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FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1231

RIN 2590-AA72

Golden Parachute and Indemnification Payments

AGENCY: Federal Housing Finance Agency.

ACTION: Final rule.

SUMMARY: The Federal Housing Finance Agency (FHFA) is amending its golden parachute payments regulation to better align it with areas of FHFA's supervisory concern and reduce administrative and compliance burdens. This final rule amends a requirement that FHFA review and consent before a regulated entity or the Office of Finance (OF) enters certain agreements to make, or makes, certain payments that are contingent on the termination of an affiliated party, if the regulated entity or the OF is in a troubled condition, in conservatorship or receivership, or insolvent. FHFA's experience implementing the regulation indicated that it required review of some agreements and payments where there was little risk of excess or abuse, and thus that it was too broad.

As amended, the rule will reduce the number of agreements and payments that are subject to FHFA prior review by focusing on those agreements and payments where there is greater risk of an excessive or abusive payment (in general, payments to and agreements with executive officers, broad-based plans covering large numbers of employees (such as severance plans), and payments made to non-executive-officer employees who may have engaged in certain types of wrongdoing). In addition, the rule as amended clarifies the inquiry into possible employee wrongdoing that a regulated

entity is required to undertake prior to entering into an agreement to make or making a golden parachute payment. Amendments also revise and clarify other rule procedures, definitions, and exemptions.

DATES: *Effective date:* [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Background

FHFA has broad discretionary authority to prohibit or limit any “golden parachute payment,” generally defined as any payment, or any agreement to make a payment, in the nature of compensation by a regulated entity for the benefit of an “affiliated party” that is contingent on the party’s termination, when the regulated entity is in troubled condition, in conservatorship or receivership, or insolvent (a “troubled institution”).¹ This

¹ The “regulated entities” are the Federal National Mortgage Association (Fannie Mae) and any affiliate, the Federal Home Loan Mortgage Corporation (Freddie Mac) and any affiliate, (collectively, the Enterprises), and the Federal Home Loan Banks (the Banks). 12 U.S.C. 4502(20). The OF is a joint office of the Banks, to which FHFA extends the Golden Parachute Payments rule through its general regulatory authority. *See id.* sec. 4511(b)(2); *see also* 78 FR 28452, 28456 (May 14, 2013) and 79 FR 4394 (Jan. 28,

provision, at 12 U.S.C. 4518(e) (Section 4518(e)), was added to the Federal Housing Enterprises Financial Safety and Soundness Act (the Safety and Soundness Act) in 2008. Legislative history suggests Section 4518(e) is intended to permit FHFA to prevent payments to departing employees and other affiliated parties that are excessive or abusive, could threaten (or further threaten) the financial condition of the troubled institution, or are inappropriate based on wrongdoing by the recipient.

Section 4518(e) requires the Director to promulgate rules defining “troubled condition” and prescribing factors to be considered when prohibiting or limiting any “golden parachute payment,” and suggests some factors the Director may consider. To ensure that FHFA had an opportunity to review and, if necessary, prohibit or limit golden parachute payments and agreements before they are made, the golden parachute payments final rule published in January 2014 (“the 2014 rule”) prohibited all golden parachute payments and agreements that were not exempt from or permitted by operation of the rule. Prohibited agreements or payments could be permitted by the Director after review.

Because the 2014 rule applied equally to golden parachute payments and agreements, it required FHFA to determine the permissibility of prohibited agreements before they were entered into and of prohibited payments before they were made. In most cases, this meant that a troubled institution was required to request FHFA’s prior review and consent to a payment that would be made in accordance with an agreement to which FHFA had already consented. This “double approval” requirement was recognized by

2014). In this notice, the terms “regulated entity” and “troubled institution” include the Enterprises, Banks, and the OF, unless the OF is otherwise expressly addressed.

FHFA and commenters when the rule was proposed in 2013 and finalized in 2014.² FHFA noted then that it was an appropriate supervisory approach because conditions could change after an agreement was approved but before a payment was made (for example, the condition of a troubled institution could further deteriorate, or an intended recipient could be found to have contributed to the deterioration or engaged in wrongdoing with a material adverse effect on the regulated entity). In practice, that approach resulted in FHFA's receiving numerous requests for review of golden parachute payments and agreements.

Narrowly drafted exemptions from the 2014 rule also gave rise to numerous requests for review. For example, because severance pay plans of the regulated entities do not meet an exemption for "nondiscriminatory" plans, troubled institutions were not permitted to make severance payments to any employees – even small payments to lower-level employees – without FHFA review and consent. Likewise, an exemption for payments pursuant to a "bona fide deferred compensation plan or arrangement" did not apply or was lost if the plan was established or amended after the date that was one year prior to the time the regulated entity became a troubled institution, meaning such plans and any plan payments required FHFA prior review.

Based on experience reviewing proposed agreements and payments, FHFA determined that the scope of the 2014 rule was too broad because it required a troubled institution to submit and FHFA to review agreements and payments where there was very little risk of an abusive or excessive payment or threat to the financial condition of the paying regulated entity, and little likelihood that the employee or other affiliated party

² See 78 FR 28452, 28545 (May 14, 2013) (Notice of Proposed Rulemaking) and 79 FR 4394, 4396 (Jan. 28, 2014) (Final Rule).

receiving payment could have engaged in the type of wrongdoing that FHFA would consider as the basis for prohibiting or limiting an agreement or payment. Separately, FHFA also determined that the 2014 rule could be harmonized with other requirements related to the compensation of executive officers of the regulated entities, including termination payments, avoiding the need to request or engage in separate reviews.³ On those bases, FHFA proposed amendments to the 2014 rule, which it fully described and on which it requested comments in an earlier *Federal Register* Notice.⁴

II. Comments

During a 45-day comment period that ended on October 12, 2018, FHFA received a joint letter from ten of the eleven Federal Home Loan Banks (Banks) and the OF (collectively, the Banks), and a letter from Freddie Mac. Commenters generally expressed support for the reduction of burdens embodied in the proposed amendments and requested changes to reduce burden further. Some comments also requested or suggested clarifications of rule provisions or topics not addressed by the rule, such as grandfathering. For organizational purposes, comments are addressed in the order of the rule provision to which they relate.

Section 1231.2, Definition of “Golden Parachute Payment”

FHFA proposed to remove the phrase “pursuant to an obligation of the regulated entity” from the regulatory “golden parachute payment” definition, to clarify that the definition covers gifts and the process by which FHFA reviews gifts by a troubled institution to a terminating employee (or other affiliated party). FHFA has general authority to prohibit an improper gift, and interprets the statutory definition of “golden

³ See generally, 12 U.S.C. 1452(h), 1723a(d)(3), and 4518(a); see also 12 CFR part 1230.

⁴ 83 FR 43802 (Aug. 28, 2018).

parachute payment,” which references “an obligation,” as clarifying that FHFA’s authority to prohibit or limit golden parachute payments *includes* those made pursuant to an obligation.⁵ FHFA was concerned that including the phrase “pursuant to an obligation” within the regulatory definition could be read to imply that the rule does not extend to excessive or abusive payments that are made gratuitously, which would be inconsistent with the policy of Section 4518(e). FHFA also noted that it had applied the 2014 rule to gifts, and that troubled institutions had requested FHFA’s review of and consent to proposed retirement gifts. Thus, the proposed change in regulatory text would align the rule with FHFA’s interpretation and application of it.

Although the Banks agreed that FHFA has authority to prohibit an improper gift, they commented that the phrase “pursuant to an obligation of the regulated entity” should remain in the rule definition. In contrast to FHFA’s interpretation, the Banks stated that they believe reference to “an obligation” in the statutory definition meant that Congress intended FHFA’s authority to prohibit or limit golden parachute payments to extend only to payments that an institution is contractually obligated to make. The Banks opined that

⁵ Under this interpretation, including the phrase “pursuant to an obligation of the regulated entity” in federal law clarifies the primacy of the federal supervisor to prohibit or limit obligatory payments, despite state laws otherwise upholding the enforceability of contracts. In fact, recent court decisions have confirmed that a taking does not occur for purposes of the Tucker Act, 28 U.S.C. 1491, when FHFA prohibits a golden parachute payment, even one made pursuant to an agreement entered into before the enactment of Section 4518(e) in 2008.

In *Piszel v. U.S.*, 833 F.3d 1366 (Fed. Cir. 2016), the Court of Appeals for the Federal Circuit held that no taking occurred because the affiliated party retained the ability to pursue a claim for damages from the regulated entity for breach of contract. FHFA agrees that there was no taking, but also observes that awarding damages for breach of contract would clearly defeat the purpose of Section 4518(e), which is to prevent the affiliated party from receiving such a payment. The Court of Federal Claims had held in that case that no taking occurred (see *Piszel v. U.S.*, 121 Fed. Cl. 793 (2015)) because of an insufficiently cognizable property interest, considering the contract in the context of the regulatory and statutory scheme (“a heavily regulated environment;” and statutory provisions expressly authorized FHFA’s predecessor agency to prohibit compensation it deemed to be unreasonable at any time and did not “guarantee[] that the government could not later change its mind” after approving compensation as reasonable). That conclusion would be even stronger with respect to a payment made subject to an agreement entered into after Section 4518(e)’s enactment, a proposition with which the Federal Circuit may have agreed, *see* 833 F.3d at 1374.

payments not pursuant to an obligation, such as improper voluntary gifts, should be regulated only to the extent that FHFA found such payments to be excessive or an unsafe and unsound practice, but not under its golden parachute payments authority.

The Banks and FHFA agree that FHFA has authority to prohibit or limit any improper voluntary gift, through its general supervisory authority.⁶ FHFA believes it is important to review payments, including gifts, to terminating employees by a troubled institution, as it is more likely that a voluntary gift would be deemed improper (for example, excessive, abusive, or the result of an unsafe and unsound practice) when made by a troubled institution. By removing the phrase “pursuant to an obligation of the regulated entity” from the regulatory “golden parachute payment” definition, FHFA is clarifying the process for its review of voluntary payments to terminating employees by a troubled institution before such payments are made, to determine their propriety in accordance with transparent regulatory considerations.

FHFA also notes that other amendments should limit the number of gifts subject to its review, including rule provisions permitting a small value gift to an executive officer of a troubled institution on a significant life event such as retirement, permitting *de minimis* payments to other affiliated parties, and exempting payments provided through a “nondiscriminatory benefit plan.”⁷ Together, these provisions are intended to balance FHFA’s supervisory concern for gifts by troubled institutions with the burden of a prior review process. For these reasons, FHFA is amending the rule as proposed, by

⁶ See generally, 12 U.S.C. 4511, 4513, and 4526, citations to which are included in the rule’s “authority” provision.

⁷ FHFA intends to interpret “agreement,” as defined in the rule, broadly where appropriate. For example, FHFA may consider a written policy governing a common practice to be an “agreement” for purposes of the rule.

removing the phrase “pursuant to an obligation of a regulated entity” from the “golden parachute payment” definition.

Section 1231.3(a), Golden Parachute Payments and Agreements Requiring FHFA Consent

FHFA proposed to retain the general construct of the 2014 rule and will continue to prohibit all golden parachute payments and agreements that are not exempt from or permitted by the rule. Prohibited agreements or payments may still be permitted by the Director after review. The Banks commented that this approach can result in a “double approval” requirement, which “creates uncertainty for executives that the compensation agreements they negotiated at the start of employment may not be honored.” The Banks suggested that “double approval” be entirely removed from the rule.

The Banks made a similar comment in response to the 2013 Notice of Proposed Rulemaking that resulted in the 2014 rule.⁸ As FHFA then responded, Section 4518(e) clearly permits FHFA to prohibit or limit golden parachute agreements and payments when a regulated entity is a troubled institution, and many policy reasons support the approach of reviewing both agreements (including plans) and associated payments (*e.g.*, a plan may be designed to cover a class of employees, where neither the regulated entity requesting review nor FHFA knows the specific employees who may, or will, ultimately receive a termination payment; or the financial condition of a troubled institution may deteriorate after FHFA consents to a plan as a golden parachute agreement, but before payments are made).⁹

⁸ 79 FR at 4396.

⁹ *Id.* at 4396-97.

It is also not clear that removing “double approval” would create the certainty desired: if an executive officer entered into a compensation arrangement prior to a Bank’s becoming a troubled institution, but terminated employment when the Bank was troubled, even under a “single approval” approach, FHFA review of either the agreement (as entered into) or the payment (as proposed to be made) would be required. The Banks do not suggest that FHFA could not prohibit or limit either the agreement or the payment at that time, although such a prohibition or a limitation would clearly disrupt the agreement the executive officer reached with the Bank when hired. FHFA also notes that its approach is consistent with that taken by the FDIC and the other federal banking agencies, and thus may be familiar to prospective employees of FHFA’s regulated entities.¹⁰ For these reasons, FHFA is retaining the construct of the 2014 rule and will require a troubled institution to submit agreements and payments that are not exempt from or permitted by operation of the rule to FHFA for prior review and consent.

Section 1231.3(b), Exempt Golden Parachute Payments and Agreements

1. Qualified pension or retirement plans

FHFA did not propose any change to an exemption in the 2014 rule for payments pursuant to any pension or retirement plan that is “qualified (or intended within a reasonable period of time to be qualified) under section 401 of the Internal Revenue Code of 1986 (26 U.S.C. 401).” That language implements a statutory exemption and was derived from a similar rule adopted by the Federal Deposit Insurance Corporation in 1996.¹¹ Freddie Mac commented, however, that although employers previously were able to obtain periodic Section 401 qualification determinations from the Internal

¹⁰ See 12 CFR 359.4(a)(1).

¹¹ Compare 12 U.S.C. 1828(k)(4)(C)(i) and 4518(e)(4)(C)(i); see also 61 FR 5,926, 5931 (Feb. 15, 1996).

Revenue Service (IRS), the IRS has curtailed its issuance of such determinations. Now, certain plans may not receive an IRS determination for quite some time, if ever.¹²

Consequently, the phrase “within a reasonable period of time” could limit application of the exemption in an unforeseen and unintended manner. Freddie Mac requested FHFA clarification that, in cases where a plan that is intended to be qualified does not have an associated IRS determination, it will nonetheless be exempt from the “golden parachute payment” definition.

The statutory exemption that the 2014 rule implements is not conditioned on an IRS determination of qualification, but applies to a plan that “is qualified (or is intended to be qualified).”¹³ The statutory exemption does not include any timing constraint on any such determination. On that basis, FHFA believes “is intended to be” is best read as referring to the employer’s intention regarding the plan’s legal status, as opposed to the employer’s intention to obtain an IRS determination about the plan’s legal status. Thus, the statutory exemption covers both a plan that is qualified and has received an IRS determination and a plan that the employer intends to be qualified under section 401 (even without an IRS determination). To reflect that scope, FHFA has removed the phrase “within a reasonable period of time” from the rule, so that it now mirrors the statutory exemption.¹⁴

2. *Nondiscriminatory benefit plans*

¹² See IRS Rev. Proc. 2016-37 (July 18, 2016).

¹³ 12 U.S.C. 4518(e)(4)(C)(i).

¹⁴ In the case that a plan that is intended to be qualified is discovered to have failed to meet the requirements for qualification, such as by receiving such a determination from the IRS, then in order to keep the exemption under the rule, the employer would need to amend the plan to correct the error and meet the requirements for qualification as soon as reasonably practicable.

Nondiscriminatory employee plans and programs. To implement a statutory exemption for “other nondiscriminatory benefit plans,” FHFA proposed to include an exemption for any benefit plan that is a “nondiscriminatory employee plan or program” in accordance with IRS rules and published guidance interpreting 26 U.S.C. 280G (Section 280G). Section 280G generally addresses the calculation of an “excess” parachute payment and exempts any “nondiscriminatory employee plan or program” from that calculation. In response to a question received, FHFA wishes to clarify that requirements necessary in order for a plan to qualify as “nondiscriminatory” for purposes of Section 280G must be met in order for the plan to be exempt from the “golden parachute payment” definition. In other words, it is not solely the type of plan (*e.g.*, a tuition assistance plan) that triggers the exemption, but the fact that the plan meets the IRS conditions and requirements to be considered “nondiscriminatory.”¹⁵

Severance pay plans. FHFA also proposed to remove an exemption for severance pay plans that met a rule definition of “nondiscriminatory” (and other conditions), based on its experience implementing the 2014 rule. Specifically, FHFA observed that the market-based severance pay plans of its regulated entities did not meet that regulatory standard, and the failure to meet it required FHFA to review all the severance pay plans and payments of its troubled institutions. Based on that review, FHFA determined as a matter of policy that severance pay plans and payments should be subject to prior review. FHFA also noted, however, that a regulated entity could request an exemption for any

¹⁵ For example, to be an exempt cafeteria plan under 26 CFR 280G-1, the plan must not increase benefits for officers or other highly compensated participants. *See* 26 U.S.C. 125. Generally, nondiscriminatory benefit plans would offer similar benefits to all participants. FHFA intends the exemption for any “nondiscriminatory employee plan or program” to be self-executing, meaning the regulated entities must determine whether their benefit plans meet any conditions imposed by the Internal Revenue Code or the IRS, in order for the exemption to apply.

severance pay plan it believes is in fact nondiscriminatory, as Section 4518(e) provides a statutory exemption for “nondiscriminatory benefit plans.” Thus, removal of the regulatory “nondiscriminatory” definition would not eliminate the possibility of an exemption for a nondiscriminatory severance pay plan; rather, it would remove a regulatory definition that the plans reviewed by FHFA did not meet.

The Banks commented on the value of severance pay plans generally and opposed removal of the definition of “nondiscriminatory.” They suggested instead that FHFA retain a “nondiscriminatory” definition but amend it to include the types of severance plans currently used at the Banks or, as an alternative, exempt severance for “rank-and-file” employees. The Banks also requested that severance pay plans (among other types of plans and agreements) in effect as of the date the rule is amended be grandfathered, expressing the view that Section 4518(e) does not support “retroactive” review.

FHFA agrees with the Banks that severance plans are an important benefit for retaining employees, and that employee retention can be an appropriate consideration for a troubled institution.¹⁶ FHFA considered amending the regulatory definition of “nondiscriminatory” when developing its proposed rule but was not able to design a definition that both plausibly expressed the “nondiscriminatory” requirement and would operate to exempt a current, market-based, severance pay plan. As a practical matter, these plans are intended to provide greater benefits to higher-ranking employees than to lower-ranking ones, and thus are intended to discriminate.¹⁷ Thus, FHFA does not

¹⁶ FHFA stated in the preamble to the proposal, for example, that “an appropriately structured severance pay plan could have a retentive effect on employees that could be stabilizing as a troubled institution works to improve its financial condition.” 83 FR at 43808.

¹⁷ FHFA also observes that no regulated entity amended its severance plan to meet the 2014 rule’s “nondiscriminatory” definition. That could demonstrate that even a troubled institution believed having a

believe the Banks' suggestion (expanding the regulatory definition of "nondiscriminatory" to include the severance plans used by the regulated entities) is workable.

FHFA also considered exempting severance pay plans and payments as they relate to lower-ranking employees when developing the proposed rule. Based on a number of policy considerations (some of which are also set forth in the proposal), FHFA determined that a better approach would be to require FHFA review of severance pay plans and, if FHFA consents to the plan, permit payments to be made to employees other than executive officers without FHFA review, provided the regulated entity determines, after appropriate due diligence, that it is reasonably assured the employee has not engaged in the types of wrongdoing described in the rule. This approach will reduce burdens imposed on a troubled institution by the 2014 rule: It eliminates the requirement to make a certification about employee wrongdoing when submitting a plan for review and eliminates the requirement to submit a request for FHFA consent to payment provided the regulated entity meets the "reasonably assured" standard, following appropriate due diligence. FHFA also believes that amendments to the 2014 rule related to assessing possible wrongdoing by employees will further reduce burden. Specifically, FHFA is clarifying both the standard that must be met ("reasonably assured") and the type of inquiry expected (appropriate due diligence, considering the level and responsibilities of the employee). FHFA recognizes that minimal due diligence may be appropriate in some cases, considering the types of wrongdoing set forth in the rule and the responsibilities of some employees who may be eligible for severance pay.

market-based severance pay plan was a more important business consideration than obtaining the regulatory exemption that would have applied.

FHFA also clarifies that it does not object to the 2014 rule’s definition of “nondiscriminatory” as a standard for nondiscrimination in a severance pay plan. If a severance pay plan of a troubled institution is structured to meet that definition – or any other plausible standard for “nondiscriminatory” – that regulated entity may request an exemption for the plan based on its “nondiscriminatory” nature. Because there is a statutory exemption for “nondiscriminatory benefit plans,” the rule as amended acknowledges that a troubled institution may request an exemption for *any* benefit plan on the basis that it is “nondiscriminatory.” If FHFA agrees with the regulated entity’s supported assertion that a benefit plan, including a severance pay plan, is “nondiscriminatory,” that plan, and payments pursuant to it, will be exempt.

Finally, FHFA does not agree that Section 4518(e) does not support review of plans and agreements in effect when a regulation is adopted or amended. The Banks made a similar comment in 2013, prior to FHFA’s adoption of the 2014 rule, which FHFA addressed at that time.¹⁸ FHFA’s view on the statutory authority and responsibility it was given by Congress has not changed. Where a rule providing for FHFA review of and consent to golden parachute payments and agreements has been in place since early 2014, and FHFA is not now establishing a stricter standard for review of such plans or agreements, it is particularly difficult to see how a “retroactive” analysis would be applied. Consequently, plans and agreements in place as of the effective date of the rule amendments are not grandfathered and will be subject to the rule provisions. *Section 1231.3(c), Agreements for which FHFA Consent is Not Required.*

¹⁸ 79 FR at 4395-6.

Plans directed by the Director. FHFA proposed to amend the 2014 rule to permit plans or agreements that provide for termination payments to affiliated parties of a troubled institution without FHFA review, when such arrangements are established or directed by FHFA acting as conservator or receiver or otherwise pursuant to authority conferred by 12 U.S.C. 4617. FHFA received a question about application of that provision, specifically, whether it was intended to permit *every* arrangement established after FHFA was appointed conservator or receiver. The questioner noted that any arrangement of the regulated entity established after FHFA was appointed conservator or receiver could be construed as “established or directed by FHFA acting as conservator or receiver” because, pursuant to 12 U.S.C. 4617, when appointed conservator or receiver, FHFA succeeds to all rights, titles, powers and privileges of the regulated entity, with all the powers of its shareholders, officers, and directors, and to all of the assets of the regulated entity. That construction was not intended (nor, FHFA believes, is it a fair interpretation of the rulemaking as a whole, since such a construction would result in the rule applying almost exclusively to a regulated entity in troubled condition but not to a regulated entity for which a conservator or receiver has been appointed, and would have been discussed in that context; nor is it a fully accurate interpretation of the relationship between the conservator and the Enterprises’ boards and management¹⁹). To avoid any future confusion, however, FHFA has added the word “expressly,” which it always viewed as implied, to provisions permitting the arrangements established or directed by the Director acting pursuant to authority conferred by 12 U.S.C. 4617, without FHFA prior review or consent.

¹⁹ See *Responsibilities of Boards of Directors, Corporate Practices and Corporate Governance Matters*, 80 FR 72328 n.2 (Nov. 19, 2015).

De minimis amount. FHFA proposed to permit a troubled institution to enter into an agreement to make a golden parachute payment to an affiliated party other than an executive officer without FHFA review and consent, and without the due diligence otherwise required, where the amount of the payment, when aggregated with other golden parachute payments, does not exceed \$2,500. FHFA also noted that a higher or lower amount than the proposal's cap of \$2,500 could be supported. Freddie Mac and the Banks each commented on this proposal, generally supporting the concept of permitting *de minimis* payments while requesting that the *de minimis* amount be increased from \$2,500 to \$5,000.

As an alternative to increasing the *de minimis* amount, Freddie Mac suggested exempting all golden parachute payments paid to employees of a certain level and below. Freddie Mac suggested a level of employee, based on its employment structure, to whom it believed payments would not be subject to FHFA review, but also acknowledged that different regulated entities would have different employee structures. Freddie Mac suggested that FHFA could determine the appropriate level of employee for such an exemption at the time the regulated entity becomes a troubled institution.

When developing the proposed rule, FHFA staff considered a *de minimis* amount of \$5,000, which is the amount of a *de minimis* exemption provided by the FDIC in guidance on application of its similar rule.²⁰ FHFA staff selected \$2,500 because, should one of FHFA's regulated entities become troubled, FHFA does not have access to a privately funded, FHFA-administered insurance fund, in contrast to the FDIC with regard to insured depository institutions. On further consideration, however, FHFA believes that

²⁰ See FDIC Guidance on Golden Parachute Applications, FIL Letter 66-2010 (Oct. 14, 2010).

increasing the amount to \$5,000 will not materially change the presumption stated in the preamble to the proposed rule, that a non-executive-officer affiliated party receiving such a *de minimis* amount upon separation either was not in a position to materially affect the financial condition of the regulated entity or engage in certain types of wrongdoing listed in the rule or, if the affiliated party was in such a position, the payment does not settle a claim involving such wrongdoing. For this reason, FHFA has increased the *de minimis* cap in the final rule to \$5,000.

In contrast, FHFA believes Freddie Mac's suggestion to exempt all golden parachute payments to all employees below a certain level would not be appropriate. It would be difficult for FHFA to establish, by rule, a level of employee for which there is no value in reviewing golden parachute payments, regardless of the size of the payment. To do so would require reasonable confidence that, among other things, an employee at or below that level could not engage in the types of wrongdoing set forth in the rule. While as a general matter the level of an employee can be an indicator of the extent of the employee's ability to affect a company, due diligence to determine whether the types of wrongdoing listed in the rule have occurred can still be important. For example, lower-level employees still have the ability to cause material harm to a company (such as reputational harm and technological sabotage) and may still receive substantial settlement payments. For those reasons, FHFA believes that the amount of the payment, rather than the level of the employee, serves as a better proxy for identifying instances where the burden of review, including due diligence, is not warranted. FHFA believes that the proposed approach, which would reduce burden by permitting smaller value payments to

employees (and other affiliated parties) who are not executive officers, strikes the appropriate balance of administrative and policy considerations.

Section 1231.3(d), Payments for which FHFA Consent is Not Required

FHFA proposed to permit some golden parachute payments to be made to an affiliated party other than an executive officer without FHFA prior review and consent. The Banks suggested a change to the proposed rule text for clarity and readability (to modify an introductory phrase to read “To an affiliated party who is not an executive officer, where:”). FHFA agrees that this change improves clarity of the rule, and has changed the text as suggested.

Section 1231.3(e), Required Due Diligence Review and Standard

FHFA proposed to require a troubled institution that concludes, after appropriate due diligence, that it is not “reasonably assured” the affiliated party has not engaged in the listed types of wrongdoing to provide notice of its concerns to FHFA, even if the regulated entity does not enter into an agreement or make a payment to the affiliated party. The Banks objected to the proposed notice requirement as unnecessary, possibly jeopardizing the attorney-client privilege of the regulated entity, and possibly “chilling” the regulated entity’s ability to enter into individually negotiated settlement agreements and other types of severance arrangements.

FHFA intends the notice to provide factual information about the possible wrongdoing in which the troubled institution believes the affiliated party may have engaged. FHFA did not intend the notice to include communications to or from lawyers, and thus does not believe it will implicate any attorney-client privilege. If FHFA has additional questions about a specific situation that may implicate any attorney-client

privileged communications, FHFA expects to work with the troubled institution to avoid any possible waiver, based on the particular facts and circumstances of the matter at hand.

Section 1231.3(f), Factors for Director Consideration.

Based on the legislative history of Section 4518(e) and FHFA's experience administering the 2014 rule, FHFA proposed adding whether a golden parachute payment or agreement is "excessive or abusive or threatens the financial condition of the troubled institution" to listed factors for the Director's consideration. The Banks requested that FHFA clarify the terms "excessive" and "abusive."

What constitutes "excessive" or "abusive" will depend on the circumstances of the agreement or payment, considering the particular troubled institution, its condition, the affiliated party to whom payment would be made, the amount of any payment proposed to be made, and the circumstances surrounding any agreement or plan governing payment. For that reason, FHFA does not believe it is possible to define those terms by rule in a manner that would expand on or illuminate their plain meaning. FHFA notes that this is only one factor among others for the Director to consider when determining whether to prohibit or limit a golden parachute payment.

Impact of Rule Amendments on Existing Plans

FHFA also wishes to clarify that plans of a troubled institution to which FHFA consented under the 2014 rule do not need to be submitted again due to the amendment of the rule, provided the regulated entity is in the same condition that caused it to be a troubled institution when FHFA previously consented to the plan. For example, if one of the Enterprises is currently operating a benefit plan to which FHFA consented, or that

FHFA has notified the Enterprise was otherwise able to continue in operation under the 2014 rule, that plan does not need to be resubmitted simply because the rule is being amended. The amendments adopted do not suggest that consent it has previously provided should now be reconsidered, and avoiding unnecessary resubmission of plans furthers FHFA's desire to reduce regulatory burden. On the other hand, payments to be made after the effective date of the rule amendments are subject to the rule as amended, and must be submitted for review if review is required by the rule.

III. Consideration of Differences between the Banks and the Enterprises

Section 1313(f) of the Safety and Soundness Act (12 U.S.C. 4513(f)), as amended by section 1201 of HERA, requires the Director, when promulgating regulations relating to the Banks, to consider the differences between the Banks and the Enterprises with respect to the Banks' cooperative ownership structure, mission of providing liquidity to members, affordable housing and community development mission, capital structure, and joint and several liability. The Director may also consider any other differences that are deemed appropriate.

In preparing this final rule, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors, and determined that the amendments in the final rule are neutral regarding the statutory factors. In the proposed rule, FHFA requested comments from the public regarding whether differences related to these factors should result in any revisions to the proposed rule. No significant relevant comments were received.

IV. Paperwork Reduction Act

The final rule 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.

V. 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 this final rule under the Regulatory Flexibility Act. The General Counsel of FHFA certifies that this final rule will not have a significant economic impact on a substantial number of small entities because the regulation applies only to the regulated entities, which are not small entities for purposes of the Regulatory Flexibility Act.

VI. Congressional Review Act

In accordance with the Congressional Review Act,²¹ FHFA has determined that this final rule is not a major rule and has verified this determination with the OMB. *See* 5 U.S.C. 504(2).

List of Subjects in 12 CFR Part 1231

²¹ *See* 5 U.S.C. 804(2).

Golden parachutes, Government sponsored enterprises, Indemnification payments.

Accordingly, for the reasons stated in the Supplementary Information, and under the authority of 12 U.S.C. 4511, 4513, 4517, 4518, 4518a, and 4526, FHFA amends part 1231 of subchapter B of chapter XII of Title 12 of the Code of Federal Regulations as follows:

PART 1231—GOLDEN PARACHUTE AND INDEMNIFICATION PAYMENTS

1. The authority citation for part 1231 is revised to read as follows:

Authority: 12 U.S.C. 4511, 4513, 4517, 4518, 4518a, 4526, and 4617.

2. Revise § 1231.1 to read as follows:

§ 1231.1 Purpose.

The purpose of this part is to implement section 1318(e) of the Safety and Soundness Act (12 U.S.C. 4518(e)) by setting forth the factors that the Director will take into consideration in determining whether to limit or prohibit golden parachute payments and agreements and by setting forth conditions for prohibited and permissible indemnification payments that regulated entities and the Office of Finance (OF) may make to affiliated parties.

3. Revise § 1231.2 to read as follows:

§ 1231.2 Definitions.

The following definitions apply to the terms used in this part:

Affiliated party means:

- (1) With respect to a golden parachute payment:
 - (i) Any director, officer, or employee of a regulated entity or the OF; and

(ii) Any other person as determined by the Director (by regulation or on a case-by-case basis) who participates or participated in the conduct of the affairs of the regulated entity or the OF, provided that a member of a Federal Home Loan Bank shall not be deemed to have participated in the affairs of that Federal Home Loan Bank solely by virtue of being a shareholder of, and obtaining advances from, that Federal Home Loan Bank; and

(2) With respect to an indemnification payment:

(i) By the OF, any director, officer, or manager of the OF; and

(ii) By a regulated entity:

(A) Any director, officer, employee, or controlling stockholder of, or agent for, a regulated entity;

(B) Any shareholder, affiliate, consultant, or joint venture partner of a regulated entity, and any other person as determined by the Director (by regulation or on a case-by-case basis) that participates in the conduct of the affairs of a regulated entity, provided that a member of a Federal Home Loan Bank shall not be deemed to have participated in the affairs of that Federal Home Loan Bank solely by virtue of being a shareholder of, and obtaining advances from, that Federal Home Loan Bank;

(C) Any independent contractor for a regulated entity (including any attorney, appraiser, or accountant) if:

(1) The independent contractor knowingly or recklessly participates in any violation of any law or regulation, any breach of fiduciary duty, or any unsafe or unsound practice; and

(2) Such violation, breach, or practice caused, or is likely to cause, more than a minimal financial loss to, or a significant adverse effect on, the regulated entity; or

(D) Any not-for-profit corporation that receives its principal funding, on an ongoing basis, from any regulated entity.

Agreement means, with respect to a golden parachute payment, any plan, contract, arrangement, or other statement setting forth conditions for any payment by a regulated entity or the OF to an affiliated party.

Bona fide deferred compensation plan or arrangement means any plan, contract, agreement, or other arrangement:

(1) Whereby an affiliated party voluntarily elects to defer all or a portion of the reasonable compensation, wages, or fees paid for services rendered which otherwise would have been paid to such party at the time the services were rendered (including a plan that provides for the crediting of a reasonable investment return on such elective deferrals); or

(2) That is established as a nonqualified deferred compensation or supplemental retirement plan, other than an elective deferral plan described in paragraph (1) of this definition:

(i) Primarily for the purpose of providing benefits for certain affiliated parties in excess of the limitations on contributions and benefits imposed by sections 401(a)(17), 402(g), 415, or any other applicable provision of the Internal Revenue Code of 1986 (26 U.S.C. 401(a)(17), 402(g), 415); or

(ii) Primarily for the purpose of providing supplemental retirement benefits or other deferred compensation for a select group of directors, management, or highly compensated employees; and

(3) In the case of any plans as described in paragraphs (1) and (2) of this definition, the following requirements shall apply:

(i) The affiliated party has a vested right, as defined under the applicable plan document, at the time of termination of employment to payments under such plan;

(ii) Benefits under such plan are accrued each period only for current or prior service rendered to the employer (except that an allowance may be made for service with a predecessor employer);

(iii) Any payment made pursuant to such plan is not based on any discretionary acceleration of vesting or accrual of benefits which occurs at any time later than one year prior to the regulated entity or the OF becoming a troubled institution;

(iv) The regulated entity or the OF has previously recognized compensation expense and accrued a liability for the benefit payments according to GAAP, or segregated or otherwise set aside assets in a trust which may only be used to pay plan benefits and related expenses, except that the assets of such trust may be available to satisfy claims of the troubled institution's creditors in the case of insolvency; and

(v) Payments pursuant to such plans shall not be in excess of the accrued liability computed in accordance with GAAP.

Executive officer means an "executive officer" as defined in 12 CFR 1230.2, and includes any director, officer, employee or other affiliated party whose participation in

the conduct of the business of the regulated entity or the OF has been determined by the Director to be so substantial as to justify treatment as an “executive officer.”

Golden parachute payment means any payment in the nature of compensation made by a troubled institution for the benefit of any current or former affiliated party that is contingent on or provided in connection with the termination of such party's primary employment or affiliation with the troubled institution.

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 affiliated party, to pay or reimburse such person for any liability or legal expense.

Individually negotiated settlement agreement means an agreement that settles a claim, or avoids a claim reasonably anticipated to be brought, against a troubled institution by an affiliated party and involves a payment in association with termination to, and a release of claims by, the affiliated party.

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 any 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.

Payment means:

(1) Any direct or indirect transfer of any funds or any asset;

(2) Any forgiveness of any debt or other obligation;

(3) The conferring of any benefit, including but not limited to stock options and stock appreciation rights; and

(4) Any segregation of any funds or assets, the establishment or funding of any trust or the purchase of or arrangement for any letter of credit or other instrument, for the purpose of making, or pursuant to any agreement to make, any payment on or after the date on which such funds or assets are segregated, or at the time of or after such trust is established or letter of credit or other instrument is made available, without regard to whether the obligation to make such payment is contingent on:

(i) The determination, after such date, of the liability for the payment of such amount; or

(ii) The liquidation, after such date, of the amount of such payment.

Permitted means, with regard to any agreement, that the agreement either does not require the Director's consent under this part or has received the Director's consent in accordance with this part.

Troubled institution means a regulated entity or the OF that is:

(1) Insolvent;

(2) In conservatorship or receivership;

(3) Subject to a cease-and-desist order or written agreement issued by FHFA that requires action to improve its financial condition or is subject to a proceeding initiated by the Director, which contemplates the issuance of an order that requires action to improve its financial condition, unless otherwise informed in writing by FHFA;

(4) Assigned a composite rating of 4 or 5 by FHFA under its CAMELSO examination rating system as it may be revised from time to time;

(5) Informed in writing by the Director that it is a troubled institution for purposes of the requirements of this part on the basis of the most recent report of examination or other information available to FHFA, on account of its financial condition, risk profile, or management deficiencies; or

(6) In contemplation of the occurrence of an event described in paragraphs (1) through (5) of this definition. A regulated entity or the OF is subject to a rebuttable presumption that it is in contemplation of the occurrence of such an event during the 90 day period preceding such occurrence.

4. Revise § 1231.3 to read as follows:

§ 1231.3 Golden parachute payments and agreements.

(a) *In general, FHFA consent is required.* No troubled institution shall make or agree to make any golden parachute payment without the Director’s consent, except as provided in this part.

(b) *Exempt agreements and payments.* The following agreements and payments, including payments associated with an agreement, are not golden parachute agreements or payments for purposes of this part and, for that reason, may be made without the Director’s consent:

(1) Any pension or retirement plan that is qualified (or is intended to be qualified) under section 401 of the Internal Revenue Code of 1986 (26 U.S.C. 401);

(2) Any “employee welfare benefit plan” as that term is defined in section 3(1) of the Employee Retirement Income Security Act of 1974, as amended (29 U.S.C. 1002(1)), other than:

(i) Any deferred compensation plan or arrangement; and

(ii) Any severance pay plan or agreement;

(3) Any benefit plan that:

(i) Is a “nondiscriminatory employee plan or program” for the purposes of section 280G of the Internal Revenue Code of 1986 (26 U.S.C. 280G) and applicable regulations;

or

(ii) Has been submitted to the Director for review in accordance with this part and that the Director has determined to be nondiscriminatory, unless such a plan is otherwise specifically addressed by this part;

(4) Any “bona fide deferred compensation plan or arrangement” as defined in this part provided that the plan:

(i) Was in effect for, and not materially amended to increase benefits payable thereunder (except for changes required by law) within, the one-year period prior to the regulated entity or the OF becoming a troubled institution; or

(ii) Has been determined to be permissible by the Director;

(5) Any payment made by reason of:

(i) Death; or

(ii) Termination caused by disability of the affiliated party; and

(6) Any severance or similar payment that is required to be made pursuant to a state statute that is applicable to all employers within the appropriate jurisdiction (with the exception of employers that are exempt due to their small number of employees or other similar criteria).

(c) *Golden parachute payment agreements for which FHFA consent is not required.* A troubled institution may enter into the following agreements to make a golden parachute payment without the Director's consent:

(1) With any affiliated party where the agreement is expressly directed or established by the Director exercising authority conferred by 12 U.S.C. 4617.

(2) With an affiliated party who is not an executive officer where the agreement:

(i) Is an individually negotiated settlement agreement, and the conditions of paragraph (e)(2) of this section are met; or

(ii) Provides for a golden parachute payment that, when aggregated with all other golden parachute payments to the affiliated party, does not exceed \$5,000 (subject to any adjustment for inflation pursuant to paragraph (g) of this section).

(d) *Golden parachute payments for which FHFA consent is not required.* A troubled institution may make the following golden parachute payments without the Director's consent:

(1) To any affiliated party where:

(i) The payment is required to be made pursuant to a permitted individually negotiated settlement agreement; or

(ii) The Director previously consented to such payment in a written notice to the troubled institution (which may be included in the Director's consent to the agreement), the payment is made in accordance with a permitted agreement, and the troubled institution has met any conditions established by the Director for making the payment.

(2) To an executive officer where the payment recognizes a significant life event and does not exceed \$500 in value (subject to any adjustment for inflation pursuant to paragraph (g) of this section).

(3) To an affiliated party who is not an executive officer, where:

(i) The payment is made in accordance with a permitted agreement and the conditions of paragraph (e)(2) of this section are met; or

(ii) The payment when aggregated with other golden parachute payments to the affiliated party does not exceed \$5,000 (subject to any adjustment for inflation pursuant to paragraph (g) of this section).

(e) *Required due diligence review; due diligence standard*—(1) *Agreements and payments where consent is requested.* A troubled institution making a request for consent to enter into a golden parachute payment agreement with, or to make a golden parachute payment to, an individual affiliated party shall conduct due diligence appropriate to the level and responsibility of the affiliated party covered by the agreement or to whom payment would be made, to determine whether there is information, evidence, documents, or other materials that indicate there is a reasonable basis to believe, at the time the request is submitted, that the affiliated party:

(i) Has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the regulated entity or the OF that is likely to have a material adverse effect on the regulated entity or the OF;

(ii) Is substantially responsible for the regulated entity or the OF being a troubled institution;

(iii) Has materially violated any applicable Federal or State law or regulation that has had or is likely to have a material effect on the regulated entity or the OF; or

(iv) Has violated or conspired to violate sections 215, 657, 1006, 1014, or 1344 of title 18 of the United States Code, or section 1341 or 1343 of such title affecting a “financial institution” as the term is defined in title 18 of the United States Code (18 U.S.C. 20).

(2) *Agreements and payments permitted without the Director’s consent.* No troubled institution shall enter into an agreement pursuant to paragraph (c)(2)(i) of this section or make a payment pursuant to paragraph (d)(3)(i) of this section unless it is reasonably assured, following due diligence in accordance with paragraph (e)(1) of this section, that the affiliated party to whom payment would be made has not engaged in any of the actions listed in paragraphs (e)(1)(i) through (iv) of this section.

(3) *Required notice to FHFA.* If a troubled institution determines it is unable to enter into an agreement pursuant to paragraph (c)(2)(i) of this section or make a payment pursuant to (d)(3)(i) of this section without the Director’s consent because it cannot meet the standard set forth in paragraph (e)(2) of this section, and thereafter does not request the Director’s consent to make the payment, then the troubled institution shall provide notice to FHFA of each reason for which it cannot meet the standard set forth in paragraph (e)(2) of this section, within 15 business days of its determination.

(f) *Factors for Director consideration.* In making a determination under this section, the Director may consider:

(1) Whether, and to what degree, the affiliated party was in a position of managerial or fiduciary responsibility;

(2) The length of time the affiliated party was affiliated with the regulated entity or the OF, and the degree to which the proposed payment represents a reasonable payment for services rendered over the period of affiliation;

(3) Whether the golden parachute payment would be made pursuant to an employee benefit plan that is usual and customary;

(4) Whether the golden parachute payment or agreement is excessive or abusive or threatens the financial condition of the troubled institution; and

(5) Any other factor the Director determines relevant to the facts and circumstances surrounding the golden parachute payment or agreement, including any fraudulent act or omission, breach of fiduciary duty, violation of law, rule, regulation, order, or written agreement, and the level of willful misconduct, breach of fiduciary duty, and malfeasance on the part of the affiliated party.

(g) *Adjustment for inflation.* Monetary amounts set forth in this part may be adjusted for inflation by increasing the dollar amount set forth in this part by the percentage, if any, by which the Consumer Price Index for all-urban consumers published by the Department of Labor (“CPI-U”) for December of the calendar year preceding payment exceeds the CPI-U for the month of November 2018, with the resulting sum rounded up to the nearest whole dollar.

5. Revise § 1231.5 to read as follows:

§ 1231.5 Applicability in the event of receivership.

The provisions of this part, or any consent or approval granted under the provisions of this part by FHFA, shall not in any way bind any receiver of a regulated entity. Any consent or approval granted under the provisions of this part by FHFA shall

not in any way obligate FHFA as receiver to pay any claim or obligation pursuant to any golden parachute, severance, indemnification, or other agreement, or otherwise improve any claim of any affiliated party on or against FHFA as receiver. Nothing in this part may be construed to permit the payment of salary or any liability or legal expense of an affiliated party contrary to section 1318(e)(3) of the Safety and Soundness Act (12 U.S.C. 4518(e)(3)).

6. Revise § 1231.6 to read as follows:

§ 1231.6 Filing instructions.

(a) *Scope.* This section contains procedures for requesting the consent of the Director and for filing any notice, where consent or notice is required by § 1231.3.

(b) *Where to file.* A troubled institution must submit any request for consent or notice required by § 1231.3 to the Manager, Executive Compensation Branch, or to such other person as FHFA may direct.

(c) *Content of a request for FHFA consent.* A request pursuant to § 1231.3 must:

(1) Be in writing;

(2) State the reasons why the troubled institution seeks to enter into the agreement or make the payment;

(3) Identify the affiliated party or describe of the class or group of affiliated parties who would receive or be eligible to receive payment;

(4) Include a copy of any agreement, including any plan document, contract, other agreement or policy regarding the subject matter of the request;

(5) State the cost of the proposed payment or payments, and the impact on the capital and earnings of the troubled institution;

(6) State the reasons why consent to the agreement or payment, or to both the agreement and payment, should be granted;

(7) For any plan that the troubled institution believes is a nondiscriminatory benefit plan, other than a plan covered by § 1231.3(b)(3)(i), state the basis for the conclusion that the plan is nondiscriminatory;

(8) For any bona fide deferred compensation plan or arrangement, state whether the plan would be exempt under this part but for the fact that it was either established or materially amended to increase benefits payable thereunder (except for changes required by law) within the one-year period prior to the regulated entity or the OF becoming a troubled institution;

(9) For any agreement with an individual affiliated party, or for any payment, either:

(i) State that the troubled institution is reasonably assured that the affiliated party has not engaged in any of the actions listed in § 1231.3(e)(1)(i) through (iv), or,

(ii) If the troubled institution is not reasonably assured that the affiliated party has not engaged in any of the actions listed in § 1231.3(e)(1)(i) through (iv) but nonetheless wishes to request consent, describe the results of its due diligence and, in light of those results, the reason why consent to the agreement or payment should be granted.

(d) *FHFA decision on a request.* FHFA shall provide the troubled institution with written notice of the decision on a request as soon as practicable after it is rendered.

(e) *Content of notice to FHFA.* A notice pursuant to § 1231.3(e)(3) must:

(1) Be in writing;

(2) Identify the affiliated party who would receive or be eligible to receive payment;

(3) Include a copy of any agreement or policy regarding the subject matter of the request; and

(4) State each reason why the troubled institution cannot meet the standard set forth in § 1231.3(e)(2).

(f) *Waiver of form or content requirements.* FHFA may waive or modify any requirement related to the form or content of a request or notice, in circumstances deemed appropriate by FHFA.

(g) *Additional information.* FHFA may request additional information at any time during the processing of the request or after receiving a notice.

_____ Dated: December 14, 2018.
Melvin L. Watt,
Director, Federal Housing Finance Agency.

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