Proposed Rules

Federal Register
Vol. 81, No. 182
Tuesday, September 20, 2016

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

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1231

RIN 2590–AA68

Indemnification Payments

AGENCY: Federal Housing Finance Agency.

ACTION: Notice of proposed rulemaking; request for comments.

SUMMARY: The Federal Housing Finance Agency (FHFA) is issuing a Notice of Proposed Rulemaking that would establish standards for identifying whether an indemnification payment by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, any of the Federal Home Loan Banks (regulated entities), or the Federal Home Loan Bank System's Office of Finance (OF) to an entity-affiliated party in connection with an administrative proceeding or civil action instituted by FHFA is prohibited or permissible. This proposed rule would not apply to a regulated entity operating in conservatorship or receivership, or to a limited-life regulated entity. It would apply to all regulated entities, each Federal Home Loan Bank, the OF, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Association, when not in conservatorship or receivership. This proposed rule takes into account public comments received by FHFA at various stages of the regulation's rulemaking process, including after the initial proposal published in 2009.

DATES: Comments must be received on or before November 21, 2016. For additional information, see **SUPPLEMENTARY INFORMATION.**

ADDRESSES: You may submit your comments on the proposed rule, identified by regulatory information number (RIN) 2590–AA68, by any of the following methods:

- *Agency Web site: www.fhfa.gov/open-for-comment-or-input.*
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at *RegComments@fhfa.gov* to ensure timely receipt by the agency. Please include Comments/RIN 2590–AA68 in the subject line of the message.
- *Courier/Hand Delivery:* The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA68, Federal Housing Finance Agency, 400 Seventh Street SW., Eighth Floor, Washington, DC 20219. Deliver the package to the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. to 5 p.m.
- *U.S. Mail, United Parcel Service, Federal Express or Other Mail Service:* The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA68, Federal Housing Finance Agency, 400 Seventh Street SW., Eighth Floor, Washington, DC 20219.

FOR FURTHER INFORMATION CONTACT: Mark D. Laponsky, Deputy General Counsel, *Mark.Laponsky@fhfa.gov,* (202) 649–3054 (this is not a toll-free number), Office of General Counsel (OGC), Federal Housing Finance Agency, Constitution Center, 400 Seventh Street SW., Washington, DC 20219. The telephone number for the Telecommunications Device for the Deaf is (800) 877–8339.

SUPPLEMENTARY INFORMATION:

I. Comments

FHFA invites comments on all aspects of this 2016 proposed rulemaking and will take all comments into consideration before issuing the final rule. Copies of all comments will be posted without change, including any personal information you provide, such as your name, address, email address, and telephone number, on the FHFA Web site at *http://www.fhfa.gov.* In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Constitution Center, Eighth Floor, 400 Seventh Street, SW., Washington, DC 20219. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 649–3804.

II. Background

FHFA published an Interim Final Rule on Golden Parachute and Indemnification Payments in the **Federal Register** on September 16, 2008 (73 FR 53356). Subsequently, it published corrections rescinding that portion of the regulation that addressed indemnification payments on September 19, 2008 (73 FR 54309) and on September 23, 2008 (73 FR 54673). On November 14, 2008, a proposed amendment to the Interim Final Rule was published in the **Federal Register** (73 FR 67424). FHFA specifically requested comments on whether it would be in the best interests of the regulated entities to permit indemnification of first and second tier civil money penalties where the administrative proceeding or civil action related to conduct occurring while the regulated entity was in conservatorship. The public notice and comment period closed on December 29, 2008. On January 29, 2009 (74 FR 5101), FHFA published a final rule on Golden Parachute Payments. On June 29, 2009 (74 FR 30975), FHFA published a proposed amendment to that 2009 Golden Parachute final rule. At the same time, FHFA re-proposed the November 14, 2008 proposed amendment on indemnification payments (2009 re-proposal). The 2009 re-proposal noted that comments received in response to the November 14, 2008 publication on indemnification payments would be considered along with comments received in response to the 2009 re-proposal. The golden parachute provisions of the rule were re-proposed in 2013 (78 FR 28452, May 14, 2013), adopted in final form in 2014 (79 FR 4394, Jan. 28, 2014), and codified as 12 CFR 1231.1, 1231.2, and 1231.5.

In this 2016 proposed rulemaking, FHFA redrafted the proposed indemnification payments rule to make it simpler and easier to understand. The substance of this 2016 proposed rulemaking has not changed since the 2009 re-proposal, other than to replace a provision concerning indemnification payments by regulated entities in conservatorship with one that clearly states that the regulation does not apply to such entities. FHFA further desires to clarify that it does not consider

indemnification payments to be subject to FHFA rules and procedures related to compensation, including 12 CFR part 1230.

The 2009 re-proposal structured its indemnification provisions in a manner similar to the indemnification provisions of the Federal Deposit Insurance Corporation's (FDIC) regulation. 12 CFR part 369. This 2016 proposed rulemaking generally carries over the structure from the 2009 re-proposal, but clarifies several provisions. Consistent with the Director's statutory discretion to ''prohibit or limit any . . . indemnification payment,'' [1] the 2009 re-proposal defined most indemnification payments to entity-affiliated parties as impermissible. Like the FDIC's regulation, it also identified exceptions to that definition based on stated standards and criteria and defined the characteristics required for a payment to be permissible. These criteria and standards, as they are carried over into this 2016 proposed rulemaking, constitute the ''factors'' that would be used for the Director to ''prohibit or limit'' indemnification payments by this regulation. In application, each regulated entity would be required to ensure that no indemnification payments under this rule were made unless the criteria and standards were met.

III. Comments on the 2009 Re-Proposal

In response to the 2009 re-proposal, FHFA received comments from the following: The 12 Federal Home Loan Banks (Banks); [2] the Council of Federal Home Loan Banks, the Banks' Office of Finance (OF); Fannie Mae; and Freddie Mac. FHFA gave careful consideration to all issues raised by the commenters.

In response to FHFA's request for comments regarding indemnification of first and second tier civil money penalties under section 1376(b)(1) and (2) of the Federal Housing Enterprises Financial Safety and Soundness Act (the Safety and Soundness Act) (12 U.S.C. 4636(b)(1) and (2)) where the administrative proceeding or civil action initiated by FHFA relates to conduct occurring while the regulated entity was in conservatorship, several Banks requested that FHFA expand indemnification authority for first and second tier civil money penalties to all regulated entities, not just those that are in conservatorship (currently, Fannie Mae and Freddie Mac). The commenters assert that, by not extending the indemnification authority to all regulated entities, healthy, solvent institutions would be penalized by the regulation. FHFA has considered the comments and determined not to extend first and second tier civil money penalties indemnification to all regulated entities. The basis for the 2009 re-proposal's provision for regulated entities in conservatorship was that such regulated entities are operating with directors and some executives who govern and manage the entities in accordance with conservator or receiver instructions of varying levels of specificity and have significant limitations on their ability to take independent action. Given these circumstances, FHFA concluded that it was appropriate that regulated entities in conservatorship or receivership (or a limited-life regulated entity) and their entity-affiliated parties be subject to a different indemnification regime. FHFA continues to be of this view and has decided that they should be excluded from the rulemaking to avoid restricting a conservator's or receiver's options. In this 2016 proposed rulemaking, new § 1231.4(d) [3] would provide that the regulation does not apply to regulated entities in conservatorship or receivership or to limited-life regulated entities. In each circumstance, FHFA's power over such a regulated entity is sufficiently extensive that FHFA as conservator itself can directly require the adoption of an indemnification regime appropriate to administrating the conservatorship or receivership (or limited-life regulated entity) in the circumstances and environment actually encountered by that regulated entity.[4]

The 2009 re-proposal would have permitted partial indemnification when there has been a final adjudication, settlement, or finding favorable to the entity-affiliated party on some, but not all, charges, unless the proceeding or action resulted in a final prohibition order. Several Banks requested clarification of this provision with a definition of the term ''final prohibition order.'' FHFA has considered the comment. The 2016 proposal clarifies that a final prohibition order is an order under section 1377 of the Act (12 U.S.C. 4636a) prohibiting an entity-affiliated party from continuing or commencing to hold any office in, or participate in any manner in the conduct of the affairs of, a regulated entity, which order has become and remains effective as described in section 1377(c)(5) of the Safety and Soundness Act (12 U.S.C. 4636a(c)(5)).

One commenter noted that, as a practical matter, most settlements do not include affirmative findings of non-violation; instead settlements typically include broad language stating that the settlement is entered into without admission. That commenter therefore requested that FHFA revise the language of the exception to ''prohibited indemnification payment'' in the previously proposed § 1231.2 to state that, unless the proceeding results in a final prohibition order, indemnification is permissible in connection with a settlement in which the entity-affiliated party does not admit wrongdoing. FHFA has considered the comment. This 2016 proposed rulemaking would permit payment of expenses of defending an action, subject to the entity-affiliated party's agreeing to repay those expenses if the entity-affiliated party: Is not exonerated of the charges to which the expenses specifically relate; enters into a settlement of those charges in which the entity-affiliated party admits culpability with respect to them; or is subject to a final order prohibiting the entity-affiliated party from participating in the affairs of the regulated entity. FHFA believes that within these reasonably flexible boundaries for permissible and impermissible indemnification, the parties involved will be able to negotiate an appropriate resolution of legal expenses, which may itself bar or significantly limit indemnification. This flexibility, in FHFA's view, is preferable to strictly dictating a result in a regulation.

Several Banks requested clarification of the scope of § 1231.4, in the 2009 re-proposal, with respect to application of its process involving specific findings by the regulated entity's board of directors after a good faith inquiry, reflected in § 1231.4(c). Specifically, the Banks sought clarity about whether the process was considered a precondition to the advancement of legal or professional expenses by a third-party insurer under insurance or bonds purchased by the regulated entity pursuant to the definition of ''prohibited indemnification payments'' in § 1231.4(b)(2)(i) of the 2009 re-

[1] 12 U.S.C. 4518(e)(1).

[2] In 2015, the Seattle and Des Moines Federal Home Loan Banks merged. There are now 11 Federal Home Loan Banks.

[3] This 2016 proposed rulemaking includes changes to the numbering of several sections. In this Supplementary Information, the sections affected by this 2016 proposed rulemaking are identified by numbers used in the current proposal rather than those used in the 2009 re-proposal. Where necessary, a cross-reference to the 2009 re-proposal is provided in a footnote at the first appearance of an affected section number.

[4] *See* 12 U.S.C. 4617(b)(2)(A) (powers of FHFA as conservator or receiver), 4617(i)(2)(D), and 4617(i)(2)(E) (FHFA appoints the directors of a limited-life regulated entity and must approve its bylaws, in which an institution's indemnification policies commonly are embodied).

proposal.[5] Under this 2016 proposed rulemaking, FHFA would not require a board of directors' inquiry and findings as a precondition for legal and professional expense advances paid directly to the entity-affiliated party by a third-party insurer under such insurance or bonds purchased by the regulated entity.

Several Banks requested confirmation that the issuance of a notice of charges in an administrative action and the filing of a complaint in a civil action would be the triggers for the indemnification provisions of § 1231.4(a), in these respective circumstances. These Banks are correct. Section 1231.4(a) is triggered by the Director issuing a notice of charges; or by the filing of a complaint in a civil action.

In connection with partial indemnification, one commenter requested a revision to the provision on ''prohibited indemnification payments'' in § 1231.4(b)(2)(i)[6] to provide that legal and professional fees incurred may be reimbursed on a proportional basis using the ratio of charges as to which the entity-affiliated party is entitled to reimbursement to the total charges. FHFA has considered the requested revision and has determined not to accept it. In many cases the appropriate amount of partial indemnification will be difficult to ascertain with certainty. The value of each charge may not equal each other charge. Services provided often will relate to multiple charges or all charges and cannot conveniently be segregated. FHFA believes that the appropriate amount of any partial indemnification is best determined on a case-by-case basis rather than by applying a predetermined formula.

The OF requested that the restriction on indemnification payments not apply to the OF; and further, confirmation that there is no intention by FHFA to assert that any funding provided by a Bank to the OF that might ultimately be used to indemnify an OF director or officer would be considered to be an indemnification payment by the Bank for purposes of the rule. FHFA considered the comment in connection with the Golden Parachute Final Rule (79 FR 4395) and determined that the OF is appropriately included in that final rule and for reasons of prudential supervision this 2016 proposed rulemaking also extends to the OF. In the Golden Parachute Final Rule, the definition of ''entity-affiliated party,'' applying to all of part 1231, reads: ''(1) With respect to the Office of Finance, any director, officer, or manager of the Office of Finance.'' 12 CFR 1231.2. This definition is appropriate because of those persons' participation in the conduct of the affairs of the Banks, specifically their funding activities.

Only the OF, including its board of directors, is responsible for OF's compliance; Banks themselves are not responsible for any improper indemnification payments by OF simply because the OF draws its funding from the Banks. However, a majority of the OF's board comprises the 11 Bank presidents, who would be responsible in their capacity as OF directors for approving indemnification payments in violation of this regulation. The issue does not require additional examination in the context of this 2016 proposal.

One commenter requested that the grandfathering provision relating to existing indemnification agreements (now reflected in § 1231.4(b)(4) of this 2016 proposed rulemaking) also be applicable to bylaw indemnification provisions that are asserted to be contractual in nature. The commenter also sought confirmation that any person who is covered by such an existing indemnification bylaw provision, which may be considered contractual, or an existing separate indemnification agreement will not be subject to any new restrictions contained in a final indemnification rule. FHFA considered the comment and determined that the grandfathering provisions are applicable only to specific indemnification agreements entered into by a regulated entity or the OF with a named entity-affiliated party on or before the day this 2016 proposed rulemaking is published in the **Federal Register**. In FHFA's view, only agreements of that type present equities that justify grandfathering. Accepting the argument that a Bank's bylaws are contractual in nature and that general indemnification provisions contained in them should be considered specific agreements and grandfathered could immunize a Bank's entire corps of managers and directors from the effect of this regulation in perpetuity.[7]

One commenter raised the issue of the standard to be used by a board of directors in conducting an investigation and making findings with respect to an entity-affiliated party. The comment suggested that for an entity-affiliated party to be eligible for advancement of expenses to the individual, the board of directors should find that the entity-affiliated party acted in good faith and in a manner that he or she believed to be in the best interests of the regulated entity. FHFA confirms that this 2016 proposed rulemaking intends that the board of directors conclude, after a good faith inquiry based on the information reasonably available to it and before agreeing to advance expenses, that the individual acted in a way that he or she believed to be in the best interest of the regulated entity or the OF. FHFA reminds the regulated entities and the OF that in addition to the standard set forth in this 2016 proposed rulemaking, they also have a concurrent obligation to follow proper corporate governance procedures in conducting their investigations.

A commenter asked about the selection of applicable state law for purposes of corporate governance practices and procedures, and indemnification consistent with the Office of Federal Housing Enterprise Oversight Corporate Governance Rule.[8] After considering the comment, FHFA has determined not to address the subject in this rulemaking. FHFA published a final rule on corporate governance that addresses this issue.[9] The regulated entities are reminded that an OF rule[10] authorizes the OF to select an appropriate body of governance law and to follow it with respect to practices and procedures related to indemnification, which would apply to the extent not inconsistent with this regulation.

FHFA considered a request by one Bank to allow indemnification by a ruling from the judge before whom the underlying case was heard, asserting that some jurisdictions recognize this as an alternative means by which a person may obtain indemnification. FHFA has determined not to accept the suggestion. FHFA believes that in actions brought by the Agency, the standards prescribed in this rule, within the framework of the Safety and Soundness Act, are the appropriate standards.

IV. Consideration of Differences between the Banks and the Enterprises

Section 1313(f) of the Safety and Soundness Act, as amended, requires

[5] This provision was designated in the 2009 re-proposal as § 1231.2(2)(i).

[6] This provision was designated in the 2009 re-proposal as § 1231.2(2)(i).

[7] The restriction, of course, will not apply until a final rule reflecting it is adopted. FHFA considers it important to the integrity of indemnification regulation that bylaws are not routinely converted to individualized contracts, and therefore grandfathered, before a final rule becomes effective. FHFA believes it best to set the date of this 2016 proposed rulemaking's publication as the grandfathering date for individualized indemnification agreements.

[8] 12 CFR 1710.10, relocated and consolidated with revisions at 80 FR 72327 (Nov. 19, 2015), recodified at 12 CFR 1239.3.

[9] 12 CFR 1239.3, 80 FR 72327 (Nov. 19, 2015).

[10] 12 CFR 1273.7(i)(2).

the Director, when promulgating regulations relating to the Banks, to consider the differences between Fannie Mae and Freddie Mac (collectively, the Enterprises) and the Banks with respect to: the Banks' cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; joint and several liability; and any other differences the Director considers appropriate. *See* 12 U.S.C. 4513(f). In preparing this 2016 proposed rulemaking, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors, and determined that the Banks should not be treated differently from the Enterprises for purposes of this 2016 proposed rulemaking. Any regulated entity in conservatorship (or receivership or a limited-life regulated entity), whether a Bank or an Enterprise, would be outside the scope of the proposed rule.

V. Paperwork Reduction Act

This proposed rulemaking does not contain any information collection requirement that requires the approval of the Office of Management and Budget (OMB) under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*). Therefore, FHFA has not submitted any information to OMB for review.

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, 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. 5 U.S.C. 605(b). FHFA has considered the impact of the 2016 proposed rulemaking under the Regulatory Flexibility Act. The General Counsel of FHFA certifies that this 2016 proposed rulemaking, if adopted as a final rule, is not likely to have a significant economic impact on a substantial number of small entities because it would apply primarily to the regulated entities and the OF, which are not small entities for purposes of the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 1231

Indemnification payments, Government-sponsored enterprises.

Accordingly, for reasons stated in the preamble, under the authority of 12 U.S.C. 4518(e) and 4526, FHFA proposes to amend part 1231 of subchapter B of chapter XII of title 12 of the CFR as follows:

PART 1231—GOLDEN PARACHUTE AND INDEMNIFICATION PAYMENTS

■ 1. The authority citation for part 1231 continues to read as follows:

Authority: 12 U.S.C. 4518(e), 4518a, 4526.

■ 2. In § 1231.2 add the definitions of ''Indemnification payment'' and ''Liability or legal expense'' in alphabetical order to read as follows:

§ 1231.2 Definitions.

* * * * *

Indemnification payment means any payment (or any agreement to make any payment) by any regulated entity or the OF for the benefit of any current or former entity-affiliated party, to pay or reimburse such person for any liability or legal expense.

Liability or legal expense means—

(1) Any legal or other professional expense incurred in connection with any claim, proceeding, or action;

(2) The amount of, and the cost incurred in connection with, any settlement of any claim, proceeding, or action; and

(3) The amount of, and any cost incurred in connection with, any judgment or penalty imposed with respect to any claim, proceeding, or action.

* * * * *

■ 3. Add § 1231.4 to read as follows:

§ 1231.4 Indemnification payments.

(a) *Prohibited indemnification payments.* Except as permitted in paragraph (b) of this section, a regulated entity or the OF may not make indemnification payments with respect to an administrative proceeding or civil action that has been initiated by FHFA.

(b) *Permissible indemnification payments.* A regulated entity or the OF may pay:

(1) Premiums for professional liability insurance or fidelity bonds for directors and officers, to the extent that the insurance or fidelity bond covers expenses and restitution, but not a judgment in favor of FHFA or a civil money penalty.

(2) Expenses of defending an action, subject to the entity-affiliated party's agreement to repay those expenses if the entity-affiliated party either:

(i) When the proceeding results in an order, is not exonerated of the charges that the expenses specifically relate to; or

(ii) Enters into a settlement of those charges in which the entity-affiliated party admits culpability with respect to them; or

(iii) Is subject to a final prohibition order under 12 U.S.C. 4636a.

(3) Amounts due under an indemnification agreement entered into with a named entity-affiliated party on or prior to [DATE OF PUBLICATION OF THE FINAL RULE IN THE **FEDERAL REGISTER**].

(c) *Process; factors.* With respect to payments under paragraph (b)(2) of this section:

(1) The board of directors of the regulated entity or the OF must conduct a due investigation and make a written determination in good faith that:

(i) The entity-affiliated party acted in good faith and in a manner that he or she reasonably believed to be in the best interests of the regulated entity or the OF; and

(ii) Such payments will not materially adversely affect the safety and soundness of the regulated entity or the OF.

(2) The entity-affiliated party may not participate in the board's deliberations or decision.

(3) If a majority of the board are respondents in the action, the remaining board members may approve payment after obtaining written opinion of outside counsel that the conditions of this regulation have been met.

(4) If all of the board members are respondents, they may approve payment after obtaining written opinion of outside counsel that the conditions of this regulation have been met.

(d) *Scope.* This section does not apply to a regulated entity operating in conservatorship or receivership or to a limited-life regulated entity.

Dated: September 13, 2016.

Melvin L. Watt,

Director, Federal Housing Finance Agency.

[FR Doc. 2016–22483 Filed 9–19–16; 8:45 am]

BILLING CODE 8070–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 25

[Docket No. FAA–2016–6137; Notice No. 25–16–05–SC]

Special Conditions: The Boeing Company Model 787–10 Airplane; Aeroelastic Stability Requirements, Flaps-Up Vertical Modal-Suppression System

AGENCY: Federal Aviation Administration (FAA), DOT.