

**FEDERAL HOUSING FINANCE AGENCY**

**12 CFR Parts 1239, 1261, and 1273**

**RIN 2590-AB24**

**Federal Home Loan Bank System Boards of Directors and Executive Management**

**AGENCY:** Federal Housing Finance Agency.

**ACTION:** Notice of proposed rulemaking.

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**SUMMARY:** The Federal Housing Finance Agency (FHFA or the Agency) is proposing to revise regulations addressing boards of directors and overall corporate governance of the Federal Home Loan Banks (Banks) and the Bank System's Office of Finance (OF) to update and clarify regulatory requirements on a variety of topics including: FHFA's annual designation of Bank directorships; Bank director eligibility and professional qualifications; nomination, election, and removal of Bank directors; the conduct of System board and committee meetings; conflicts of interest; and the respective responsibilities of System boards of directors and executive management.

**DATES:** Written comments must be received on or before **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

**ADDRESSES:** You may submit your comments on the proposed rule, identified by regulatory information number (RIN) 2590-AB24, by any one of the following methods:

- *Agency website:* <https://www.fhfa.gov/regulation/federal-register?comments=open>.

- *Federal eRulemaking Portal:* <https://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov) to ensure timely receipt by FHFA. Include the following information in the subject line of your submission: Comments/RIN 2590-AB24.
- *Hand Delivered/Courier:* The hand delivery address is: Clinton Jones, General Counsel, Attention: Comments/RIN 2590-AB24, Federal Housing Finance Agency, 400 Seventh Street SW, Washington, DC 20219. Deliver the package at the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- *U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:* The mailing address for comments is: Clinton Jones, General Counsel, Attention: Comments/RIN 2590-AB24, Federal Housing Finance Agency, 400 Seventh Street SW, Washington, DC 20219. Please note that all mail sent to FHFA via U.S. Mail is routed through a national irradiation facility, a process that may delay delivery by approximately two weeks. For any time-sensitive correspondence, please plan accordingly.

**FOR FURTHER INFORMATION CONTACT:** Lindsay Spadoni, Assistant General Counsel, Office of General Counsel, (202) 649-3634, [Lindsay.Spadoni@FHFA.gov](mailto:Lindsay.Spadoni@FHFA.gov); or Janna Bruce, Senior Financial Analyst, Division of Bank Regulation, (202) 649-3202, [Janna.Bruce@FHFA.gov](mailto:Janna.Bruce@FHFA.gov). These are not toll-free numbers. For TTY/TRS users with hearing and speech disabilities, dial 711 and ask to be connected to any of the contact

numbers above.

## **SUPPLEMENTARY INFORMATION:**

### **I. Comments**

FHFA invites comments on all aspects of the proposed rule and will take all comments into consideration before issuing a final rule. Comments will be posted to the electronic rulemaking docket on the FHFA public website at <https://www.fhfa.gov>, except as described below. Commenters should submit only information the commenter wishes to make available publicly. FHFA may post only a single representative example of identical or substantially identical comments, and in such cases will generally identify the number of identical or substantially identical comments represented by the posted example. FHFA may, in its discretion, redact or refrain from posting all or any portion of any comment that contains content that is obscene, vulgar, profane, or threatens harm. All comments, including those that are redacted or not posted, will be retained in their original form in FHFA's internal rulemaking file and considered as required by all applicable laws. Commenters that would like FHFA to consider any portion of their comment exempt from disclosure on the basis that it contains trade secrets, or financial, confidential or proprietary data or information, should follow the procedures in section IV.D. of FHFA's *Policy on Communications with Outside Parties in Connection with FHFA Rulemakings*, see [https://www.fhfa.gov/sites/default/files/documents/Ex-Parte-Communications-Public-Policy\\_3-5-19.pdf](https://www.fhfa.gov/sites/default/files/documents/Ex-Parte-Communications-Public-Policy_3-5-19.pdf). FHFA cannot guarantee that such data or information, or the identity of the commenter, will remain confidential if disclosure is sought pursuant to an applicable statute or regulation. See 12 CFR 1202.8 and 1214.2 and the FHFA *FOIA*

Reference Guide at <https://www.fhfa.gov/about/foia-reference-guide> for additional information.

## **II. Background**

### **A. Statutory Requirements on Bank System Governance**

The Bank System consists of eleven district Banks and the OF. The Banks are wholesale, cooperatively owned financial institutions, the debt of which is the joint and several obligation of all eleven Banks. They are organized under authority of the Federal Home Loan Bank Act (Bank Act) to serve the public interest by enhancing the availability of residential housing finance and community lending credit through their member institutions and, to a very limited extent, through certain eligible nonmembers. In general, only members may obtain advances (low-cost secured loans) and access other products and services provided by a Bank.

The Bank Act vests the management of each Bank in its board of directors.<sup>1</sup> As required by statute, each Bank's board comprises two types of directors: (1) member directors, who are drawn from the officers and directors of member institutions located in the Bank's district and who are elected to represent members in each respective state in that district; and (2) independent directors, who are unaffiliated with any of the Bank's member institutions or borrowing housing associates,<sup>2</sup> but who reside in the Bank's district and are elected on an at-large basis.<sup>3</sup> The Bank Act specifies that a majority of seats on each Bank's board of directors must be member directorships, while not less

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<sup>1</sup> See 12 U.S.C. 1427(a)(1).

<sup>2</sup> FHFA's regulations refer to eligible nonmember borrowers as "housing associates." See 12 CFR part 1264.

<sup>3</sup> See 12 U.S.C. 1427(a)(4), (b), and (d).

than 40 percent must be independent directorships.<sup>4</sup> Both types of directors serve four-year terms, which must be staggered so that approximately one-quarter of a Bank's total directorships are up for election every year.<sup>5</sup> The Bank Act establishes the eligibility requirements for both types of Bank directors, including the professional qualifications required for independent directors, and sets forth requirements for their nomination and election.<sup>6</sup> The statute requires the FHFA Director to annually designate the size and composition of each Bank's board of directors for the following calendar year, including by establishing the number of member and independent directorships and allocating member directorships among the states of the Bank district.<sup>7</sup>

The Bank Act requires that at least two of a Bank's independent directors qualify as "public interest" independent directors, each of which must "have more than 4 years of experience in representing consumer or community interests on banking services, credit needs, housing, or financial consumer protections."<sup>8</sup> Each independent director that is not a public interest independent director (referred to in this proposed rule as a "regular independent director") must "have demonstrated knowledge of, or experience in, financial management, auditing and accounting, risk management practices, derivatives, project development, or organizational management, or such other knowledge or expertise as the [FHFA] Director may provide by regulation."<sup>9</sup> By regulation, FHFA has added "the law" to that list of qualifying knowledge and experience.<sup>10</sup>

## **B. Existing Regulations on Corporate Governance of Banks and OF**

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<sup>4</sup> See 12 U.S.C. 1427(a)(2).

<sup>5</sup> See 12 U.S.C. 1427(d).

<sup>6</sup> See 12 U.S.C. 1429, 1430(a)(1), 1430b.

<sup>7</sup> See 12 U.S.C. 1427(b)(1), (c).

<sup>8</sup> 12 U.S.C. 1427(a)(3)(B)(ii).

<sup>9</sup> 12 U.S.C. 1427(a)(3)(B)(i).

<sup>10</sup> See 12 CFR 1261.7(e)(1).

Part 1261 of FHFA’s regulations, entitled “Federal Home Loan Bank Directors,” implements the statutory provisions and otherwise establishes requirements and processes relating to the composition and operations of Bank boards of directors. With respect to the former, sections in subpart B of the regulation (§§ 1261.2 through 1261.15) cover the annual designation of Bank directorships by the FHFA Director, director eligibility, the nomination and election processes, reporting and record retention requirements, handling conflicts of interest, and the filling of vacancies. Sections in subpart C (§§ 1261.20 through 1261.24) address director compensation and expenses and the conduct of board and committee meetings.<sup>11</sup>

In addition to the corporate governance issues addressed in part 1261, part 1239 of FHFA’s regulations, entitled “Responsibilities of Boards of Directors, Corporate Practices, and Corporate Governance,” addresses duties and responsibilities of directors, required board committees, and programs and policies each Bank must establish and maintain. Although part 1239 generally applies to all of FHFA’s regulated entities, subpart E of the regulation sets forth requirements that are specific to the Banks. Part 1273 of FHFA’s regulations governs the Bank System’s OF, with governance issues—including composition and meetings of the OF board of directors—being addressed primarily in § 1273.8.

### **III. Overview of the Proposed Rule**

The proposed rule would make numerous revisions to part 1261, as well as more limited revisions to parts 1239 and 1273 to address various issues related to the corporate governance of the Banks and the OF. While the greater portion of the proposed changes

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<sup>11</sup> Subpart A of the existing regulation, entitled “Definitions,” has no content.

to existing regulatory text are intended merely to restate existing requirements more clearly, many of the proposed revisions are substantive. The latter are being proposed primarily to ensure that the Banks maintain strong corporate governance that enables them to effectively fulfill their public policy mission while maintaining safe and sound operations. New proposed requirements and authorities would help ensure the Banks have the leadership and resources to forestall avoidable difficulties and to address challenges that may arise in the years ahead. The proposed revisions reflect FHFA's view that corporate governance of the Banks is strengthened when: the public interest is adequately represented; Bank boards have the collective knowledge and expertise to guide the Bank through new and emerging risks and complex problems; independent directors represent a true independent voice; each Bank has the tools to ensure that its directors are fit to serve in a fiduciary role with the Bank; and Bank directors and management are incentivized to carry out their duties and responsibilities conscientiously.

As discussed further below, several of the proposed changes implement action items from FHFA's *FHLBank System at 100: Focusing on the Future* Report (FHLBank System at 100 Report or Report), published in November 2023. The proposed rule would also address issues raised in comments received in response to FHFA's April 2023 Notice of Regulatory Review, which was published pursuant to FHFA's Regulatory Review Plan.<sup>12</sup> Other substantive changes are intended to increase transparency by codifying existing guidance or practices or to provide clarity on issues for which there

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<sup>12</sup> See 88 FR 22919 (Apr. 14, 2023) (FHFA Notice of Regulatory Review). The Regulatory Review Plan establishes a process by which, at least every five years, FHFA issues a notice of the regulatory review in the *Federal Register* and requests comments on how its regulations may be made more effective and less burdensome in achieving the Agency's regulatory objectives. See 77 FR 10351 (Feb. 22, 2012) (FHFA Regulatory Review Plan).

currently exists no formal guidance, but on which FHFA has received inquiries. Finally, FHFA is also proposing many non-substantive revisions to part 1261, which are intended merely to address existing requirements, processes, and authorities pertaining to Bank boards and directors more clearly than does the existing regulation.

The FHLBank System at 100 Report provides a blueprint for innovative and prudent steps to bolster and improve the Bank System over the next several years, with the goal of ensuring that the Banks remain well positioned to meet the needs of their members and the communities they serve as they approach their 100<sup>th</sup> anniversary. The Report was informed by a year-long review of the Bank System involving significant stakeholder outreach, a historical review of the role of the Banks, and detailed analysis of both the strengths and areas for improvement in the System's current structure. As stated in the Report, FHFA's vision for the future is to have an effectively governed Bank System that efficiently provides stable and reliable funding to creditworthy members and delivers innovative products and services to support the housing and community development needs of the communities its members serve, all in a safe and sound manner. The Report noted that each Bank's "effectiveness in achieving its mission and safety and soundness goals is influenced by its governance."<sup>13</sup>

The Report laid out four regulatory actions to be taken by FHFA to strengthen Bank boards of directors and enable them to effectively address emerging risks and to oversee the safety and soundness and mission achievement of the Banks in today's financial market environment: (1) clarify required qualifications for public interest independent directors; (2) expand the list of qualifying experience for regular

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<sup>13</sup> See FHLBank System at 100 Report at 64.



independent directors to reflect business developments in housing finance and new and emerging risks and complex problems; (3) encourage the Banks to evaluate potential gaps in board knowledge and pursue opportunities to address these gaps by nominating individuals with particular skills, backgrounds, and experience; and (4) facilitate the nomination of individuals with technical subject matter expertise.<sup>14</sup> The proposed rule would address each of those four action items.

The proposed rule would clarify required qualifications for public interest independent directors, including by specifying criteria for a Bank to consider when determining if an individual has “represented” consumer or community interests on banking services, credit needs, housing, or financial consumer protections, as required by statute to qualify as a public interest independent director. The rule would codify existing guidance that a person must have advocated for, or otherwise acted primarily on behalf of or for the direct benefit of, consumers or the community to meet the representation requirement.

The revised regulation would require each Bank to take affirmative measures to ensure that its board of directors has the knowledge and experience needed to adequately oversee the management of the Bank. Based on input received during the FHLBank System at 100 outreach, the proposed rule would add artificial intelligence, information technology and security, climate-related risk, Community Development Financial Institution (CDFI) business models, and modeling to the list of qualifying experience for regular independent directors. To ensure coverage of critical areas, each Bank’s board would be required to conduct an annual assessment of the skills and experience possessed

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<sup>14</sup> See FHLBank System at 100 Report at 67.

by its incumbents and those for which the board has a need. “Skills and experience” assessments are authorized, but not required, under the existing regulation.<sup>15</sup>

Banks would be required to take active steps to seek independent directorship nominees—and to encourage member directorship nominees—who possess needed skills and experience. The revised regulation also would require the Banks to prioritize knowledge and experience relevant to the business, programs, and mission of the Bank and gained primarily through full time paid executive, management, or other senior positions when considering potential independent directorship nominees. To provide Banks with more flexibility to address critical needs when filling board vacancies, the proposed rule would add a provision expressly permitting Banks to fill a vacant public interest independent directorship by redesignating a qualifying incumbent regular independent director as a public interest independent director and vice versa. The Bank could then find new nominees to fill the resulting independent directorship vacancy (a practice FHFA currently permits).

At several points during the outreach phase of the FHLBank System at 100 initiative, stakeholders stressed the importance of independent voices on a Bank’s board. The proposed rule includes provisions addressing director independence. It would make modest changes to increase the separation between independent directors and Bank members by extending “independence” requirements (which currently only apply to seated directors) to independent directorship nominees and prohibiting former member directors from serving as an independent director until they have been off the board for at least two years.

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<sup>15</sup> See 12 CFR 1261.9(a).

In response to a Regulatory Review Notice comment, the proposed rule includes a new provision clarifying the definition of “advances” for purposes of the prohibition against an independent director serving as an officer, employee, or director of any “recipient of advances” from the Bank. This issue is of particular relevance for independent directors who lead or work for entities certified as housing associates.<sup>16</sup> As proposed, the word “advances” would refer to any loan from a Bank to the recipient, regardless of form or nomenclature, except for debt securities traded in the public capital markets. This definition strikes a balance between preventing circumvention of the independence requirements and allowing Banks to tap into their housing associates’ valuable expertise without having to relinquish, or decline to make, investments in their debt securities.

The proposed rule would codify requirements and authorities relating to the “fitness” of an individual to serve as a director. It would require that a Bank decline to nominate or seat as a director any individual it knows to be “unfit” to serve and authorize each Bank’s board to adopt bylaws or policies under which it may remove directors “for cause” upon a two-thirds vote of the board. As proposed, “cause” for removal would include code of ethics or policy violations, violations of the law, posing a risk of material harm to the Bank, conduct or a mental condition indicating an inability to oversee the Bank, and poor performance or lack of participation. The proposed rule would also require that each Bank’s board conduct an annual assessment of director performance and participation to determine whether each director is contributing positively to the board’s ability to adequately oversee the operations of the Bank. The proposed rule would

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<sup>16</sup> See 12 CFR part 1264. A Bank may make an advance to an entity, such as a state housing finance agency, that is certified as a housing associate, but housing associates cannot become bank members.

require that director compensation reflect performance, as determined through the annual assessment, and permit the board to remove a director where the assessment reveals that a director's continuous poor performance or lack of participation is compromising the board's ability to adequately oversee the operations of the Bank. Additionally, the proposed rule would allow the FHFA Director to establish and provide notice of an annual amount of director compensation determined to be reasonable.

As further assurance that all Bank directors are fit to serve, the proposed rule would codify as a regulatory requirement the Banks' existing practice of conducting thorough background checks on independent directorship nominees, as well as individuals under consideration to fill a vacant directorship. It would also for the first time expressly require the Banks to conduct background checks for their member directorship nominees. The revised regulation would prohibit a Bank from including any individual on the ballot without having first confirmed, based on the background check, the individual's fitness to serve in a fiduciary role with the Bank.

With respect to directorship terms and term limits, the proposed rule would expressly provide that FHFA may continue, as part of the annual designation of directorships process, to adjust downward the length of terms from time to time where required to maintain the even staggering of directorship terms on a Bank's board. The proposed rule would make clear that such truncated terms do not count as "full terms" for purposes of the statutory term limit provisions, but that full terms on either side of a truncated term must be counted as consecutive for those purposes.

In one of only a few revisions to address corporate governance issues below the board level, the proposed rule would require each Bank to adopt and implement a conflicts of interest policy covering all Bank employees. The required policy would

establish appropriate limitations, standards, and procedures on the holding of outside positions and financial interests by Bank employees and close family members and associates. Although the treatment of different types of employees under such a policy may be calibrated to the risk presented, each Bank's policy would be required to prohibit its executive officers and senior management from holding paid positions with any entity that is, or may be eligible to become, a member or housing associate of any Bank or with any affiliate of such entity.

Finally, the proposed rule would revise the regulation's existing provisions on record retention. Changes would increase the amount of time a Bank must retain materials pertaining to its directors and the director nomination and election process from two years to the longer of seven years or seven years after the director to which the information pertains leaves the board. This requirement is consistent with recognized best practices and should not be burdensome to implement in an electronic environment.

Although the proposed rule would impose new requirements (in addition to codifying some existing expectations), it would also implement new, or make permanent previously temporary, flexibilities. As requested in a Regulatory Review Notice comment, the proposed rule would remove the requirement that Bank boards satisfy their six meeting per year minimum only through in-person meetings. The proposed revision would codify the substance of a waiver that has been in place since early in the COVID-19 pandemic by permitting Bank and OF board and committee meetings to be held by video or teleconferencing, or in a hybrid format, provided all directors have an opportunity to communicate, have access to all written documents and presentations, and all participants are within a state or U.S. Territory that is part of a Bank district.

To reduce burden in other areas, the proposed rule would also implement a

number of other recommendations received as comments on the Regulatory Review Notice. These changes include expanding the range of arms-length transactions not considered to be a prohibited “financial interest” for purposes of the Bank director conflicts-of-interest requirements, updating and expanding the authorized methods for withdrawal of OF operating funds, and allowing the OF board of directors to delegate review and approval of contracts as specified in applicable governance documents.

In addition to these substantive revisions, the proposed rule would make non-substantive revisions throughout part 1261 to improve the readability of the regulatory text and provide greater clarity on the requirements, processes, and authorities pertaining to Bank directors. In particular, provisions governing the annual designation of directorships, director eligibility, the nomination and election processes, and the filling of vacant directorships would be updated. These proposed non-substantive revisions include substitution of clearer phrasing, changes to assure consistent use of terminology, consolidation of related subject matter, replacement of statutory cross-references with either substantive text or regulatory cross-references, reorganization of sections and revision of headings, and removal of transitional material that is no longer needed.

#### **IV. Section-by-Section Analysis of the Proposed Rule**

##### **A. Revisions to 12 CFR part 1261**

##### ***1. Definitions—§ 1261.2***

Section 1261.2 of the existing regulation sets forth definitions applicable to subpart B of part 1261, which consists of the provisions governing Bank director eligibility, nominations, and elections. Existing § 1261.2 includes definitions for “independent directorship,” “member directorship,” “public interest director,” and “public interest directorship.” As described below, the proposed rule would add to and

revise the regulatory terms describing the Bank directorship types and sub-types. The proposals are intended to provide clarity, and revisions to existing definitions are not intended to change the scope of the defined terms.

The existing regulation defines the terms “independent directorship” and “member directorship” by means of cross-references to the relevant provisions of the Bank Act. The proposed rule would replace these statutory references with cross-references to the regulatory provisions establishing the eligibility and designation requirements for those two types of Bank directorships. FHFA believes it is preferable to define terms with reference to the regulation itself, as opposed to requiring reference to the statute the regulation is intended to implement. Because part 1261 addresses both “directorships” (the designated seats comprising a Bank’s board) and “directors” (the individuals filling those seats), those variants would be defined together for each directorship type.

While both the Bank Act and the existing regulation define “public interest directorship” (referring to an independent directorship to be filled by an individual meeting the “representing consumer or community interests” qualification requirement), both refer to an independent directorship to be filled by an individual meeting the “knowledge and experience” qualification requirement of the statute with such undefined terms as “an independent directorship, other than a public interest directorship” and “an independent director that is not a public interest director.” The proposed rule would establish a joint definition for “regular independent directorship and regular independent director” to refer to those types of independent directorships and directors, and would define the terms with a cross-reference to the new provision addressing the qualifications

requirements for such directors under the proposed rule (§ 1261.5(c)(1), discussed below).

The existing regulation defines “public interest directorship” as “an independent directorship filled by an individual with more than four years of experience representing consumer or community interests in banking services, credit needs, housing or consumer financial protections.” The regulation separately defines “public interest director” to mean “an individual serving in a public interest directorship.” The proposed rule would revise the former term to “public interest *independent* directorship” to make clear that it refers to a sub-type of independent directorship and so the construction of the term parallels that of its counterpart, “regular independent directorship.” The proposed rule would also combine the “directorship” and “director” definitions into one paragraph and define the terms with a cross-reference to the new provision addressing the qualifications requirements for such directors under the proposed rule (§ 1261.5(c)(2), also discussed below), so that the definitions parallel those of the other directorship types.

The proposed rule would also add a definition for the term “nominee,” referring to an individual formally nominated by a Bank’s members or board of directors, as appropriate, to stand for election for a Bank directorship. This change is intended to allow a clearer distinction in the regulatory text between requirements that apply to persons requesting or being considered for nomination for a directorship and requirements that apply only to those that have been duly nominated.

Existing § 1261.2 defines the term “voting State” to mean “the District of Columbia, Puerto Rico, or the State of the United States in which a member's principal place of business, as determined in accordance with 12 CFR part 1263, or any successor



provision, is located as of the record date,” and further clarifies that “[t]he voting State of a member with a principal place of business located in the U.S. Virgin Islands as of the record date is Puerto Rico, and the voting State of a member with a principal place of business located in American Samoa, Guam, or the Commonwealth of the Northern Mariana Islands as of the record date is Hawaii.” The proposed rule would amend this definition to eliminate the unnecessary references to the District of Columbia and Puerto Rico in the first clause. Section 1201.1 of FHFA’s regulations, which defines terms that are used frequently throughout the regulations, already defines the term “State” to include the District of Columbia and Puerto Rico (as well as American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the United States Virgin Islands), so there is no reason to specify their inclusion in the definition of “voting State.”

Where appropriate, the proposed rule would also revise numerous references to a “State” in existing part 1261 to refer to a “voting State.” This is especially important with respect to provisions on the allocation of member directorships and member directorship nominations and voting, as the latter term includes the concept that members in U.S. Virgin Islands nominate, vote for, and are represented by member directors for Puerto Rico, while members in American Samoa, Guam, or the Northern Mariana Islands nominate, vote for, and are represented by member directors for Hawaii.

## **2. *General Provisions—§ 1261.3***

Section 1261.3 of the existing regulation sets forth “General provisions” addressing board size and composition, length of term of directorships, annual elections, location of members for purposes of voting to fill member directorships, and the calculation of dates for purposes of determining compliance with deadlines required

under the regulation. The proposed rule would remove the material on board size and composition in existing § 1261.3(a), the substance of which would be consolidated with related material on the designation of directorships in revised § 1261.4. The remaining paragraphs of § 1261.3 would be redesignated as appropriate and revised to remove or replace statutory references and streamline language for greater clarity and consistency. No change in substantive meaning is intended.

**3. *Annual Designation of Directorships—§ 1261.4***

Section 1261.4 of the existing regulation addresses the annual “designation of directorships” process which results in the issuance of an order by the FHFA Director designating the size and composition of each Bank’s board of directors for the following calendar year. The proposed rule would make various revisions to this section to consolidate provisions relating to the designation of directorships and to provide clarity regarding the methods through which FHFA determines the appropriate size and composition for each Bank’s board and the requirements and procedures associated with the process. The proposed rule would also change the heading of § 1261.4 to “Annual designation of directorships” to reflect that the process is annual and that the Director designates not only member directorships, but also independent directorships for each Bank. The proposed revisions are not intended to change any current procedure or requirement.

The proposed rule would redesignate existing § 1261.4(a) as § 1261.4(b) and would add a new paragraph (a) providing that the Director will annually issue a written order designating for each Bank’s board of directors for the following calendar year: (1) the total number of member directorships and their allocation among the voting States of

the Bank's district; (2) the total number of independent directorships; and (3) the directorships for which an election will be held for terms beginning on January 1 of the following year, and the length of those terms.<sup>17</sup> The designation of directorships has been carried out by means of a Director's order since the inception of FHFA and the new regulatory text would make this explicit and would more accurately describe the content of the designations order than existing § 1261.3(a). Consistent with current practice, the proposed rule would provide that the Director will issue the designation of directorships order by June 1 of each year.

Redesignated § 1261.4(b), requiring each Bank to submit a capital stock report to provide data for the allocation of member directorships and the determination of the number of votes each member may cast in the election, would remain substantively unchanged. For clarity, however, the sentence providing that “[i]f a Bank has issued more than one class of stock, it shall report the total shares of stock of all classes required to be held by members” would be revised to refer to “the total shares of *each class of stock* required to be held by the members.”

Paragraphs (b) and (c) of existing § 1261.4—entitled “Designation of member directorships” and “Allocation of directorships,” respectively—would be replaced by a new § 1261.4(c), which is intended to describe the process through which FHFA sets the total number of member directorships for each Bank and allocates them among the respective States of the Bank district.

Proposed paragraph (c)(1) would describe the first part of the statutorily required

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<sup>17</sup> Bank directorship terms, for both member and independent directors, are generally four years but, as discussed below, FHFA may on rare occasions truncate the term length for a Bank directorship to maintain the equal staggering of terms.

process, whereby member directorships are allocated among the States of each district based on the relative amount of Bank stock the members in each respective state were required to hold as of December 31 of the preceding year. As described in the proposed regulatory text, FHFA begins by choosing for each Bank a “base” number of member directorships to allocate among the states of the district. For practical reasons, the base number is typically eight,<sup>18</sup> but may differ where there is a legal or policy reason for selecting a different number. For example, where the number of states comprising a Bank district exceeds eight, FHFA must begin with a higher base number for that Bank because the Bank Act requires that each state have a minimum of one member directorship. In other cases, for example where application of the statutory “grandfather provision” (discussed below) would otherwise result in an excessively large board size, FHFA may start with a base number lower than eight.<sup>19</sup>

Proposed § 1261.4(c)(1)(i) provides that FHFA will then use the “method of equal proportions” to allocate those member directorships among the voting States of the Bank district, based on the ratio of the number of shares of Bank stock required to be held by the members in each State to the number of shares required to be held by all members of the Bank. As required by statute,<sup>20</sup> proposed § 1261.4(c)(1)(ii) makes clear that each State must be allocated at least one, but no more than six, member directorships. As does the existing regulation, proposed § 1261.4(c)(1)(iii) provides that, for those Banks that have issued more than one class of stock, member directorships will be allocated based

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<sup>18</sup> Among other things, a base number of eight seats has been shown to result in most cases in a board that is not excessively large, but is large enough so that the board’s composition meets all statutory requirements.

<sup>19</sup> The Bank Act provides that each Bank is to have a board of 13 directors, “or such other number as the Director determines appropriate.” *See* 12 U.S.C. 1427(a)(1).

<sup>20</sup> *See* 12 U.S.C. 1427(c).

on the combined number of shares required to be held by members. Proposed § 1261.4(c)(1)(iv) would make clear that the required stock amounts on which the allocations are based shall be the amounts as of the record date (December 31 of the preceding calendar year, as defined in § 1261.2) shown in the capital stock report required to be submitted by the Banks under redesignated § 1261.4(b).

In practice, when allocating member directorships for a Bank, FHFA first allocates one member directorship to each State in the Bank district to fulfill the minimum statutory requirement. Any remaining seats are then allocated using the “method of equal proportions,” which is the method that has been used to apportion seats in the United States House of Representatives since 1941.<sup>21</sup> The use of the method of equal proportions is intended to result in the stock-based allocation of member directorships having the closest possible correlation with the relative amounts of stock required to be held by Bank members in each respective state of the district.

Under the method of equal proportions, after each state has been allocated one seat, a priority value is calculated for each potential subsequent seat a state could be allocated—out to the maximum of six member directorships that may be allocated to each State—based on the following formula:

$$V = \frac{P}{\sqrt{n(n-1)}}$$

- $V$  represents a priority value.
- $P$  represents the total shares of Bank stock required to be held by members

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<sup>21</sup> The method of equal proportions has been the required method for the stock-based allocation of Bank member directorship seats since 1998. See 63 FR 65683, 65685, 65688 (Nov. 30, 1998) (final rule); 63 FR 26532, 26533 (May 13, 1998) (proposed rule).

in a particular State.

- $n$  represents the number of member directorships the state would have if it gained a seat.

The remaining seats are then allocated sequentially among the states of the district based on those priority values.

For example, if FHFA were to allocate eight member directorships among the states of a Bank district including three states having required member stock holdings of 20 million, 12.5 million, and 5 million shares, respectively, the priority values for potential seats #2 through #6 for each state would be as follows:

Seat # >	2nd Seat	3rd Seat	4th Seat	5th Seat	6th Seat
Multiplier >	0.707106 8	0.408248 3	0.288675 1	0.223606 8	0.182574 2
State A (20,000,000 sh)	14,142,136	8,164,966	5,773,503	4,472,136	3,651,484
State B (12,500,000 sh)	8,838,835	5,103,104	3,608,439	2,795,085	2,282,177
State C (5,000,000 sh)	3,535,534	2,041,241	1,443,376	1,118,034	912,871

This would result in a priority order for the allocation of seats #2 through #6 for each state as follows:

Seat # >	2nd	3rd	4th	5th	6th
State A	1	3	4	6	7
State B	2	5	8	10	11
State C	9	12	13	14	15

Assuming a base number of eight total member directorships are to be allocated, there would be five remaining seats after each state has been allocated one seat. Based on the priority order reflected in the table above, State A would be allocated the first of the remaining seats, State B the second, State A the third and fourth, and State B the fifth,

resulting in an overall allocation of four seats to State A, three seats to State B, and one seat to State C.

The Bank Act generally requires that FHFA allocate member directorships based on the ratio of required stock holdings. However, the statute also requires that, whenever the number of member directorships representing the members located in any State would not be at least equal to the total number representing that State on December 31, 1960, FHFA “shall add to the board of directors” such additional seats as are necessary to bring the total number being allocated to that State up to the 1960 total (the “grandfather provision”).<sup>22</sup> The minimum number of member directorships that must be allocated to each State to meet the requirements of the grandfather provision is specified in a table set forth in existing § 1261.15, which would not be revised as part of this rulemaking.

Existing § 1261.4(c) implements the grandfather provision through a bare cross-reference to the statute. In contrast, proposed § 1261.4(c)(2) would expressly provide that, where the stock-based allocation has resulted in a state being allocated fewer member directorships than shown for that State in § 1261.15, FHFA will allocate it as many additional member directorships as are necessary to increase the total number of member directorships for that State to the number shown on the table in that section. Only those states that have been “grandfathered” at more than one member directorship appear on the table in § 1261.15. Proposed § 1261.4(c)(2) would deem the minimum number of member directorships required to fulfill the “grandfather provision” to be one for those States not appearing on the table. In the example above, if all three States had

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<sup>22</sup> 12 U.S.C. 1427(c). By its express terms, the statutory grandfather provision does not apply to the directorships of any Bank resulting from the merger of two or more Banks—currently only the Federal Home Loan Bank of Des Moines.

been represented by three member directorships in 1960, FHFA would need to allocate two additional seats to State C, beyond the one earned in the stock-based allocations, increasing the total number of member directorships for the Bank to 10.

Proposed § 1261.4(d) would state that, after the total number of member directorships and their allocation have been determined for each Bank, FHFA will set the number of independent directorships at a number within the statutorily prescribed range of at least 40 percent, but less than 50 percent, of total directorships. In the example above, with 10 member directorships, FHFA could choose to designate seven, eight, or nine independent directorships (with independent directors representing 41 percent, 44 percent, or 47 percent of boards comprising 17, 18, or 19 directors). That decision is based on a variety of general and Bank-specific considerations, including the number of independent directorships designated for the current year.

Under the designation of directorships process, year-to-year changes in the relative level of required stock holdings for the members in the various States of a Bank district may result in the redesignation of one or more member directorships from one state to another. In some cases, the interaction of changes in the relative level of required stockholdings with the requirements of the grandfather provision may result in the addition of a new member directorship to a Bank's board. This could also lead to the addition of a new independent directorship if needed to maintain the required ratio of independent directorships to total directorships. In other instances, FHFA may simply choose to add a new independent directorship for policy reasons or at the request of a Bank's board.

Proposed § 1261.4(e) would address these redesignations and additions. Proposed



paragraph (e)(1) (like existing § 1261.4(e)) would make clear that the member directorship representing the state that is losing a seat terminates as of December 31 of the year the designation of directorships order is issued and a new directorship is created as of January 1 of the following year to represent the state that is gaining a seat. The Bank would need to hold an election to fill the newly added member directorship during the year the designation of directorships order is issued, with the duly elected director to begin serving on the following January 1. The individual occupying the member directorship being terminated would cease to be a director after December 31 of the current year.

As does the existing regulation, proposed paragraph (e)(1) would further provide that the length of the initial term of the newly added member directorship shall be adjusted to equal the remaining term of the directorship being terminated, to ensure that the terms of the Bank's directorships remain staggered with approximately one quarter of the terms expiring each year, as required by statute.<sup>23</sup> Similarly, proposed paragraph (e)(2) would provide that the Director may truncate the initial term of any new directorship added to a Bank's board if needed to maintain the even staggering of terms. As under the existing regulation, such truncated terms would not be counted in determining term limits for Bank directors (this is discussed further below).

Finally, proposed § 1261.4(f) would provide that the board of directors of each Bank shall determine the number of public interest independent directorships to be included among its designated independent directorships for the following year, a requirement that appears in § 1261.3(a) of the existing regulation. Under the proposed

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<sup>23</sup> See 12 U.S.C. 1427(d).

provision, a Bank would now also be expressly permitted to change the number of public interest independent directorships during the year (a practice which FHFA has permitted). As required by statute, a Bank would at all times need to have at least two such directorships.

#### **4. *Director Eligibility—§ 1261.5***

The proposed rule would make numerous revisions to § 1261.5 of the existing regulation, which governs director eligibility, including qualifications for independent directors and term limits. These revisions are intended to consolidate provisions relating to director eligibility, strengthen eligibility requirements to encourage strong corporate governance, fill in gaps in the coverage of the existing regulation, and provide greater overall clarity than the existing regulation.

The proposed rule would make clarifying revisions to § 1261.5(a), which implements the statutory eligibility requirements for member directors, with no intended change to the substance. The heading to the provision would be revised to make clear (as does the existing text) that the eligibility requirements apply not just to sitting directors, but to nominees as well. Proposed paragraph (a)(1) would provide that each member director, and each nominee for a member directorship must be: (i) a citizen of the United States; and (ii) an officer or director of a member institution that is located in the voting State of the Bank district to which the directorship being occupied, sought, or filled has been allocated under proposed § 1261.4(c). As required by statute, paragraph (a)(1)(ii) would make clear that the member institution with which any member director or member directorship nominee is associated must meet all minimum capital requirements established by its appropriate Federal banking agency or appropriate State regulator. As

does existing § 1261.5(a), paragraph (a)(2) would provide that the institution with which the director is associated must have been a member as of the “record date” (that is, December 31 of the year preceding the election) or, in the case of a director chosen by a Bank's board of directors to fill a vacancy, as of the time the board acts.

Existing § 1261.5(b) provides that each member director, and each nominee to a member directorship, must be an officer or director of a member located in the State to which the Director has allocated the directorship. Because its substance would be incorporated into proposed § 1261.5(a), the proposed rule would delete this provision.

Existing § 1261.5(c), entitled “Eligibility requirements for independent directors” provides that each independent director and each nominee to an independent directorship shall be: (1) a citizen of the United States; and (2) a bona fide resident of the district in which the Bank is located. The Bank Act actually sets forth a total of four requirements each independent director must meet to be eligible to serve. In addition to the two covered by existing § 1261.5(c), an independent director may not serve as an officer of any Bank or as a director, officer, or employee of any member of a Bank, or of any recipient of advances from a Bank<sup>24</sup> and must possess certain professional qualifications, which differ depending on whether the individual is filling a public interest independent directorship or a regular independent directorship.<sup>25</sup> While the latter two requirements are covered in separate provisions of the existing regulation (§§ 1261.10 and 1261.7, respectively), they are not identified as “eligibility requirements” in § 1261.5(c).

The proposed rule would redesignate § 1261.5(c) as § 1261.5(b) and would expand the list of eligibility requirements set forth therein to include the independence

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<sup>24</sup> 12 U.S.C. 1427(a)(3)(B)(iii).

<sup>25</sup> 12 U.S.C. 1427(a)(3)(B)(i), (ii).

and qualifications requirements. This proposed revision is intended to provide clarity by itemizing in one provision all of the requirements an individual must meet to be eligible for nomination and service as an independent director. In the case of the independence and qualifications requirements, proposed § 1261.5(b) would cross-reference other provisions of the revised regulation (§§ 1261.10 and 1261.5(c), respectively) providing more detail on how a Bank must determine whether an individual meets those requirements. Under proposed § 1261.5(b), all four requirements would apply to both sitting independent directors and to independent directorship nominees. While the citizenship, residency, and qualifications requirements apply to nominees as well as sitting directors under the existing regulation, the independence requirement currently applies only to seated directors. The extension of this requirement to nominees is discussed below in the analysis of proposed § 1261.10.

The proposed rule would add a new paragraph (c) to § 1261.5 to address the required professional qualifications for both regular and public interest independent directors. Under the existing regulation, both sets of required qualifications are fully or partially stated in multiple provisions, which FHFA believes is a potential source of confusion.<sup>26</sup> Under the proposed rule, the required qualifications for regular and public interest independent directors would be described once—in proposed § 1261.5(c)—which would, in turn, simply be cross-referenced where relevant in other provisions of the revised regulation. As explain below, the proposed rule would also make substantive revisions to the regulatory text describing the qualifications.

The existing regulation, at § 1261.7(e), provides that each independent

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<sup>26</sup> See 12 CFR 1261.5(c)(2), .7(d)(1)(i), .7(e)(2) (public interest independent director qualifications); 12 CFR 1261.7(d)(1)(ii), .7(e)(1), .8(a)(1)(iii) (regular independent director qualifications).

director that is not a public interest independent director (*i.e.*, a “regular independent director” under the proposed rule) must “have experience in, or knowledge of, one or more of the following areas: auditing and accounting, derivatives, financial management, organizational management, project development, risk management practices, and the law.”<sup>27</sup> To that list of qualifying knowledge and experience, which would now appear in proposed § 1261.5(c)(1), the proposed rule would add artificial intelligence, information technology and security, climate-related risk, CDFI business models, and modeling.

These additions were developed both from input on critical areas of expertise that should be covered by a Bank’s board of directors sought and received during the FHLBank System at 100 initiative and from understanding of the Banks’ corporate governance needs developed through FHFA’s general supervisory efforts. Their inclusion is intended to encourage each Bank’s board to take active steps to ensure it has sufficient knowledge and expertise regarding recent business developments in housing finance and new and emerging risks and complex problems that could affect Bank operations. To allow FHFA and the Banks to respond more rapidly to evolving conditions and risks going forward, the list of qualifying knowledge or expertise for regular independent directors in proposed § 1261.5(c)(1) would also include “such other areas as the Director shall determine,” thus allowing FHFA to add other areas to the list, as appropriate, without going through the rulemaking process. Such additions would be conveyed through guidance.

FHFA requests comment on whether these areas of qualifying experience are appropriate and whether other specific areas should be included.

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<sup>27</sup> See 12 CFR 1261.7(e).

Proposed § 1261.5(c)(2) would implement the statutory requirement that each public interest independent director qualify by having “more than four years of experience representing consumer or community interests in banking services, credit needs, housing, or consumer financial protection.” The application of this requirement has been a frequent subject of inquiry and discussion between FHFA and Bank boards of directors and staff, potential directors, and trade groups since it was adopted as part of the Housing and Economic Recovery Act of 2008 (HERA).<sup>28</sup> In early 2022, FHFA issued a revised version of the Bank Independent Director Application Form (FHFA Form #129), the instructions for which provide guidance on how to determine whether an applicant for a public interest independent directorship meets the statutory qualifications.<sup>29</sup> The guidance provided on the Form is consistent with advice given by FHFA in individual cases over the years. In addition to restating the statutory requirement, proposed § 1261.5(c)(2) would include the substance of this material to provide clarity on the implementation of the statutory standard in the regulation itself.

The new provision would stipulate that, for purposes of determining compliance with the public interest qualification requirements, “representing” means advocating for, or otherwise acting primarily on behalf of or for the direct benefit of, consumers or the community in one of the four enumerated areas. Those who have not advocated for or acted on behalf of or for the direct benefit of consumers and the community in any material capacity cannot reasonably be viewed as representatives of those constituencies.

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<sup>28</sup> Under existing §§ 1261.7(f) and 1261.14(b), FHFA has an opportunity to review the completed Independent Director Application Forms and other supporting materials for each Bank’s proposed independent directorship nominees and to provide comments to the Bank where warranted. For public interest independent directorship nominees, FHFA’s review includes evaluation of whether the individual’s professional experience meets the statutory standard.

<sup>29</sup> FHFA released an updated version of the Form with some additional minor revisions in 2023.

Industry-side interests are more than adequately represented among the Banks' member and regular independent directors. Among other things, FHFA believes that experience related to fair housing, fair lending, consumer protection, affordable housing, community development, and diversity and inclusion that otherwise meets the requirements of the statute and regulation would be qualifying experience for public interest independent directors.

Proposed § 1261.5(c)(2) would also provide that qualifying experience in one of the four enumerated areas may have been acquired in professional, public service, or significant volunteer positions, so long as the work done was substantial in terms of time commitment and responsibility and that the experience was accrued from activities personally undertaken by the director or nominee, as opposed to being attributed based solely on the activities of organizations with which the person was associated.

Prior to 2008, the Bank Act required the appointment of at least two "community interest" directors at each Bank "chosen from organizations with more than a 2-year history of representing consumer or community interests on banking services, credit needs, housing, or financial consumer protections." In 2008, HERA substituted the current language focusing on the personal experience of the individual in representing community or consumer interests, as opposed to the mission of the organization with which they were affiliated. The additional clarifying regulatory text is intended to ensure that nominees meet the statutory requirement of personal experience and have the kind of knowledge, experience, and perspective necessary to oversee a Bank and guide it in the safe and sound fulfillment of its public policy mission. Experience gained through full-time paid employment is almost always qualifying. FHFA has generally viewed

experience with nonprofits, community organizations, state and local housing finance agencies, and non-member CDFIs, or service as an elected, appointed, or career government official, to be qualifying. Ultimately, determinations as to qualification to serve as a public interest independent director must be made on a case-by-case basis, given the numerous ways in which a person could conceivably meet the statutory standard.

Both regular and public interest independent directors need to have the capacity to challenge Bank management on important issues, including the sufficiency and effectiveness of its mission programs. While Bank boards can benefit from a wide variety of viewpoints, FHFA has observed that the most effective directors possess knowledge and experience that are relevant to the business, programs, and mission of the Bank and that provide a basis for understanding the actual and potential impact of the Bank's activities on its members and on communities within the Bank's district. FHFA also believes that service in full-time executive, management, or other senior paid professional positions generally provides the most valuable experience for a Bank director. Proposed § 1261.5(c)(3) would require that Banks' boards prioritize those characteristics when soliciting and choosing Bank independent directorship nominees.

With respect to length of board service, the Bank Act limits Bank directors to "three consecutive full terms" and requires former directors who have termed out to sit out for a minimum of two years before seeking to serve again as a Bank director.<sup>30</sup> Section 1261.5(d) of the existing regulation, entitled "Restrictions," implements the

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<sup>30</sup> 12 U.S.C. 1427(d). (The Bank Act provides that "[i]f any person . . . has been elected to each of three consecutive full terms as a director of a [Bank] and has served for all or part of each of said terms, such person shall not be eligible for election to a directorship of such [Bank] for a term which begins earlier than two years after the expiration of the last expiring of said three terms").



statutory term limit provisions by setting forth principles for determining whether a director has been elected to and served three consecutive full terms. In general, under the existing regulation, four-year terms to which a director has been elected and has served any part count as full terms, while terms that have been truncated to maintain board staggering and terms served out by a vacancy electee do not. Much of the material in existing § 1261.5(d) is intended to address issues arising from the transition from the pre-HERA regime, under which directors served three-year terms and independent directors were appointed by the Bank System regulator, to the current regime, under which directors serve four-year terms and independent directors are nominated by Bank boards and elected by Bank members.

Proposed § 1261.5(d) (which would be re-titled “Term limits”) would continue to address director term limits using the principles reflected in the existing regulation. The proposed rule, however, would remove from the regulatory text the post-HERA transition material, which is no longer needed because all directors who were serving at the time of the statutory change have now termed out, and otherwise streamline the language and structure of the provision. Consistent with other revisions, the proposed rule would replace cross-references to the Bank Act with either an express substantive statement or a cross-reference to a substantive regulatory provision. As proposed, § 1261.5(d) would continue to provide that truncated terms do not count as full terms, but would make clear that two full terms on either side of a truncated term count as consecutive full terms; that is, while a truncated term may not count in the term limit calculation, it cannot re-set the term limit calculation back to zero.

Existing § 1261.5(e) explains that a director shall become ineligible to remain in

office if, during their incumbency, the directorship to which they have been elected is eliminated. The proposed rule would add to this provision a cross-reference to the section of the proposed rule (§ 1261.4, governing the designation of directorships) under which a seat could be eliminated. As under the existing regulation, proposed § 1261.5(e) would continue to provide that the incumbent director shall become ineligible after the close of business on December 31 of the year in which the directorship is eliminated.

Section 1261.6 of the existing regulation, governing the determination of members votes, would not be changed by the proposed rule.

**5. *Nominations for member and independent directorships—§ 1261.7***

Section 1261.7 of the existing regulation governs nominations for member and independent directorships, including election announcements, the submission and acceptance of member directorship nominations, independent directorship qualifications and nominations, and eligibility verification. The proposed rule would make numerous textual and structural revisions to § 1261.7, most of which are non-substantive and intended only to provide clarity.

Existing § 1261.7(a) requires that “[w]ithin a reasonable time in advance of an election,” a Bank provide notice to each member in its district of the commencement of the election process to include: (1) the number of member directorships designated for each voting State and the total number of independent directorships; (2) the name of, and pertinent information about, each incumbent Bank director; (3) a brief statement of the skills and experience the Bank believes are most likely to add strength to its board; (4) an attachment identifying every member, its voting state, and the number of votes it is eligible to cast; and (5) a certificate to be used by member institutions to make any

desired nominations.

The proposed rule would make three substantive revisions to the list of information to be included in or with the election announcement, each of which FHFA believes is consistent with the current practice of most Banks. First, the proposed rule would require that the statement regarding the number of member and independent directorships include the number of independent directorships designated by the Bank as public interest independent directorships for the following calendar year. Second, the proposed rule would require that the election notice identify the member directorships, regular independent directorships, and public interest independent directorships, respectively, for which the Bank will be holding an election in the current year. Finally, while the existing regulation makes inclusion of a brief statement of sought-after skills and experience contingent on the Bank having carried out the assessment of board skills and experience permitted under existing § 1261.9, the proposed rule would make the inclusion of the statement mandatory because, as discussed below, the annual assessment would also be made mandatory. In addition to these substantive revisions, the proposed rule would also move a misplaced heading and renumber the paragraphs to accommodate the additional material.

The proposed rule would combine into proposed § 1261.7(b) material that appears in existing paragraphs (b) and (c) governing member directorship nominations by members and the acceptance of such nominations by a Bank's board. The one substantive change would be the removal in two places of the requirement that election and nomination records be retained for at least two years after the date of the election. These provisions would be replaced by a new § 1261.7(f), requiring each Bank to retain

all information received under proposed § 1261.7 for at least seven years after the date of the election in question and, in the case of any information about a specific director, for at least seven years after that director leaves the board (discussed below). The remaining changes consist of non-substantive paragraph redesignations, revised headings, and minor textual changes to provide clarity.

In the existing regulation, § 1261.7(d) and (e) address independent director nominations and independent director required qualifications, respectively. The proposed rule would remove § 1261.7(e) in its entirety because, under the revised regulation, the required qualifications for regular and public interest independent directors would be stated in only one provision—proposed § 1261.5(c). Further duplicative statements regarding the required qualifications would also be removed from existing § 1261.7(d), which would be redesignated as § 1261.7(c). The proposed rule would also remove from the redesignated provision language indicating that an interested individual may not submit, and a Bank may not consider, an Independent Director Application Form that does not demonstrate that the applicant is both eligible and qualified to serve; these restrictions are not consistent with the intended use of the completed Form as a means through which eligibility may be determined. Instead, the proposed rule would include in proposed § 1261.7(d)(3), discussed below, a new express provision prohibiting a Bank's board from nominating any individual for an independent directorship or accepting the nomination of any individual for a member directorship if it has not concluded based on the appropriate completed Form and supplementary materials that the individual is eligible to serve.

The proposed rule would also remove the language in existing § 1261.7(d)(3)

requiring that each Bank determine and announce to its members the number of public interest independent directorships to be included among its authorized independent directorships for the following year, because this requirement would be covered by proposed § 1261.4(f). The proposed rule would also remove language requiring each Bank to retain all completed Independent Director Application Forms for at least two years after the date of the election because, as mentioned, the record retention requirements for all records related to the nomination and election of directors would now be governed by proposed § 1261.7(f). The remaining changes to the existing provisions on the nomination of independent directors would be non-substantive textual and organizational revisions (including the division of different topical material into paragraphs) for better readability.

Existing § 1261.7(f) addresses the steps each Bank must take to verify the eligibility of its member and independent director nominees. It requires each Bank to use the information provided on the Member Director Eligibility Certification Form or the Independent Director Application Form, as applicable, to verify that each nominee meets the relevant eligibility requirements and, for independent directorship nominees, possesses the required qualifications. The provision further requires that, before announcing any independent director nominee, the Bank deliver to FHFA for review a copy of the proposed nominee's executed Independent Director Application Form. Although the existing regulation does not generally require FHFA approval of Bank independent directorship nominees, existing § 1261.7(f) requires a Bank's board to consider any comments on a proposed nominee provided by FHFA within two weeks of

FHFA's receipt of the Application Form for that individual.<sup>31</sup>

The proposed rule would redesignate § 1261.7(f) as § 1261.7(d) and, for clarity, would break the existing text into topical paragraphs and revise references to the member and independent director eligibility requirements to add cross-references to the applicable substantive provisions of the revised regulation (proposed § 1261.5(a) and (b) respectively). The proposed rule would also add a new paragraph (d)(3) expressly prohibiting a Bank's board from nominating any individual for an independent directorship or including on the ballot any individual nominated for a member directorship except where it has concluded that the individual meets the applicable eligibility requirements and is not term limited. Although this concept is implicit in the existing regulation, FHFA believes it is preferable for the regulation to set forth a clear statement to this effect.

The proposed rule would add a new § 1261.7(e), which would prohibit a Bank's board from nominating any person for an independent directorship or including on the election ballot any individual nominated for a member directorship without having first conducted a thorough background check and concluding that the individual is fit to serve in a fiduciary role with the Bank. The proposed rule would require each Bank to include a discussion of the results of the background check for each independent directorship nominee when submitting its Independent Director Application Forms to FHFA, including any potentially concerning information that was revealed and how the Bank's concerns were allayed. In recent years, the Banks have typically conducted background

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<sup>31</sup> In 2022, in conjunction with FHFA's issuance of the revised Bank Independent Director Application and Certification Forms, FHFA's Division of Bank Regulation issued a Supervisory Letter on the proper submission of Independent Director Application Forms and pertinent supplementary material to FHFA for review. This guidance would remain in effect under the proposed rule.

checks on independent directorship nominees and addressed the results of those checks in their submissions to FHFA; the proposed rule would codify this practice. The rule would also require each Bank to conduct a background check on nominees for a member directorship, as the risks background checks are designed to mitigate are no less of a concern for member directors than they are for independent directors.

Although the Bank Act clearly vests in a Bank's members the authority to nominate and elect their own representatives on a Bank's board, the continued safe and sound operation of every Bank depends upon the reservation of some mechanism for identifying and addressing potential risks to the institution that could be posed by its own directors. Bank directors not only have a unique opportunity to influence a Bank's course of action, they also are privy to the most sensitive inside information, including confidential supervisory information (CSI), about the operations, finances, and personnel of the Bank. It is critical that a Bank's board retain the ability to police itself and prevent individuals whose history of criminality, malfeasance, poor judgment, or other concerning behavior indicates they are not fit to fulfill a fiduciary role with the Bank from being or remaining seated as directors. Conducting a background investigation in support of a director's nomination, whether for a member or independent directorship, is a common-sense way to prevent problems before they start.

In July 2020, FHFA's Division of Bank Regulation issued a Supervisory Letter discussing the importance of conducting a thorough background check on any individual a Bank's board intends to nominate for an independent directorship. The guidance given in the letter remains applicable to background checks to be carried out under proposed § 1261.7(e).

Without a background investigation, a Bank could not reasonably determine whether a potential nominee meets its own standards, including codes of conduct, codes of ethics, conflicts of interest policies, and anti-fraud policies. A background check also gives a Bank an opportunity to verify that eligibility requirements have been met and that the employment and educational history shown on nominee's Application Forms is accurate. On occasion, a background check may reveal information that calls into question the validity of the responses on the Application Form, or the fitness of the nominee to serve in a fiduciary role with a large financial institution like the Bank. Examples that may give rise to concerns about the latter include a criminal record, past bankruptcy, or failure to pay taxes. A Bank should evaluate the circumstances surrounding each issue of concern and take appropriate steps to determine whether the risk can be satisfactorily mitigated or whether the board should decline to nominate an individual for an independent directorship or post a member-nominated individual on the ballot for a member directorship. In either case, the board should thoroughly document its decision-making process.

Finally, the proposed rule would add a new § 1261.7(f), which would require each Bank to retain all information received under proposed § 1261.7 for at least seven years after the date of the election in question and, in the case of any information about a specific director, for at least seven years after that director leaves the board. Each Bank would be required to maintain those records pursuant to a duly adopted policy. As mentioned above, existing § 1261.7 includes a number of separate provisions requiring that a Bank retain various documents for at least two years after an election.<sup>32</sup> FHFA

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<sup>32</sup> See 12 CFR 1261.7(b)(3), (c), (d)(2) (nominating certificates, executed Membership Director Certification Forms, and Independent Directorship Application Forms, respectively).



believes that all material documentation regarding a Bank's nomination and election process should be subject to the same retention requirements and that two years is not a sufficient length of time to retain those types of important records. Seven years is a conservative retention period that is frequently required by law or corporate policy,<sup>33</sup> and one that is an appropriate minimum for Bank nomination and election records and not burdensome for a Bank to fulfill given the ease with which electronic records are stored.<sup>34</sup>

Where information involves an individual that was elected to the board, proposed § 1261.7(f) would require the information to be retained for the duration of that director's service and then for at least seven years after that director leaves the board. Issues regarding sitting Bank directors arise from time to time that call for reference to information or materials submitted years earlier as part of the nomination process and these materials should remain accessible until well after the directors to which they pertain have left the board.

#### **6. *Election process—§ 1261.8***

Section 1261.8 of the existing regulation governs the various aspects of the Bank director election process. The proposed rule would make several substantive revisions to this section, including revisions regarding the required contents of a Bank's director election ballot, the authority of a Bank's board to decline to seat a director-elect for cause, and the length of time ballots need to be retained.

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<sup>33</sup> See, e.g., 17 CFR 210.2-06 (Securities and Exchange Commission rule requiring records of an audit or review of an issuer's financial statements to be retained for seven years).

<sup>34</sup> FHFA's regulations at 12 CFR 1235 establish general minimum requirements for record retention for the Agency's regulated entities, including the Banks and the OF. The standards established require that the regulated entities maintain adequate records in accordance with consistent accounting policies and practices that enable the Director to evaluate the financial condition of each regulated entity and the OF and such other operational and management standards as the Director determines to be appropriate.

Existing § 1261.8(b) provides that if a Bank has conducted an annual assessment of the skills and experience possessed by the board permitted by § 1261.9 and has included the results of the assessment as part of the election notice, it may include with each ballot a statement of the results of that assessment or any subsequent assessment. As discussed below, the proposed rule would revise § 1261.9 to make the now optional assessment mandatory for each Bank. The proposed rule would also require that the results of that assessment be included as part of the election notice required under § 1261.7(a).

Consistent with those changes, the proposed rule would delete existing § 1261.8(b) and revise § 1261.8(a) to require that a Bank include on the ballot a statement of the results of the assessment, including an explanation for any differences between the statement on the ballot and that appearing on the earlier election notice. Revised § 1261.8(a) would also require that each Bank include on its election ballot a brief description of the skills and experience of each nominee for a member directorship. This is permitted but not required under the existing regulation, which does require that that qualifying areas of expertise for independent directorship nominees be noted on the ballot (a requirement that would be retained under the proposed rule). To accommodate these substantive revisions, the provisions within § 1261.8(a) would be redesignated as paragraphs (1) through (6).

Given the ever changing business and societal landscape within which the Banks operate, it is prudent to look beyond the four to six regular independent directors they are likely to have on their respective boards and find ways to promote the nomination and election to member directorships of individuals that have the experience to cover some of

the critical areas of board expertise. For example, if the Chief Technology Officer (CTO) of a Bank member were to be elected as a member director, that individual would likely be able to provide the board with necessary expertise in information technology and security and possibly in other critical areas enumerated in proposed § 1261.5(c).

Even if the nomination and election of member directors is largely within the control of Bank members in the respective voting States of the district, the required statement of needed skills and expertise on the election notice and ballot and the required inclusion on the ballot of a statement on the knowledge and skills possessed by individual member directorship nominees would encourage Bank members to take into account the expertise needed to allow the board to most effectively supervise the operations of the Bank. The coverage of vital areas of expertise through member directors, where possible, would allow the Bank to seek independent directors to cover some of the areas of expertise that senior officers and directors of Bank member institutions would be less likely to have.

Existing § 1261.8(f)(4) provides that a “[b]ank shall not declare elected a nominee that it has reason to know is ineligible to serve, nor shall it seat a director-elect that it has reason to know is ineligible to serve.” This provision, which would be redesignated as § 1261.8(e)(4), would be revised also to prohibit a Bank’s board from declaring elected a nominee or seating any director-elect it has reason to know is “unfit” to serve. As discussed above with respect to the background check required under § 1261.7(e), a Bank’s board must retain the ability to address the directorship status of individuals who may pose a material risk to the Bank to fulfill its fiduciary duty to protect the Bank’s interests. Proposed § 1261.8(e)(4) would authorize and require a Bank to prevent the

seating of a director if it obtains information indicating the individual poses a material and unacceptable risk to the Bank that was not available to it at the time it conducted the required background check.

Because § 1261.8(b) would be eliminated, the proposed rule would redesignate existing paragraphs (c) through (h) as paragraphs (b) through (g). It would also make multiple non-substantive changes throughout the section by adding cross-references to appropriate provisions of the revised regulation, removing redundant statements of the required qualifications for independent directors, and making other minor changes to nomenclature and phrasing.

**7. *Actions affecting director elections—§ 1261.9***

Existing § 1261.9 addresses actions affecting director elections. Paragraph (a) authorizes each Bank to “conduct an annual assessment of the skills and experience possessed by its board of directors as a whole and [to] determine whether the capabilities of the board would be enhanced through the addition of individuals with particular skills and experience.” The proposed rule would make this annual assessment mandatory and require that the results of the assessment be reflected in the election announcement under proposed § 1261.7(a) and the election ballot under proposed § 1261.8(a), as discussed above. It would also require that the assessment be undertaken “pursuant to policies adopted by the board.”

To effectively oversee a Bank’s operations, its board should be balanced and includes a diversity of experience and perspectives across member and independent directors. Periodic assessment of the knowledge and skills possessed by sitting board directors and identification of areas that require better coverage is critical to ensuring that

a Bank's board of directors is able to effectively oversee and guide the operations of the Bank.

FHFA requests comment on whether requiring that such an assessment be completed on a less frequent cadence than annually would compromise a Bank's ability to plan effectively.

Aside from this, to plan effectively, Bank boards of directors should develop and maintain a director's service timeline to track all directors' terms from beginning to end; develop and annually review and update a director position description for member directors, regular independent directors, and public interest independent directors; and focus recruiting on addressing gaps in knowledge and skills identified by the assessment. Insufficient board succession planning can lead to a lack of experience and expertise needed to effectively oversee a Bank's operations. For example, if several long-tenured directors were to vacate a Bank's board simultaneously, the board may face a critical loss of institutional knowledge. Without appropriate succession planning, a Bank's board may find itself lacking knowledge, skills, and abilities that are critical to providing effective strategic direction and oversight.

The remaining revisions to § 1261.9(a) would be non-substantive clarifying revisions to change the heading from the cryptic "Banks" to the more descriptive "Annual assessment of skills and experience," add cross-references to appropriate provisions of the revised regulation, remove redundant statements of the required qualifications for independent directors, and make other minor changes to nomenclature and phrasing. Existing § 1261.9(b) and (c) would remain unchanged.

**8. *Independent director independence—§ 1261.10***

Section 1261.10 is currently entitled “Independent director conflict of interests.” Because the focus of the section is to elaborate on the “independence” requirements for independent directors, the proposed rule would revise the heading of § 1261.10 to read “Independent director independence.” Conflicts-of-interest policies for all Bank directors are covered separately from independence requirements, in § 1261.11.

Existing § 1261.10(a) prohibits any independent director from serving as an officer, employee, or director of any member of the Bank, or of any recipient of advances from the Bank, or as an officer of any Bank, during that director’s term of service on the Bank’s board. The proposed rule would redesignate paragraph (a) as paragraph (a)(1) and revise the provision to prohibit an independent director from serving not only as an officer, but also as any kind employee, of another Bank. Permitting even a non-executive employee of one Bank to serve on the board of another Bank could not only compromise the independence of the board on which the individual sits, but could also give rise to internal control concerns for the Bank employing the individual.

The proposed rule would further revise newly-redesignated § 1261.10(a)(1) to prohibit not just the seating, but also the nomination of individuals with any of the impermissible connections. Under the existing regulation, FHFA has permitted Banks to nominate individuals with a prohibited connection for an independent directorship, provided the nominee agrees to relinquish the impermissible position prior to being seated on the board. Extending the independence requirement to the nomination phase creates greater separation between a director’s term of service and pursuit of possible conflicting interests and helps ensure that anyone wishing to serve as an independent

director is committed to being a true outside voice.<sup>35</sup>

The proposed rule would also create a new paragraph (a)(2), which would define the term “advances” for purposes of applying the prohibition against the seating or nomination of any officer, employee, or director of any “recipient of advances” from the Bank. As proposed, the term would include any loan from a Bank to the recipient, regardless of form or nomenclature, except for debt securities traded in the public capital markets. This definition is intended to prevent Banks and housing associates such as state housing finance agencies (SHFAs) from skirting the independence requirements by creating bespoke lending terms for the housing associate by which an independent director or nominee is employed in an arrangement called something other than an “advance.” At the same time, the definition would allow Banks to support their housing associates through the purchase of debt securities on the open market on the same terms and conditions as are applicable to other market participants even where an employee of the housing associate is serving as an independent director. Providing clarity regarding the meaning of the word “advances” in this context was suggested in the Bank System’s joint letter in response to FHFA’s Spring 2023 Regulatory Review notice. FHFA requests comment on whether the proposed definition adequately addresses the relevant legal and policy concerns or whether a different definition would be more appropriate.

The proposed rule would make no revisions to existing § 1261.10(b).

Existing § 1261.10(c) provides that, for purposes of determining compliance with the independence requirements, a Bank shall attribute to the independent director any

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<sup>35</sup> Notwithstanding FHFA’s approach to this issue since the post-HERA requirements were implemented, the extension of the independence requirements to independent directorship nominees is consistent with section 7(b)(2)(B) of the Bank Act, which provides that “[n]ominees shall meet all applicable requirements prescribed in this section.” *See* 12 U.S.C. 1427(b)(2)(B).

officer position, employee position, or directorship of the director's spouse. The proposed rule would further strengthen independence requirements by extending the attribution requirement to all “immediate family members” of the director or nominee. Existing § 1261.11(f) defines “immediate family member” to include a “parent, sibling, spouse, child, or dependent, or any relative sharing the same residence as the director” for purposes of the director conflicts-of-interest requirements; under the proposed rule, the same definition would apply for purposes of the independence provisions. The proposed change recognizes that director independence can be compromised through the activities and financial interests of close family members other than a spouse, seeks to prevent circumvention of the spirit of the independence requirement, and aligns the standards for the independence requirement with those of the conflicts-of-interest requirements.

In line with the extension of the independence requirements to nominees under proposed § 1261.10(a), the rule would also add a new paragraph (d) to § 1261.10 to require any former member director to wait at least two years after leaving a member directorship before returning to the board as an independent director (assuming all eligibility requirements are met for the position). The two-year requirement parallels the two-year requirement set forth in the statutory provision at 18 U.S.C. 207 that is the primary source of post-employment restrictions applicable to officers and employees of the executive branch of the federal government and the two year period during which former Bank directors who have termed out are prohibited from serving.<sup>36</sup> These types of transitions have happened on occasion and FHFA has typically permitted a member director to transition to an independent directorship upon relinquishing the impermissible

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<sup>36</sup> See 12 U.S.C. 1427(d).



position, without any “cooling off” period. By requiring a two-year sit out period FHFA intends to create greater separation between the seating of an independent director and the individual’s employment with a member. The Agency requests comments on whether a different length of time would more effectively ensure board independence.

**9. *Conflicts of interest policy for Bank directors—§ 1261.11***

In § 1261.11, the proposed rule would revise the section heading to read “Conflicts of interest” instead of “Conflict of interests” and would make related conforming changes throughout the section. The only other changes to § 1261.11 would be to revise the definition of “financial interest” in paragraph (f) and to list definitions in alphabetical order.

Existing § 1261.11(b) requires a Bank director to disclose any “financial interests,” as well as those of any immediate family member or business associate, in any matter to be considered by the Bank's board of directors and in any other proposed or actual business matter involving the Bank and any other person or entity and to refrain from considering or voting on any issue in which the director, any immediate family member, or any business associate has any financial interest. For purposes of those requirements, existing § 1261.11(f) defines “financial interest” to mean “a direct or indirect financial interest in any activity, transaction, property, or relationship that involves receiving or providing something of monetary value, and includes, but is not limited to any right, contractual or otherwise, to the payment of money, whether contingent or fixed.” The provision further states that the term “does not include a deposit or savings account maintained with a member, nor does it include a loan or extension of credit obtained from a member in the normal course of business on terms

that are available generally to the public.”

In its letter in response to FHFA’s Spring 2023 Regulatory Review Notice, the Bank System commented that the list of exclusions in the definition of “financial interest” found in existing § 1261.11 is too narrow in scope and should be broadened to reflect other financial services products obtained under similar circumstances. In response to the comment, FHFA is proposing to revise the exclusion from the definition of “financial interest” in § 1261.11(f) to refer to “a deposit or savings account, loan or extension of credit, or other accounts and products obtained in the normal course of business on non-preferential terms generally available to the public from a member institution or from a non-member counterparty to the Bank on whose board the director sits.”

In the same letter, the Bank System recommended that FHFA harmonize the standard for what constitutes a conflict under FHFA’s Affordable Housing Program (AHP) regulation<sup>37</sup> with the standard for Bank directors under § 1261.11—specifically, that the definitions of “financial interest” and “immediate family member” be made identical for both regulations. Existing § 1261.11 defines “immediate family member” as a parent, sibling, spouse, child, or dependent, or any relative sharing the same residence as the director. That definition would remain unchanged under the proposed rule and would also be used, along with the revised definition of “financial interest,” in the new provision on Bank employee conflicts under proposed 12 CFR 1239.31 (discussed

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<sup>37</sup> The AHP regulation prohibits Bank directors, employees, and advisory council members from participating in decisions regarding AHP projects in which they or a family member have a financial interest and requires each Bank to adopt a conflicts-of-interest policy for its AHP. *See* 12 CFR 1291.16. For purposes of these requirements, the regulation defines “family member” as “any individual related to a person by blood, marriage, or adoption,” *see* 12 CFR 1291.1, but does not define “financial interest.”

below). FHFA anticipates that the Bank System's request regarding the AHP regulation will be addressed in a subsequent rulemaking.

The proposed rule would not make any other revisions to § 1261.11.

**10. *Reporting requirements for Bank directors—§ 1261.12***

The proposed rule would make only one change to § 1261.12, which establishes reporting requirements for Bank directors. Existing § 1261.12(b) provides that at any time a director believes or has reason to believe that they no longer meet the eligibility requirements set forth in the Bank Act or the regulation, the director shall promptly notify the Bank and FHFA in writing. The proposed rule would eliminate the requirement that a director submit the notification to FHFA, requiring only that it be submitted to the Bank. The last sentence of § 1261.12(b) requires a Bank to promptly notify FHFA in writing any time it believes or has reason to believe that any director no longer meets the eligibility requirements, and this has typically been the method through which FHFA has been informed of director ineligibility. Director eligibility is an issue for a Bank to monitor and address in the first instance and there is no reason for an individual director to contact FHFA directly about eligibility issues.

**11. *Ineligibility and removal of Bank directors—§ 1261.13***

Existing § 1261.13 addresses the ineligibility of Bank directors. It provides that upon a determination by FHFA or a Bank that any director of the Bank no longer satisfies the statutory or regulatory eligibility requirements, or has failed to comply with the reporting requirements, the directorship shall immediately become vacant. The proposed rule would retain this provision without revision, other than to redesignate it as paragraph (a), with the heading "Ineligibility."

The proposed rule would also create a new paragraph (b) to establish the authority of a Bank's board to remove directors for good cause, which may be based upon: (i) a material violation of the Bank's code of ethics or other applicable Bank policy; (ii) a material violation of the Bank Act, FHFA regulations or other criminal or civil law; (iii) a determination by the board that continuation in office of such director would be materially harmful to the Bank; (iv) conduct, or a mental or physical condition, that raises substantial questions concerning the director's ability to fulfill their duties and obligations; or (v) a determination under proposed § 1261.22(b)(3) (discussed below, requiring that the board assess director performance annually) that the director's continuous poor performance or lack of participation is compromising the board's ability to adequately oversee the operations of the Bank. Under the proposed rule, a Bank would also be required to promptly notify FHFA in writing of any pending or final removal actions taken pursuant to this authority.

As stated above with respect to the required background check for directorship nominees, the safe and sound operation of every Bank depends, in part, upon the existence of some mechanism for identifying and addressing potential risks to a Bank that could be posed by its own directors. It is important that a Bank's board have clear authority to address risks posed by sitting directors, as well as potential risks posed by those seeking to become directors. FHFA believes that the prescribed list of "good cause" bases for removal, as well as the requirements that two-thirds of disinterested Bank directors vote to remove and that a Bank carry out any actions pursuant to policies adopted by the Bank's board should minimize the chance that any removal authority would be abused or applied in anything other than an objective fashion in the best

interests of the Bank.

Some Banks already have a policy providing for the good cause removal of directors, which FHFA believes is appropriate. FHFA believes it is important to make clear that each Bank's board retains this limited authority and requests comment on whether it would be appropriate to require each Bank to adopt policies on good cause removal. The Agency also requests comment on whether any factors should be added or eliminated from the list of "good cause" bases for removal and on whether the revised regulation should require separate votes by member and independent directors or something other than a two-thirds vote for removal.

**12. *Vacant Bank directorships—§ 1261.14***

Section 1261.14 of the existing regulation establishes the requirements and procedures for the filling of vacant Bank directorships by the Bank's board of directors. The proposed rule would make numerous clarifying edits to this section.

Existing § 1261.14(a), entitled "Filling of unexpired terms," requires that, when a directorship vacancy occurs, the Bank's board elect an individual to complete the unexpired term of office of the vacant directorship. The election is determined by a majority vote of the remaining Bank directors sitting as a board, regardless of whether the remaining Bank directors constitute a quorum.<sup>38</sup> The regulation permits a Bank's board to fill an anticipated vacancy prior to its occurrence, but it may do so no sooner than the regularly scheduled board meeting immediately prior to the effective date of the vacancy.<sup>39</sup> To fill a particular vacancy, a Bank's board may elect only an individual who satisfies all the statutory and regulatory eligibility requirements "that applied to his or her

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<sup>38</sup> 12 CFR 1261.14(a)(1).

<sup>39</sup> 12 CFR 1261.14(a)(2).

predecessor” and, for independent directorships, also satisfies any of the independent director qualifications. If a Bank does not have at least two sitting public interest independent directors, its board must designate the vacant directorship as a public interest independent directorship and elect an eligible and qualified individual to fill it.<sup>40</sup>

While retaining the same basic approach, the proposed rule would restate the standards for determining who is eligible to fill a particular vacancy and expressly allow Banks some flexibility in filling vacant independent directorships. The proposed rule would also reconfigure existing paragraph (a)(1) into the introductory paragraph to § 1261.14(a) and redesignate the succeeding paragraphs accordingly.

With respect to determining who is an eligible successor to a director that has left the board, the existing regulation provides that the board “shall elect only an individual who satisfies all the eligibility requirements in the Bank Act and in this subpart that applied to his or her predecessor and, for independent directorships, also satisfies any of the qualifications in the Bank Act or this subpart.” The proposed rule would delete this language and state, simply, in § 1261.14(a)(2) that a Bank’s board must: (i) fill a vacant member directorship only with an individual who meets the member director eligibility requirements set forth in proposed § 1261.5(a) (including by being an officer or director of a member located in the voting state to which the vacant member directorship is allocated); and (ii) fill a vacant independent directorship only with an individual who meets the eligibility requirements for independent directors set forth in proposed § 1261.5(b).

By statute, a Bank’s board must at all times have at least two seats designated as

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<sup>40</sup> 12 CFR 1261.14(a)(3).

public interest independent directorships. If one of those seats becomes vacant, it should be filled as expeditiously as possible. Proposed § 1261.14(a)(3) would provide more express flexibility in filling a vacant public interest independent directorship than the existing regulation by permitting a Bank's board either to: (i) elect an individual who is qualified under § 1261.5(c)(2) to serve as a public interest independent director to fill the vacancy; or (ii) elect to redesignate as a public interest independent director a sitting regular independent director who is qualified under § 1261.5(c)(2) to serve as a public interest independent director. In the latter case, the board would elect another individual who is qualified under § 1261.5(c)(1) to serve as a regular independent director to fill the resulting vacant regular independent directorship. The proposed change would also make it possible for the board of directors to redesignate a public interest independent director as a regular independent director. This may occur, for example, if the Bank already has more than two sitting public interest independent directors on its board. Although FHFA views such scenarios as permissible under the existing language and has permitted Banks to fill vacant public interest and regular independent directorships in that way, the proposed revisions would make it clear that the Banks have this flexibility.

Proposed § 1261.14(a)(4) would make clear that a Bank's board of directors must consult with the Bank's Advisory Council before considering any individual to fill a vacant independent directorship, just as is required under existing § 1261.7(d)(2) (proposed § 1261.7(c)(3)) when a board is considering independent directorship nominations during the regular election cycle.

Existing § 1261.14(b), entitled "Verifying eligibility," requires that prior to any election to fill a board vacancy, the Bank obtain an executed Application or Certification

Form (as appropriate) from each individual being considered to fill the vacancy and use the Forms to verify each individual's eligibility and qualifications. The existing provision also requires that the Bank deliver to FHFA for its review a copy of the Application Form of each individual being considered by the board.

The proposed rule would make several clarifications to § 1261.14(b), as well as breaking the revised material into four paragraphs for better readability. Proposed § 1261.14(b)(1) would continue to require that a Bank obtain the appropriate executed Application or Certification Form from each individual being considered to fill a vacancy and would clarify that this requirement applies even when a Bank's board is contemplating the redesignation of a sitting regular independent director as a public interest independent director or vice versa.

Proposed § 1261.14(b)(2) would require that a Bank conduct a background check on any individual being considered to fill a vacant directorship in the same manner as required for nominees in the regular election cycle under proposed § 1261.7(e).

Proposed § 1261.14(b)(3) would continue to require that a Bank's board deliver to FHFA for review the executed Independent Director Application Form for each individual being considered by the board to fill a vacant independent directorship and would clarify that (as is the case for its review of Independent Director Application Forms during the regular election cycle) FHFA has two weeks within which to provide comments to the Bank. The proposed provision would also require a Bank to provide a summary of the background check.

Finally, proposed § 1261.14(b)(4) would require a Bank to retain all information obtained under § 1261.14(b) for at least seven years after the date of the election in



question and, in the case of any information about a specific director, for at least seven years after that director leaves the board. This parallels the retention requirements that would apply to materials received during the regular nomination and election cycles under §§ 1261.7(f) and 1261.8(e)(5).

Existing § 1261.14(c), governing notification, would remain unchanged under the proposed rule.

In the remainder of subpart B of part 1261, the proposed rule would make no changes to existing § 1261.15 (setting forth the table for “grandfathered” member directorships) and would remove § 1261.16, which contains no regulatory text and is designated as “[Reserved].”

### **13. (Directors’ Compensation) General—§ 1261.21**

In subpart C of the existing regulation, § 1261.21 addresses Bank and OF director compensation.<sup>41</sup> Existing § 1261.21(a) authorizes each Bank and OF to pay its directors reasonable compensation and necessary expenses. This authority is subject to further provisions of subpart C requiring each Bank and the OF to compensate its directors pursuant to an annually adopted and FHFA-reviewed written compensation policy<sup>42</sup> and authorizing the Director to disapprove compensation or expenses determined not to be reasonable.<sup>43</sup> Existing § 1261.21(b) requires that each Bank and OF report to the Director annually about the compensation it anticipates paying out in the following year and director compensation, expenses, and meeting attendance for the immediately

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<sup>41</sup> Section 1261.21 applies to OF independent directors by operation of 12 CFR 1273.7(f)(2). Bank presidents serve as *ex officio* directors of the OF but are not compensated for such service. 12 CFR 1273.7(f)(1).

<sup>42</sup> See 12 CFR 1261.22(a) and (d).

<sup>43</sup> See 12 CFR 1261.23.

preceding calendar year. FHFA is proposing changes to both paragraphs (a) and (b) of existing § 1261.21, as described below.

*Proposed amendment to paragraph (a), “Standard.”* By statute, the Banks and OF are authorized to pay their directors reasonable compensation for the time required of them and necessary expenses they incurred in performing their duties, provided the Bank System regulator approves such compensation.<sup>44</sup> As did predecessor Bank System regulators, FHFA interprets its statutory obligation to approve reasonable director compensation as conferring authority to establish a maximum amount or level of reasonable compensation and to provide prior notice of that amount to each Bank and the OF. FHFA now proposes to state that authority in the regulation.

Current section 7(i)(1) of the Bank Act is identical to the provision regarding director compensation originally enacted as section 7(h) of the Bank Act in 1932, providing that “[e]ach bank may pay its directors reasonable compensation for the time required of them, and their necessary expenses, in the performance of their duties, in accordance with the resolutions adopted by such directors, subject to the approval of the board.”<sup>45</sup> Although the current statutory provision does not expressly identify FHFA as the approving authority, review of the Bank Act demonstrates that “board,” as used in the approval proviso, must be read to refer to FHFA.

When originally enacted in 1932, the Bank Act defined “board” as the Federal Home Loan Bank Board (FHLBB), the original regulator of the Bank System.<sup>46</sup> Thus, through use of the word “board,” section 7(h) as originally enacted unambiguously

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<sup>44</sup> See 12 U.S.C. 1427(i)(1). FHFA has applied section 7(i) to OF pursuant to the Director’s authorities under 12 U.S.C. 4511(b)(2).

<sup>45</sup> Compare 12 U.S.C. 1427(i)(1) with Pub L. No. 72-304, sec. 7(h), 47 Stat. 725, 730 (July 22, 1932).

<sup>46</sup> Pub L. No. 72-304, sec. 2(1), 47 Stat. 725.

provided the FHLBB authority to approve Bank director compensation. When section 7 of the original Bank Act is read as a whole, it is apparent that Congress used the term “board” standing alone to mean the Bank System regulator, and used “board of directors” or a clear derivative of that term (*e.g.*, a “board of eleven directors,” or “such board”) when referring to a Bank’s board of directors.<sup>47</sup> Moreover, that approach is evident throughout the Bank Act as originally enacted<sup>48</sup> and across amendments over time.<sup>49</sup>

Original section 7(h) was redesignated as section 7(i) in 1935.<sup>50</sup> When Congress amended paragraphs 7(a) through (h) in 1961 to revise provisions governing the election and appointment of Bank directors it added a clause stating that “Federal Home Loan Bank Board” would be “hereinafter in this section referred to as the Board” to paragraph (a).<sup>51</sup> Paragraph 7(i) on director compensation and paragraph 7(j) on administration of the affairs of each Bank by its board of directors were not addressed in the 1961 amendments, and section 2(1) of the Bank Act, defining “board” as the FHLBB, also was not amended or repealed. As a result, after the 1961 amendments, section 7 used both “Board” and “board” standing alone, and each term was identified or defined as—and understood to refer to—the Bank System regulator.

Reading “board” otherwise – as referring to a Bank’s board of directors -- leads to an implausible outcome. For example, the Bank’s board of directors would then be

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<sup>47</sup> Pub L. No. 72-304, sec. 7(a) and (b), 47 Stat. 730.

<sup>48</sup> *See generally*, Pub. L. 72-304, secs. 12, 17, 18, and 20, 47 Stat. 735-38.

<sup>49</sup> Amendments from 1935 also used “Board” in uppercase to refer to the FHLBB. Among other changes, amendments to section 7 in 1935 provided for the election of “[t]wo of such [Bank] directors” by Bank members without regard to classes, under “rules and regulations to be prescribed by the *Board*.” Pub. L. 74-76, sec. 3(b), 49 Stat. 293, 294 (May 28, 1935) (emphasis added). As later examples, *see* Pub. L. 84-345, sec. 109(a)(2), 69 Stat. 635, 640 (Aug. 11, 1955) and Pub. L. 86-349, sec. 1 and 2, 73 Stat. 625 (Sept. 22, 1959). The 1935 amendments also added a new paragraph (d), such that original paragraph (h) on Bank director compensation was re-lettered paragraph (i), as it is today.

<sup>50</sup> Pub. L. 74-76, sec. 3(b), 49 Stat. 294.

<sup>51</sup> Pub. L. 87-211, 75 Stat. 486 (Sept. 8, 1961).

statutorily required to act twice on the matter of directors' compensation – once by resolution and once by “approval” – or one of the two actions (resolution or approval) is unnecessary, because it would be redundant.<sup>52</sup> Moreover, such a reading also requires assuming that in 1961 Congress intended to withdraw authority from the Bank System regulator and confer it on each Bank's board of directors through a new practice, used in only one place in the Bank Act, of referring to the Bank's board of directors as “board,” standing alone in lowercase and as distinguished from “Board,” meaning the Bank System regulator, standing alone in uppercase. The correct reading of section 7 after the 1961 amendments is that *either* “board” *or* “Board,” when standing alone in section 7, meant the “Federal Home Loan Bank Board.” This conclusion is also supported by the Bank System regulator's contemporaneous understanding, as evidenced by the fact that following the 1961 amendments, the FHLBB did not revise its Bank director compensation regulation adopted in 1958, which stated that Bank directors' fees were subject to the approval of the FHLBB.<sup>53</sup>

In 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) established the Federal Housing Finance Board (Finance Board) to replace the FHLBB as the Bank System regulator and revised the Bank Act to replace all uses of “board” except in section 7 with “Board,” which FIRREA defined as the Finance Board.<sup>54</sup> Because this change in terms did not cover section 7 (plausibly to avoid

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<sup>52</sup> “Every clause and word of a statute should, if possible, be given effect.” *United States v. Menasche*, 348 U.S. 528, 538-539 (1955) (internal citations omitted). “The presence of statutory language cannot be regarded as mere surplusage; it means something.” *Potter v. U.S.*, 155 U.S. 438, 446 (1894).

<sup>53</sup> See 23 FR 9878, 9885 (Dec. 23, 1958). Presumably Congress was aware of this interpretation in 1961, when it chose not to amend paragraph (i). The FHLBB did not amend its Bank directors' compensation regulation again until 1978, when it codified its policy, first established in 1974, of imposing supervisory limits on Bank director compensation. See 43 FR 46835 (Oct. 11, 1978).

<sup>54</sup> Pub. L. 101-73, secs. 401(a)(2), 702(a), and 703, 103 Stat. 354, 413, and 415 (Aug. 9, 1989); see also Pub. L. 101-73, sec. 701(a)(1) and (b), 103 Stat. 411, 412.

changing “board” in the term “board of directors” to “Board”), in paragraphs 7(a) through (h) “Board” continued to connote the Bank System regulator while paragraph 7(i) continued to use the lowercase “board.” There is no evidence that FIRREA’s failure to change the word “board” in section 7(i) as part of the conforming amendments to reflect the name of the new System regulator, however, was intended to change the long-held understanding that the word refers to the Bank System regulator. In contrast, FHLBB regulations in effect immediately prior to FIRREA’s enactment and later regulations of the Finance Board demonstrate that those agencies understood “board” in the approval proviso to refer to the System regulator.<sup>55</sup>

Most recently, section 7(i) of the Bank Act was amended by HERA in 2008, when paragraph 7(i)(2), which was added by the Gramm-Leach-Bliley Act (GLBA) in 1999 and imposed statutory limits on Bank director compensation, was repealed.<sup>56</sup> The 2008 amendment thus returned paragraph 7(i)(1) to the same language as paragraph 7(i) before GLBA was enacted, providing that director compensation was subject to the approval of the “board” – in lowercase but standing alone. Because HERA also made FHFA the Bank System regulator, replacing the Finance Board, HERA included a number of general amendments changing references to the “Board” or the “Finance Board” to the

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<sup>55</sup> See 12 CFR 522.60 (1989), as originally adopted in 1978, 43 FR at 46837. This regulatory provision was not thereafter amended by the FHLBB but was transferred without change by the Finance Board after FIRREA’s enactment, see 54 FR 36757, 36758 (Sept. 5, 1989). See also 61 FR 43151, 43153 (Aug. 21, 1996) (wherein the Finance Board determined that a dollar cap on Bank director compensation was appropriate considering “the agency’s statutory responsibility to ‘approve’ Bank directors’ compensation, see 12 U.S.C. 1427(i), the Bank Act’s requirement that such compensation be ‘reasonable,’ see *id.*, and the preference for providing a clear regulatory standard.”).

<sup>56</sup> Pub. L. 110-289, sec. 1202(7), 122 Stat. 2783 (July 30, 2008); see also Pub. L. 106-102, sec. 606(b), 113 Stat. 1450, 1453 (Nov. 12, 1999). Even after GLBA’s imposition of statutory limits the Bank System regulator continued to assert approval authority by regulation, see 12 CFR 932.17(f) (2000) (“Payments made to directors in compliance with the limits on annual directors’ compensation and the standards set forth in this section are deemed to be approved by the Finance Board for purposes of section 7(i) of the [Bank] Act, as amended.”).

“Director” of FHFA.<sup>57</sup> Likely because “board” in the section 7(i)(1) approval proviso was not capitalized, it was not identified as a reference in need of updating. Once again however, the fact that the proviso was not changed indicates that Congress did not intend to change its meaning. And, as has been consistently demonstrated from the enactment of the Bank Act in 1932 through its many amendments and in the regulations of successive System regulators, the proviso means that the Bank System regulator – now FHFA – has authority to approve Bank director compensation.<sup>58</sup>

The legislative and regulatory history that substantiates FHFA’s authority to approve Bank director compensation also affirms its authority to establish limits on “reasonable” compensation. As early as 1974, the Bank System regulator limited Bank director compensation by policy, exercising statutory authority identical to that in existing section 7(i)(1).<sup>59</sup> Thereafter, the Bank System regulator’s authority to determine a level of “reasonable” Bank director compensation was codified in regulation, first in 1978 and again in 1989, 1996, 1999, 2000, 2002, and 2010.<sup>60</sup>

In common with earlier Bank System regulators, FHFA views its express statutory authority to approve Bank director compensation on the basis that it is reasonable as conferring authority to establish and provide to the Banks and OF an amount of director compensation that FHFA has determined would be reasonable. After administering the existing regulation for almost 15 years, FHFA believes it could be useful to provide the Banks and OF information on a level or amount of director

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<sup>57</sup> Pub. L. 110-289, sec. 1204, 122 Stat. 2785.

<sup>58</sup> Consistent statutory interpretation by the administrative regulator “is of persuasive force,” *U.S. v. Madigan*, 300 U.S. 500, 505 (1937); *see also Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

<sup>59</sup> *See* 61 FR 17603 (Apr. 22, 1996).

<sup>60</sup> *See* 43 FR at 46837 (Oct. 11, 1978), 54 FR 36757 (Sept. 5, 1989), 61 FR 43151 (Aug. 21, 1996), 64 FR at 71278 (Dec. 21, 1999), 65 FR at 8260 (Feb. 18, 2000), 67 FR at 12846 (Mar. 20, 2002), and 75 FR at 17040 (Apr. 5, 2010).

compensation FHFA has determined to be reasonable, for consideration when each Bank and OF develops its directors' compensation policy.

The existing regulation requires each Bank and OF to submit its director compensation policy to FHFA for prior review and addresses FHFA's obligation to disapprove director compensation that is not reasonable. The Bank Act does not define "reasonable," but FHFA relies on concepts and processes similar to those used in its review of Bank executive officer compensation (where, by statute, FHFA is required to prohibit the regulated entities from providing executive officers compensation that is not reasonable and comparable to compensation paid by similar institutions for the performance of similar duties<sup>61</sup>). When determining if proposed compensation of Bank or OF directors is "reasonable," FHFA considers a variety of factors including compensation of directors at other banking institutions; the Banks' status as government-sponsored enterprises and features of their statutory charters, governance, and businesses that may distinguish them from other institutions; their statutory purposes and mission; and the fact that they were created to serve a public purpose.

Currently, if FHFA determines that proposed director compensation is not reasonable, it does not provide the relevant Bank or OF information on an alternative amount of compensation that FHFA would deem to be reasonable. Instead, the Bank or OF must submit a new proposal, subject to a new FHFA review. FHFA believes this process imposes a burden on the Banks and OF which could be reduced or avoided if FHFA provided notice of a maximum amount of annual director compensation FHFA has determined would be reasonable. Because FHFA has not previously exercised that

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<sup>61</sup> See 12 U.S.C. 4518(a); *see also* 12 CFR part 1230.

authority, and for consistency with earlier System regulators which stated such authority in regulation, FHFA now believes it should state its authority to establish an amount of “reasonable” director compensation and to provide prior notice of that amount to the Banks and OF in regulation.

FHFA does not propose to establish a maximum amount or level of compensation in this regulatory action. In the future, FHFA may establish such an amount and may do so through a regulatory amendment or an order. FHFA may also provide guidance on an amount of Bank or OF director compensation it believes would be reasonable. In any case, FHFA expects any amount or level of “reasonable” compensation so established would reflect consideration factors such as those set forth above.

Likewise, FHFA does not propose to amend other provisions of existing subpart C that currently require each Bank and OF, when submitting its directors’ compensation policy to FHFA, to include all studies or other supporting materials upon which the board relied in determining the level of compensation and expenses to pay to its directors; require FHFA to review the policy; and acknowledge FHFA’s authority to disapprove the policy if FHFA determines that compensation and/or expenses to be paid to the directors are not reasonable.<sup>62</sup> Should FHFA in the future provide the Banks and OF prior notice of a maximum amount of director compensation determined to be reasonable, FHFA does not intend that each Bank or OF simply adopt that amount in its policy. Instead, FHFA expects that the board of directors of each Bank and OF would continue to evaluate and affirmatively determine reasonable director compensation and that each annual policy submission would continue to provide studies, supporting materials, and justification for

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<sup>62</sup> See 12 CFR 1261.22 and 1261.23.



such determinations. As it does currently, FHFA expects to review each submission in full and may disapprove proposed compensation that is not supported as reasonable. FHFA may also approve a proposal to pay compensation that exceeds the amount FHFA has communicated by prior notice if the Bank or OF provides appropriate support.

*Proposed amendment to paragraph (b), “Reporting.”* As noted above, existing § 1261.21(b) requires that each Bank report to the Director annually about the compensation it anticipates paying out in the following year and director compensation, expenses, and meeting attendance for the immediately preceding calendar year. One of the items required to be included in the latter category under the existing regulation is “[t]he number of board and designated committee meetings each director attended in-person or through electronic means such as video or teleconferencing.” In order to conform more closely to the language that would be used in revised § 1261.24 (discussed below), the proposed rule would revise the description of this item to refer to “meetings each director attended in person or remotely, through video or teleconferencing, and in accordance with § 1261.24(b).”

#### ***14. Directors’ compensation policy—§ 1261.22***

Existing § 1261.22 requires that a Bank adopt a written compensation policy to “provide for the payment of reasonable compensation and expenses to the directors for the time required of them in performing their duties as directors.” The policy must “address the activities or functions for which director attendance or participation is necessary and which may be compensated, and . . . explain and justify the methodology used to determine the amount of compensation to be paid to the Bank director.” A Bank’s compensation policy must require that compensation be reduced, as necessary, to

reflect lesser attendance or performance at board or committee meetings during a given year.

The proposed rule would split paragraph (b), addressing minimum contents for Bank compensation plans, into two paragraphs. It would also add a third paragraph, § 1261.22(b)(3), requiring each Bank to establish, as part of its compensation policy, a fair and impartial process for annually evaluating individual director performance and participation, including, but not limited to, an assessment of whether each director: (i) demonstrated understanding of the Bank System; (ii) demonstrated knowledge of the Bank's policies and governance documents; (iii) demonstrated understanding of his or her legal and ethical responsibilities as a board member; (iv) made suggestions congruent with the Bank's mission, vision and values (even if divergent from majority opinion); and (v) acted in support of Board decisions, regardless of initial position. The proposed rule would also revise newly designated § 1261.22(b)(2) to stipulate that, as a consequence for poor performance or participation, a Bank's board may not only reduce a director's pay, but may also remove a director whose lack of performance or participation is compromising the board's ability to adequately oversee the operations of the Bank. This authority is also referenced in proposed § 1261.13, which addresses a board's authority to remove a director for good cause.

Bank directors hold positions of trust and are well compensated for their time and efforts. Each Bank needs all of its directors to devote the time, attention, and thought necessary to properly oversee the Bank and its operations. It is a matter of strong corporate governance for a Bank's board of directors to have an effective process for assessing the performance of board directors; this process can help improve individual

and collective board performance.<sup>63</sup> It is just as essential that a Bank's board have an effective mechanism for addressing lack of performance. In extreme cases, where a director's performance is so poor or detrimental that it poses a risk to the board's ability to effectively oversee the Bank's operations, this could include removal of a director using the procedures established under proposed § 1261.13(b).

**15. Board meetings—§ 1261.24**

The proposed rule would make multiple substantive changes to codify a waiver FHFA first issued in 2020 permitting Bank System board and committee meetings to be held in virtual formats.

Existing § 1261.24(a) requires that the board of directors of each Bank hold as many meetings each year as are necessary and appropriate to carry out its fiduciary duties regarding its oversight of the Bank, provided that each board must hold a minimum of six in-person meetings during each calendar year. A similar regulatory requirement applies to the board of directors of the OF.<sup>64</sup> As mentioned above, FHFA regulations also require that each Bank annually adopt a written compensation policy to provide for the payment of reasonable compensation and expenses to the directors for the time required of them in performing their duties as directors.<sup>65</sup> The OF is required to pay reasonable compensation to independent directors in accordance with the requirements of part 1261 applying to the compensation of Bank directors, including the requirement that compensation be reduced to reflect lesser attendance or performance at board or

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<sup>63</sup> See PwC's, Governance Insights Center, *Individual director assessments*, (August 2023), available at <https://www.pwc.com/us/en/services/governance-insights-center/library/assets/pwc-individual-director-assessments.pdf>.

<sup>64</sup> See 12 CFR 1273.8(b).

<sup>65</sup> See 12 CFR 1261.22.

committee meetings.<sup>66</sup>

The requirements for Bank and OF boards to hold at least six in-person meetings are prudential measures adopted by FHFA as an aid to promoting sound governance; they are not required by statute. In response to the COVID-19 pandemic, the FHFA Director issued a letter in March 2020 waiving the need to comply with the in-person board meeting regulatory requirements and with provisions of compensation policies tying compensation to attendance at in-person board and committee meetings. Over the course of the pandemic, the waiver was extended nine times and the last extension remains in effect without an expiration date.

Although the COVID-19 public health emergency has ended and FHFA prefers that Banks and OF hold in-person board meetings whenever possible, it also recognizes the benefits of allowing greater flexibility in fulfilling the Agency's regulatory requirement to hold at least six board meetings a year, particularly in times of emergency. The proposed revisions allowing boards to meet remotely at their discretion without seeking prior Agency approval could promote efficiency by minimizing delays in response to urgent issues and reducing travel costs and unexpected travel disruptions while fostering greater board participation for directors unable to attend in person. Additionally, the Bank System has already demonstrated its ability to use electronic platforms to engage in discourse and conduct business over the past four years. The proposed rule would permanently address the issue by codifying the substance of the existing waiver into regulation.

The principal effect of modifying the regulation would be to allow the Banks and

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<sup>66</sup> See 12 CFR 1273.7(f)(2).

OF an alternative means of holding a board meeting that would otherwise be held in person. The interests of the members and the public should be equally represented through either type of board meeting. Expectations for attendance and performance at meetings and the compensation methodology should be communicated to board members in the compensation policy, which, with supporting materials, must be submitted to the FHFA Director annually.<sup>67</sup> Consequently, the Agency would expect the Banks and OF to keep adequate meeting records to sufficiently document board member attendance and performance. FHFA also expects the Banks and OF to appropriately mitigate any security risks that may arise from meeting in a virtual setting.

The proposed rule would revise existing § 1261.24(a) to remove the requirement that the six minimum board meetings be “in-person.” In conjunction with this, the proposed rule would revise § 1261.24(b) to provide that “[a] Bank’s board of directors and its committees may conduct meetings in-person, through video conferencing or teleconferencing, or in a hybrid format, provided that all directors have an opportunity to communicate and have access to all written documents and presentations.” Any meeting of the type described can be counted as one of the minimum six meetings required under § 1261.24(a).

Proposed § 1261.24(b)(2) would state an expectation that that each Bank will “generally” hold board and committee meetings within the Bank district and would retain the prohibition against holding any board or committee meeting that is not within a “State” as defined by 12 CFR 1201.1. This definition includes “United States, American Samoa, the Commonwealth of the Northern Mariana Islands, the District of Columbia,

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<sup>67</sup> See 12 CFR 1261.22(d).

Guam, Puerto Rico, or the United States Virgin Islands.”<sup>68</sup> It would further require that all directors be located within a State, as so defined, when attending a board or committee meeting via video conference or teleconference.

The proposed rule would also add to § 1261.24 a new paragraph (c) to define “quorum” to mean “for purposes of meetings of a Bank’s board of directors, . . . a majority of sitting directors, which must include a majority of sitting independent directors.” This provision would better ensure that independent voices are heard on critical Bank issues and provide consistency within the Bank System. The proposed provision parallels the definition of “quorum” as it is currently stated in the OF regulation at 12 CFR 1273.8(b).

#### **B. Revisions to 12 CFR part 1239**

Although each Bank is required under existing § 1261.11 to adopt a conflicts-of-interest policy to cover all of its board directors, there is currently no equivalent requirement with respect to Bank employees, many of whom are in no less a position of trust at the Bank than are its board directors.

Part 1239 of FHFA’s regulations addresses responsibilities of boards of directors, corporate practices, and corporate governance for FHFA’s regulated entities. The proposed rule would add to part 1239 a new § 1239.31 requiring each Bank to adopt a conflicts-of-interest policy covering its employees and establishing the requirements for those policies. The content and format of the new section is based on that of § 1261.11, which addresses the Bank director conflicts-of-interest policy requirement, appropriately modified to be applicable to Bank employees.

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<sup>68</sup> See 12 CFR 1201.1.

Proposed § 1239.31(a) would require that each Bank's board of directors adopt a written conflicts-of-interest policy covering all employees, which must, at a minimum:

- (1) require that all employees of the Bank discharge their official responsibilities in an objective and impartial manner in furtherance of the interests of the Bank's membership as a whole and consistent with the public interest;
- (2) establish appropriate limitations, standards, and procedures regarding the holding of outside positions and financial interests by Bank employees and close family members and associates;
- (3) prohibit executive officers and senior management from holding paid positions with any entity that is, or may be eligible to become, a member or housing associate of any Bank or with any affiliate of such entity;
- (4) prohibit employees from participating in any particular matter in which the employee or any immediate family member or business associate has a financial interest;
- (5) prohibit employees from otherwise holding financial interests that conflict with the conscientious performance of duty;
- (6) require employees to disclose actual or apparent conflicts of interests and establish procedures for addressing such conflicts, including recusal;
- (7) require the establishment of internal controls to ensure that conflicts-of-interest reports are made and filed and that conflicts-of-interest issues are disclosed and resolved; and
- (8) establish procedures to monitor compliance with the conflicts-of-interest policy.

While the proposed rule would require each Bank's policy to set appropriate guidelines for all of its personnel, FHFA would expect a Bank to appropriately calibrate the treatment of different types of employees under the policy according to the risk presented, including by setting more stringent standards for executives and officers.

Paralleling § 1261.11, paragraphs (b) and (c) of proposed § 1239.31 would

prohibit employees in most cases from disclosing or using confidential information they receive by reason of their position with the Bank and discourage Bank employees from accepting gifts that appear to be intended to influence the employee's actions.

Proposed paragraph (d) would employ the same definitions that are used in proposed § 1261.11(f). For purposes of attribution, "immediate family member" means a parent, sibling, spouse, child, or dependent, or any relative sharing the same residence as the director and the term "business associate" means any individual or entity with whom a director has a business relationship, including, but not limited to: (1) Any corporation or organization of which the employee is an officer or partner, or in which the employee beneficially owns ten percent or more of any class of equity security, including subordinated debt; (2) Any other partner, officer, or beneficial owner of ten percent or more of any class of equity security, including subordinated debt, of any such corporation or organization; and (3) Any trust or other estate in which an employee has a substantial beneficial interest or as to which the employee serves as trustee or in a similar fiduciary capacity. The definition of "financial interest" matches the revised definition of that term in proposed § 1261.11(f).

### **C. Revisions to 12 CFR part 1273**

The proposed rule would also make several revisions to part 1273, which governs the OF. Primarily, the proposed rule would amend part 1273 to revise the provision governing the minimum number and site of OF board meetings to match the revised language with respect to the Bank's boards in § 1261.24. The remaining proposed revisions are in response to comments provided by the Bank System in response to FHFA's Spring 2023 Regulatory Review notice.



**1. Funding of the OF—§ 1273.5**

Existing § 1273.5 addresses the funding of the OF. Existing § 1273.5(b)(1)(ii) limits OF operating funds withdrawals to check, wire transfer, or draft signed by the Chief Executive Officer (CEO) or other persons designated by the OF board of directors.

In its letter sent in response to FHFA’s Spring 2023 Regulatory Review Notice, the Bank System commented that the existing regulation governing the withdrawal of OF operating funds is both limited and outdated. It suggested that the regulation be modernized to permit the use of other widely accepted fund transfer methods that have been or will be developed in the future and that the regulation be expanded to allow CEO delegation of authority to achieve greater operational efficiency. In response, FHFA is proposing to revise § 1273.5(b)(1)(ii) to expand the range of permissible OF withdrawal methods to include “draft[s]” and “other funds transfer methods with written authorization by the CEO or other persons designated by the CEO or OF board of directors in accordance with OF governance documents.”

**2. General duties of the OF board of directors—§ 1273.8**

Existing § 1273.8 addresses the “general duties of the OF board of directors.” Paragraph (b) of this section establishes requirements for OF board meetings, requiring that the OF board of directors conduct its business by majority vote of its members at meetings convened in accordance with its by-laws, and hold no fewer than six in-person meetings annually.

The proposed rule would subdivide § 1273.8(b) into four paragraphs for clarity and would revise the existing text concerning meeting frequency and location in a manner paralleling the proposed changes to the board meeting requirements for the Banks

set forth in § 1261.24. The reasons for these revisions are discussed in depth in the discussion of proposed § 1261.24, above.

Proposed § 1273.8(b)(1) would allow the OF board of directors and its committees to conduct meetings “in person, through video conferencing or teleconferencing, or in a hybrid format, provided that all meeting attendees have an opportunity to communicate and have access to all written documents and presentations.” Under the proposed rule, all such meetings could be counted toward the minimum of six board meetings per year that is required under the existing regulation and as proposed. The proposed rule, in § 1273.8(b)(2), would prohibit the OF from holding any board or committee meeting that is not within a “State” as defined by 12 CFR 1201.1 and would also require that all directors be located within a State, as so defined, when attending the meeting via teleconference or video conference. Proposed § 1273.8(b)(3) and (4) would retain the meeting notice and quorum provisions, respectively, of the existing regulation.

In existing § 1273.8, paragraph (d) enumerates duties of the OF board, other than those relating to Bank System consolidated obligations, among which is included the duty to review and approve all contracts of the OF, except for contracts for which exclusive authority is provided to the Audit Committee by regulation. In its letter sent in response to FHFA’s Spring 2023 Regulatory Review Notice, the Bank System commented that the current requirement seems impractical and unnecessary, as those activities generally fall under management’s responsibilities. In response, FHFA is proposing to eliminate the requirement that the OF board of directors review and approve *all* contracts of the OF, except for those reserved to the audit committee by regulation. Instead, proposed § 1273.8(d)(4) would state that the OF board of directors will review

and approve contracts of the OF, as specified in OF governance documents.

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

Section 1313(f) of the Safety and Soundness Act requires the Director of FHFA, when promulgating regulations relating to the Banks, to consider the differences between the Banks and the Enterprises (Fannie Mae and Freddie Mac) as they relate to: the Banks' cooperative ownership structure; the mission of providing liquidity to members; the affordable housing and community development mission; their capital structure; and their joint and several liability on consolidated obligations.<sup>69</sup> The Director also may consider any other differences that are deemed appropriate. In preparing this proposed rule, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors, and determined that the rule is appropriate. FHFA requests comments regarding whether differences related to those factors should result in any revisions to the proposed rule.

## **VI. Paperwork Reduction Act**

The proposed rule would not contain any changes to information collection requirements that would require the approval of the Office of Management and Budget (OMB) under the Paperwork Reduction Act.<sup>70</sup> Therefore, FHFA has not submitted any information to OMB for review.

## **VII. Regulatory Flexibility Act**

The Regulatory Flexibility Act<sup>71</sup> (RFA) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses,

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<sup>69</sup> 12 U.S.C. 4513(f).

<sup>70</sup> 44 U.S.C. 3501 *et seq.*

<sup>71</sup> 5 U.S.C. 601 *et seq.*

or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities.<sup>72</sup> FHFA has considered the impact of the proposed rule under the RFA. FHFA certifies that the proposed rule, if adopted as a final rule, would not have a significant economic impact on a substantial number of small entities because the proposed rule applies only to the Banks and OF, which are not small entities for purposes of the RFA.

### **VIII. Providing Accountability Through Transparency Act of 2023**

The Providing Accountability Through Transparency Act of 2023 (5 U.S.C. 553(b)(4)) requires that a notice of proposed rulemaking include the internet address of a summary of not more than 100 words in length of a proposed rule, in plain language, that shall be posted on the internet website under section 206(d) of the E-Government Act of 2002 (44 U.S.C. 3501 note) (commonly known as Regulations.gov). FHFA's proposal and the required summary can be found at <https://www.regulations.gov>.

#### **List of Subjects**

##### *12 CFR Part 1239*

Administrative practice and procedure, Federal home loan banks, Government-sponsored enterprises, Reporting and recordkeeping requirements.

##### *12 CFR Part 1261*

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<sup>72</sup> See 5 U.S.C. 605(b).

Administrative practice and procedure, Compensation, Conflicts of interest, Directors, Elections, Eligibility, Federal home loan banks, Meetings, Reporting and recordkeeping requirements.

*12 CFR Part 1273*

Administrative practice and procedure, Audit committee, Consolidated obligations, Directors, Office of Finance.

Accordingly, for the reasons stated in the preamble, under the authority of 12 U.S.C. 4511, 4513, and 4526, FHFA proposes to amend parts 1239, 1261, and 1273 of chapter XII of title 12 of the Code of Federal Regulations, as follows:

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

1. The authority citation for part 1239 continues to read as follows:

**Authority:** 12 U.S.C. 1426, 1427, 1432(a), 1436(a), 1440, 4511(b), 4513(a), 4513(b), 4526, and 15 U.S.C. 7800(b).

2. Revise and republish § 1239.31 to read as follows:

**§ 1239.31 Conflicts of interest policy for Bank employees.**

(a) *Adoption of conflicts-of-interest policy.* Each Bank's board of directors shall adopt a written conflicts-of-interest policy covering all Bank employees. At a minimum, the conflicts-of-interest policy of each Bank shall:

(1) Require that all Bank employees discharge their official responsibilities in an objective and impartial manner in furtherance of the interests of the Bank's membership as a whole and consistent with the public interest;

(2) Establish appropriate limitations, standards, and procedures regarding the

holding of outside positions and financial interests by Bank employees and close family members and associates;

(3) Prohibit Bank executive officers and senior management from holding paid positions with any entity that is, or may be eligible to become, a member or housing associate of any Bank or with any affiliate of such entity;

(4) Prohibit Bank employees from participating in any particular matter in which the employee or any immediate family member or business associate has a financial interest;

(5) Prohibit Bank employees from otherwise holding financial interests that conflict with the conscientious performance of duty;

(6) Require Bank employees to disclose actual or apparent conflicts of interests and establish procedures for addressing such conflicts, including recusal;

(7) Require the establishment of internal controls to ensure that conflicts-of-interest reports are made and filed and that conflicts-of-interest issues are disclosed and resolved; and

(8) Establish procedures to monitor compliance with the conflicts-of-interest policy.

(b) *Confidential Information.* Bank employees shall not disclose or use confidential information they receive solely by reason of their position with the Bank to obtain any benefit for themselves or for any other individual or entity.

(c) *Gifts.* No Bank employee shall accept, and each Bank employee shall discourage the employee's immediate family members from accepting, any gift that the employee believes or has reason to believe is given with the intent to influence the

employee's actions, or where acceptance of such gift would have the appearance of intending to influence the employee's actions. Any insubstantial gift would not be expected to trigger this prohibition.

(d) *Definitions.* For purposes of this section:

*Business associate* means any individual or entity with whom a Bank employee has a business relationship, including, but not limited to:

(1) Any corporation or organization of which the employee is an officer or partner, or in which the employee beneficially owns ten percent or more of any class of equity security, including subordinated debt;

(2) Any other partner, officer, or beneficial owner of ten percent or more of any class of equity security, including subordinated debt, of any such corporation or organization; and

(3) Any trust or other estate in which an employee has a substantial beneficial interest or as to which the employee serves as trustee or in a similar fiduciary capacity.

*Financial interest* means a direct or indirect financial interest in any activity, transaction, property, or relationship that involves receiving or providing something of monetary value, and includes, but is not limited to any right, contractual or otherwise, to the payment of money, whether contingent or fixed. It does not include a deposit or savings account, loan or extension of credit, or other accounts and products obtained in the normal course of business on non-preferential terms generally available to the public from a member institution or from a non-member counterparty to the Bank by which the individual is employed.

*Immediate family member* means a parent, sibling, spouse, child, or dependent of

a Bank employee, or any relative sharing the same residence as a Bank employee.

3. Revise and republish part 1261 to read as follows:

## **PART 1261—FEDERAL HOME LOAN BANK DIRECTORS**

### **Subpart A—Definitions**

1261.1 [Reserved]

### **Subpart B—Federal Home Loan Bank Boards of Directors: Eligibility and Elections**

1261.2 Definitions.

1261.3 General provisions.

1261.4 Annual designation of directorships.

1261.5 Director eligibility.

1261.6 Determination of member votes.

1261.7 Nominations for member and independent directorships.

1261.8 Election process.

1261.9 Actions affecting director elections.

1261.10 Independent director independence.

1261.11 Conflicts of interest policy for Bank directors.

1261.12 Reporting requirements for Bank directors.

1261.13 Ineligibility and removal of Bank directors.

1261.14 Vacant Bank directorships.

1261.15 Minimum number of member directorships.

### **Subpart C—Federal Home Loan Bank Directors' Compensation and Expenses**

1261.20 Definitions.

1261.21 General.

1261.22 Directors' compensation policy.

1261.23 Director disapproval.

1261.24 Board meetings.

**Authority:** 12 U.S.C. 1426, 1427, 1432, 4511 and 4526.

### **Subpart A—Definitions**

**§ 1261.1 [Reserved]**

### **Subpart B—Federal Home Loan Bank Boards of Directors: Eligibility and Elections**

**§ 1261.2 Definitions.**

As used in this subpart B:



*Advisory Council* means the Advisory Council each Bank is required to establish pursuant to section 10(j)(11) of the Bank Act (12 U.S.C. 1430(j)(11)), and part 1291 of this chapter.

*Bona fide resident* of a Bank district means an individual who:

- (1) Maintains a principal residence in the Bank district; or
- (2) If serving as an independent director, owns or leases in his or her own name a residence in the Bank district and is employed in a voting state in the Bank district.

*FHFA ID number* means the number assigned to a member by FHFA and used by FHFA and the Banks to identify a particular member.

*Independent directorship* and *independent director* mean, respectively, a directorship designated as provided under § 1261.4 to be filled by an individual meeting the eligibility requirements of § 1261.5(b) and an individual serving in such a directorship.

*Member directorship* and *member director* mean, respectively, a directorship designated as provided under § 1261.4 to be filled by an individual meeting the requirements of § 1261.5(a) and an individual serving in such a directorship.

*Method of equal proportions* means the mathematical formula used by FHFA to allocate member directorships among the States in a Bank's district based on the relative amounts of Bank stock required to be held as of the record date by members located in each State.

*Nominee* means an individual who has been nominated for a Bank directorship under the applicable provision of § 1261.7.

*Public interest independent directorship* and *public interest independent director*

mean, respectively, an independent directorship designated by a Bank to be filled by an individual having the qualifications specified in § 1261.5(c)(2) and an individual serving in such a directorship.

*Record date* means December 31 of the calendar year immediately preceding the election year.

*Regular independent directorship* and *regular independent director* mean, respectively, an independent directorship designated by a Bank to be filled by a person having the qualifications specified in § 1261.5(c)(1) and an individual serving in such a directorship.

*Voting State* means the State in which a member's principal place of business, as determined in accordance with 12 CFR part 1263, or any successor provision, is located as of the record date. The voting State of a member with a principal place of business located in the U.S. Virgin Islands as of the record date is Puerto Rico, and the voting State of a member with a principal place of business located in American Samoa, Guam, or the Commonwealth of the Northern Mariana Islands as of the record date is Hawaii.

### **§ 1261.3 General provisions.**

(a) *Term of directorships.* The term of office of each directorship shall be four years, except as adjusted pursuant to § 1261.4(e) or (f) to achieve a staggered board, and shall commence on January 1 of the calendar year so designated by FHFA.

(b) *Annual elections.* Each Bank annually shall conduct an election the purpose of which is to fill all directorships designated by FHFA as commencing on January 1 of the calendar year immediately following the year in which such election is commenced. Subject to the provisions of the Bank Act and in accordance with the requirements of this

subpart, the disinterested directors of each Bank, or a committee of disinterested directors, shall administer and conduct the annual election of directors. In so doing, the disinterested directors may use Bank staff or independent contractors to perform ministerial and administrative functions concerning the elections process.

(c) *Location of members.* For purposes of the election of member directors, a member is deemed to be located in its voting State, unless otherwise specified by the Director.

(d) *Dates.* If any date specified in this subpart for action by a Bank, or specified by a Bank pursuant to this subpart, falls on a Saturday, Sunday, or Federal holiday, the relevant time period is deemed to be extended to the next calendar day that is not a Saturday, Sunday, or Federal holiday.

#### **§ 1261.4 Annual designation of directorships.**

(a) *Designation of directorships order.* As provided in this section, the Director will by June 1 of each year issue a written order designating for each Bank's board of directors for the following calendar year:

- (1) The total number of member directorships and their allocation among the voting States of the Bank's district;
- (2) The total number of independent directorships; and
- (3) The directorships for which an election will be held for terms beginning on the January 1 of the following year, and the length of those terms.

(b) *Capital stock reports.* (1) On or before April 10 of each year, each Bank shall deliver to FHFA a capital stock report that indicates, as of the record date, the number of members located in each voting State in the Bank's district, the number of shares of Bank

stock that each member (identified by its FHFA ID number) was required to hold, and the number of shares of Bank stock that all members located in each voting State were required to hold. If a Bank has issued more than one class of stock, it shall report the total shares of each class of stock required to be held by the members. The Bank shall certify to FHFA that, to the best of its knowledge, the information provided in the capital stock report is accurate and complete, and that it has notified each member of its minimum capital stock holding requirement as of the record date.

(2) The number of shares of Bank stock that any member was required to hold as of the record date shall be determined in accordance with the minimum investment established by the capital plan for that Bank.

(c) *Allocation of member directorships.* For each Bank's board of directors, the Director will designate a total number of member directorships and allocate them among the voting States of the Bank's district as follows:

(1) *Method of equal proportions.* (i) FHFA will choose a base number of member directorships and, using the method of equal proportions, allocate those among the voting States of the Bank district according to the ratio of the number of shares of Bank stock required to be held by the members in each State to the number of shares required to be held by all members of the Bank.

(ii) In no case shall the number of member directorships allocated to a voting State be fewer than one or more than six.

(iii) If a Bank has issued more than one class of stock, the Director will allocate the member directorships based on the combined number of shares required to be held by members.

(iv) The Director will allocate a Bank's member directorships based upon members' minimum required stock holdings as of the record date, as shown in the Bank's capital stock report required by paragraph (b) of this section.

(2) *Grandfather provision.* If, after completing the process described in paragraph (c)(1) of this section for a Bank, the number of member directorships allocated to any voting State is not at least equal to the minimum number shown for that voting State on the table in § 1261.15, the Director will allocate to that voting State such number of additional member directorships as are necessary to increase the total number of member directorships allocated to that voting State to the number shown on the table. If a voting State does not appear on the table in § 1261.15, the minimum number of member directorships for that voting State is deemed to be one for purposes of this paragraph.

(d) *Independent directorships.* After designating the member directorships for a Bank's board of directors as provided in paragraph (c) of this section, the Director will designate a number of independent directorships for the Bank's board that is at least 40 percent, but less than 50 percent, of the total number of directorships on the board.

(e) *Adjustments—(1) Redesignated member directorships.* If the annual designation of directorships results in an existing member directorship being redesignated as representing members in a different voting State, that directorship shall be deemed to terminate in the previous voting State as of December 31 of the current year, and a new directorship to begin in the succeeding voting State as of January 1 of the next year. The new directorship shall be filled by vote of the members in the succeeding voting State and, in order to maintain the staggered terms of directorships, shall be adjusted to a term equal to the remaining term of the previous directorship if it had not been redesignated to

another State.

(2) *New directorships.* If the annual designation of directorships results in the addition of one or more directorships to a Bank's board, the Director may truncate the initial term of any such new directorship if required to ensure that the terms of the Bank's directorships are staggered with approximately one quarter of the terms expiring each year.

(f) *Public interest independent directorships.* Annually, the board of directors of each Bank shall determine the number of public interest independent directorships to be included among its designated independent directorships for the following year, ensuring that at all times the Bank will have at least two such directorships. In its discretion, a Bank's board may change the number of public interest independent directorships during the year, provided that there are at all times at least two such directorships.

#### **§ 1261.5 Director eligibility.**

(a) *Eligibility requirements for member directors and nominees.*

(1) Each member director, and each nominee for a member directorship, shall be:

(i) A citizen of the United States; and

(ii) An officer or director of a member that is located in the voting State of the Bank district to which the directorship being occupied, sought, or filled has been allocated under § 1261.4(c) and that meets all minimum capital requirements established by its appropriate Federal banking agency or appropriate State regulator.

(2) In the case of a director elected by a Bank's members under § 1261.8, the institution of which the director is an officer or director must have been a member as of the record date. In the case of a director elected by a Bank's board of directors to fill a

vacancy under § 1261.14, the institution of which the director is an officer or director must be a member at the time the board acts.

(b) *Eligibility requirements for independent directors and nominees.* Each independent director, and each nominee for an independent directorship, shall at all times:

(1) Be a citizen of the United States;

(2) Be a bona fide resident of the district in which the Bank is located;

(3) Meet the independence requirements of § 1261.10; and

(4) Meet the applicable qualifications requirements specified in paragraph (c) of this section.

(c) *Independent director qualifications—(1) Regular independent directors.* Each regular independent director and each nominee for a regular independent directorship shall have experience in, or knowledge of, one or more of the following areas: auditing and accounting; derivatives; financial management; organizational management; project development; risk management practices; artificial intelligence; information technology and security; climate-related risk; CDFI business models; modeling; the law; and such other areas as the Director shall determine. Before nominating any individual for a regular independent directorship, the board of directors of a Bank shall determine that such knowledge or experience of the nominee is commensurate with that needed to oversee a financial institution with a size and complexity that is comparable to that of the Bank.

(2) *Public interest independent directors.* Each public interest independent director and each nominee for a public interest independent directorship shall have more

than four years of experience representing consumer or community interests in banking services, credit needs, housing, or consumer financial protection. For purposes of this requirement, “representing” means advocating for, or otherwise acting primarily on behalf of or for the direct benefit of, consumers or the community. Qualifying experience in one of the four enumerated areas may have been acquired in professional, public service, or significant volunteer positions, so long as the work done was substantial in terms of time commitment and responsibility. Such experience must have accrued from activities personally undertaken by the director or nominee, as opposed to being attributed based solely on the activities of organizations with which the person was associated.

(3) *Relevance of experience to be considered.* In considering potential nominees for independent directorships, a Bank’s board of directors shall give special consideration to individuals that:

(i) Possess knowledge and experience that are relevant to the business, programs, and mission of the Bank and that provide a basis for understanding the actual and potential impact of the Bank’s activities on its members and on communities within the Bank’s district; and

(ii) Have gained their knowledge and experience primarily through full time paid executive, management, or other senior positions.

(d) *Term limits.*

(1) The following are ineligible for nomination or election to a directorship of a Bank:

(i) Any incumbent director whose term of office would not expire before the new



term of office would begin; and

(ii) Any person that has been elected to each of three consecutive full terms as a director of a Bank and has served for all or part of each of those terms, unless the term of the directorship to be filled begins at least two years after the expiration of the third consecutive term.

(2) For purposes of determining whether a person is ineligible under the term limit provision of paragraph (d)(1)(ii) of this section:

(i) A four-year term of office shall count as a full term;

(ii) A term of office that is adjusted to a period of fewer than four years as provided in § 1261.4(e) shall not count as a full term;

(iii) Any full term of office that ends immediately before a term of office that is adjusted to a period of fewer than four years as provided in § 1261.4(e), and any full term of office commencing immediately following such adjusted term of office, shall count as consecutive full terms of office; and

(iv) Any period of time served by a director who has been elected by the board of directors to fill a vacancy under § 1261.14 shall not count as a full term.

(e) *Loss of eligibility.* A director shall become ineligible to remain in office if, during the director's term of office, the directorship to which the director has been elected is eliminated through the annual designation of directorships process described in § 1261.4. The incumbent director shall become ineligible after the close of business on December 31 of the year in which the directorship is eliminated.

#### **§ 1261.6 Determination of member votes.**

(a) *In general.* Each Bank shall determine, in accordance with this section, the

number of votes that each member of the Bank may cast for each directorship that is to be filled by the vote of the members.

(b) *Number of votes.* For each member directorship and each independent directorship that is to be filled in an election, each member shall be entitled to cast one vote for each share of Bank stock that the member was required to hold as of the record date. Notwithstanding the preceding sentence, the number of votes that any member may cast for any one directorship shall not exceed the average number of shares of Bank stock required to be held as of the record date by all members located in the same State as of the record date. If a Bank has issued more than one class of stock, it shall calculate the average number of shares separately for each class of stock, using the total number of members in a State as the denominator, and shall apply those limits separately in determining the maximum number of votes that any member owning that class of stock may cast in the election. The number of shares of Bank stock that a member was required to hold as of the record date shall be determined in accordance with the minimum investment requirement established by the Bank's capital plan.

(c) *Voting preferences.* If the board of directors of a Bank includes any voting preferences as part of its approved capital plan, those preferences shall supersede the provisions of paragraph (b) of this section that otherwise would allow a member to cast one vote for each share of Bank stock it was required to hold as of the record date. If a Bank establishes a voting preference for a class of stock, the members with voting rights shall remain subject to the provisions of section 7(b) of the Bank Act (12 U.S.C. 1427(b)) that prohibit any member from casting any vote in excess of the average number of shares of stock required to be held by all members in its state.

**§ 1261.7 Nominations for member and independent directorships.**

(a) *Election announcement.* Within a reasonable time in advance of an election, a Bank shall notify each member in its district of the commencement of the election process. Such notice shall include:

(1) The number of member directorships designated for each voting State in the Bank district and the number of independent directorships designated for the Bank, including the number of independent directorships designated by the Bank as public interest independent directorships, for the following calendar year;

(2) The name of each incumbent Bank director, the name and location of the member at which each member director serves, and the name and location of the organization with which each independent director is affiliated, if any, and the expiration date of each Bank director's term of office;

(3) Identification of the member directorships, regular independent directorships, and public interest independent directorships for which an election will be held;

(4) A brief statement describing the skills and experience the Bank believes are most likely to add strength to the board of directors, as determined through the annual assessment required under § 1261.9;

(5) An attachment indicating the name, location, and FHFA ID number of every member in the member's voting State, and the number of votes each such member may cast for each directorship to be filled by such members, as determined in accordance with § 1261.6; and

(6) If a member directorship is to be filled by members in a voting State, a nominating certificate for those members.

(b) *Member directorship nominations*—(1) *Nominating certificates.* (i) Any member that is entitled to vote in the election may nominate an eligible individual to fill each available member directorship for its voting State by delivering to its Bank, prior to a deadline to be established by the Bank and set forth in the notice required in paragraph (a) of this section, a nominating certificate duly adopted by the member's governing body or by an individual authorized by the member's governing body to act on its behalf.

(ii) The nominating certificate shall include the name of the nominee and the name, location, and FHFA ID number of the member the nominee serves as an officer or director.

(iii) The Bank shall establish a deadline for delivery of nominating certificates, which shall be no earlier than 30 calendar days after the date on which the Bank delivers the notice required by paragraph (a) of this section, and the Bank shall not accept certificates received after that deadline.

(2) *Accepting member directorship nominations.* Promptly after receipt of any nominating certificate, a Bank shall notify in writing any individual nominated for a member directorship. An individual may accept the nomination only by delivering to the Bank, prior to a deadline established by the Bank and set forth in its notice, an executed member director eligibility certification form prescribed by FHFA. A Bank shall allow each nominee at least 30 calendar days after the date the Bank delivered the notice of nomination within which to deliver the executed form. A nominee may decline the nomination by so advising the Bank in writing, or by failing to deliver a properly executed member director eligibility certification form prior to the deadline.

(c) *Independent directorship nominations*—(1) *Potential nominees.* Any

individual may request to be considered for nomination to an independent directorship of the board of directors of a Bank by delivering to the Bank, on or before the deadline set by the Bank for delivery of nominating certificates, an executed independent director application form prescribed by FHFA. Any other interested party also may recommend to the Bank that it consider a particular individual as a nominee for an independent directorship, but the Bank shall not nominate any individual unless the individual has delivered to the Bank, on or before the date the Bank has set for delivery of nominating certificates, an executed independent director application form prescribed by FHFA.

(2) *Application form.* The independent director application form prescribed by FHFA will provide a means by which an individual can indicate an intent to be considered for a public interest independent directorship. The board of directors of the Bank shall nominate for a public interest independent directorship only an individual who indicates on the application form a desire to be considered for a public interest independent directorship.

(3) *Advisory Council.* The board of directors of the Bank shall consult with the Bank's Advisory Council before nominating any individual for any independent directorship.

(4) *Procedures.* Each Bank shall include in its bylaws the procedures it intends to use for the nomination and election of the independent directors.

(5) *Minimum number of nominees.* Each Bank shall nominate at least as many individuals as there are respective regular and public interest independent directorship to be filled in that year's election.

(d) *Eligibility verification—(1) Member directorship nominees.* Using the

information provided on executed member director eligibility certification forms prescribed by FHFA, each Bank shall verify that each nominee for each member directorship meets all the eligibility requirements of § 1261.5(a).

(2) *Independent directorship nominees*—(i) Using the information provided on executed independent director application forms prescribed by FHFA, each Bank shall verify that each nominee for each public interest independent directorship and each regular independent directorship meets the eligibility requirements of § 1261.5(b).

(ii) Before announcing any independent director nominee, the Bank shall deliver to FHFA for its review a copy of the independent director application forms executed by the individuals nominated for independent directorships. If within two weeks of such delivery FHFA provides comments to the Bank on any independent director nominee, the board of directors of the Bank shall consider FHFA's comments in determining whether to proceed with those nominees or to reopen the nomination.

(3) *Eligible nominees*. A Bank's board shall neither nominate any individual for an independent directorship nor include any nominee for a member directorship on the ballot required under § 1261.8(a) if it has not concluded based on the submissions required under this part and any pertinent supplementary material that the individual meets the applicable eligibility requirements set forth in § 1261.5(a) or (b) and is not term-limited as provided under § 1261.5(d).

(e) *Background checks*. A Bank's board shall neither nominate any individual for an independent directorship nor include any nominee for a member directorship on the ballot required under § 1261.8(a), without having first concluded, based on a thorough background check, that the individual is fit to serve in a fiduciary role with the Bank.

Each Bank shall include with its submission required under paragraph (d)(2)(ii) of this section a discussion of the results of the background check for each independent directorship nominee, including any potentially concerning information that was revealed and how the Bank's concerns were allayed.

(f) *Record retention.* Subject to a duly enacted record retention policy, each Bank shall retain all information received under this section for at least seven years after the date of the election in question and, in the case of any information about a specific director, for at least seven years after that director leaves the board.

#### **§ 1261.8 Election process.**

(a) *Ballots.* Promptly after fulfilling the requirements of § 1261.7(d), each Bank shall prepare and deliver a ballot to each member that was a member as of the record date. The Bank shall include with each ballot a closing date for the Bank's receipt of voted ballots, which date shall be no earlier than 30 calendar days after the date such ballot is delivered to the member. A ballot shall include at least the following provisions:

(1) For states in which one or more member directorships are to be filled in the election, an alphabetical listing of the names of each nominee for such directorship, the name, location, and FHFA ID number of the member each nominee serves, the nominee's title or position with the member, a brief description of the skills and experience of each nominee, and the number of member directorships to be filled by the members in that voting state in the election;

(2) An alphabetical listing of the names of each nominee for a public interest independent directorship and a brief description of how each nominee meets the qualifications requirements for public interest independent directors set forth in

§ 1261.5(c)(2);

(3) An alphabetical listing of the names of each nominee for regular independent directorships and a brief description of how each nominee meets the required qualification requirements for regular independent directors set forth in § 1261.5(c)(1);

(4) A statement of the results of assessments conducted under § 1261.9 and, if the statement differs from the statement provided under § 1261.7(a)(4), an explanation of why the statements differ;

(5) A statement that write-in candidates are not permitted; and

(6) A confidentiality statement prohibiting the Bank from disclosing how any member voted.

(b) *Lack of member directorship nominees.* If, for any voting State, the number of nominees for the member directorships for that State is equal to or fewer than the number of such directorships to be filled in that year's election, the Bank shall deliver a notice to the members in the affected voting State (in lieu of including any member directorship nominees on the ballot for that State) that such nominees shall be deemed elected without further action, due to an insufficient number of nominees to warrant balloting.

Thereafter, the Bank shall declare elected all such eligible nominees. The nominees declared elected shall be included as directors-elect in the report of election required under paragraph (f) of this section. Any member directorship that is not filled due to a lack of nominees shall be deemed vacant as of January 1 of the following year and shall be filled by the Bank's board of directors in accordance with § 1261.14.

(c) *Voting.* For each directorship to be filled, a member may cast the number of votes determined by the Bank pursuant to § 1261.6. A member may not split its votes



among multiple nominees for a single directorship, and, where there are multiple directorships to be filled, either within the member's voting state or at large, in the case of independent directorships, a member may not cumulatively vote for a single nominee. If any member votes, it shall by resolution of its governing body either authorizing the voting for specific nominees or delegating to an individual the authority to vote for specific nominees. To vote, a member shall:

(1) Mark on the ballot the name of not more than one of the nominees for each directorship to be filled. Each nominee so selected shall receive all of the votes that the member is entitled to cast.

(2) Execute and deliver the ballot to the Bank on or before the closing date. A Bank shall not allow a member to change a ballot after it has been delivered to the Bank.

(d) *Counting ballots.* A Bank shall not review any ballot until after the closing date, and shall not include in the election results any ballot received after the closing date. Promptly after the closing date, each Bank shall tabulate the votes cast in the election: for the member directorships, the Bank shall tabulate votes by each voting state; for the independent directorships, the Bank shall tabulate votes for the district at-large. Any ballots cast in violation of paragraph (c) of this section shall be void.

(e) *Declaring results—*(1) *For member directorships.* The Bank shall declare elected the nominee receiving the highest number of votes. If more than one member directorship is to be filled for a particular State, the Bank shall declare elected each successive nominee receiving the next highest number of votes until all such open directorships are filled.

(2) *For independent directorships.* (i) The bank shall tabulate separately the votes

received for public interest independent directorship nominees and those received for regular independent directorship nominees, in each case in accordance with paragraph (e)(2)(ii) of this section.

(ii) If the number of nominees exceeds the number of directorships to be filled, the Bank shall declare elected the nominee receiving the highest number of votes. If more than one directorship is to be filled, the Bank shall declare elected each successive nominee receiving the next highest number of votes for such directorship until all such open directorships are filled.

(iii) If the number of nominees is no more than the number of directorships to be filled, the Bank shall declare elected each nominee receiving at least 20 percent of the number of votes eligible to be cast in the election. If any directorship is not filled due to any nominee's failure to receive at least 20 percent of the votes eligible to be cast, the Bank shall continue the election process for that directorship under the procedures in paragraph (g) of this section.

(3) *Tie votes.* In the event of a tie for the last available directorship, the disinterested incumbent directors of the Bank, by a majority vote, shall declare elected one of the nominees for whom the number of votes cast was tied.

(4) *Eligibility.* A Bank's board shall not declare elected a nominee that it has reason to know is ineligible or unfit to serve, nor shall it seat a director-elect that it has reason to know is ineligible or unfit to serve.

(5) *Record retention.* The Bank shall retain all ballots it receives for at least seven years after the date of the election, and shall not disclose how any member voted.

(f) *Report of election.* Promptly following the election, each Bank shall deliver a

notice to its members, to each nominee, and to FHFA that contains the following information:

(1) For each member directorship, the name of the director-elect, the name and location of the member at which he or she serves, his or her title or position at the member, the voting State represented, and the expiration date of the term of office;

(2) For each independent directorship, the name of the director-elect, whether the director-elect will fill a public interest or a regular independent directorship and, as appropriate, the consumer or community interest represented by such director, any qualifications under § 1261.5(c)(1), and the expiration date of the term of office;

(3) For member directorships, the total number of eligible votes, the number of members voting in the election, and the total number of votes cast for each nominee, which shall be reported by State; and

(4) For independent directorships, the total number of eligible votes, the number of members voting in the election, and the total number of votes cast for each nominee, which shall be reported for the district at large.

(g) *Failure to fill all independent directorships.* If any independent directorship is not filled due to the failure of any nominee to receive at least 20 percent of the eligible vote, the Bank shall continue the election process for that directorship under the following procedures:

(1) The Bank's board of directors, after again consulting with the Bank's Advisory Council, shall nominate at least as many individuals as there are independent directorships to be filled. It may nominate individuals who failed to be elected in the initial vote. The Bank thereafter shall deliver to FHFA a copy of the independent director

application form executed by each nominee.

(2) The Bank then shall follow the provisions in this section that are applicable to the election process for independent directors, except for the following:

(i) The Bank shall not place the name of any nominee on a ballot without prior approval of FHFA; and

(ii) The Bank may adopt a closing date that is earlier than 30 calendar days after delivery of the ballots to the eligible voting members, provided the Bank determines that an earlier closing date provides a reasonable amount of time to vote the ballots.

**§ 1261.9 Actions affecting director elections.**

(a) *Annual assessment of skills and experience.* Each Bank, acting through its board of directors pursuant to policies adopted by the board, shall conduct an annual assessment of the skills and experience possessed by its board of directors as a whole and may determine whether the capabilities of the board would be enhanced through the addition of individuals with particular skills and experience. If the board of directors determines that the Bank could benefit by the addition to the board of directors of individuals with particular qualifications such as those described in § 1261.5(c)(1), it shall identify those qualifications and inform the members that the Bank is seeking member and independent director nominees that have those qualifications as part of its election announcement pursuant to § 1261.7(a).

(b) *Support for nomination or election.* (1) A Bank director, officer, attorney, employee, or agent, acting in his or her personal capacity, may support the nomination or election of any individual for a member directorship, provided that no such individual shall purport to represent the views of the Bank or its board of directors in doing so.

(2) A Bank director, officer, attorney, employee or agent and the board of directors and Advisory Council (including members of the Council) of a Bank may support the candidacy of any individual nominated by the board of directors for election to an independent directorship.

(c) *Prohibition.* Except as provided in paragraphs (a) and (b) of this section, or § 1223.21(b)(7) of this chapter, no director, officer, attorney, employee, or agent of a Bank shall:

(1) Communicate in any manner that a director, officer, attorney, employee, or agent of a Bank, directly or indirectly, supports or opposes the nomination or election of a particular individual for a directorship; or

(2) Take any other action to influence the voting with respect to any particular individual.

**§ 1261.10 Independent director independence.**

(a) *Employment interests.*

(1) An independent director, and a nominee for an independent directorship, shall not serve as an officer, employee, or director of any member of the Bank on whose board the individual serves or has been nominated to serve, or of any recipient of advances from such Bank, and shall not serve as an officer or employee of any Bank. An independent director or nominee for any independent directorship, and any individual seeking nomination for an independent directorship, shall disclose all such interests to the Bank on whose board of directors the individual serves or which is considering the individual for nomination to its board of directors.

(2) For purposes of paragraph (a)(1) of this section, “advances” includes any loan

from a Bank to the recipient, regardless of form or nomenclature, except for debt securities traded in the public capital markets.

(b) *Holding companies.* Service as an officer, employee, or director of a holding company that controls one or more members of, or one or more recipients of advances from, the Bank on whose board an independent director serves is not deemed to be service as an officer, employee or director of a member or recipient of advances if the assets of all such members or all such recipients of advances constitute less than 35 percent of the assets of the holding company, on a consolidated basis.

(c) *Attribution.* For purposes of determining compliance with this section, a Bank shall attribute to the independent director any officer position, employee position, or directorship of the director's immediate family members (as defined in § 1261.11(f)).

(d) *Member Director Transition Period.* An individual who has served as a member director of any Bank may not serve as an independent director of any Bank until at least two years has elapsed since the date the individual officially left the member directorship, whether due to ineligibility or otherwise.

#### **§ 1261.11 Conflicts of interest policy for Bank directors.**

(a) *Adoption of conflicts of interest policy.* Each Bank shall adopt a written conflicts of interest policy that applies to all members of its board of directors. At a minimum, the conflicts 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;
- (2) Require independent directors to comply with § 1261.10(a);
- (3) Prohibit the use of a director's official position for personal gain;

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

(5) Require the establishment of internal controls to ensure that conflicts of interest reports are made and filed and that conflicts of interest issues are disclosed and resolved; and

(6) Establish procedures to monitor compliance with the conflicts of interest policy.

(b) *Disclosure and recusal.* A director shall disclose to the Bank's board of directors any financial interests he or she has, as well as any financial interests known to the director of any immediate family member or business associate of the director, in any matter to be considered by the Bank's board of directors and in any other business matter or proposed business matter involving the Bank and any other person or entity. A director shall disclose fully the nature of his or her interests in the matter and shall provide to the Bank's board of directors any information requested to aid in its consideration of the director's interest. A director shall refrain from considering or voting on any issue in which the director, any immediate family member, or any business associate has any financial interest.

(c) *Confidential Information.* Directors shall not disclose or use confidential information they receive solely by reason of their position with the Bank to obtain any benefit for themselves or for any other individual or entity.

(d) *Gifts.* No Bank director shall accept, and each Bank director shall discourage the director's immediate family members from accepting, any gift that the director believes or has reason to believe is given with the intent to influence the director's actions

as a member of the Bank's board of directors, or where acceptance of such gift would have the appearance of intending to influence the director's actions as a member of the board. Any insubstantial gift would not be expected to trigger this prohibition.

(e) *Compensation.* Directors shall not accept compensation for services performed for the Bank from any source other than the Bank for which the services are performed.

(f) *Definitions.* For purposes of this section:

*Business associate* means any individual or entity with whom a director has a business relationship, including, but not limited to:

(1) Any corporation or organization of which the director is an officer or partner, or in which the director beneficially owns ten percent or more of any class of equity security, including subordinated debt;

(2) Any other partner, officer, or beneficial owner of ten percent or more of any class of equity security, including subordinated debt, of any such corporation or organization; and

(3) Any trust or other estate in which a director has a substantial beneficial interest or as to which the director serves as trustee or in a similar fiduciary capacity.

*Financial interest* means a direct or indirect financial interest in any activity, transaction, property, or relationship that involves receiving or providing something of monetary value, and includes, but is not limited to any right, contractual or otherwise, to the payment of money, whether contingent or fixed. It does not include a deposit or savings account, loan or extension of credit, or other accounts and products obtained in the normal course of business on non-preferential terms generally available to the public



from a member institution or from a non-member counterparty to the Bank on whose board the director sits.

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

#### **§ 1261.12 Reporting requirements for Bank directors.**

(a) *Annual reporting.* Annually, each Bank shall require each of its directors to execute and deliver to the Bank the appropriate director eligibility certification form prescribed by FHFA for the type of directorship held by such director. The Bank promptly shall deliver to FHFA a copy of the certification form delivered to it by each director.

(b) *Report of noncompliance.* At any time that any director believes or has reason to believe that he or she no longer meets the eligibility requirements set forth in the Bank Act or this subpart, the director promptly shall so notify the Bank in writing. At any time that a Bank believes or has reason to believe that any director no longer meets the eligibility requirements set forth in the Bank Act or this subpart, the Bank promptly shall notify FHFA in writing.

#### **§ 1261.13 Ineligibility and removal of Bank directors.**

(a) *Ineligibility.* Upon a determination by FHFA or a Bank that any director of the Bank no longer satisfies the eligibility requirements set forth in the Bank Act or this subpart, or has failed to comply with the reporting requirements of § 1261.12, the directorship shall immediately become vacant. Any director that is determined to have failed to comply with any of these requirements shall not continue to serve as a Bank director. Whenever a Bank makes such a determination, the Bank promptly shall notify

the Bank director and FHFA in writing.

(b) *Removal for good cause.* (1) A Bank's board of directors may, upon a vote of two-thirds of its disinterested directors, remove any director for good cause pursuant to policies adopted by the board. Removal for good cause may be based upon:

(i) A material violation of the Bank's code of ethics or other applicable Bank policy;

(ii) A material violation of the Bank Act, FHFA regulations or other civil or criminal law;

(iii) A determination by the board that continuation in office of such director would be materially harmful to the Bank;

(iv) Conduct, or a mental or physical condition, that raises substantial questions concerning the director's ability to fulfill his or her duties and obligations; or

(v) A determination under § 1261.22(b)(3) that the director's continuous poor performance or lack of participation is compromising the board's ability to adequately oversee the operations of the Bank.

(2) A Bank shall promptly notify FHFA in writing of any pending or final removal action under this provision.

**§ 1261.14 Vacant Bank directorships.**

(a) *Filling unexpired terms.* Subject to the provisions of this section, when a vacancy occurs on the board of directors of a Bank, the board shall elect, by a majority vote of the remaining Bank directors sitting as a board, an individual to fill the unexpired term of office of the vacant directorship, regardless of whether the remaining Bank directors constitute a quorum of the Bank's board of directors.

(1) The board of directors may fill an anticipated vacancy prior to the effective date of the vacancy, provided the board does so no sooner than the date of the regularly scheduled board meeting that occurs immediately prior to the effective date of the vacancy.

(2) The board of directors shall:

(i) Fill a vacant member directorship only with an individual who meets the requirements of § 1261.5(a); and

(ii) Fill a vacant independent directorship only with an individual who meets the requirements of § 1261.5(b).

(3) If a Bank does not have at least two sitting public interest independent directors, its board of directors shall either:

(i) Elect an individual who is qualified under § 1261.5(c)(2) to serve as a public interest independent director to fill the vacancy; or

(ii) Elect to redesignate as a public interest independent director a sitting regular independent director who is qualified under § 1261.5(c)(2) to serve as a public interest independent director and elect another individual who is qualified under § 1261.5(c)(1) to serve as a regular independent director to fill the resulting vacant regular independent directorship.

(4) If the Bank has more than two sitting public interest independent directors, the board of directors may redesignate as a regular independent director a sitting public interest independent director who is qualified under § 1261.5(c)(2).

(5) The board of directors of the Bank shall consult with the Bank's Advisory Council before considering any individual to fill a vacant independent directorship.

(b) *Verifying eligibility.* Prior to any election by the board of directors to fill a board vacancy, the Bank shall fulfill the requirements of this paragraph (b).

(1) The Bank shall obtain an executed member director eligibility certification form prescribed by FHFA from each individual being considered to fill a vacant member directorship and an executed independent director application form prescribed by FHFA from each individual being considered to fill a vacant independent directorship (including any sitting regular independent director to be redesignated as public interest independent director). Using the executed forms, each Bank shall verify each individual's eligibility and, as to independent directors, also shall verify that the individual meets the qualifications requirements for regular independent directors under § 1261.5(c)(1) or public interest independent directors under § 1261.5(c)(2), as appropriate.

(2) For each individual being considered to fill a vacant directorship, the Bank shall conduct a background check, as provided in § 1261.7(e).

(3) The Bank shall deliver to FHFA for its review a copy of the executed independent director application form for each individual being considered by the board to fill a vacant independent directorship, as well as a summary of the results of the background check. If within two weeks of such delivery FHFA provides comments to the Bank on any of those individuals, the board of directors of the Bank shall consider FHFA's comments in determining whether to elect a director from among those individuals or to seek additional individuals for consideration.

(4) The Bank shall retain the information it receives pursuant to this paragraph (b) for at least seven years after the date of the election in question and, in the case of any information about a specific director, for at least seven years after that director leaves the

board.

(c) *Notification.* Promptly after allowing the individual to assume the directorship, as provided in paragraph (b) of this section, a Bank shall notify FHFA and each member located in the Bank's district in writing of the following:

(1) For each member directorship filled by the board of a Bank, the name of the director, the name, location, and FHFA ID number of the member the director serves, the director's title or position with the member, the voting State that the director represents, and the expiration date of the director's term of office; and

(2) For each independent directorship filled by the board of a Bank, the name of the director, the name and location of the organization with which the director is affiliated, if any, the director's title or position with such organization, and the expiration date of the director's term of office.

**§ 1261.15 Minimum number of member directorships.**

Except with respect to member directorships of a Bank resulting from the merger of any two or more Banks, the number of member directorships allocated to each state shall not be less than the number of directorships allocated to that state on December 31, 1960. The following table sets forth the states within Bank districts not created from the merger of two or more Banks whose members held more than one directorship on December 31, 1960:

<b>State</b>	<b>Number of elective directorships on December 31, 1960</b>
California	3
Colorado	2

Illinois	4
Indiana	5
Kansas	3
Kentucky	2
Louisiana	2
Massachusetts	3
Michigan	3
New Jersey	4
New York	4
Ohio	4
Oklahoma	2
Pennsylvania	6
Tennessee	2
Texas	3
Wisconsin	4

**Subpart C—Federal Home Loan Bank Directors' Compensation and Expenses**

**§ 1261.20 Definitions.**

As used in this subpart C:

*Compensation* means any payment of money or the provision of any other thing of current or potential value in connection with service as a director. Compensation includes all direct and indirect payments of benefits, both cash and non-cash, granted to or for the benefit of any director.

*Expenses* means necessary and reasonable travel, subsistence and other related expenses incurred in connection with the performance of official duties as are payable to senior officers of the Bank under the Bank's travel policy, except gift or entertainment expenses.

**§ 1261.21 General.**

(a) *Standard.* Each Bank may pay its directors reasonable compensation for the time required of them, and their necessary expenses, in the performance of their duties, as determined by a resolution adopted by the board of directors of the Bank and subject to the provisions of this subpart. The Director may establish and provide notice of an annual amount of compensation determined to be reasonable.

(b) *Reporting—(1) Following calendar year.* By December 31 of each calendar year, each Bank shall report to the Director the compensation it anticipates paying to its directors for the following calendar year.

(2) *Preceding calendar year.* No later than the tenth business day of each calendar year, each Bank shall report to the Director the following information relating to director compensation, expenses and meeting attendance for the immediately preceding calendar year:

(i) The total compensation paid to each director;

(ii) The total expenses paid to each director;

(iii) The total compensation paid to all directors;

(iv) The total expenses paid to all directors;

(v) The total of all expenses incurred at group functions that are not reimbursed to individual directors, such as the cost of group meals in connection with board and committee meetings;

(vi) The total number of meetings held by the board and its designated committees; and

(vii) The number of board and designated committee meetings each director

attended in-person or remotely, through video conferencing or teleconferencing, and in accordance with § 1261.24(b).

**§ 1261.22 Directors' compensation policy.**

(a) *General.* Each Bank's board of directors annually shall adopt a written compensation policy to provide for the payment of reasonable compensation and expenses to the directors for the time required of them in performing their duties as directors. Payments under the directors' compensation policy may be based on any factors that the board of directors determines reasonably to be appropriate, subject to the requirements in this subpart.

(b) *Minimum contents.* (1) The compensation policy shall address the activities or functions for which director attendance or participation is necessary and which may be compensated, and shall explain and justify the methodology used to determine the amount of compensation to be paid to the Bank directors.

(2) The compensation policy shall require that any compensation paid to a director reflect the amount of time the director has spent on official Bank business and shall require that compensation be reduced or a director removed, as necessary, to reflect lesser attendance or performance at board or committee meetings during a given year.

(3) In addition to attendance, the compensation policy shall establish a fair and impartial process for annually evaluating individual director performance and participation, including, but not limited to, an assessment of whether each director:

- (i) Demonstrated understanding of the Bank System;
- (ii) Demonstrated knowledge of the Bank's policies and governance documents;
- (iii) Demonstrated understanding of his or her legal and ethical responsibilities as



a board member;

(iv) Made suggestions congruent with the Bank's mission, vision and values (even if divergent from majority opinion); and

(v) Acted in support of Board decisions, regardless of initial position.

(c) *Prohibited payments.* A Bank shall not pay a director who regularly fails to attend board or committee meetings, and shall not pay fees to a director that do not reflect the director's performance of official Bank business conducted prior to the payment of such fees.

(d) *Submission requirements.* No later than the tenth business day after adopting its annual policy for director compensation and expenses, and at least 30 days prior to disbursing the first payment to any director, each Bank shall submit to the Director a copy of the policy, along with all studies or other supporting materials upon which the board relied in determining the level of compensation and expenses to pay to its directors.

#### **§ 1261.23 Director disapproval.**

The Director may determine, based upon his or her review of a Bank's director compensation policy, methodology and/or other related materials, that the compensation and/or expenses to be paid to the directors are not reasonable. In such case, the Director may order the Bank to refrain from making any further payments under that compensation policy. Any such order shall apply prospectively only and will not affect either compensation or expenses that have been earned but not yet paid or reimbursed or payments that had been made prior to the date of the Director's determination and order.

#### **§ 1261.24 Board meetings.**

(a) *Number of meetings.* The board of directors of each Bank shall hold as many

meetings each year as necessary and appropriate to carry out its fiduciary responsibilities with respect to the effective oversight of Bank management and such other duties and obligations as may be imposed by applicable laws, provided the board holds a minimum of six meetings in any year.

(b) *Site of meetings.* (1) A Bank’s board of directors and its committees may conduct meetings in-person, through video conferencing or teleconferencing, or in a hybrid format, provided that all directors have an opportunity to communicate and have access to all written documents and presentations.

(2) Each Bank should generally hold board and committee meetings within the district served by the Bank. A Bank shall not hold board or committee meetings in any location that is not within a State, as defined by 12 CFR 1201.1. A director must be located within a State when attending a meeting remotely through video conferencing or teleconferencing.

(c) *Quorum.* A quorum, for purposes of meetings of a Bank’s board of directors, shall require a majority of sitting directors, which must include a majority of sitting independent directors.

#### **PART 1273—OFFICE OF FINANCE**

4. The authority citation for part 1273 continues to read as follows:

**Authority:** 12 U.S.C. 1431, 1440, 4511(b), 4513, 4514(a), 4526(a).

5. Amend § 1273.5 by revising paragraph (b)(1) to read as follows:

#### **§ 1273.5 [Amended]**

\* \* \* \* \*

(b) \* \* \* (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 in order to maintain sufficient operating funds under the budget approved by the OF board of directors. The OF operating funds shall be:

(i) Available for expenses of the OF and the OF board of directors, according to their approved budgets; and

(ii) Subject to withdrawal by check, draft, wire transfer, or other funds transfer methods with written authorization by the CEO or other persons designated by the CEO or OF board of directors in accordance with OF governance documents.

6. Amend § 1273.8 by revising paragraphs (b) and (d) to read as follows:

**§ 1273.8 General duties of the OF board of directors.**

\* \* \* \* \*

(b) *Meetings and quorum*—(1) *Meeting frequency*. The OF board of directors shall conduct its business by majority vote of its members at meetings convened in accordance with its by-laws, and shall hold no fewer than six meetings annually, which may be conducted in-person, through video conferencing or teleconferencing, or in a hybrid format, provided that all directors have an opportunity to communicate and have access to all written documents and presentations.

(2) *Meeting location*. The OF shall not hold board or committee meetings in any location that is not within a State, as defined by 12 CFR 1201.1. A director must be located within a State when attending a meeting remotely through videoconferencing or teleconferencing.

(3) *Notice*. Due notice shall be given to FHFA by the Chair prior to each meeting.

(4) *Quorum*. A quorum, for purposes of meetings of the OF board of directors,

shall require a majority of sitting board members, which must include a majority of sitting Independent Directors.

\* \* \* \* \*

(d) *Other duties.* The OF board of directors shall:

(1) Set policies for management and operation of the OF;

(2) Approve a strategic business plan for the OF in accordance with the provisions of § 1239.14 of this chapter, as appropriate;

(3) Select, employ, determine the compensation for, and assign the duties and functions of a CEO of the OF who shall—

(i) Be head of the OF and direct the implementation of the OF board of directors' policies;

(ii) Serve as a member of the Directorate of the FICO, pursuant to section 21(b)(1)(A) of the Bank Act (12 U.S.C. 1441(b)(1)(A)); and

(iii) Serve as a member of the Directorate of the REFCORP, pursuant to section 21B(c)(1)(A) of the Bank Act (12 U.S.C. 1441b(c)(1)(A)).

(4) Review and approve contracts of the OF, as specified in OF governance documents.

(5) Assume any other responsibilities that may from time to time be assigned to it by FHFA.

\* \* \* \* \*

\_\_\_\_\_/s/  
Sandra L. Thompson,  
*Director, Federal Housing Finance Agency.*

October 16, 2024