Comment # 4

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VIA EMAIL TO REGCOMMENTS@FHFA.GOV AND BY HAND:

Alfred M. Pollard, General Counsel (OFHEO)
Christopher Curtis, General Counsel (FHFB)
Attention: Comments / RIN: 2590-AA08
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Re: Proposed Amendment to Interim Final Rule on Golden Parachute and Indemnification Payments, RIN 2590-AA08

Dear Messrs. Pollard and Curtis:

The Federal Home Loan Bank of Boston ("Boston Bank"), the Federal Home Loan Bank of Indianapolis ("Indianapolis Bank"), the Federal Home Loan Bank of New York ("New York Bank") and the Federal Home Loan Bank of Des Moines ("Des Moines Bank") (together the "Banks") are writing to comment on the proposed amendment by the Federal Housing Finance Agency ("FHFA") to the interim final regulation on Golden Parachute Payments and Indemnification Payments ("Interim Final Regulation"),[1] which was published on November 14, 2008 ("Proposal").[2] The Interim Final Regulation is to be codified at 12 C.F.R. Part 1231. The Proposal addresses limits on indemnification payments to an entity-affiliated party of a regulated entity with regard to certain administrative proceedings or civil actions brought by the FHFA against an entity-affiliated party. The Proposal also includes a statement regarding the applicability of Part 1231 in the event of a receivership of a regulated entity.

The Banks welcomes this opportunity to comment on the Proposal. Our comments are focused on four principal points.

- First, the FHFA should delete a sentence in proposed section 1231.6, which provides that even if otherwise vested, employee welfare or other benefits which are contingent because they require termination of employment, are not provable claims or actual, direct compensatory damage claims against a receiver. This sentence, as described below, is not supported by the weight of judicial decisions.

- Second, the Proposal should make clear that grandfathered indemnification "agreements" apply to both contractual indemnification provisions contained in a

1 The Interim Final Regulation was published on September 16, 2008, 73 Fed. Reg. 53356, and correcting amendments were published on September 19, 2008, 73 Fed. Reg. 54309, and September 23, 2008, 73 Fed. Reg. 54673.

2 73 Fed. Reg. 67424 (2008).

regulated entity's bylaws, as well as to separate indemnification agreements between a regulated entity and an entity-affiliated party.

- Third, the requirements of section 1231.2 of the Proposal regarding the necessary findings that the entity-affiliated party has not engaged in any wrongdoing with respect to the charges for which partial indemnification is sought are not consistent with the general practice in settlements of administrative actions and will unnecessarily discourage settlements. This provision should be amended to permit partial indemnification of legal and professional expenses related to any particular charges that do not form the basis for any remedies imposed on the entity-affiliated party under the terms of the settlement. Likewise, the FHFA should modify the methodology for determining the extent to which permissible partial indemnification of legal and professional expenses would be calculated to better reflect actual practice.

- We have also included an example of how we would expect a board of directors of a regulated entity to deal with a request for indemnification under the Proposal, including comments on the requirements imposed on the board of directors of a regulated entity in connection with an advancement determination.

- Finally, we request that the FHFA promulgate a regulation to allow the Federal Home Loan Banks (the "FHLBanks") to select an applicable body of law for purposes of corporate governance practices and procedures, and indemnification.

I. Comments on proposed section 1231.6 – Applicability in the event of receivership

Section 1231.6 of the Proposal, which discusses the applicability of Part 1231 in the event of a receivership, provides in part that: "Claims for employee welfare benefits or other benefits which are contingent, even if otherwise vested, when a receiver is appointed for any regulated entity, including any contingency for termination of employment, are not provable claims or actual, direct compensatory damage claims against such receiver" ("Employee Benefits Sentence"). A substantially identical sentence is contained in the Federal Deposit Insurance Corporation's ("FDIC") Golden Parachute and Indemnification Rule codified at 12 C.F.R. § 359.7, which appears to implement the FDIC's interpretation of 12 U.S.C. § 1821(e)(3)(A), a provision which generally limits the liability of a receiver in the event of a contract repudiation to the payment of "actual direct compensatory damages."[3]

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3 12 U.S.C. § 1821(e)(3)(B) generally provides that actual direct compensatory damages does not include: (i) punitive or exemplary damages; (ii) damages for lost profits or opportunity; or (iii) damages for pain and suffering. Section 1145 of the Housing and Economic Recovery Act of 2008 ("HERA") includes provisions regarding the receivership and conservatorship of a regulated entity that are largely drawn from section 11 of the Federal Deposit Insurance Act, 12 U.S.C. § 1821. Section 1145 includes language that is almost identical to the provisions of 12 U.S.C. § 1821(e)(3)(A)-(B). As a result, court decisions regarding the interpretation of 12 U.S.C. § 1821(e)(3)(A)-(B) in many instances will be directly relevant to matters that might arise under 12 U.S.C. § 4617(d)(3)(A)-(B). The discussion below generally assumes that 12 U.S.C. § 4617(d)(3)(A)-(B) will be interpreted in the same general manner as courts have interpreted comparable provisions of 12 U.S.C. § 1821(e)(3)(A)-(B).

The Proposal does not contain any discussion of how the FHFA expects the Employee Benefits Sentence to be interpreted and applied.[4] As described below, the case law runs directly counter to the way that the FDIC has attempted to implement this same sentence in its regulations.

In numerous reported cases, the FDIC and the Resolution Trust Corporation ("RTC")[5] took the position that the Employee Benefits Sentence means that an employee who had vested rights under some type of employment arrangement did not have a provable claim and did not have actual direct compensatory damages because a contingency, such as the retirement, death or termination of the employee had not been satisfied as of the date of the appointment of a receiver.[6] In other words, while the FDIC would consider an employee to have been fully entitled to payments under such an employment arrangement if his or her employment had terminated the day before a receiver was appointed, by remaining employed at the time the receiver was appointed he or she would lose all of his or her rights under the employment arrangement.

The FDIC's and RTC's position has been rejected by courts of appeals in five circuits. For example, in *Modzelewski v. RTC*, the RTC took the position that while a savings association executive had reached the required age to be entitled to payments under a salary continuation agreement, he was not entitled to any damages when the RTC as receiver terminated his employment, because he had not retired prior to the appointment of the receiver, and that if the executive had been terminated for cause he would have lost all his benefits under his agreement. The Ninth Circuit found in favor of the executive. It rejected the FDIC's termination for cause contingency claim as a "somewhat remote contingency."[7] The court found that the executive's rights under his agreement had vested at the time the RTC was appointed because he had an unconditional right to retire and collect benefits and therefore was entitled to actual direct compensatory damages under 12 U.S.C. § 1823(d)(3)(A).[8]

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4 Neither the FDIC's second proposed golden parachute and indemnification rule, where the FDIC's similar sentence was first proposed, or the FDIC's final rule ("FDIC Final Rule"), which adopted the sentence, contained a discussion of how the FDIC intended to apply the sentence. 60 Fed. Reg. 16069 (1995); 61 Fed. Reg. 5926 (1996).

5 The RTC was responsible for operating the receiverships and conservatorships of savings institutions following the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The RTC operated under the same provisions of 12 U.S.C. § 1821 as apply to the FDIC. 12 U.S.C. § 1441a(b)(4).

6 As demonstrated by the cases discussed below, the FDIC has maintained the position reflected in the Employee Benefits Sentence both prior to and following the adoption of its version of the Employee Benefits Sentence in the FDIC Final Rule

7 *Modzelewski v. Resolution Trust Corp.*, 14 F.3d 1374, 1378 (9th Cir. 1994).

In *Office & Professional Employees Int'l Union, Local 2 v. FDIC*, the FDIC was appointed receiver and it repudiated a union collective bargaining agreement with the bank under which the bank was to make severance payments to terminated employees under certain circumstances.[9] The FDIC refused to make any severance payments. On appeal the Court of Appeals for the District of Columbia Circuit found for the employees, concluding that severance payments are properly characterized as consideration for entering into, or continuing under, an employment contract, and, therefore are compensable as actual direct compensatory damages when the contract is repudiated.

In *McMillian v. FDIC*, the FDIC rejected a claim for severance pay by an employee under a bank's reduction in force severance plan, basing its rejection on the ground that the employee's right to receive severance pay was contingent when the FDIC was appointed receiver.[10] On appeal the FDIC argued that contingent contract rights do not form a basis for recovery, and that if a contract is in any way contingent, its subsequent breach does not give rise to damages. In that regard the FDIC argued that the right to receive severance pay remained a contingent right and thus was not recoverable.

The Eleventh Circuit Court of Appeals found in favor of the employee. It noted the contract rights that gave rise to the employee's claim were created before the FDIC was appointed receiver. It further concluded that the fact that these rights were contingent at the time the receiver was appointed was of no moment. The court stated that it would make no sense to limit recovery to only those contracts in which all contingencies had been eliminated prior to the appointment of the receiver.

In *Navarro v. FDIC*, the FDIC was appointed receiver and terminated a savings association president.[11] The president filed claims on two deferred compensation agreements. The FDIC rejected her claims finding that she was not entitled to any benefits because the association's obligations terminated as a result of the receivership.

On appeal the court found that the president at all times had full control of when she could begin receiving begin receiving benefits. It found that the president had completed the

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8 The dissenting member of the panel argued that the executive's contractual rights were not vested at the time of the receivership because they remained subject to condition precedent, which was that he had not been terminated for cause.

See also Monrad v. FDIC, 62 F.3d 1169 (9th Cir. 1995). (The Ninth Circuit found that the FDIC's liability for actual direct compensatory damages under 12 U.S.C. § 1821(e)(3) includes severance pay. The court found that the fact that an employee's actual termination post-dates the appointment of the receiver is insufficient to defeat an otherwise valid claim to severance pay).

9 *Office & Professional Employees Int'l Union, Local 2*, 27 F.3d 598 (D.C. Cir. 1994).

10 *McMillian v. FDIC*, 81 F.3d 1041 (11th Cir. 1996).

11 *Navarro v. FDIC*, 371 F.3d 979 (7th Cir. 2004).

necessary amount of service and that there were no further conditions required for her to vest her rights under the agreements. The court concluded by observing:

> To say that she could have unquestionably received the benefits if she quit - - or was fired for cause - - on June 26 but she cannot recover because she came to work on June 27 defies logic and common sense.[12]

We believe the clear weight of court decisions have rejected the view that the repudiation of an employment agreement in which an employee has vested rights but has not satisfied what the FDIC would characterize as an employment termination contingency, *i.e.*, the employee continues to be employed at the bank at the time a receivership is appointed, does not result in a provable claim. These courts have instead recognized that the nature of these types of employee relationships create vested rights that support a provable claim and result in actual direct compensatory damages when an applicable employment arrangement is repudiated by a receiver.

Moreover, from a public policy perspective, it is clearly undesirable to create an incentive for experienced and talented directors, officers, and employees to feel that their economic interests compel them to terminate their relationship with a Federal Home Loan Bank ("FHLBank") and thereby deprive the FHLBank of an essential asset and resource at a critical time.[13]

As currently proposed, section 1231.6 could be interpreted to deny employees of an FHLBank who participate in a range of employment related arrangements, such as a deferred

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12 *Navarro*, 371 F.3d at 982. *See also McCarron v. FDIC*, 111 F.3d 1089 (3d Cir. 1997) (finding that a former bank executive could recover damages for the repudiation of a non-qualified pension plan, because at the time of the FDIC's appointment as receiver, the executive's benefits had vested pursuant to a clause in his contract which waived the otherwise applicable five-year vesting period, even though at the time of the receivership he was still employed by the bank); *Soriero v. FDIC*, 887 F. Supp. 103 (E.D. Pa. 1995) (ruling that claims for supplemental benefits were sufficiently fixed and certain to be provable against the FDIC where the plaintiff had reached an age prior to the receivership where he could have retired and received benefits).

We note that in *Howell v FDIC*, 986 F.2d 569 (1st Cir. 1993) the First Circuit found that severance payments were analogous to liquidated damages and did not comprise actual direct compensatory damages. The *Howell* court did not hold that the repudiation of vested but contingent rights were not provable claims focusing instead on whether the nature of the damages was recoverable. In *Hennessy v. FDIC*, 58 F.3d 908 (3d Cir. 1995), the court relying on *Howell* held that severance payments were not recoverable as actual direct compensatory damages. *See also McCarron* (following *Hennessy* holding that severance payments were analogous to liquidated damages and were not compensable as actual direct compensatory damages).

13 Proposed section 1231.6 is limited to a discussion of the application of Part 1231 in the case of a receivership. We note that under section 1145 of the HERA, a conservator also has the authority to repudiate contracts under 12 U.S.C. § 4617(d)(1), and the same measure of damages applies to repudiations by a conservator as applies to a receiver under 12 U.S.C. § 4617(d)(3). If left unchanged the Employee Benefits Sentence could have the same undesirable affect in relation to employee concerns about an FHLBank being placed in conservatorship.

compensation plan (as in *Navarro*), from claiming a right to damages for repudiation of the deferred compensation plan by a receiver because that particular participant's right to receive payment under the plan, while vested, was still contingent upon the participant's employment being terminated prior to the appointment of the receiver. Under this interpretation, employees who in good faith accept reduced amounts of compensation and who continue to serve the best interests of their FHLBank could later be told that their rights in the deferred compensation plan are nonexistent and not recognized because they failed to terminate their employment with the FHLBank just a day before the FHLBank was placed in receivership (or potentially conservatorship). This is the very type of result that was repeatedly reached by the FDIC and RTC, but that was rejected by the circuit court panels in *Modzelewski*, *Monrad*, *OPEIU*, *McMillian*, *Navarro* and *McCarron*.

Accordingly the Banks believe that the Employee Benefits Sentence should be deleted. In the event of a repudiation of a vested employee benefit arrangement, the FHFA should follow the majority of courts, which means that vested rights should be recognized and compensated without regard to contingencies, including employment termination contingencies. This principle should extend to vested rights, such as rights under severance, deferred compensation and retirement plans.

II. The final regulation should expressly state that the grandfathering provisions relating to existing indemnification agreements applicable to bylaw indemnification provisions that are contractual in nature

The Proposal states that the FHFA recognizes that prior to enactment of the Housing and Economic Recovery Act of 2008 ("HERA"), the regulated entities may have entered into indemnification agreements that provide for indemnification beyond what is proposed to be permissible under 12 U.S.C. § 4518(e) and the Proposal. The Proposal also contains a grandfathering provision that provides that the FHFA intends that the Proposal would only apply to "agreements" entered into by a regulated entity with an entity-affiliated party *on or after* the date the regulation is effective. However, the Proposal does not define what constitutes an "agreement" for purposes of this grandfathering treatment.

Section 7 of the Federal Home Loan Bank Act allows the FHLBanks to determine the terms and conditions under which an FHLBank may indemnify its directors, officers, employees or agents.[14] In this regard, similar to other FHLBanks and as is widespread among corporations in general,[15] the Boston Bank, the Indianapolis Bank and the New York Bank currently operate

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14 12 U.S.C. § 1427(k).

15 "Probably the most common type of provision found in charter and bylaw documents is one which converts the permissive provisions of a state statute into a mandatory right which is automatically available to corporate officers, directors . . . " Berger and Kaufman, Director and Officer Liability, § 9.6.

See Advanced Mining Systems, Inc. v *Lutin*, 623 A.2d 82, 83 (Del. Ch. 1992) (While permissive authority to indemnify may be exercised by a corporation's board of directors on a case-by-case basis, in fact most corporations and virtually all public corporations have exercised the authority recognized by Section 145 of under an indemnification bylaw.[16] It is well recognized that persons who are covered by contractual indemnification bylaws have legally enforceable rights to indemnification and advancement that arise directly from those bylaws.[17] The Boston Bank, the Indianapolis Bank, and the New York Bank have not entered into separate indemnification agreements with their directors, officers or employees.[18]

The FHFA should clarify the final rule so that both an indemnification bylaw provision that is expressly contractual in nature and a separate indemnification agreement will be treated equally as an "agreement," for grandfathering purposes. If notwithstanding the foregoing, the FHFA determines that a contractual bylaw does not constitute an "agreement," the Banks request that the final rule contain a 60-day delay of the effective date so that FHLBanks will have a reasonable opportunity to execute separate indemnification agreements that will be treated as grandfathered agreements.

In addition, the final rule should also confirm that any person who is covered (either by virtue of current or past service to an FHLBank) by an existing contractual indemnification bylaw provision, or an existing separate indemnification agreement, will not be subject to any new restrictions on indemnification payments contained in the final indemnification rule that did not exist prior to the effective date of the final rule.[19] In contrast, an individual whose coverage

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the Delaware General Corporation Law in their bylaws so as to mandate the extension of indemnification rights in circumstances in which such indemnification would be permissible under Section 145).

16 The Boston Bank's contractual indemnification bylaw provides, among other things, that all rights under the indemnification bylaw are deemed to be a contract between the Bank and each director, officer or employee of the Bank who serves or served in such capacity at any time while the bylaw is in effect.

The Indianapolis Bank's contractual indemnification bylaw provides, among other things, that the right to be indemnified or advanced expenses under the bylaw is a contract right based upon good and valuable consideration, pursuant to which the person entitled thereto may bring suit as if the provisions thereof were set forth in a separate written contract between the person and the Indianapolis Bank

The New York Bank's contractual indemnification bylaw provides, among other things, that the indemnification and advancement of expenses provided under the bylaw shall be deemed a contract between the Bank and its directors, officers and employees.

17 *See e.g., Underbrink v. Warrior Energy Services Corp.*, Civ. Action No. 2982-VCP, 2008 Del. Ch. LEXIS 65 (Del. Ch. May 30, 2008) (holding that two former directors of a company were entitled to advancement of expenses under the terms of the company's bylaws); *Sassano v. CIBC World Markets Corp.*, 948 A.2d 453 (Del. Ch. 2008) (granting a former employee's claims for indemnification and advancement pursuant to the company's bylaws).

18 The Des Moines Bank has entered into separate indemnification agreements with some of its executive officers in addition to its contractual indemnification bylaw.

19 We note that 12 C.F.R. § 908.6(i) currently provides that an FHLBank shall not reimburse, indemnify or otherwise compensate directly or indirectly any executive officer or director for a third-tier civil money penalty imposed under the pre-HERA version of 12 U.S.C. § 4636. Thus, an individual subject to a

under either a contractual indemnification bylaw or a separate indemnification agreement that begins on or after the effective date of the final rule will be subject to any new limitations imposed under the final rule.

III. Partial indemnification in relation to settlements and formal adjudications and findings

Section 1231.2(l)(2)(ii) of the Proposal provides that the term "prohibited indemnification payment" shall not include "any reasonable payment by a regulated entity that represents partial indemnification for legal or professional expenses specifically attributable to particular charges for which there has been a formal and final adjudication or *finding in connection with a settlement that the entity-affiliated party has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty*, unless the administrative proceeding or civil action has resulted in a final prohibition order against the entity-affiliated party." (Emphasis added).

The Banks believe it is important that the definition of the term "prohibited indemnification payment" not unduly restrict the potential to negotiate and consummate settlements with an entity-affiliated party. To the extent an entity-affiliated party is unable to obtain partial indemnification for legal and professional expenses which are not specifically or directly related to the remedy provided in a settlement agreement, the entity-affiliated party's willingness to settle other charges with the FHFA may be adversely impacted. This may lead to unnecessary and wasteful litigation.

In this regard, settlements with federal financial regulatory agencies do not typically contain findings by the charging agency which exculpate the party settling the charges from wrongdoing with respect to some or all of the charges. They almost always contain statements to the effect that the person settling the charges "neither admits nor denies" the agency's allegations. As a result, the availability of partial indemnification under proposed section 1231.2(l)(2)(ii) may prove to be illusory.

In the case of either a settlement or a formal and final adjudication, the Proposal only allows indemnification for expenses specifically attributable to particular charges as to which the entity-affiliated party has been successful. As a practical matter, it will often be difficult, if not impossible, to precisely allocate expenses related, for example, to the review of documents, or the preparation for a deposition to a particular individual charge.[20] The principle sought to be

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grandfathered FHLBank contractual indemnification bylaw or a separate indemnification agreement would be permitted to receive indemnification of a first or second- tier civil money penalty under 12 U.S.C. § 4636(b)(1)-(2) and would not be subject to any limitation on advancement or ultimate indemnification of legal or other expenses incurred in connection with an administrative proceeding or civil action brought by the FHFA.

20 In the FDIC's Final Rule, the FDIC acknowledged the difficulty in allocating expenses between different charges: "The FDIC recognizes that in many cases the appropriate amount of any partial indemnification will be difficult to ascertain with certainty." 61 Fed. Reg. 5926, 5929 (1996).

addressed by this aspect of the Proposal would be better and more fairly effectuated by providing that legal and professional fees incurred may be reimbursed in proportion to the percentage of charges as to which the entity-affiliated party is entitled to reimbursement under the terms of the Proposal.

In light of the foregoing, the Banks suggest that the FHFA revise the applicable exception to the definition of the term "prohibited indemnification payment" in section 1231.2(l) as follows:

> The term prohibited indemnification payment shall not include any reasonable payment by a regulated entity that represents partial indemnification for legal or professional expenses **[Delete the following bracketed text]** [specifically] attributable to particular charges for which there has been a formal and final adjudication **[Insert the following bracketed text]** [that the entity-affiliated party has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty], or **[Insert the following bracketed text]** [any matters which were the subject of a notice of charges which do not form the basis for any remedies imposed on the entity-affiliated party under the terms of a settlement with the entity-affiliated party,] **[Delete the following bracketed text]** [finding in connection with a settlement that the entity-affiliated party has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty] unless the administrative proceeding or civil action has resulted in a final prohibition order against the entity-affiliated party **[Insert the following text]** [; provided that the amount of such permissible partial indemnification shall be determined by the ratio that is (a) the charges as to which the entity-affiliated party is deemed to be permitted to receive indemnification under this paragraph, to (b) the total number of charges.]

IV. Comments Regarding the Operation of the Proposal

In view of the limited discussion of the intended operation of the Proposal in the supplementary information section, the final regulation should describe how the indemnification provisions in the Proposal would operate in practice. In that regard, we have set forth below a brief description of the issues that would likely need to be addressed by the board of directors ("Board") of a regulated entity following a request by an entity-affiliated person ("Individual") for indemnification (including an advancement of expenses).

Following the receipt of a notice of charges from the FHFA, and before any final order or settlement, the Individual may request that the Board agree to advance expenses under proposed section 1231.4(c) to cover any reasonable legal costs and other expenses to be incurred by the

Individual in defending himself or herself against such charges. The Board may (but would not be required) to advance the reasonable expenses incurred by the Individual in defense of such charges. Before advancing any such payment, however, the Board would make a good-faith determination in writing after "due investigation" and consideration that (a) the Individual acted in good-faith and in a manner that the Individual believed to be in the best interests of the regulated entity[21] and (b) making such payments would not materially adversely affect the soundness of the regulated entity.[22] The Individual would be prohibited from participating in any way in the Board's discussion and approval of such payments, except that the Individual may present his or her request to the Board and respond to any inquiries from the Board concerning his or her involvement in the circumstances giving rise to the administrative proceeding or civil action.[23]

It is important to note that in making this good-faith/best interests determination, in the normal course, the Board will not have access to significant portions of the FHFA's investigative record that led to the filing of charges. Further, the Board's ability to conduct a "due investigation" into the conduct alleged in the notice of charges will necessarily be limited by the difference in its status, as compared to the status of the FHFA. For example, the Board would not have the power to compel third parties to testify, or to produce documents for its examination, as the FHFA does. In light of these considerations, our understanding is that the FHFA is not expecting that the Board conduct an investigation comparable to the FHFA's own investigation before agreeing to make an advancement of expenses to the Individual. The Board would be required to make a good faith inquiry, based on the information reasonably available to it, to reach its determination that the Individual acted in a way that he or she believed to be in the best interests of the regulated entity.

In the event that the Board advanced expenses to the Individual, the Individual would be required to agree in writing to reimburse the regulated entity, only to the extent that amounts are not covered by insurance or fidelity bonds, for the portion of any advanced indemnification payments made by the regulated entity that subsequently become prohibited indemnification payments pursuant to the application of proposed section 1231.2(l)(1) and (2).[24]

If an administrative proceeding or civil action instituted by the FHFA results in a final order or settlement that contains certain provisions specified in proposed section 1231.2(l)(1)(i)-(iii), the regulated entity would be prohibited from paying or reimbursing the Individual for the cost of any assessed amount, or any other liability or legal expense with respect to the administrative or civil action, except to the extent that partial indemnification is permitted. The

21 Proposed section 1231.4(c)(1)(i).

22 Proposed section 1231.4(c)(1)(ii).

23 Proposed section 1231.4(c)(2).

24 Such an obligation should not arise until any applicable opportunity to appeal the findings in any administrative proceeding or civil action has expired and the findings have become final.

regulated entity would also be prohibited from maintaining insurance or a fidelity bond to pay or reimburse the Individual for the cost of any civil money penalty or judgment resulting from any administrative or civil action instituted by the FHFA.[25] The regulated entity would not be prohibited, however, from maintaining insurance or a fidelity bond to pay or reimburse the Individual for the cost of any legal or professional expenses incurred in connection with such proceeding or action or the amount of any restitution to the regulated entity or receiver.

V. Request for Regulation Regarding Law Applicable to Corporate Governance and Indemnification

In connection with the FHFA's consideration of certain indemnification limitations on regulated entities under section 1114 of HERA, we note that there is currently a divergence between the regulations governing indemnification by Freddie Mac and Fannie Mae ("Enterprises"), as compared to the FHLBanks. In 2002, the Office of Federal Housing Enterprise Oversight ("OFHEO") issued a rule addressing the corporate governance of the Enterprises ("Enterprises Corporate Governance Rule"). The rule required each Enterprise to designate a body of law that it would use for corporate governance practices and procedures: (i) the law of the jurisdiction in which the principal office of the Enterprise is located; (ii) the Delaware General Corporation Law; or (iii) the Revised Model Business Corporation Act ("RMBCA").[26] OFHEO stated that the Enterprises were authorized to operate under the indemnification requirements set forth by the elected body of state law or the RMBCA.[27]

The regulations issued by the Federal Housing Finance Board do not contain any provision addressing the law applicable to the corporate governance procedures or indemnification. Accordingly, the FHFA should promulgate a regulation applicable to the FHLBanks to allow them to select an applicable body of law for purposes of corporate governance practices and procedures, and indemnification consistent with the Enterprises Corporate Governance Rules.

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25 We note that the definition of prohibited indemnification payments does not cover actions by any party (whether governmental or private) other than the FHFA.

26 12 C.F.R. § 1710.10. A similar rule has been adopted by the Office of the Comptroller of the Currency with respect to national banks and by the Office of Thrift Supervision with respect to federal savings institutions. 12 C.F.R. § 7.200 (OCC); 12 C.F.R. § 552.5(b)(3) (OTS). The rule provides that the corporate governance practices and procedures of each Enterprise shall comply with applicable federal law and regulations and shall be consistent with safe and sound operations. The rule further provides that to the extent not inconsistent with the preceding sentence, each Enterprise is to select the practices and procedures of one of the three identified bodies of law.

27 67 Fed. Reg. 38361, 38369 (2002).

If you have questions or need clarification with respect to these comments, please feel free to contact any of the General Counsels of the Banks. On behalf of the Banks, we appreciate your consideration of these comments.

Sincerely,

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By: Ellen McLaughlin
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FEDERAL HOME LOAN BANK OF DES MOINES

By: Nicholas Spaeth
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