

Memorandum

January 7, 1992

TO: Sylvia C. Martinez
Director, Housing Finance Directorate

THROUGH: Arnold Intrater ~~AS~~
Deputy General Counsel

FROM: Sharon B. Like
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SUBJECT: Potential AHP and CIP Conflicts of Interest

Issue: Whether directors of the Federal Home Loan Banks ("FHLBanks") and Advisory Council members who are involved in specific pending or approved projects under the Affordable Housing Program ("AHP") or Community Investment Program ("CIP") may participate in the evaluation, approval or implementation process for such projects.

Conclusion: FHLBank directors and Advisory Council members who are personally involved, or whose organizations are involved, in specific pending or approved AHP or CIP projects should be advised not to participate in or attempt to influence the evaluation, approval or implementation process for such projects, in order to avoid the potential for actual or apparent conflicts of interest. As a general rule, the directors and Advisory Council members should not be required to resign their positions on the FHLBanks' boards and Advisory Councils, respectively, or discontinue their involvement in such AHP or CIP projects.

One of the current members of the Finance Board is involved in several organizations which, from time to time, propose projects for approval under the Affordable Housing Program. The Office of Government Ethics has agreed that the Board member's **recusal** from the Finance Board's evaluation and approval process for such AHP projects is an appropriate resolution of the conflicts issue.

I. Background

The Housing Finance Directorate ("HFD") has asked for our advice on whether conflicts of interest exist where FHLBank directors are involved in pending or approved AHP projects. This question was raised by the Community Investment Officer ("CIO") of the FHLBank-Pittsburgh, which has several directors who are involved in pending or approved AHP projects.

A. Involvement of FHLBank Director6 in AHP Project6

By including community interest director6 on the board6 of the FHLBanks, the Federal Home Loan Bank Act ("Bank Act") recognizes the value of having persons serve the FHLBank System who have backgrounds in housing. Specifically, section 7(a) of the Bank Act provides that at least two of the FHLBank directors who are appointed by the Finance Board shall be representatives chosen from organizations with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing or financial consumer protections. 12 U.S.C. § 1427(a). A number of such community interest directors on the board6 of the FHLBanks represent groups involved in the promotion of affordable housing. In addition, some FHLBanks, including the FHLBank-Pittsburgh, encourage their directors to be significantly involved in developing and presenting AHP projects to the FHLBanks. In fact, a number of FHLBank directors currently are involved in AHP projects that have been approved by the Finance Board.

B. FHLBank Approval Process For AHP Projects

HFD has advised us that the boards of most FHLBanks have no formal role in the evaluation and scoring of AHP applications, or the voting on recommended funding decisions? For example, at the FHLBank-Des Moines, the AHP funding decision6 are made solely by the FHLBank's CIO, who then transmits her recommendation6 directly to the Finance Board for final approval, with summaries of the recommendations provided to the FHLBank's board and Advisory Council after they have been submitted to the Finance Board.

However, the board of at least one FHLBank -- the FHLBank-Pittsburgh -- exercises a prior approval function with respect to AHP applications. The day-to-day management of the AHP at the FHLBank-Pittsburgh is delegated to the CIO. The CIO reviews the AHP applications submitted, and assigns preliminary scores pursuant to the AHP Regulations. These initial scores are then reviewed by senior management, and by the AHP executive committee of the board. The Advisory Council to the FHLBank-Pittsburgh also is briefed on the AHP application and may offer its own insights on the proposed projects, but does not vote on their applications. The AHP executive committee then makes recommendations on the applications to the full board. The board votes on the recommendations, and forwards the approved projects to the Finance Board for final approval.

1. HFD has indicated that it may need to further confirm this information through surveying the FHLBanks.

2. See Letter from FHLBank-Pittsburgh CIO Calvin D. Baker to Richard Tucker, dated December 12, 1991.

II. Discussion

A. Directors Should Not Participate In, or Attempt to Influence, the AHP or CIP Process

Actual or apparent conflicts of interest may arise where FHLBank director6 who are involved in specific CIP or AHP projects also participate directly in the evaluation and approval process for such CIP projects, or for such AHP projects under consideration or to be considered by their FHLBank during a particular AHP round. Conflicts also may arise where directors who do not have a formal role attempt to influence FHLBank staff in the evaluation and approval process by actively advocating their specific projects of interest, or lobbying against competing projects, in order to raise the AHP rankings and prospects for their projects. Fact patterns which may give rise to a concern that a director is "involved" in an AHP or CIP project such as to raise a conflict of interest or the appearance of a conflict of interest can include: (1) having a personal financial interest in the project; (2) holding the position of director, officer or employee of an organization which has a financial interest in the project; or (3) having a family member who has a financial interest in the project?

In addition, conflicts may arise where directors who are involved in approved AHP or CIP projects seek to influence decisions regarding the implementation of such projects, as through involvement in the negotiations for AHP direct subsidy or subsidized advance agreements, or the subsequent monitoring of the projects.

Finally, even if directors could remain impartial and vote for AHP or CIP projects solely on their merits, the appearance of conflicts of interest may still exist.

The available options for avoiding such conflicts of interest which are discussed further below, include the following: (1) requiring the directors to discontinue any involvement in all AHP or CIP projects or, in the alternative, to resign from the FHLBanks' boards; or (2) requiring the directors to refrain from participating in or attempting to influence the evaluation, approval or implementation process for the CIP projects or for the AHP projects in the specific AHP round.

1. Resignation From the FHLBank Board; Prohibition On Involvement in AHP or CIP Projects

3. The term "involved" is not more specifically defined here because of the difficulty in anticipating every possible fact situation where actual or apparent conflicts of interest can arise.

The potential for actual or apparent conflicts of interest in the AHP or CIP process can be avoided by requiring directors who are involved in specific AHP or CIP projects to resign from their FHLBanks' boards, or discontinue their involvement in such projects if they do not wish to resign.

However, such a policy could discourage persons with housing expertise from serving as FHLBank directors, contrary to the Bank Act's recognition of the value of having such persons serve on the FHLBanks' boards. The FHLBanks' ability to attract such specially qualified candidates for directorship positions on their boards could thereby be significantly impaired. Moreover, given the significant involvement of FHLBank staff in the AHP process and the independent Finance Board review and approval role, requiring such action ordinarily may be too drastic a solution to the conflicts issue.

2. Refraining From Participating In or Attempting to Influence the AHP or CIP Process

Where the board of a FHLBank exercises a prior approval role with respect to AHP or CIP projects, the potential for conflicts of interest arises. There is the possibility that decisions of FHLBank staff and other directors on AHP or CIP projects may be influenced by their knowledge of a particular director's involvement in an AHP or CIP project. Moreover, even if their decisions are not so influenced, the appearance of such influence and of conflicts of interest may still exist.

At those FHLBanks whose boards have no formal role in the evaluation and approval of AHP or CIP applications, the risks of actual or apparent conflict of interest are much smaller than where the board exercises a prior approval role. However, as discussed earlier, even where directors have no voting role with respect to AHP or CIP funding decisions, they could nevertheless exercise influence over the AHP or CIP process by actively advocating to FHLBank staff specific projects in which they are involved, including projects not yet formally submitted to the FHLBank for review, and/or lobbying against competing projects. Similarly, directors who are involved in approved projects could attempt to influence the implementation of such projects, as through involvement in the negotiation of AHP subsidy agreements or subsequent monitoring of the projects.

In both instances, directors who are involved in specific AHP or CIP projects should be advised not to participate in or attempt to influence the evaluation and approval process for any CIP projects, or AHP projects under consideration or to be considered in the particular AHP round. In the case of FHLBank board prior approval of AHP or CIP projects, the directors should recuse.

themselves from voting on such projects.' Directors who **are** involved in approved AHP or CIP projects also should be advised not to participate in or attempt to influence the implementation process for such projects.

By refraining from participating in or attempting to influence the evaluation, approval and implementation process for AHP and CIP projects, the FHLBank directors should avoid the potential for conflicts of interest or the appearance of conflicts of interest. In addition, the Finance Board's final independent review and approval of the FHLBanks' AHP recommendations adds another significant layer of protection from potential conflict of interest at the FHLBank level.

B. Conflict of Interest Standards Applicable to Finance Board Directors and Advisory Council Members

1. Finance Board Directors

As with the requirements for FHLBank boards, the Bank Act recognize⁶ the value of having persons serve as Finance Board directors who have backgrounds in housing. Specifically, section 2A of the Bank Act provides that the appointed directors of the Finance Board shall be from among persons with extensive experience or training in housing finance or with a commitment to providing specialized housing credit. 12 U.S.C. § 1422a(h)(2)(A). Section 2A also requires that at least one director of the Board be chosen from an organization representing consumer or community interests in banking services, credit needs housing or financial consumer protections. *Id.* at § 1422a(h)(2)(B). The Finance Board's community **interest** director, William Perkins, currently is involved in approved AHP projects through his housing finance organization, Wisconsin Partnership for Housing Development, Inc. ("Wisconsin Partnership").

The Federal Government has provided useful guidance in the area of AHP conflicts of interest for the Finance Board. Specifically, the OGC has approved a recusal policy for Finance Board Director Perkins. Director Perkins has agreed to recuse himself from participation by vote, discussion recommendation **or** advice on the merits of any AHP application forwarded by the FHLBank-Chicago in which Wisconsin Partnership has an interest that goes before the Board for approval. See Ethics Agreement

4. The OGE has approved a similar AHP recusal policy for Finance Board Director William Perkins. See discussion in II.B *infra*. We have been advised by DBD staff that a similar recusal policy also is followed by elective directors at a number of FHLBanks, when members apply to the FHLBanks for advances. At the end of each month, the FHLBank's board is asked to ratify the advances made to members during that month. Those elective directors whose members received advances recuse themselves from the ratification vote.

Memorandum from William C. Perkins to Arnold Intrater, dated August 16, 1990.

Thus, the recommended restrictions on participation and influence for FHLBank directors would be in accordance with OGC's conflict of interest policy for Finance Board Director Perkins.

2. Advisory Council Members

The potential for conflicts of interest also arises as a result of the role of the Advisory Councils in the AHP. Section 10(j)(II) of the Bank Act and the Finance Board's implementing regulations provide that the Advisory Councils shall advise the FHLBanks on the utilization of AHP advances for low- and moderate-income housing programs and needs in the district. 12 U.S.C. § 1430(j)(II). Conflicts of interest may arise where Advisory Council members who are personally involved, or whose organizations are involved, in specific AHP projects also offer advice to the FHLBanks on the proposed projects.

Similarly, conflicts may arise where Advisory Council members who are personally involved, or whose organizations are involved, in specific cip projects attempt to influence the evaluation, approval or implementation process for such projects.

By requiring that members of the Advisory Council be "persons drawn from community and nonprofit organizations actively involved in providing or promoting low and moderate-income housing," the Bank Act recognizes the value of having persons serve the FHLBank System who have backgrounds in housing. See *id.* Requiring Advisory Council members who are involved in specific AHP or CIP projects to resign from their Councils, or discontinue their involvement in such projects if they do not wish to resign, would discourage persons with housing expertise from serving as Advisory Council members.

As with FHLBank directors, Advisory Council members who are personally involved, or whose organizations are involved, in specific pending or approved AHP or CIP projects should be advised not to participate in or attempt to influence the evaluation, approval or implementation process for such projects.

cc: Beth L. Climo