

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**Office of Federal Housing Enterprise Oversight****12 CFR Part 1770**

RIN 2550-AA13

Executive Compensation**AGENCY:** Office of Federal Housing Enterprise Oversight, HUD.**ACTION:** Final regulation.

SUMMARY: The Office of Federal Housing Enterprise Oversight ("OFHEO") is issuing a final regulation that clarifies the procedures OFHEO employs in overseeing compensation provided by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (collectively, "the Enterprises") to their executive officers. The final regulation formalizes processes by which OFHEO performs its separate reviews of executive compensation and termination benefits. The processes require the submission of relevant information by the Enterprises on a timely basis to enable OFHEO to efficiently carry out its executive compensation functions.

EFFECTIVE DATE: The effective date of this regulation is October 29, 2001.

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SUPPLEMENTARY INFORMATION:**I. Background**

Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, entitled the "Federal Housing Enterprises Financial Safety and Soundness Act of 1992" (the "Act"),¹ established the Office of Federal Housing Enterprise Oversight ("OFHEO") as an independent office within the Department of Housing and Urban Development. OFHEO is the safety and soundness regulator of two of the nation's largest housing-related government sponsored enterprises: the Federal National Mortgage Association ("Fannie Mae") and the Federal Home

Loan Mortgage Corporation ("Freddie Mac") (collectively, the "Enterprises"). In addition to establishing OFHEO, the Act made amendments to the Enterprises' enabling statutes (collectively, the "charter acts"),² in part to accommodate OFHEO's statutory supervisory powers.

Included in the supervisory responsibilities of the Director of OFHEO (the "Director") is oversight of compensation provided by the Enterprises to their respective executive officers. Briefly, the Director's statutory oversight of executive compensation involves two statutory mandates: (1) The prohibition of excessive compensation, as required by the Act; and (2) the prior review of termination benefits, as required by the charter acts. Notably, the differing statutes use similar but not identical terms in delineating the standards and identifying the different comparator groups to be used in these matters.

Specifically, the Act requires the Director to prohibit the Enterprises from providing compensation to any executive officer that is not reasonable and comparable with that paid by similar businesses to executives doing similar work. Businesses used for comparison purposes include publicly held financial institutions or major financial services companies.³

The charter acts were amended by the Act to similarly provide that an Enterprise may only pay compensation that it determines is reasonable and comparable with compensation for employment in other similar businesses, and that the Enterprise must report annually to Congress on the comparability of the compensation policies for their employees with the compensation policies of other similar businesses.⁴ The Enterprises have the general power to select the individuals who will work for them and to set their specific compensation. The Act explicitly provides that OFHEO may not prescribe or set a specific level or range of compensation for executive officers of the Enterprises.⁵

To effectuate OFHEO's charge to prohibit excessive compensation, the Act requires OFHEO to take such actions and perform such functions as the Director determines to be

necessary.⁶ OFHEO may also require an Enterprise to submit reports and special reports as deemed appropriate and in such form as the Director may require.⁷ Moreover, OFHEO has express statutory authority to retain any consultant that the Director determines is necessary to assist in such matters.⁸ The Act also grants OFHEO a wide array of enforcement powers. Thus, without regard to the capital condition of an Enterprise, the Director can undertake enforcement actions, both formal and informal, including the issuance of a notice of charges, for conduct in violation of the compensation provisions of the Act, the charter acts or this regulation.⁹ The Director can require an Enterprise, or any executive officer or member of the board of directors ("Board") to correct or remedy any violation in such manner as the Director determines to be appropriate.¹⁰

In addition to prohibiting the payment of excessive executive compensation, OFHEO is required to review termination benefits provided by the Enterprises to their executive officers. The respective charter acts of the Enterprises were identically amended by the Act to provide that an Enterprise may not enter into an agreement or contract to provide for payment of money or other thing of current or potential value in connection with the termination of employment of an executive officer unless the agreement or contract is approved in advance by OFHEO.¹¹ The Act further amended the charter acts to prohibit the Director from approving termination benefits that are not comparable to such benefits provided by other public or private entities involved in financial services and housing interests to executives with comparable duties and responsibilities.

These amendments to the charter acts were effective after October 28, 1992. Therefore, agreements to provide termination payments to executives that were entered into before that date are not subjected to retroactive review for approval or disapproval by OFHEO. However, the amended charter acts provide that any subsequent renegotiation, amendment or change to any such agreement entered into on or

⁶ Section 1313(8) (12 U.S.C. 4513(8)).⁷ Section 1314(a) (12 U.S.C. 4514(a)).⁸ Section 1315(e) (12 U.S.C. 4515(e)).⁹ Section 1371(a)(3) (12 U.S.C. 4631) and section 1372 (12 U.S.C. 4632).¹⁰ Section 1371(d)(7) (12 U.S.C. 4631(d)(7)).¹¹ Section 310(d)(3)(B) of Federal National Mortgage Association Charter Act (12 U.S.C. 1723a(d)(3)(B)), and section 303(h)(2) of Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(h)(2)).² Federal National Mortgage Association Charter Act (12 U.S.C. 1716-1723i) and Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451-1459).³ Section 1318(a) (12 U.S.C. 4518(a)).⁴ Section 309(d)(2) and (3) of Federal National Mortgage Association Charter Act (12 U.S.C. 1723a(d)(2) and (3)) and section 303(c) and (h) of Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(c) and (h)).⁵ Section 1318(b) (12 U.S.C. 4518(b)).¹ 12 U.S.C. 4501 *et seq.*

before October 28, 1992, is to be considered as entering into an agreement subject to approval by OFHEO. An extension of such an agreement is deemed to constitute a change subject to OFHEO's prior approval. OFHEO's approval is required regardless of how such an extension is structured, *e.g.*, by a written agreement or by a resolution adopted by the Board of the Enterprise.

OFHEO published a notice of proposed rulemaking for public comment relating to its executive compensation oversight responsibilities.¹² Comments on the proposed regulation were received only from the two Enterprises. Those comments were carefully considered in developing this final regulation. A discussion of those comments and OFHEO's response to those comments follows.

II. Comments on the Proposed Executive Compensation Regulation

General Comments

OFHEO's Role and Authority

Both Enterprises commented that OFHEO has a narrow and precisely defined role with regard to executive compensation oversight. They described OFHEO's role as reviewing Board-established executive compensation decisions to determine whether they meet the comparability standards contained in the Enterprises' charter acts. One Enterprise stated that OFHEO cannot regulate what an Enterprise's Board chooses to pay senior executives or the Board's choice of a compensation structure. The Enterprise suggested that such regulation by OFHEO would interfere with management prerogatives; would amount to an undue regulatory interference; and would be contrary to a balance intended by Congress between regulatory action and the Enterprises' independence.

Both Enterprises noted other constraints on their executive compensation in addition to OFHEO's review. They stated that their executive compensation practices are subject to public disclosure under ERISA and other benefit laws and regulations. One Enterprise commented that extensive public disclosure also results from conformance with federal securities laws and stock exchange rules, responsiveness to market discipline, and compliance with reporting requirements to Congress.

OFHEO agrees that it has a defined role with regard to oversight of Enterprise executive compensation

practices. Under the Act, OFHEO is required to prohibit executive compensation that exceeds certain standards. Under the charter acts, OFHEO cannot approve termination benefits provided by an Enterprise to an executive officer that are not comparable to the requisite standards. In the event that OFHEO determines that compensation is excessive or that termination benefits are not similar, the Enterprise would have to revise the executive officer's compensation in order to render it reasonable and comparable. In fulfilling its congressionally defined role, OFHEO does not set executive salaries or dictate an Enterprise's choice of a compensation structure. OFHEO seeks to carry out its responsibilities in this area in the most efficient and least burdensome manner. The regulation sets forth clear processes designed to meet OFHEO's oversight needs, including the submission by the Enterprises of relevant information on a timely basis.

Safety and Soundness Issues

Both Enterprises asserted that OFHEO's executive compensation authority is separate and distinct from its safety and soundness authority. One Enterprise referred to the legislative history of OFHEO's enabling statute, suggesting that Congress was not concerned that excessive compensation practices pose a financial threat to the Enterprises, *i.e.*, asserting that such practices do not present a safety and soundness concern. The other Enterprise stated that, unlike the federal bank regulators, OFHEO's executive compensation oversight is not tied to the regulated entities' financial condition.

One Enterprise argued that OFHEO does not have broad authority under its executive compensation oversight authorities and that OFHEO's rulemaking should not take the same approach to remedial and corrective actions employed to address safety and soundness concerns, *i.e.*, remedies that address a threat to the financial integrity or stability of a regulated institution.

OFHEO disagrees. The executive compensation practices of corporations are widely acknowledged to reflect the integrity of management and soundness of corporate governance practices, as indicators of safe and sound operation. OFHEO recognizes that in addition to its broad authority to oversee the safety and soundness of the Enterprises policies and practices, including executive compensation matters, the agency has specific responsibilities unlike those of the banking agencies to review

compensation and termination benefits of the Enterprises' executive officers. OFHEO may use its full range of preventative and remedial tools to address problems in this area, including rescission agreements and recovery. OFHEO has modified the language of the final rule to clarify the special nature of executive compensation under the statute and the range of supervisory tools it may employ, both formal and informal.

Confidentiality Concerns

One Enterprise stated that inadvertent release of nonpublic executive compensation information may cause competitive and economic harm. The Enterprise suggested that such information only be subject to on-site review.

OFHEO recognizes the sensitive, nonpublic nature of certain information submitted by the Enterprises regarding their executive compensation practices and OFHEO has established appropriate safeguards under its internal procedures and regulations and in line with applicable federal law. Restricted review of executive compensation information at an Enterprise would be contrary to past and current practice. The suggested restriction would result in a less effective and inefficient implementation of OFHEO's oversight responsibilities and could delay timely reviews sought by the Enterprises. The final regulation continues to require the timely submission of all relevant information by the Enterprises to OFHEO in the manner and format specified by OFHEO.

Section Comments

Definitions (§ 1770.3(g))

Both Enterprises made several suggestions to narrow the definition of the term "executive officer" in the proposed regulation. The proposed definition of the term "executive officer" included the chairman of the Board, chief executive officer, chief financial officer, president, vice chairman and any executive vice president, and added the position of chief operating officer, and any individual who performs functions similar to such positions whether or not the individual has an official title. Additionally, the proposed definition of term "executive officer" covered any senior vice president ("SVP") or other individual with similar responsibilities, without regard to title, who is in charge of a principal business unit, division or function, or who reports directly to the Enterprise's chairman of the Board, vice

¹² 65 FR 81771 (December 27, 2000).

chairman, president or chief operating officer.

One Enterprise argued that the proposed definition of executive officer is inconsistent with the plain language and intent of the Act and suggested a narrower definition. The Enterprise objected to defining the term "executive officer" by reference to job function and including consideration of individuals performing "similar responsibilities, without regard to title." The Enterprise suggested that the definition of "executive officer" be confined to those titled SVPs in charge of a principal business unit, division or function; and that all other provisions in the proposed definition should be deleted. It further stated that the statutory language "in charge of" should be read narrowly to mean managerial and policymaking authority and responsibilities; and that "principal" business means of "highest importance," similar to the term's definition as used in accounting.

Both Enterprises noted the past use by OFHEO of a reporting function to define the term "executive officer." They suggested that, if OFHEO determines to use a broad standard, OFHEO should look to the Enterprises' principal lines of business to identify officers who play a key role in management and policymaking decisions. They asserted that an approach limiting review to officers managing key business units would avoid unnecessary reviews of officers engaged in support or subsidiary functions.

After consideration of the comments, OFHEO has determined to retain the definition of the term "executive officer" set forth in the proposed regulation, with one modification. The final regulation adds a provision that the Director shall inform the Enterprises of those officers covered by the definition. This is intended to allow continued discussion between OFHEO and the Enterprises as to the appropriate coverage of particular officers under the regulation.

OFHEO has retained from the proposed regulation the determination that, under the Enterprises' current organizational structure, any officer who reports directly to the chairman of the Board, vice chairman, president or chief operating officer is deemed to be in charge of a principal business unit, division, or function and has an important policymaking role, regardless of his or her title. The Director of OFHEO has discretion to define coverage of SVPs under the term "executive officer" whenever warranted by changes in either Enterprise's organizational structure, position responsibilities or other relevant factors.

In response to one Enterprise's request for clarification, it is noted here that administrative and support staff, such as secretaries and special assistants who report directly to the chairman, vice chairman, *etc.*, are not considered to be executive officers for purposes of this regulation.

Submissions Requirements (§ 1770.4) Categories of Information Relating to Prohibition of Excessive Compensation (§ 1770.4(b))

Both Enterprises commented that § 1770.4(b)(1) and (2) of the proposed regulation appear to require the submission of committee and board minutes within a week after the meeting of either. The Enterprises recommended that OFHEO amend both paragraphs to require the submission of minutes only after they are finalized, that is, after the adoption of minutes at the next board or committee meeting.

For purposes of clarification, paragraph (b) has been amended in this final regulation to provide that information on actions relating to compensation by the board of directors or the committee of the board responsible for compensation that are *effective immediately* upon board or committee action should be submitted to OFHEO within a week (along with supporting materials). Otherwise, OFHEO expects information regarding compensation to be submitted within a week of adoption of minutes by the board or the committee responsible for compensation, as this is the normal effective date for board or committee actions, usually taken at the next meeting of these bodies.

In response to one Enterprise's request for clarification, the term "supporting materials" as used in § 1770.4(b)(1) and (2) of the proposed regulation is defined here to mean copies of compensation documents that are referenced in or are incorporated by reference in the board or in committee resolutions, *e.g.*, human resources documents and benefit plans of the Enterprise. Continuing existing OFHEO practice, the regulation excepts individual performance ratings from its submission requirements.

Both Enterprises objected to proposed paragraph (b)(8) of § 1770.4, which requires submission to OFHEO of information regarding the hiring and payment of compensation to an executive for whom a contract remains under negotiation. One Enterprise suggested that proposed paragraph (b)(8) is not consistent with § 1770.5(a), which authorizes employment contracts to be entered into prior to OFHEO approval, provided they contain notice of the

approval requirement. The Enterprise recommended that paragraph (b)(8) be deleted.

OFHEO agrees that paragraph (b)(8) is unnecessary and has deleted the paragraph from the final regulation. The requirements contained in § 1770.5(a) will govern any contract negotiated and entered into prior to OFHEO's approval.

Revisions to paragraph (b) in this final regulation include the following: materials required for submission under paragraphs (b)(1) and (2) of the proposed regulation are now contained in paragraphs (b)(1) through (3) of the final regulation, and paragraphs (b)(3) through (7) of the proposed regulation are redesignated as paragraphs (b)(4) through (8) in the final regulation.

Timing of Submissions Related to Prior Approval of Termination Benefits (§ 1770.4(c))

Both Enterprises made extensive comment regarding paragraph (c) of § 1770.4. The paragraph sets out when information relevant to the Director's prior approval of termination benefits should be submitted by an Enterprise to OFHEO. As proposed, the paragraph requires that the relevant information be provided to OFHEO when the Enterprise: (1) Enters into any agreement or contract with a new or existing executive officer that includes termination benefits; (2) makes any extension or other amendment to such an agreement or contract; (3) takes any other action to provide termination benefits to a specific executive officer, regardless of how effected; (4) makes any changes in post-employment benefit programs affecting multiple executive officers; or (5) changes the termination provisions of other compensation programs affecting multiple executive officers.

One Enterprise recommended the deletion of the requirement in § 1770.4(c)(1) that requires submission of information on an agreement between an Enterprise and a new or existing officer because, assertedly, most executive officers "are not terminated," but rather leave voluntarily. The commenter suggested that this would save OFHEO from reviewing hypothetical terminations. The Enterprise noted that it could choose to submit a termination agreement for a current executive officer for review by OFHEO at any time.

OFHEO disagrees with this argument. Prior approval by OFHEO is mandatory whenever an Enterprise enters into or changes an agreement or contract with a new or existing executive that contains provisions providing termination benefits. The legislative

history of the Act contains no indication that the term "termination" is limited to involuntary situations. OFHEO considers the specific benefits to which an officer would be entitled under those provisions at the end of his or her employment term and compares those termination benefits to the applicable standard. This determination includes consideration of the effect on termination benefits if the executive departs prior to the expiration of the employment term, either on a voluntary or an involuntary basis. The proposed submission requirements of § 1770.4(c)(1) are therefore retained in the final regulation.

Both Enterprises objected to the language of paragraphs (c)(4) and (5) of § 1770.4 relating to changes in post-employment programs and in the termination provisions of other compensation programs affecting multiple executive officers. They noted that, as drafted, the provisions suggest that OFHEO has prior approval authority over changes in any compensation or benefit plan or program provided to all officers or corporate-wide. The Enterprises requested clarification that the provisions cover only individual termination packages that provide special benefits to an executive officer under so-called "top hat" plans, as opposed to benefits provided to multiple officers under general welfare and benefit plans. One Enterprise further stated that prior approval by OFHEO is not required for executive compensation generally available to similarly situated executives which is received as part of annual compensation, even if it is to be paid post-employment, *e.g.*, pensions, deferred compensation, stock option plans, and retirees' health benefits. It recommended deleting reporting requirements for general welfare and benefit plans and relocating provisions (4) and (5) from paragraph (c) to paragraph (b), which addresses review of "excessive" compensation. The Enterprise also recommended that only "material" changes to covered plans and programs be submitted to OFHEO.

OFHEO has made several clarifications and modifications to the submissions section of the final regulation. Section 1770.4(c), addressing timing of submissions of information for review of termination benefits, has been revised. The revisions indicate that, except as provided under § 1770.5(a), an Enterprise must submit certain delineated information before entering into agreements, making amendments or taking other actions on termination benefits and when changes to

termination benefits are made that affect multiple executive officers. Paragraph (d) of § 1770.4 has been revised to make clear that such submissions need not include information on benefit plans of general applicability, as the statute only contemplates review of "golden parachute" and similar contracts or grants.

Further, for purposes of clarification, OFHEO notes that information submissions under paragraph (c), at the times stated under provisions (1) through (4)—paragraphs (4) and (5) being consolidated in the final regulation—enable OFHEO to determine an individual executive officer's termination benefits. The total payment or value derived from all such termination benefits are included in OFHEO's consideration of compensation. The final regulation makes clear that, while OFHEO has access to benefit plans of general applicability under its oversight authorities, they are not required to be submitted for purposes of prior approval under the consideration of termination benefits. As noted earlier, the intent of the statute and the regulation is to focus on so-called "top hat plans," golden parachutes and similar arrangements. Any change in such benefits may alter the value of the total termination benefits package. Notably, if a change in termination benefits affects an executive officer, the Enterprise may request OFHEO's consideration of the change in officer termination benefits, in the context of previously-granted termination benefits, either at that time or when the officer leaves the Enterprise.

Additionally, both Enterprises expressed concern that the language of paragraphs (c)(4) and (5) appears to suggest that OFHEO can review an officer's compensation twice (under the "excessive" standard in the Act and under the standard for prior approval of termination benefits in the charter acts). One Enterprise stated that such review could result in retroactive disapproval of previously awarded compensation, creating recruitment, retention, and constitutional issues. The other Enterprise asserted that reviewing twice would be contrary to congressional intent.

OFHEO's review authority extends both to the "compensation" and to the individualized termination benefits package provided to an executive officer by an Enterprise. The term "compensation" is broadly defined to include benefits to an executive officer that are derived from post-employment benefit plans or programs and other compensatory benefit arrangements

containing termination benefits, which affect the executive officer individually or as part of a group. As a result, OFHEO reviews the value of benefits provided under such plans, programs and arrangements on an ongoing basis in exercising its dual review authorities. OFHEO aggregates the benefits provided under such plans, programs and arrangements with all other payments of money or any other thing of current or potential value to determine whether an officer's overall "compensation" is excessive.

OFHEO also reviews termination benefits provided by such plans, programs and arrangements in exercising its prior approval authority. Such a review is performed when any agreement that includes termination benefits is entered into, as well as at the time the executive officer leaves his or her employment with an Enterprise, if there have been benefit enhancements or modifications since the time the package was agreed upon. Upon determining that an officer's termination benefits package, as previously approved by OFHEO, has not changed in structure or terms, such package will not be subject to subsequent review or disapproval.

Specific Information to Calculate Termination Benefits (§ 1770.4(d))

Paragraph (d) of § 1770.4 of the proposed regulation specifies what information the Enterprise is to submit and when in order for OFHEO to calculate an executive officer's termination benefits package. Both Enterprises commented that paragraph (d) seems to prevent them from entering into an agreement with a new or departing officer prior to OFHEO approval if that agreement contains individualized termination provisions. They suggested that this would be a departure from current practice and would impede their ability to hire expeditiously. They also asserted that such a requirement would be inconsistent with proposed § 1770.5(a), which authorizes employment contracts to be entered into prior to OFHEO approval, provided they contain notice of the approval requirement.

As noted above in response to the Enterprises' comments on proposed § 1770.4(b)(8), an employment agreement subject to OFHEO's prior approval may be entered into prior to that approval, provided that such agreement satisfies the notice requirements set forth in § 1770.5(a).

One Enterprise requested clarification on paragraph (d)(1), which requires submission of details of a program change before entering into an

agreement containing termination provisions. The Enterprise suggested that the requirement not apply to programmatic benefits available to executives as part of their total compensation, but to "individualized departures" from programmatic termination benefits.

As noted above, in response to the Enterprises' comments on proposed § 1770.4(c)(4) and (5), paragraph (d) has been clarified in the final regulation to provide that submissions need not include information on benefit plans of general applicability, such as so-called 401(k) plans or general health plans.

Compliance (§ 1770.5)

One Enterprise requested deletion of proposed § 1770.5(b), which would require the Enterprises to adopt written procedures implementing the regulation's submission requirements, as unwarranted "micro-management" of the Enterprises' internal procedures. It further asserted that the regulation's force of law and the enforcement remedies of paragraph (d) are sufficient to ensure compliance without the need for written procedures.

OFHEO agrees that the regulation need not require written procedures implementing the submission requirements contained in § 1770.4. Therefore, paragraph (b) has been deleted from this final regulation. Paragraphs (c) and (d) have been consolidated and redesignated as paragraph (b) in the final regulation. Failure by an Enterprise to comply with the requirements of this regulation may warrant remedial action. OFHEO has broad formal and informal authorities to remedy problems and to enforce its determinations, including rescission agreements and recovery.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

This regulation is not classified as a significant rule under Executive Order 12866 because it will not result in an annual effect on the economy of \$100 million or more or a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or have significant adverse effects on competition, employment, investment, productivity, innovation or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or foreign markets. Accordingly, no regulatory impact assessment is required and this final regulation has not been submitted to the

Office of Management and Budget for review.

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). OFHEO has considered the impact of this final regulation under the Regulatory Flexibility Act. The General Counsel of OFHEO certifies that the rule, as herein adopted, is not likely to have a significant economic impact on a substantial number of small business entities because the regulation only affects the Enterprises.

Paperwork Reduction Act

This final regulation does not contain any information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

Unfunded Mandates Reform Act of 1995

This final regulation does not require the preparation of an assessment statement in accordance with the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1531. Assessment statements are not required for regulations that incorporate requirements specifically set forth in law. As explained in the preamble, this regulation implements specific statutory requirements. In addition, this regulation does not include a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year.

List of Subjects in 12 CFR Part 1770

Administrative practice and procedure, Confidential business information, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, OFHEO adds 12 CFR part 1770 to subchapter C to read as follows:

PART 1770—EXECUTIVE COMPENSATION

Sec.

- 1770.1 Authority and scope.
- 1770.2 Purpose.
- 1770.3 Definitions.
- 1770.4 Submission requirements.
- 1770.5 Compliance.

Authority: 12 U.S.C. 1452(h)(2), 1723a(d)(3)(B), 4501(6), 4502(3), 4502(7), 4513, 4514, 4517, 4518(a), 4631, 4632, 4636, 4641.

§ 1770.1 Authority and scope.

(a) *Authority.* Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, entitled the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("the Act") (12 U.S.C. 4501 *et seq.*), established the Office of Federal Housing Enterprise Oversight ("OFHEO") as an independent office within the Department of Housing and Urban Development. In general, OFHEO is the safety and soundness regulator of two housing-related government sponsored enterprises: the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the Enterprises"). The supervisory responsibilities of the Director of OFHEO (the "Director") include oversight of compensation provided by the Enterprises to their executive officers.

(b) *Scope.* The procedures set forth in this part apply to OFHEO's oversight of executive compensation under the following two statutory mandates:

(1) *Prohibition of excessive compensation.* The Act requires the Director to prohibit an Enterprise from providing compensation to any executive officer that is not reasonable and comparable with that paid by other similar businesses to executives doing similar work, *i.e.*, having similar duties and responsibilities. Businesses used for comparison purposes include publicly held financial institutions or major financial services companies. (12 U.S.C. 4518(a)). To effectuate this compensation oversight responsibility, the Act provides that the Director has full authority to take such actions as the Director determines are necessary. (12 U.S.C. 4513(8)). However, the Director may not prescribe or set a specific level or range of compensation for executive officers of the Enterprises. (12 U.S.C. 4518(b)).

(2) *Prior approval of termination benefits.* The Enterprises' enabling statutes ("charter acts") similarly provide that an Enterprise may not enter into any agreement or contract to provide any payment of money or other

thing of current or potential value in connection with the termination of employment of an executive officer unless the agreement or contract is approved in advance by the Director. The Director may only approve termination benefits that are comparable to benefits provided by other public or private entities involved in financial services and housing interests to executives with comparable duties and responsibilities. Agreements or contracts that provide for termination payments to executives that were entered into before October 28, 1992 are not retroactively subject to approval or disapproval by the Director. However, a renegotiation, amendment or change to such an agreement or contract entered into on or before October 28, 1992 shall be considered as entering into an agreement or contract that is subject to approval by the Director. (Section 309(d)(3)(B); 12 U.S.C. 1723a(d)(3)(B) of Fannie Mae's Charter Act; Section 303(h)(2); 12 U.S.C. 1452(h)(2) of Freddie Mac's Corporation Act)

§ 1770.2 Purpose.

In exercising responsibilities related to executive compensation, the Director has established a structured process for the submission of relevant information by each Enterprise. This part codifies those procedures and clarifies the terms used therein in order to facilitate and enhance the efficiency of OFHEO's oversight.

§ 1770.3 Definitions.

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

(a) *The Act* is Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, Oct. 28, 1992, 106 Stat. 3672, 3941 through 4012 (1993), 12 U.S.C. 4501 *et seq.*, separately entitled the "Federal Housing Enterprises Financial Safety and Soundness Act of 1992."

(b) *Affiliate* means, except as provided by the Director, any entity that controls, is controlled by, or is under common control with, an Enterprise.

(c) *Charter acts* mean the Federal National Mortgage Association Charter Act and the Federal Home Loan Mortgage Corporation Act, which are codified at 12 U.S.C. 1716 through 1723i and 12 U.S.C. 1451 through 1459, respectively.

(d) *Compensation* means any payment of money or the provision of any other thing of current or potential value in connection with employment. Compensation includes all direct and indirect payments of benefits, both cash and non-cash, granted to or for the benefit of any executive officer,

including, but not limited to, payments and benefits derived from an employment contract compensation or benefit agreement, fee arrangement, perquisite, stock option plan, post employment benefit or other compensatory arrangement.

(e) *Director* means the Director of OFHEO or his or her designee.

(f) *Enterprise* means the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation and, except as provided by the Director, any affiliate thereof.

(g)(1) *Executive officer* means, with respect to an Enterprise:

(i) The chairman of the board of directors, chief executive officer, chief financial officer, chief operating officer, president, vice chairman, any executive vice president, and any individual who performs functions similar to such positions whether or not the individual has an official title; and

(ii) Any senior vice president (SVP) or other individual with similar responsibilities, without regard to title:

(A) Who is in charge of a principal business unit, division or function, or

(B) Who reports directly to the Enterprise's chairman of the board of directors, vice chairman, president or chief operating officer.

(2) The Director shall inform the Enterprises of those officers covered by this definition.

(h) *OFHEO* means the Office of Federal Housing Enterprise Oversight.

§ 1770.4 Submission requirements.

(a) *Submission of information to OFHEO.* All information required to be filed for purposes of this part is to be provided in a timely fashion by each Enterprise to OFHEO's Associate Director of the Office of Policy Analysis and Research, as specified in this section, or as designated by the Director.

(b) *Categories of information relating to prohibition of excessive compensation.* The following materials, unless otherwise specified, shall be provided by each Enterprise to OFHEO for review within one week after the specified action or event:

(1) Resolutions, including supporting materials and related reports, from meetings of the Enterprise's committee responsible for compensation when the committee takes any action regarding a compensation matter that under the committee's authority is effective without further action by the committee or the board of directors;

(2) Resolutions, including supporting materials and related reports (not otherwise provided to OFHEO under paragraph (b)(1) of this section), from meetings of the board of directors

relating to executive compensation when the board of directors takes any action regarding a compensation matter that is effective without any further action by the board of directors;

(3) Minutes, including supporting materials and related reports, when adopted by the committee responsible for compensation and those portions of minutes of the board of directors, including supporting materials and related reports, related to compensation matters (except for materials previously provided under paragraphs (b)(1) or (2) of this section);

(4) General benefit plans applicable to executive officers when adopted or amended;

(5) Any study conducted by or on behalf of an Enterprise with respect to compensation of executive officers;

(6) The Enterprise's annual compensation report to Congress when submitted;

(7) A current organizational chart when changes occur affecting the status of executive officers under this part;

(8) Proxy statements when issued; and,

(9) Such other information as deemed appropriate by the Director, except that submissions required under this paragraph shall not include materials related to the performance of specific individuals.

(c) *Timing of submissions related to prior approval of termination benefits.* All relevant information, except as provided under § 1770.5(a), should be provided to OFHEO, unless already provided under paragraph (b) of this section:

(1) Before an Enterprise enters into any agreement or contract with a new or existing executive officer that includes termination benefits;

(2) Before an Enterprise makes any extension or other amendment to such an agreement or contract;

(3) Before an Enterprise takes any other action to provide termination benefits to a specific executive officer, regardless of how effected; or

(4) When an Enterprise makes any changes to the termination provisions of any compensation or benefit program affecting multiple executive officers.

(d) *Specific information required for calculation of termination benefits.* For submissions under paragraph (c) of this section, an Enterprise shall submit to OFHEO the following materials:

(1) The details of the agreement or program change, e.g., employment agreements, termination agreements, severance agreements, and portions of minutes of the board of directors relating to executive compensation and minutes and supporting materials of the

compensation Committee of the board of directors;

(2) All information, data, assumptions and calculations for the potential total dollar value or range of values of the benefits provided, such as but not limited to salary, bonus opportunity, short-term incentives, long-term incentives, special incentives and pension provisions or related contract or benefit terms; and

(3) Such other information deemed appropriate by the Director, except that information required to be submitted under paragraph (c) of this section or under this paragraph shall not include information on benefit plans of general applicability.

§ 1770.5 Compliance.

(a) An employment agreement or contract subject to the Director's prior approval, as set forth in § 1770.1(b)(2), may be entered into prior to that approval, *provided that* such agreement or contract specifically provides that termination benefits under the agreement or contract shall not be effective and no payments shall be made thereunder unless and until approved by OFHEO. Such notice should make clear that alteration of benefit plans subsequent to OFHEO approval under this section, that affect final termination benefits of an executive officer, requires review at the time of the individual's termination from the Enterprise and prior to the payment of any benefits.

(b) Failure by an Enterprise to comply with the requirements this regulation

may warrant remedial action by OFHEO. Such action may be taken in the form determined appropriate by the Director and may be taken separately from, in conjunction with, or in addition to any other corrective or remedial action, including an enforcement action to require an individual to make restitution to or reimbursement to the Enterprise of excessive compensation or inappropriately paid termination benefits.

Dated: September 4, 2001.

Armando Falcon, Jr.,
Director, Office of Federal Housing Enterprise Oversight.

[FR Doc. 01-22926 Filed 9-11-01; 8:45 am]

BILLING CODE 4220-01-U