

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## FEDERAL HOUSING FINANCE BOARD

### 12 CFR Part 915

[No. 2007-05]

RIN 3069-AB34

#### Financial Interests of Appointive Directors

**AGENCY:** Federal Housing Finance Board.

**ACTION:** Proposed rule.

**SUMMARY:** The Federal Housing Finance Board (Finance Board) is proposing to clarify the types of financial interests a Federal Home Loan Bank (Bank) appointive director may own in a Bank member. The proposal would incorporate into Finance Board rules its long-standing policy that financial interests in a Bank member acquired through ownership of shares of a diversified mutual fund are permissible holdings for an appointive director. The proposal would extend the rationale for permitting mutual fund investments to other types of vehicles and accounts that share certain of the same key features as mutual funds and thus are unlikely to pose a risk of conflict of interest for an appointive director. The proposal also would set forth additional criteria to define when owning shares of a holding company, or having other types of financial interests in a member, would be permissible for an appointive director.

**DATES:** The Finance Board will accept written comments on the proposed rule on or before May 17, 2007.

**ADDRESSES:** Submit comments to the Finance Board using any one of the following methods:

*E-mail:* [comments@fhfb.gov](mailto:comments@fhfb.gov).

*Fax:* 202-408-2580.

*Mail/Hand Delivery:* Federal Housing Finance Board, 1625 Eye Street NW., Washington DC 20006, *Attention:* Public Comments.

*Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the

Federal eRulemaking Portal, please also send it by e-mail to the Finance Board at [comments@fhfb.gov](mailto:comments@fhfb.gov) to ensure timely receipt by the agency. Include the following information in the subject line of your submission: Federal Housing Finance Board. *Proposed Rule:* Financial Interests of Appointive Directors. RIN Number 3069-AB34. Docket Number 2007-05.

We will post all public comments we receive without change, including any personal information you provide, such as your name and address, on the Finance Board Web site at <http://www.fhfb.gov/Default.aspx?Page=93&Top=93>.

**FOR FURTHER INFORMATION CONTACT:** Neil R. Crowley, Acting General Counsel, [crowleyn@fhfb.gov](mailto:crowleyn@fhfb.gov) or 202-408-2990; or Thomas E. Joseph, Senior Attorney-Advisor, Office of General Counsel, [josepht@fhfb.gov](mailto:josepht@fhfb.gov) or 202-408-2512. You can send regular mail to the Federal Housing Finance Board, 1625 Eye Street NW., Washington, DC 20006.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

Section 7(a) of the Federal Home Loan Bank Act (Bank Act) (12 U.S.C. 1427(a)), provides for management of each Bank by a board of directors of at least 14 persons, with 8 directors elected by the members and 6 directors appointed by the Finance Board. This provision also states that any individual appointed by the Finance Board may not, "during such Bank director's term of office, serve as an officer of any Federal Home Loan Bank or a director or officer of any member of a Bank, or hold shares, or any other financial interest in, any member of a Bank."<sup>1</sup> The provision concerning the qualifications for appointive directors was added to the Bank Act by section 706 of the Finance Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Pub. L. 101-73, 103 Stat. 183 (Aug. 9, 1989)). In adopting the FIRREA amendments, Congress indicated that it did not intend these conflict of interest provisions to preclude an appointive director from

<sup>1</sup> Should an appointive directorship become vacant during the term of the appointment because the director no longer meets any of the statutory or regulatory requirements for serving on a Bank's board or for any other reason, section 7(f) of the Bank Act (12 U.S.C. 1427(f)) authorizes the Finance Board to fill the vacancy for the remainder of the unexpired term.

investing in a diversified mutual fund that in turn may own shares in a Bank member. See H.R. Conf. Rep. 101-209 at 430 (1989). The Bank Act, however, does not further define the terms "shares" or "financial interests," nor does it otherwise indicate how the provision should be applied. As a result, the Finance Board has had to interpret these terms whenever prospective appointive directors have asked whether certain of their investments were permissible under this provision. The Finance Board has provided guidance to these individuals in the past on a case-by-case basis, as well as through its regulations.

In January 1990, the Finance Board adopted an interim final rule implementing the FIRREA appointive director and conflict of interest provision. See Interim Final Rule: Election of Directors; Eligibility Requirements, 55 FR 1393 (Jan. 18, 1990), codified at 12 CFR 932.18 (1991). The Finance Board later modified this rule somewhat based on the comments it received on the interim final rule. See Final Rule: Eligibility and Financial Disclosure Requirements for Directors of the Federal Home Loan Banks, 56 FR 55205 (Oct. 25, 1991). The rule, as amended in October 1991, provided among other things, that no appointive director may during his or her term of office have a financial interest in any member (or a subsidiary or non-diversified holding company thereof, or affiliate of such holding company) of the Bank on whose board the director served.<sup>2</sup> It also specifically defined a financial interest to include the ownership or control, either directly or indirectly, of any shares of common or

<sup>2</sup> See 56 FR at 55220. The 1991 amendments clarified the prohibition on serving on the board of, or ownership in, a member, member subsidiary or a non-diversified holding company of a member or affiliate of such holding company to make clear that the term "member" meant only a member of the Bank on whose board an appointive director served and not a member of another Bank. See 56 FR at 55206-207. The 1991 amendments also added a definition for the term "diversified holding company" that read:

A holding company whose member subsidiary and related activities, as specified in 12 U.S.C. 1467a(c)(2), represented on either an actual or pro forma basis less than fifty (50) percent of both its consolidated net worth and its consolidated net earnings at the close of its preceding fiscal year. For purposes of the foregoing, consolidated net worth and consolidated net earnings shall be determined in accordance with generally accepted accounting principles. 56 FR at 55219.

preferred capital stock, any other equity security, any debt security or obligation (except deposit or savings accounts) including subordinated debt, but allowed an appointive director to hold such interests if they arose solely through ownership of shares or other investment units of one or more diversified mutual funds (as defined in section 5(a) and (b)(1) of the Investment Company Act of 1940, as amended).<sup>3</sup> The rule also prohibited an appointive director from having other financial relationships, including loans or other extensions of credit, with a member of the Bank on whose board the director served, or with the member's subsidiary, or its non-diversified holding company (or an affiliate of such holding company), which were not transacted in the ordinary course of business and on normal commercial terms, as discussed in the rule itself. 56 FR at 55220.

In 1998, the Finance Board substantially revised its rules governing elective and appointive directors.<sup>4</sup> Among other things, the 1998 amendments required the Banks to adopt conflict of interest policies that applied to both elective and appointive directors. The rule specifically required the conflict of interest policy to prohibit an appointive director from serving as an officer of any Bank or as an officer or director of any member or from owning any equity or debt security issued by a member or from having any other financial interest in a member. See 63 FR at 65690.

The 1998 revisions also deleted the detailed provisions addressing appointive director qualifications and prohibited financial interests in favor of more general references to the Bank Act and somewhat more general definitions of terms such as "financial interests." The new definition of "financial interests" specifically excluded deposit or savings accounts maintained with a member and loans and other extensions of credit from a member so long as they were obtained in the normal course of business on terms generally available to the public. See 63 FR at 65691. Among the provisions that were dropped in 1998, however, was the one that specifically had allowed an appointive director to hold shares or other financial interests in a member if they arose

solely through ownership of one or more diversified mutual funds. Notwithstanding that change, the Finance Board has continued to interpret section 7(a) as it had done previously, and has allowed appointive directors to have indirect financial interests in a member if held through ownership of shares of a diversified mutual fund.

The conflict of interest rules for appointive directors remain substantively the same as adopted in 1998, and currently are found at 12 CFR § 915.11. The Finance Board recently adopted an interim final rule to address procedures for how appointive directors are selected.<sup>5</sup> Under the new procedures, the boards of directors of each Bank have to submit to the Finance Board a list of individuals who could serve in appointive directorships. Along with the list, the Banks must submit information regarding each individual's eligibility and qualifications to serve as a Bank director.

## II. Analysis of the Proposed Rule

### A. Reasons for the Proposed Changes

The recent changes in the selection process for appointive directors have prompted questions to the Finance Board about whether specific investments held by potential candidates would be barred by section 7(a), and thus would have to be sold if the person were to accept an appointment to the board of a Bank. These questions have brought to light the extent to which developments in the financial services marketplace in recent years have created different types of investment accounts and investment vehicles that either did not exist when FIRREA was enacted or were not as widely held as they are today, and for which the Finance Board has not previously provided formal guidance.

The Finance Board believes that the lack of a rule providing clear guidance as to what investments are encompassed by the terms "shares" and "financial interests" could cause some potential appointive director candidates to decline to consider an appointive directorship for fear that they would be required to divest certain investments in order to accept the position. Any such divestiture could prove financially costly and disruptive to their personal

financial planning strategies. At the same time, the Finance Board recognizes that as the Banks have become involved in more complex financial activities, it is important that some of a Bank's individual appointive directors have more sophisticated skills and a deeper understanding of financial markets to provide strong oversight. Such persons can bring business and leadership skills to the boards that will complement the skills and expertise brought by the elective directors and the community interest directors. In some cases, persons who possess those analytical skills and related business experience may also be sophisticated investors in their own right and have investments that go beyond traditional stock, bond, and mutual fund holdings.

The possibility that persons who can bring needed skills and experience to the board of a Bank might be discouraged from serving as appointive directors due to uncertainty about how the conflict of interest limitations may apply to their investments has caused the Finance Board to consider whether it should amend its regulations. The Finance Board hopes that in updating these provisions, a new rule will better reflect the range of investments or investment vehicles (beyond traditional investments) through which an appointive director may obtain some interest in a member but which, because of the director's lack of control over the investment or the minimal value of the interest obtained, would not present concerns that should disqualify such individual from serving as an appointive director. Thus, the Finance Board is proposing this rule in an attempt to balance the need to assure that appointive directors do not have actual or apparent conflicts that would undermine their ability to represent the public interest against the need to attract a sufficient pool of candidates with sophisticated skills in areas such as housing and finance to build boards of directors capable of overseeing the Banks as they evolve and undertake new activities.

The proposal is based primarily on the Finance Board's experience to date in administering section 7(a) and the questions raised about potential conflicts as a result of interests in various investment vehicles and strategies. The Finance Board recognizes that it has had only limited experience in dealing with the types of investment products that are available in today's financial marketplace, particularly those that are available to high net worth individuals. In order to craft a final rule that will strike an appropriate balance between allowing investments that

<sup>3</sup> 56 FR at 55219, 55220. The definition of "financial interest" applied if the interest was held by an appointive director or director candidate or by his or her immediate family member and related interests, or the related interest of the immediate family member. 56 FR at 55219.

<sup>4</sup> See Final Rule: Election of Federal Home Loan Bank Directors, 63 FR 65683 (Nov. 30, 1998). These rules are now found in part 915 of the Finance Board's regulations (12 CFR part 915).

<sup>5</sup> See Interim Final Rule: Federal Home Loan Bank Appointive Directors, 72 FR 3028 (Jan. 24, 2007) (adopting new § 915.10). The Finance Board also solicited comments on this interim final rule. The Finance Board considered the comments received and adopted a final rule to address the selection process at the same meeting in which it approved this proposed rule for publication in the **Federal Register**.

share key characteristics associated with mutual fund shares, which were permitted by Congress, and barring investments that are more like direct ownership interests in member stock, the Finance Board will benefit greatly from the perspectives of persons more familiar with the universe of investment products currently available. Accordingly, the Finance Board welcomes all comments on how to further refine the proposal to assure that the rule will not unintentionally allow individuals to hold investments that may create conflicts with their duties as appointive directors but still remain flexible enough not to create unnecessary barriers to finding candidates with the skills and experience to be strong Bank directors.

### B. Proposed Rule Changes

*General.* The Finance Board is proposing to add a new paragraph (f) to § 915.10 of its rules to address the issues described above.<sup>6</sup> The proposed provision first would set out the general prohibition against an appointive director owning any debt or equity securities issued by, or otherwise having any financial interest in, a member of the Bank on whose board the director serves. The provision also would restate the statutory requirements that an appointive director may not serve as an officer of any Bank or as an officer or director of any member of the Bank on whose board the director serves.<sup>7</sup> This proposed language closely follows the wording of section 7(a) of the Bank Act and the requirements of current § 915.11(a)(2) of the Finance Board's rules.<sup>8</sup> The proposal goes on to describe certain types of investments or contractual relationships that would not be deemed to constitute shares or financial interests in a member for purposes of determining whether an appointive director may hold such interests while serving on the board of a Bank.

The Finance Board emphasizes that because it is not proposing to amend the

broad definition of "financial interests" now contained in § 915.11(f)(2), the proposed rule would not change the extent to, or the manner in which an individual Bank's disclosure and recusal policies must address the types of investments or activities identified in proposed § 915.10(f), even if the investments themselves would no longer be deemed to disqualify an individual from serving as an appointive director. See 12 CFR §§ 915.11(b) and (f)(2). The Finance Board views continued application of the rules related to the Bank's recusal and disclosures policies to the types of investments identified in proposed § 915.10(f) as an additional safeguard to assure that these investments would not create a conflict of interest. The Finance Board, however, requests comments on whether this approach is appropriate or if some modification to §§ 915.11(b) and (f)(2) may be warranted. The Finance Board also requests comment on whether it should require appointive directors to disclose their financial holdings to the Banks as part of their application so the Banks can verify that the investments—including the vehicles and accounts described below—do not create a conflict that would be barred by section 7(a).

*Investment Vehicles.* Both the legislative history of FIRREA and the Finance Board's prior regulations expressly permitted an appointive director to own shares of a diversified mutual fund that in turn owned debt or equity securities issued by a member of the Bank on whose board the director served. The legislative history offers scant insight into the intent of Congress in adding this provision, but the use of the term "diversified mutual fund" appears to reflect a view that an appointive director can own indirectly securities he or she cannot own directly under certain circumstances. Thus, in the case of mutual funds, indirect ownership of member securities would be permissible, provided the securities are owned by a legally distinct entity (the fund), and the investment decisions are made by that entity (or by an investment adviser acting on its behalf), and the appointive director lacks any control over the purchase or sale of the securities owned by the entity. The proposed rule is intended to include within the universe of permissible investments other types of investment vehicles and accounts that share those key concepts, and thus should pose no greater risk of conflict than would exist in the case of ownership of shares through a mutual fund.

Accordingly, proposed § 915.11(f)(1) would allow an appointive director to

own shares or other interests in certain investment vehicles, which in turn may own equity or debt securities issued by a member of the director's Bank, without violating section 7(a) of the Bank Act. In order for such an investment to be permissible, the investment vehicle must be a legally separate entity and the appointive director must not control the investment vehicle or play any role in the selection of the entity's underlying investments. By providing that the investment vehicle must be organized as a "legally recognized entity," the proposal would require that the vehicle be a corporation, limited partnership, trust, or similar entity that is recognized as having its own corporate existence under state law and is legally separate and distinct from the individual appointive director. As drafted, the provision would include registered investment companies (mutual funds) as well as limited partnership interests and other passive interests in distinct entities, even if those investment vehicles were not required to register under the Investment Company Act.

The proposal would require that an appointive director not control the investment entity or be involved in decisions involving investments or trading strategies, which is intended to assure that the director could not direct the entity to purchase or sell member securities or otherwise manipulate trading based on knowledge acquired as a result of the individual's duties on the Bank's board. Because a general partner typically is deemed under state law to have the ability to control or otherwise act on behalf of either a general or limited partnership, a general partnership interest would not be permissible under this proposal.

*Investment Accounts.* Since the Congress adopted the limitation on appointive directors' financial interests in 1989, the financial investment marketplace has evolved considerably. It has come to the attention of the Finance Board that among the investment alternatives used with much greater frequency by the investing public are arrangements that, while structured differently than mutual funds, are functionally similar, especially with respect to the client's lack of control over the investment decisions for the portfolio. Such investments may have somewhat differing structures and may have different names depending on the company offering the investment. One such investment alternative has been described as a "managed account" or a "separately managed account." Persons using these accounts may direct the

<sup>6</sup> As already noted, § 915.10 sets forth the new process for the selection of appointive directors.

<sup>7</sup> For purposes of applying the prohibitions on financial interests in a member and on serving as an officer or director of a member, the Finance Board interprets the term "member" broadly to include the member institutions itself, as well as any subsidiary, holding company and affiliate. See Federal Home Loan Bank Appointive Director Application Form, Statutory Eligibility Requirements § 4, Conflict of Interests (reproduced at 72 FR at 3033). The Finance Board currently intends to continue to interpret the term "member" in this broad manner.

<sup>8</sup> See 12 U.S.C. 1427(a) and 12 CFR § 915.11(a)(2). As discussed in the next section, the Finance Board also is proposing conforming changes to § 915.11(a)(2) of its rules.

investment adviser to allocate the portfolio among certain classes of assets, such as growth stocks, value stocks, bonds, or foreign equities, but do not direct the purchase or sale of securities within those asset classes. A key distinction between a mutual fund and a managed account is that in the former case the investor owns shares of the fund, which in turn owns the portfolio securities in its own name, whereas in the latter case the investor will own the portfolio securities in his or her own name. A key similarity between the two is that in both cases the investor plays no role in the purchase or sale of the portfolio securities, as a typical requirement of the managed account is that the investor must confer full investment discretion on the investment adviser that manages the portfolio.

Proposed § 915.10(f)(2) is intended to allow appointive directors to hold securities of a member through such an account, based principally on the requirement that the director would have no control over the acquisition of securities for the account. Thus, the proposal would deem any debt or equity securities issued by a member that an appointive director owns through accounts where the director has no investment discretion not to constitute shares or financial interests in a member. To qualify for the exclusion under the proposed provision, however, the account would have to be managed by an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act, the appointive director would have to pay a fee to the adviser for the advisory services that are provided as an integral component of the account, and the director would have to give the adviser complete discretion to buy or sell all securities in the account. The Finance Board believes that where an appointive director has turned over all investment decisions regarding the portfolio to a professional adviser and is not otherwise involved in the investment decisions concerning the account to have no greater interest in the member securities, in a practical sense, than does a director who owns such securities indirectly through a mutual fund. To further assure that the director could not indirectly influence the purchase or sale of securities within the portfolio, the proposal provides that the director could not be affiliated with the investment adviser and could not otherwise have control over the choice of securities acquired for the account. Given these proposed safeguards (coupled with the continued application of current disclosure and recusal

policies), the Finance Board views accounts covered by this proposed provision as not presenting risks of a conflict of interest greater than those posed by investments in mutual funds or similar investments.

In applying this provision, an investor's right to identify broad financial goals or broad investment strategies or asset classes (e.g., aggressive growth, value investing, etc.) would not constitute sufficient investment discretion to violate section 7(a), so long as the strategies would not allow a director to direct the purchase of individual securities. The Finance Board understands that persons investing through such accounts sometimes are able to direct an investment adviser not to purchase securities issued by a particular company, such as where the investor is an officer or director of a publicly traded company and instructs the adviser not to purchase any securities issued by that company. In such circumstances, the Finance Board would not be inclined to view that limited right to identify specific companies whose securities should be excluded from the account as violating the statute or the proposed rule. If the type of account held by an appointive director gives the director the ability to identify securities to sell on an ad hoc basis or based on current market conditions, however, such an arrangement would confer significant investment discretion in the client, and thus would not fall within the proposed exclusion established by this provision.

*Holding Companies.*  Section 7(a) of the Bank Act speaks in terms of shares or other financial interests in "any member" of the Bank, but does not refer expressly to treatment of securities issued by a holding company for a member. In the current financial services sector, many depository institutions are owned by one or more holding companies and thus do not issue their own equity securities to the public. Although the statute does not address this matter, the Finance Board previously had regulations that effectively exempted securities issued by certain holding companies from the reach of section 7(a). Under that regulation, which was in effect from 1991 to 1998, securities issued by a diversified holding company were permissible investments for an appointive director. A bank holding company or a savings and loan holding company was deemed to be "diversified" for these purposes if less than 50 percent of its net worth and net earnings, on a consolidated basis, were attributable to the depository

institutions that it controlled. See n.2. The Finance Board is proposing to adopt a similar test for determining whether an appointive director may own securities issued by a holding company that controls one or more members of the Bank on whose board the director serves.

Accordingly, proposed § 915.10(f)(3) would deem debt or equity securities issued by a holding company that controls one or more members to not constitute "shares" or "financial interests" in a member, provided that the assets of all members of the Bank that are controlled by the holding company constitute less than 25 percent of the total assets of the holding company, on a consolidated basis. The Finance Board believes that where the assets of the institutions that are members of the Bank on whose board the director sits constitute less than 25 percent of the total assets of a holding company, the debt or equity instruments issued by the holding company represent interests that are predominately something other than an interest in a member.

The Finance Board believes the proposed standard limiting members' assets to less than 25 percent of the consolidated assets would be more restrictive than the standard applied under the former the definition of "diversified holding company" (i.e., 50 percent of consolidated net worth and net earnings). The Finance Board also believes the proposed standard would be easier to apply and would be less subject to fluctuations over time (so that companies would be less likely to shift status under the exclusion from year-to-year). Nonetheless, the Finance Board specifically seeks comments on how best to measure the relative sizes of the holding company and its member subsidiaries (i.e., a percentage of assets or a percentage of capital or earnings) and whether some threshold other than 25 percent would be appropriate.

Moreover, while proposed § 915.10(f)(3) would deem interests in certain holding companies not to constitute shares or financial interests in a member, the proposed provision does not deal with other relationships with a holding company. Given the current practice, however, the Finance Board would not permit an appointive director to serve as an officer or director of any holding company that controls a member, even if the member constitutes less than 25 percent of the assets of the holding company.<sup>9</sup> It would appear to

<sup>9</sup> While the prohibition on an appointive director serving as an officer or director of a holding company or an affiliate or a subsidiary of a member

be incompatible with the independence expected of an appointive director and the public interests the director is expected to serve to allow that person simultaneously to serve as an officer or director of any holding company that controlled any member of the Bank. As an appointive director, the individual would owe fiduciary duties to the Bank and the Finance Board does not believe that an appointive director also should owe fiduciary duties to a member or its holding company. These competing duties could make it difficult for the appointive director to competently serve in either capacity. The Finance Board is requesting comment on whether it should apply the same standard for determining if a holding company's securities are permissible investments for an appointive director to other types of relationships, such as service as a director or officer of such company or contractual relationships with, or receipt of income from, such company.

**Loans and Deposits.** Proposed § 915.10(f)(4) would provide that loans from, or deposits in, a member would not constitute a financial interest in the member if the transaction occurs in the normal course of business and on terms that are no more favorable than those available under like circumstances to members of the public. This provision does not represent a change in current Finance Board practices. Loans and deposits meeting the proposed criteria already are excluded from the definition of financial interest contained in § 915.11(f)(2) and holding such loans and deposits does not currently disqualify a candidate from consideration for an appointive directorship. See 12 CFR § 915.11(f)(2); see also Federal Home Loan Bank Appointive Director Application Form, Statutory Eligibility Requirements § 4, Conflict of Interest. Such items also had been permitted under the prior regulations. See, e.g., 56 FR at 52220 (adopting §§ 931.30 and 932.18 of the Finance Board's rules).

**Contractual Relationships.** There have been instances in the past in which individuals have asked if certain contractual relationships with a member, such as those associated with serving as legal counsel or as auditor,

is not set out in the current rules, it has been agency policy to interpret the term "member" for purposes of applying the conflict of interest rules broadly to refer to the member itself, any subsidiary or affiliate of the member or any holding company of the member. See n.7. As previously noted, this interpretation currently is embodied in the explanation addressing conflict of interest provided in the application form for appointive directors, but the Finance Board specifically is requesting comment as to whether this interpretation should be clearly incorporated into the text of its rules.

would constitute a financial interest in the member that is prohibited by section 7(a).<sup>10</sup> The answers to such questions are largely dependent on the facts of each case, and typically have been addressed by staff on a case-by-case basis. Although it is not practicable to create a regulation that would address all such circumstances, the Finance Board believes that the regulations could be revised to establish a type of safe harbor for contractual relationships that do not contribute a significant amount to the person's income. Accordingly, proposed § 915.11(f)(5) would establish a presumption that an appointive director's contractual relationships with members of the Bank would not constitute a financial interest in a member if the money paid to the person under such contracts in any calendar year constitutes less than 10 percent of the appointive director's adjusted gross income for that year.

The Finance Board would intend the director to calculate his or her adjusted gross income for the purposes of this proposed test in the same manner as would be done for federal tax purposes. The Finance Board would also expect the director to aggregate all amounts earned (or to be earned) under contracts with all members of the Bank on whose board the director serves in determining the amount due the director for purposes of applying the proposed test. Given the attribution provision in proposed § 915.11(f)(6), if an appointive director's spouse has contractual relationships with Bank members, the amounts due under those contracts also would be combined with those of the director (and the adjusted gross income would represent that of both the director and the spouse) to determine if the contracts exceed the 10 percent threshold. If only the director's spouse had a contract with Bank members, the adjusted gross income used in applying the test would be that of the spouse only.

The proposed rule also would require an appointive director to disclose all contractual relationships with members of the Bank on whose board the director serves (or will serve) whether or not the amounts due exceed 10 percent of the director's adjusted gross income, as well as those of a spouse. Where the amounts due under such contracts would be 10 percent or more of the director's adjusted gross income, the proposed rule would require the Finance Board to

<sup>10</sup> As already noted, when determining if a contractual relationship with a member exists, the Finance Board would interpret the term "member" broadly to include a member itself, any subsidiary or affiliate of a member, and any holding company of a member. See n.7 and n.9.

determine on a case-by-case basis whether the contractual relationships represent a financial interest that would disqualify an individual from serving as an appointive director. In making the determination, the Finance Board would consider, among other things, if the contractual relationships may result in the appointive director not fairly representing the public interest when considering matters that come before the board or otherwise causing the director to be partial toward or biased against any member or otherwise partial in his or her judgment. In weighing this matter, the Finance Board would consider whether the contractual relationships may create an appearance of partiality in deciding if the contractual relationship may disqualify a person from holding an appointive directorship.

**Attribution.** Proposed § 915.10(f)(6) would establish that debt or equity securities owned by a spouse or minor child of an appointive director are attributed to the appointive director for purposes of complying with proposed § 915.10(f). This proposed provision also would make clear that any contractual relationships between a member and the spouse of a director would be attributed to the appointive director. How the calculation would be performed to determine whether such contracts exceeded the proposed threshold in § 915.10(f)(5) has already been discussed above. The Finance Board has not included minor children in the proposed attribution provision with regard to contracts because it would not expect that minor children would, or could legally, enter into such agreements. The Finance Board believes that the financial interests of a spouse or minor child of a director would be so closely aligned with the interests of the director that these proposed attribution provisions are fair and are generally consistent with how attribution provisions dealing with conflict of interests and similar matters are generally structured.

### C. Other Conforming Amendments

The Finance Board also is proposing amendments to § 915.11(a)(2) to conform this provision to the changes proposed in new § 915.10(f). As now written, § 915.11(a)(2), given the broad definition of financial interest in § 915.11, could be read to require the Banks to adopt policies for appointive directors that would be more restrictive with regard to allowable investments than the changes proposed in § 915.10(f). Because the Bank Act provides the Finance Board the sole discretion to select appointive directors,

the Finance Board would not intend the Banks to apply more restrictive criteria in determining when an appointive director may hold certain investments than that set forth in the Finance Board rules and policies. Thus, proposed § 915.11(a)(2) would state that a Bank's conflict of interest policy must require appointive directors to comply with § 915.10(f).

The Finance Board also is proposing to delete §§ 915.16 and 915.17, which applied only to election cycles that occurred between 1999 and 2001 and primarily were needed to implement changes made by the Gramm-Leach-Bliley Act<sup>11</sup> to the Bank Act's election and director provisions. Thus, the regulatory provisions in §§ 915.16 and 915.17 no longer serve any purpose and are not applicable to current or future election cycles. Similarly, the Finance Board is proposing to delete Appendix A to part 915, which includes matrices that were created in conjunction with earlier elections and appointments and related to the directorships of the Banks. Over the past few years, as part of its annual designation of elective directorships, the Finance Board has created updated versions of these matrices to reflect the revised board structure for each Bank for that year, and expects to continue to create new matrices as part of each annual designation exercise. Because the matrices in Appendix A relate to prior years and have been superseded by more current versions, it no longer is necessary to include them in the regulations.

### III. Paperwork Reduction Act

The appointive director application form is part of the information collection entitled "Federal Home Loan Bank Directors." Under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Office of Management and Budget (OMB) has assigned control number 3069-0002, which is due to expire on November 30, 2007. The Finance Board and the Banks use the information contained in the application form to determine whether prospective appointive Bank directors satisfy the statutory and regulatory eligibility requirements and are well qualified to serve as a Bank director. Only individuals meeting these requirements may serve as Bank directors. See 12 U.S.C. 1427. The proposed rule, if adopted as a final rule, would not make substantive or material modifications to the "Federal Home Loan Bank Directors" information

collection. Consequently, the Finance Board has not submitted any information to OMB for review.

### IV. Regulatory Flexibility Act

The proposed rule would apply only to the Banks and to individuals who may be willing to serve as Bank appointive directors. Neither the Banks nor individuals come within the meaning of "small entities" as defined in the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Thus, in accordance with section 605(b) of the RFA, 5 U.S.C. 605(b), the Finance Board hereby certifies that the proposed rule, if promulgated as a final rule, will not have a significant economic impact on a substantial number of small entities.

### Lists of Subjects in 12 CFR Part 915

Conflict of interests, Elections, Federal home loan banks, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Finance Board is proposing to amend 12 CFR Part 915 as follows:

### PART 915—BANK DIRECTOR ELIGIBILITY, APPOINTMENT, AND ELECTIONS

1. The authority citation for part 915 continues to read as follows:

**Authority:** 12 U.S.C. 1422a(a)(3), 1422b(a), 1426, 1427, and 1432.

2. Amend § 915.10 by adding a new paragraph (f) to read as follows:

#### § 915.10 Selection of appointive directors.

\* \* \* \* \*

(f) Financial interests. Except as otherwise provided in this section, an appointive director may not own any debt or equity securities issued by, or have any other financial interest in, a member of the Bank on whose board the director serves. An appointive director also may not serve as an officer or director of any member of the Bank on whose board the director serves or serve as an officer of any Bank.

(1) Investment vehicles. An appointive director's investment in a legally recognized entity that owns debt or equity securities issued by a member shall not be deemed to constitute the shares or other financial interests in a member, provided that the appointive director does not control the entity and plays no role in the purchase or sale of the securities owned by the entity.

(2) Investment accounts. Debt or equity securities owned by an appointive director through an account managed by an investment adviser registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1

*et seq.*), for which the director pays a fee for advisory services and with respect to which the director has given the investment adviser complete discretion to buy and sell all securities in the account, shall not be deemed to constitute the shares or other financial interests in a member, provided that the appointive director is not affiliated with the investment adviser and has no control over the selection of securities acquired for the account.

(3) Holding companies. Debt or equity securities issued by a holding company that controls one or more members of the Bank on whose board an appointive director serves shall not be deemed to constitute the shares or other financial interest in a member, provided that the assets of all such members constitute less than 25 percent of the assets of the holding company, on a consolidated basis.

(4) Loans and deposits. Loans obtained from a member and money placed on deposit with a member shall not be deemed to constitute a financial interest in a member, provided that the transactions occur in the normal course of business of the member and are on terms that are no more favorable than those that would be available under like circumstances to members of the public.

(5) Contractual relationships. Any contractual relationship between an appointive director and one or more members of the Bank on whose board an appointive director serves, under which the director has a contractual right to the payment of money, shall be presumed not to constitute a financial interest in a member if the amount due to the director under such contracts in any calendar year is less than 10 percent of the director's adjusted gross income for that calendar year. An appointive director with any such contractual relationships, or any contractual relationship involving amounts greater than the above threshold, shall disclose the relationship to the board of directors of the Bank and to the Finance Board. The Finance Board shall determine, on a case by case basis, whether any contractual relationships greater than the above threshold constitutes a financial interest in a member.

(6) Attribution. Any debt or equity securities owned by the spouse or minor children of an appointive director shall be attributed to the director for purposes of complying with this section, as shall be any contractual relationships between a member and the spouse of an appointive director.

3. Amend § 915.11 by revising paragraph (a) to read as follows:

<sup>11</sup> Pub. L. No. 106-102, 133 Stat. 1338 (Nov. 12, 1999).

**§ 915.11 Conflict of interests policy for Bank directors.**

(a) Adoption of conflict of interest policy. Each Bank shall adopt a written conflict of interest policy that shall apply to all Bank directors. At a minimum, the conflict of interest policy of each Bank shall:

(1) Require the directors to administer the affairs of the Bank fairly and impartially and without discrimination in favor of or against any member or nonmember borrower;

(2) Require appointive directors to comply with § 915.10(f) of this part;

(3) Prohibit the use of a director's official position for personal gain;

(4) Require directors to disclose actual or apparent conflict of interests and establish procedures for addressing such conflicts;

(5) Provide internal controls to ensure that reports are filed and that conflicts are disclosed and resolved in accordance with this section; and

(6) Establish procedures to monitor compliance with the conflict of interests policy.

\* \* \* \* \*

**§ 915.16 [Removed]**

4. Remove § 915.16.

**§ 915.17 [Removed]**

5. Remove § 915.17.

**Appendix A to Part 915—[Removed]**

6. Remove Appendix A to part 915.

Dated: March 27, 2007.

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

**Ronald A. Rosenfeld,**  
*Chairman.*

[FR Doc. E7-5973 Filed 3-30-07; 8:45 am]

BILLING CODE 6725-01-P

**DEPARTMENT OF TRANSPORTATION****Federal Aviation Administration****14 CFR Part 39**

[Docket No. FAA-2007-27348; Directorate Identifier 2007-CE-015-AD]

RIN 2120-AA64

**Airworthiness Directives; Diamond Aircraft Industries GmbH Model DA 40 Airplanes**

**AGENCY:** Federal Aviation Administration (FAA), Department of Transportation (DOT).

**ACTION:** Notice of proposed rulemaking (NPRM).

**SUMMARY:** We propose to adopt a new airworthiness directive (AD) for the

products listed above. This proposed AD results from mandatory continuing airworthiness information (MCAI) originated by an aviation authority of another country to identify and correct an unsafe condition on an aviation product. The MCAI describes the unsafe condition as:

Abnormal manufacturing variations of the universal joints in combination with mechanical wear can lead to a joint failure and subsequent disconnection between selector and the fuel valve. This result in a loss of capability to select the fuel tank for supply. This condition might remain unrecognized by the pilot and can result in fuel starvation during flight and/or unavailability of emergency fuel shutoff.

The proposed AD would require actions that are intended to address the unsafe condition described in the MCAI.

**DATES:** We must receive comments on this proposed AD by May 2, 2007.

**ADDRESSES:** You may send comments by any of the following methods:

- *DOT Docket Web site:* Go to <http://dms.dot.gov> and follow the instructions for sending your comments electronically.

- *Fax:* (202) 493-2251.

- *Mail:* Docket Management Facility, U.S. Department of Transportation, 400 Seventh Street, SW., Nassif Building, Room PL-401, Washington, DC 20590-0001.

- *Hand Delivery:* Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

**Examining the AD Docket**

You may examine the AD docket on the Internet at <http://dms.dot.gov>; or in person at the Docket Management Facility between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this proposed AD, the regulatory evaluation, any comments received, and other information. The street address for the Docket Office (telephone (800) 647-5227) is in the **ADDRESSES** section. Comments will be available in the AD docket shortly after receipt.

**FOR FURTHER INFORMATION CONTACT:** Mr. Sarjapur Nagarajan, Aerospace Engineer, FAA, Small Airplane Directorate, 901 Locust, Room 301, Kansas City, Missouri 64106; *telephone:* (816) 329-4145; *fax:* (816) 329-4090.

**SUPPLEMENTARY INFORMATION:****Streamlined Issuance of AD**

The FAA is implementing a new process for streamlining the issuance of

ADs related to MCAI. This streamlined process will allow us to adopt MCAI safety requirements in a more efficient manner and will reduce safety risks to the public. This process continues to follow all FAA AD issuance processes to meet legal, economic, Administrative Procedure Act, and **Federal Register** requirements. We also continue to meet our technical decision-making responsibilities to identify and correct unsafe conditions on U.S.-certificated products.

This proposed AD references the MCAI and related service information that we considered in forming the engineering basis to correct the unsafe condition. The proposed AD contains text copied from the MCAI and for this reason might not follow our plain language principles.

**Comments Invited**

We invite you to send any written relevant data, views, or arguments about this proposed AD. Send your comments to an address listed under the

**ADDRESSES** section. Include "Docket No. FAA-2007-27348; Directorate Identifier 2007-CE-015-AD" at the beginning of your comments. We specifically invite comments on the overall regulatory, economic, environmental, and energy aspects of this proposed AD. We will consider all comments received by the closing date and may amend this proposed AD because of those comments.

We will post all comments we receive, without change, to <http://dms.dot.gov>, including any personal information you provide. We will also post a report summarizing each substantive verbal contact we receive about this proposed AD.

**Discussion**

The European Aviation Safety Agency (EASA), which is the Technical Agent for the Member States of the European Community, has issued AD No. 2006-0067, dated March 24, 2006 (referred to after this as "the MCAI"), to correct an unsafe condition for the specified products. The MCAI states:

Abnormal manufacturing variations of the universal joints in combination with mechanical wear can lead to a joint failure and subsequent disconnection between selector and the fuel valve. This result in a loss of capability to select the fuel tank for supply. This condition might remain unrecognized by the pilot and can result in fuel starvation during flight and/or unavailability of emergency fuel shutoff.

**Revision History:**

This inspection was initially addressed by Austrian AD A-2004-003. The design of the fuel selector/fuel valve universal joint has than been changed by design change M-M