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November 25, 2008

*Via Electronic Mail: [comments@fhfb.gov](mailto:comments@fhfb.gov)*

Federal Housing Finance Agency  
1625 Eye Street, NW  
Washington, DC 20006  
Attention: Public Comments/RIN 2590-AA03

RE: Federal Housing Finance Agency Interim Final Rule with Request for Comments  
– Federal Home Loan Bank Boards of Directors: Eligibility and Elections; RIN  
2590-AA03

Ladies and Gentlemen:

The Federal Home Loan Bank of Dallas (the “Dallas Bank”) appreciates the opportunity to comment on the interim final rule (the “Interim Final Rule”) on the eligibility and election of Federal Home Loan Bank (“Bank”) directors, which was issued by the Federal Housing Finance Agency (the “FHFA”) and published in the Federal Register on September 26, 2008. We appreciate the FHFA’s effort to expedite its rulemaking on this topic, and we thank you for the opportunity to comment on this important matter.

The Dallas Bank shares the FHFA’s goal of promoting safety and soundness and believes that the election of qualified and accountable directors is a critical element in achieving that goal. With that shared goal in mind, we offer the following comments for your consideration.

## **1. Board Size and Composition -- Public Interest Directorships**

In the Interim Final Rule, the FHFA requested comment on whether the number of public interest directorships for each Bank should be established by the board of directors of that Bank rather than by the Director of the FHFA (the “Director”), as the Interim Final Rule currently provides. We believe that each Bank’s directors are in the best position to identify the skills and experience needed by its board as a whole. For example, depending on the skills of the Bank’s incumbent directors and the

Bank's particular goals, a Bank's board might at times determine that corporate governance would be enhanced by having on the board a greater number of individuals who would qualify as public interest directors. At other times, a board might determine that its shareholders would be better served by limiting the number of public interest directors on the board to the statutory minimum and instead having a greater number of independent directors with more experience in other areas, such as accounting, derivatives, or risk management, that better address the Bank's needs at that time. Although a board could reduce the number of public interest directors only as the incumbent public interest directors' terms expire, giving each Bank's board the flexibility to establish the number of public interest directorships would enhance the board's ability to ensure that the board as a whole possesses the optimum combination of skills and experience.

## **2. Director Eligibility -- Term Limitations**

The FHFA seeks comment on the Interim Final Rule's application of the consecutive term limitation in section 7(d) of the Federal Home Loan Bank Act (the "Bank Act"), as amended by the Housing and Economic Recovery Act of 2008 ("HERA"), which provides that a person who has been elected to, and has served for all or part of, three consecutive full terms is not eligible to be re-elected to any term that begins less than two years after the expiration of the last such term.

Based on the preamble to the regulation, the Dallas Bank believes that the rule's intent is (1) to deem any existing three-year terms (of both member and independent directors) that expire after December 31, 2008 and any new four-year terms that begin after the effective date of HERA (July 30, 2008) to be full terms and (2) to clarify that any terms that begin after July 30, 2008 that are shortened to implement staggering are not intended to be full terms, but are also not intended to be gaps in service. For example, if a director who has served a three-year term that ended December 31, 2005 and is currently serving a three-year term that ends December 31, 2008, is elected to a term that begins in January 2009, the length of that term will determine whether the director would be eligible to serve an additional term. If the term that begins in January 2009 is designated by the FHFA as being shorter than four years, the director could serve one more four-year term immediately following that shorter term. If, however, the term beginning in January 2009 is a full four-year term, that would be the last term the director could serve before taking the statutorily-prescribed two-year break in service.

The Dallas Bank also believes, based on the rule's intent, that a term that was shortened as a result of the staggering provisions added to the Bank Act by the Gramm-Leach-Bliley Act would not be considered a full term under Section 1261.4(c)(2) of the Interim Final Rule. In the scenario described above, therefore, if, prior to the term that ended December 31, 2005, the director had served a one-year term that ended December 31, 2002, that one-year term would not be considered a full term under Section 1261.4(c)(2) and the director would still be eligible to serve one more full term beginning

on or after January 2009, as described above. Because Section 1261.4(c)(2) of the Interim Final Rule did not carry over the provisions of former Section 915.7(c)(2), which specified that the shortened Gramm-Leach-Bliley terms were not deemed to be full terms, the Dallas Bank suggests that the FHFA add to the final rule language that clarifies that this is the case under Section 1261.4(c)(2).

Consequently, the Dallas Bank suggests that the final rule be revised to clarify that any term that begins after the effective date of HERA and is for fewer than four years is not considered a full term for purposes of applying the term limitation provisions. Section 1261.4(c)(2)(ii) of the Interim Final Rule states, “ Any three year term of office ending immediately before a term of office that is adjusted after July 30, 2008 to a period of fewer than four years and ***any term of office commencing immediately following such adjusted term of office*** shall constitute consecutive full terms of office” [emphasis added]. The italicized phrase could be read as modifying Section 1261.4(c)(2)(i), which provides that any term of office that is adjusted after July 30, 2008 to a period of fewer than four years is not deemed to be a full term, so that any term of office immediately following a shortened term would be considered a full term even if it is also shorter than four years. Based on the FHFA’s explanation of the Interim Final Rule, the Dallas Bank does not believe that this corresponds with the FHFA’s intent and requests that the FHFA clarify that any term that is adjusted after the effective date of HERA to be for a period of fewer than four years would not be considered a full term, whether or not that term commences immediately following another term that was similarly adjusted. Rather than retain the language currently in 1261.4(c)(2)(ii), the FHFA could revise it to state simply that terms shortened after July 30, 2008 to achieve staggering do not constitute breaks or gaps in service.

Also for consistency in applying the statutory term limitation provision to all classes of directors (including directors previously appointed by the Federal Housing Finance Board) to correspond to the intent stated in the preamble, Section 1261.4(c)(2)(iii) could be revised to clarify that any three year term of office existing on or before July 30, 2008 is deemed to be a full term, whether the director was elected to the directorship or was appointed by the Federal Housing Finance Board. Without such clarification, the rule does not address the application of the term limitation provision to directors previously appointed by the Federal Housing Finance Board.

Accordingly, the Dallas Bank suggests that the FHFA revise Section 1261.4(c)(2) as follows:

- (2) For purposes of applying the term limit provision of section 7(d) of the Act (12 U.S.C. 1427(d)):
  - (i) A term of office that was adjusted on or before July 30, 2008 to a period of fewer than three years shall not be deemed to be a full term;

- (ii) A term of office that is adjusted after July 30, 2008 to a period of fewer than four years shall not be deemed to be a full term; and
- (iii) A term of office that is adjusted after July 30, 2008 to a period of fewer than four years does not constitute a break or gap in the director's service.

### **3. Independent Directorship Nominations**

#### **A. Role of the Advisory Council in Independent Director Nominations**

The FHFA seeks comment on whether it should require a Bank's Advisory Council to play any specific role in consulting with the Bank's board of directors regarding independent director nominees and whether the FHFA should prescribe procedures on how the consultation should take place. The Dallas Bank believe that the nomination of independent directors implicates the fiduciary duties of each Bank's board of directors and that each board should have the flexibility to consult with the Advisory Council in a way that, in the board's judgment, best assists the board in fulfilling those fiduciary duties. The form, content, and timing of advice that each Bank needs from its Advisory Council might differ depending on the background and experience of the Bank's board and its process for identifying nominees. A regulatorily-prescribed process may not meet the unique requirements of each Bank. The Interim Final Rule provides each Bank the flexibility to establish a process that will meaningfully assist its board of directors in fulfilling its statutory mandate to nominate independent directors, and the Dallas Bank encourages the FHFA to retain the text of the Interim Final Rule in this respect.

#### **B. Existing Public Interest Directors**

The FHFA has asked whether it should apply to a Bank's current public interest directors the additional two years of relevant experience required by HERA. The Dallas Bank believes that, in general, each Bank will benefit more from retaining the continuity of service of its current public interest directors than it would from possibly gaining directors with two additional years of experience in the required areas. If, however, the FHFA changes the final rule to apply HERA's requirements to existing public interest directors, the Dallas Bank suggests that, because the Banks have conducted their 2008 elections based on the Interim Final Rule, the FHFA provide for a transition period.

### **C. Number of Nominees**

The FHFA seeks comment on whether the Banks' boards of directors should be required to nominate more candidates for independent directorships than there are positions to be filled, if the board determines that there are sufficient applicants who are both eligible and qualified. As stated above, the Dallas Bank believes that, because nomination of independent directors implicates the board's fiduciary duties, boards should be free to nominate the candidates who are the most qualified and who will contribute particular experience and skills that would enhance the board's corporate governance abilities. If the rule requires each Bank to submit more than one nominee for each directorship to be filled, it may force boards to nominate candidates who, while meeting the minimum requirements for eligibility and qualifications, are not the best-suited candidates considering the board's particular needs at the time.

At the same time, the Dallas Bank believes that each Bank's board of directors should have the flexibility to nominate more than one candidate for each position to be filled if, based on the qualifications of the candidates in any given election, the board determines that more of the candidates possess skills and experience that would address the board's needs.

### **D. Qualifications for Independent Directors**

In response to the FHFA's request for comment on whether it should add additional areas of expertise to the list of specific qualifications that independent directors, other than public interest directors, must have, the Dallas Bank suggests that the FHFA consider adding the following areas of expertise, which the Dallas Bank has found to be valuable in its independent directors: policymaking in business, government, education or community affairs; capital markets; fiduciary duties of an independent director or of a director of a public company or utility; compliance with the Securities and Exchange Commission's rules and regulations; affordable housing and community development; human resources; local, state, or federal agencies, government, or public infrastructure; state or federal legislative process; and information technology.

## **4. Election Process**

### **A. Declaring Results**

The Dallas Bank requests that the FHFA revise Section 1261.7(f)(2) so that the election process for independent directorships comports with the election process for member directorships, and that for each independent directorship a Bank shall declare elected the nominee receiving the highest number of votes. The Bank notes that the language in the Bank Act, as amended by HERA, that addresses the election of member directors is similar to the language regarding the election of independent directors. With

respect to member directorships, the Bank Act requires the Banks to fill each member directorship from the nominees by a plurality of the votes cast by members in the applicable states, while the Bank Act requires independent directors to be elected by a plurality of the votes of the members of the Bank at large. The Dallas Bank therefore believes that applying the same standards to filling positions for member directors and independent directors would be appropriate given the similar statutory language.

The Dallas Bank understands the FHFA's concern, which was outlined in the release accompanying the Interim Final Rule, that each director reflect the choice of the Bank's members. As explained above, however, the Dallas Bank believes that the board of directors of each Bank is in the best position to assess the particular needs of the board at any given time, how the qualifications of each candidate address those needs, and how many candidates should be nominated for a given directorship. A requirement that each independent director be elected by a certain percentage could, however, discourage the Banks' boards from nominating more than one candidate for each slot. Additionally, in an election where a Bank's board of directors has determined that there is more than one well-qualified candidate for each directorship, the Bank's members' preference for a particular candidate may be better shown by giving them a choice between two or more candidates than by requiring that a candidate receive a certain percentage of votes to be elected. Accordingly, the Bank respectfully requests that the FHFA reconsider the twenty-percent requirement. If the FHFA determines to retain a percentage requirement, the Dallas Bank suggests that the percentage be determined based on the number of votes actually cast rather than the votes eligible to be cast.

#### **B. Failure to Fill All Independent Directorships**

If the FHFA retains some percentage requirement for the election of independent directors, the Dallas Bank requests that the FHFA more explicitly define the process for holding elections subsequent to an election in which a nominee fails to obtain the required percentage of votes. For example, the rule could (1) specify shortened time frames for delivery of independent director applications, review by the FHFA, and voting, so that the vacancy can be filled prior to the January 1 commencement of the director's term, (2) address the content of the report of election required by Section 1261.7(g) in the context of a failed election, and (3) clarify that a Bank's board is permitted to nominate the same candidate(s) in a subsequent election, which the board might do if it believed that low voter participation, rather than shareholder disfavor of the candidate(s), caused the candidates' failure to receive the required percentage of eligible votes.

#### **C. Lack of Member Directorship Nominees**

The Dallas Bank requests that the FHFA revise Section 1261.7(c) to amend the time at which a Bank's board of directors may fill a member directorship that was not filled due to lack of nominees. The Section 1261.7(c) of the Interim Final Rule states that a member directorship that is not filled due to lack of nominees is deemed vacant as of January 1 of the

following year, and 1261.14(a) provides that a Bank's board of directors must fill such a vacancy "as soon as practicable after any vacancy occurs," which means that the board must wait until January 1 to choose a successor. The Dallas Bank believes that, in cases such as this where a Bank knows that there will be a vacancy as of January 1 of the following year, the Bank's board of directors should be able to immediately choose an individual to serve in that directorship so that any vacancy is as short as possible.

#### **D. Bylaws and Independent Director Nominating and Election Procedures**

Although the FHFA did not ask for comment on this issue, the Dallas Bank respectfully requests that the FHFA not require the Banks to include in their bylaws detailed procedures in their bylaws for the nomination and election of independent directors. While Section 1427(b)(2)(C) requires that the Banks' bylaws prescribe procedures for the nomination and election of independent directors, the Interim Final Rule is, effectively, the procedure. Therefore, the statutory requirement for inclusion of such procedures in the Banks' bylaws can be satisfied with a reference to applicable regulations.

### **5. Conflict of Interests Rules**

#### **A. Independent Director Conflict of Interest Rules**

The Dallas Bank seeks clarification on the language in Section 1261.10(a), specifically the provision that an independent director may not serve as an officer, employee, or director of "any recipient of advances from [the] Bank." The Dallas Bank believes that this provision is intended to prevent officers, employees, and directors of non-member borrowers from serving on a Bank's board, but is concerned that this language could prevent an officer, employee, or director of a Bank's housing associate from serving on the Bank's board of directors. Given the experience and skill sets that the officers, employees, and directors of housing associates possess, the Banks may find these individuals to be valuable members of the Banks' boards of directors. If the regulations do not clarify that an officer, employee, or director of a housing associate is not prohibited by this section from serving as an independent director of a Bank, those individuals will not be eligible to serve on a Bank's board in any capacity (since they are not eligible to be member directors) and the Banks may miss the opportunity to put well-qualified individuals on their boards.

#### **B. General Conflict of Interest Rules**

The Dallas Bank believes that Section 1261.11 of the Interim Final Rule creates ambiguity about a director's ability to accept reasonable and customary entertainment and ordinary-course business gifts by deleting the prior rule's safe harbor for non-substantial gifts. Under the Federal Housing Finance Board's prior rule, prohibited "substantial gifts" included gifts of more than token value, entertainment the cost of which is unreasonable, non-customary and not accepted business practice, and any item

or service for which a director pays less than market value. While a director's acceptance of any gift could have the appearance of influencing a director's actions, only substantial gifts (as defined in the prior rule) are likely to do so. Accordingly, the Dallas Bank asks that the FHFA include the safe harbor for non-substantial gifts that was included in the prior rule, and that the rule also be revised to expressly permit member directors to accept gifts that are customarily given to other members, as such gifts by their nature are not intended to influence a director's actions as a member of the board.

## **6. Actions Affecting Director Elections**

The Dallas Bank requests that section 1261.9(b) of the Interim Final Rule be clarified to permit individual Advisory Council members to support the candidacy of a Bank's nominees for independent directorships; as currently written, the rule implies that only the Advisory Council as a whole may do so.

Finally, the Dallas Bank notes that section 1261.9(b)(1) of the Interim Final Rule provides that a director, officer, attorney, employee, or agent of a Bank, acting in his or her personal capacity, may support the nomination or election of any individual for a member directorship, and then states that in doing so a director of the Bank is prohibited from purporting to represent the views of a Bank or its board of directors. The Dallas Bank requests that the FHFA clarify whether or not this prohibition extends to officers, attorneys, employees, or agents of a Bank as well as to directors.

Thank you for the opportunity to be heard on this matter, and for your consideration of our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Terry Smith", with a stylized flourish at the end.

Terry Smith  
President and CEO