or to be acquired by two or more Banks pursuant to any agreement or contract, including Member Mortgage Assets;

(ii) Providing market information to the Banks concerning joint asset activities, or other assets or investments, as necessary from time to time;

(iii) Conducting and providing to the Banks research reasonably related to joint asset activities or other assets or investments of the Banks, as necessary from time to time;

(iv) Developing, administering, and maintaining appropriate systems for timely monitoring of each Bank's unsecured credit exposure to individual counter-parties, and appropriate systems to manage Bank System exposure to counter-party risk within Bank System limits;

(v) Adopting and administering procedures to enable the Banks to jointly manage their liquidity; and

(vi) Adopting procedures to facilitate the sale or participation of advances and other assets among the Banks.

(3) In accordance with policies and procedures established by the OF Board of Directors, the OF shall perform such

duties and responsibilities for the Financing Corporation (FICO) or the Resolution Funding Corporation (REFCorp) on behalf of the Banks, as may be required.

(d) *Use of facilities or personnel.* The OF may contract with a Bank or Banks for the use of Bank facilities or personnel in order to perform its functions.

§ 941.3 Finance Board oversight.

(a) *Oversight and enforcement actions.* The Finance Board has the same regulatory oversight authority and enforcement powers over the OF, the OF Board of Directors, the directors, officers, employees, agents, attorneys, accountants or other OF staff, as it has over a Bank and its respective directors, officers, employees, attorneys, accountants, agents or other staff.

(b) *Examinations.* Pursuant to section 20 of the Act (12 U.S.C. 1440), the Finance Board shall examine the OF, all funds and accounts that may be established pursuant to this part 941, and the operations and activities of the OF, as provided for in the Act or any regulations promulgated pursuant thereto.

§ 941.4 The OF board of directors.

(a) *Composition of the OF board of directors.* The OF Board of Directors shall consist of 24 members, 6 of whom shall be appointed by the Finance Board, 6 of whom shall be elected by members of the Banks, and 12 of whom shall be appointed by the Banks.

(1) *Finance Board appointments.* The Finance Board shall appoint a total of six directors. Each director appointed by the Finance Board shall be a citizen of the United States having demonstrated experience in financial markets or asset management. An individual who is affiliated with any consolidated obligation selling or dealer group member under contract with the OF is not eligible to be appointed or serve as a member of the OF Board of Directors.

(2) *Bank appointments.* Each Bank shall, by resolution of its board of directors, appoint one director, who shall be an officer, director or employee of the Bank.

(3) *Member elections.* Bank System Members shall elect six directors through annual elections conducted by the OF.

(i) *Eligibility requirements.* To be eligible for nomination, election, and service as a member of the OF Board of Directors, an individual shall be a citizen of the United States with demonstrated experience in financial markets or asset management. An individual who is affiliated with any

consolidated obligation selling or dealer group member under contract with the OF is not eligible to serve as a member of the OF Board of Directors. A Bank System member and its affiliates may not have more than one representative on the OF Board of Directors at any time.

(ii) *Member-elected directorships and certain restrictions.* Each member of the Bank System is entitled to nominate an eligible person for service on the OF Board of Directors in each annual election. Two member-elected directorships shall be filled each year from such nominees by a plurality of the votes which such members may cast in an election held by the OF under this part 941. Each member may cast a number of votes equal to the number of shares of stock in such Bank held by the member at the end of the calendar year preceding the election.

(iii) *Nominations.* The OF shall prepare the nomination forms and transmit them to the Bank System members no later than March 1st of the election year. The nomination forms shall state the director eligibility requirements and the restrictions. Members shall have not less than 30 calendar days to submit nomination forms to the OF. The OF shall create acceptance and certification of eligibility forms, and provide such forms to the nominees no later than May 1st of the election year and the nominees shall have 30 days to accept or decline the nomination and provide the written eligibility certification to the OF.

(iv) *Ballots.* The OF shall prepare a ballot for the OF Board of Directors election to be used in each Bank district based on the acceptance and certification forms, and provide the ballot to the Banks no later than July 1st of the election year. The Banks shall transmit the ballot to their members with the election ballots for the election of the Banks' respective boards of directors. Bank System members shall have a minimum of 30 days to vote and return the OF Board of Directors election ballot to the OF. The OF will tabulate the ballots and announce the slate of the OF Board of Directors no later than November 1st of the election year.

(b) *Terms.* The term of each director shall be three years and initial terms shall be staggered such that $\frac{1}{3}$ of the terms expire each year.

(c) *Vacancies.* (1) *In general.* An OF director appointed or elected to fill a vacancy shall be appointed or elected only for the remainder of the term during which the vacancy occurred.

(2) *Appointed directors.* Vacancies in directorships appointed by the Finance Board or the Banks shall be filled in the manner in which the original appointment was made.

(3) *Elected directors.* Vacancies in directorships elected by Bank System members shall be filled by a majority vote of the remaining directors.

(d) *Chair and vice chair.* (1) The Finance Board shall designate one member of the OF Board of Directors as the chair, and another member as the vice chair.

(2) The chair shall preside over meetings of the OF Board of Directors. In the absence of the chair, the vice chair shall preside. The chair is responsible for ensuring that the directives and resolutions of the OF Board of Directors are drafted and maintained and for keeping the minutes of all meetings.

(e) *Compensation.* Members of the OF Board of Directors may receive compensation and reimbursement for expenses incurred as a result of their service on the OF Board of Directors.

(f) *Committees.* (1) The OF Board of Directors shall establish an audit committee consistent with the requirements set forth in part 917 of this chapter.

(2) The OF Board of Directors shall establish an executive committee comprising member-elected directors, Bank-appointed directors, and Finance Board-appointed directors, each represented in the same proportions as they are on the full OF Board of Directors.

(3) The OF Board of Directors shall establish a committee to coordinate the issuance and servicing of consolidated obligations under part 910 of this chapter.

(4) The OF Board of Directors may establish additional committees that are necessary and appropriate to carry out the duties and responsibilities of the OF Board of Directors.

(5) The OF Board of Directors shall promulgate policies and define the roles and duties of any committees so established, which shall be binding upon such committees.

(g) *Quorum.* A quorum, for purposes of meetings of the OF Board of Directors and of meetings of committees of the OF Board of Directors, shall be a simple majority of the total directorships on the OF Board of Directors or the committee.

§ 941.5 Powers of the OF board of directors.

(a) *General.* The OF Board of Directors shall enjoy such incidental powers under section 12(a) of the Act (12 U.S.C. 1432(a)), as are necessary, convenient

and proper to accomplish the efficient operation and management of the OF pursuant to this part, consistent with part 917 of this chapter.

(b) *Agent.* Subject to any limitations set by the Finance Board, the OF Board of Directors, in the performance of its duties, shall have the power to act on behalf of:

(1) The Banks in issuing consolidated obligations pursuant to section 11(a) of the Act (12 U.S.C. 1431(a));

(2) The Finance Board in issuing consolidated obligations pursuant to section 11(c) of the Act (12 U.S.C. 1431(c)); and

(3) The Banks in paying principal and interest due on the consolidated obligations, or other obligations of the Banks.

(c) *Delegation.* The OF Board of Directors may delegate any of its powers to any employee of the OF in order to enable the OF to carry out its functions.

(d) *Indemnification.* (1) The OF Board of Directors may determine the terms and conditions under which its members, the Chief Executive Officer, and other officers and employees of the OF will be indemnified by the OF, provided that such terms and conditions are consistent with the terms and conditions of indemnification of directors, officers and employees of the Bank System, generally.

(2) Such indemnification procedures, when duly adopted, may be supplemented by a contract of insurance, and all expenses incident to indemnification will be treated as an expense of the OF.

§ 941.6 Duties of the OF board of directors.

(a) *General.* (1) *Bylaws.* The OF Board of Directors shall adopt bylaws, consistent with applicable laws and regulations as administered by the Finance Board, governing its operation and issue such guidance or instruction as will promote the efficient operation of the OF.

(2) *Conduct of business.* The OF Board of Directors shall conduct its business by majority vote of its members convened at a meeting in accordance with its bylaws.

(b) *Oversight.* The OF Board of Directors shall:

(1) Be responsible for the conduct and performance of all duties, functions, operations and activities of the OF and for its efficient and effective operation;

(2) Set policies for management of the OF, including a policy addressing the relationship between the Banks as issuers of debt and Bank System members as issuers of debt;

(3) Approve a strategic business plan for the OF and monitor the progress of its operations under such plan;

(4) Review, adopt and monitor the annual operating and capital budgets of the OF including any supplemental expenditure thereto;

(5) Select, employ and define the duties of a Chief Executive Officer of the OF. The Chief Executive Officer, or the Chief Executive Officer's designee, shall be:

(i) The Fiscal Agent of the Banks;

(ii) A member of the Directorate of the Financing Corporation, pursuant to section 21(b)(1)(A) of the Act (12 U.S.C. 1441(b)(1)(A)); and

(iii) A member of the Directorate of the Resolution Funding Corporation, pursuant to section 21B(c)(1)(A) of the Act (12 U.S.C. 1441b(c)(1)(A)).

(6) Review and approve all contracts of the OF; and

(7) Assume any other responsibilities that may from time to time be delegated to it by the Finance Board.

(c) The OF Board of Directors shall be subject to and shall operate in accordance with Finance Board policies and regulations as applicable to the boards of directors of the Banks, including part 917 of this chapter.

§ 941.7 Funding of the OF.

(a) *General.* The Banks are responsible for jointly funding the OF.

(b) *Method.* (1) At the direction of and pursuant to policies and procedures adopted by the OF Board of Directors, the Banks shall periodically reimburse the OF Operations Imprest Fund in order to maintain in such fund an amount approved by the OF Board of Directors sufficient to fund operations of the OF under a budget approved by the OF Board of Directors.

(2) Each Bank's respective *pro rata* share of the reimbursement described in paragraph (b)(1) of this section shall be based on the ratio of the total paid-in value of its capital stock relative to the total paid-in value of all capital stock in the Bank System. With the prior approval of the Finance Board, the OF Board of Directors may implement an alternative formula for determining each Bank's respective share of the OF expenses or, by contract with a Bank or Banks, may choose to be reimbursed through a fee structure in lieu of or in addition to assessment, for services provided to the Bank or Banks for the issuance or servicing of consolidated obligations or the management and administration of joint asset activities.

§ 941.8 Savings clause.

All actions taken by the OF as it existed prior to the amendments made

to this part shall continue to be valid as regards the Finance Board and the Bank System.

Appendix A to Part 941—Exceptions to the General Disclosure Standards

A. Related-Party Transactions. Item 404 of Regulation S-K, 17 CFR 229.404, requires the disclosure of certain relationships and related party transactions. In light of the cooperative nature of the Bank System, related-party transactions are to be expected, and a disclosure of all related-party transactions that meet the threshold would not be meaningful. Instead, the combined annual report will disclose the percent of advances to members an officer of which serves as a Bank director, and list the top 10 holders of advances in the Bank System and the top 5 holders of advances by Bank, with a further disclosure indicating which of these members had an officer that served as a Bank director.

B. Biographical Information. The biographical information required by Items 401 and 405 of Regulation S-K, 17 CFR

229.401 and 405, will be provided only for the members of the Board of Directors of the Finance Board, Bank presidents, chairs and vice chairs, and the directors and Chief Executive Officer of the OF.

C. Compensation. The information on compensation required by Item 402 of Regulation S-K, 17 CFR 229.402, will be provided only for Bank presidents and the Chief Executive Officer of the OF. Since stock in each Bank trades at par, the Finance Board will not include the performance graph specified in Item 402(1) of Regulation S-K, 17 CFR 229.402(1).

D. Submission of Matters to a Vote of Stockholders. No information will be presented on matters submitted to shareholders for a vote, as otherwise required by Item 4 of the SEC's form 10-K, 17 CFR 249.310. The only item shareholders vote upon is the annual election of directors.

E. Exhibits. The exhibits required by Item 601 of Regulation S-K, 17 CFR 229.601, are not applicable and will not be provided.

F. Per Share Information. The statement of financial information required by Items 301 and 302 of Rule S-K, 17 CFR 229.301 and

302, is inapplicable because the shares of the Banks are subscription capital that trades at par, and the shares expand or contract with changes in member assets or advance levels.

G. Beneficial Ownership. Item 403 of Rule S-K, 17 CFR 229.403, requires the disclosure of security ownership of certain beneficial owners and management. The combined financial report will provide a listing of the 10 largest holders of capital stock in the Bank System and a listing of the 5 largest holders of capital stock by Bank. This listing will also indicate which members had an officer that served as a director of a Bank.

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

Dated: December 14, 1999.

Bruce A. Morrison,
Chairman.

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