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FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1229

RIN 2590–AA21

Capital Classifications and Critical Capital Levels for the Federal Home Loan Banks

AGENCY: Federal Housing Finance Agency.

ACTION: Interim final rule; request for comments.

SUMMARY: The Federal Housing Regulatory Reform Act, Division A of the Housing and Economic Recovery Act of 2008 (HERA), requires the Director of Federal Housing Finance Agency (FHFA) to establish criteria based on the amount and type of capital held by a Federal Home Loan Bank (Bank) for each of the following capital classifications: adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. In addition, HERA provides that the critical capital level for each Bank shall be the amount of capital that the Director by regulation shall require. HERA also sets forth prompt corrective action (PCA) authority that the Director has for the Banks. To implement these new provisions, the FHFA is adopting this interim final rule to define critical capital for the Banks, establish the criteria for each of the capital classifications identified in HERA and delineate its PCA authority over the Banks.

DATES: *Effective Date:* January 30, 2009.

Comment Date: Comments on the interim final rule must be received on or before April 30, 2009. For additional information, see **SUPPLEMENTARY INFORMATION**.

ADDRESSES: You may submit your comments on the proposed regulation, identified by regulatory information number (RIN) 2590–AA21 by any of the following methods:

- *U.S. Mail, United Parcel Post, Federal Express, or Other Mail Service:* The mailing address for comments is: Alfred M. Pollard, General Counsel and Christopher Curtis, Senior Deputy General Counsel, Attention: Comments/RIN 2590–AA21, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.
- *Hand Delivered/Courier:* The hand delivery address is: Alfred M. Pollard, General Counsel and Christopher T. Curtis, Senior Deputy General Counsel, Attention: Comments/RIN 2590–AA21, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- *E-mail:* Comments to Alfred M. Pollard, General Counsel and Christopher T. Curtis, Senior Deputy General Counsel, may be sent by e-mail at *RegComments@FHFB.gov.* Please include ''RIN 2590–AA21'' in the subject line of the message.
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

FOR FURTHER INFORMATION CONTACT: Julie Paller, Senior Financial Analyst, (202) 408–2842, and Anthony Cornyn, Senior Associate Director, (202) 408–2522, Division of Federal Home Loan Bank Regulation; or Thomas E. Joseph, Senior Attorney-Advisor, (202) 408–2512, Office of General Counsel, Federal Housing Finance Agency, 1625 Eye Street, NW., Washington, DC 20006. The telephone number for the Telecommunications Device for the Deaf is (800) 877–8339.

SUPPLEMENTARY INFORMATION:

I. Comments

The FHFA invites comments on all aspects of the interim final rule, and will amend the rule as appropriate after taking all comments into consideration. FHFA requests that comments submitted in hard copy also be accompanied by the electronic version in Microsoft® Word or in portable document format (PDF) on CD–ROM. Copies of all comments will be posted on the internet Web site at *https://www.fhfa.gov.* In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 414–3751.

II. Background

A. Federal Housing Finance Agency and Recent Legislation

Effective July 30, 2008, HERA, Public Law No. 110–289, 122 Stat. 2654 (2008), transferred the supervisory and oversight responsibilities of the Office of Federal Housing Enterprise Oversight (OFHEO) over the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises) and the oversight responsibilities of the Federal Housing Finance Board (FHFB or Finance Board) over the Banks and the Office of Finance (which acts as the Banks' fiscal agent) to a new independent executive branch agency, the FHFA. The FHFA is responsible for ensuring that the Enterprises and the Banks operate in a safe and sound manner, including that they maintain adequate capital and internal controls, that their activities foster liquid, efficient, competitive and resilient national housing finance markets, and that they carry out their public policy missions through authorized activities. *See id.* at § 1102, 122 Stat. 2663–64. The Enterprises and the Banks continue to operate under regulations promulgated by OFHEO and the FHFB until the FHFA issues its own regulations. *See id.* at §§ 1302, 1313, 122 Stat. 2795, 2798.

Section 1141 of HERA states that the Director shall adopt regulations specifying the critical capital level for each Bank. *See id.* at § 1141, 122 Stat. 2730 (adopting 12 U.S.C. 4613(b)). In establishing this requirement, HERA provides that the Director shall take due consideration of the critical capital levels established for the Enterprises, with such modifications as the Director determines to be appropriate to reflect the difference in operations between the Banks and the Enterprises. HERA further requires the Director to issue regulations establishing the critical capital levels for the Banks no later than the expiration of the 180 day period from the date that HERA was enacted.

In addition, section 1142 of HERA requires that the Director, no later than 180 days from its enactment, establish for the Banks the following four capital classifications and criteria for each classification: adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. *See id.* at § 1142, 122 Stat. 2730–32. HERA specifies that the criteria should be based on the amount and types of capital held by a Bank and the risk-based, minimum and critical capital levels for the Banks, taking due consideration of the capital classifications established for the Enterprises, with such modifications as the Director determines to be appropriate to reflect the difference in operations between the Banks and the Enterprises. HERA also provides the FHFA prompt corrective action authority over the Banks and amends the Federal Housing Enterprises Safety and Soundness Act of 1992 (Safety and Soundness Act) so that specific mandatory or discretionary supervisory actions and restrictions under that statute would apply to any Bank determined to be undercapitalized, significantly undercapitalized or critically undercapitalized. *See id.* at §§ 1143–1145, 122 Stat. 2732–34. The general purpose for the PCA framework is to supplement the FHFA's other regulatory and supervisory authority and provide for timely and, in some situations, mandatory intervention by the regulator.

B. The Bank System Generally

The twelve Banks are instrumentalities of the United States organized under the Federal Home Loan Bank Act (Bank Act).[1] *See* 12 U.S.C. 1423, 1432(a). The Banks are cooperatives; only members of a Bank may purchase the capital stock of a Bank, and only members or certain eligible housing associates (such as state housing finance agencies) may obtain access to secured loans, known as advances or other products provided by a Bank. *See* 12 U.S.C. 1426(a)(4), 1430(a), 1430b. Each Bank is managed by its own board of directors and serves the public interest by enhancing the availability of residential mortgage and community lending credit through its member institutions. *See* 12 U.S.C. 1427. Any eligible institution (generally a federally-insured depository institution or state-regulated insurance company) may become a member of a Bank if it satisfies certain criteria and purchases a specified amount of the Bank's capital stock. *See* 12 U.S.C. 1424; 12 CFR part 925. The Bank Act also requires each Bank to establish an affordable housing program (AHP) and contribute a specified portion of its previous year's net income to support that program. *See* 12 U.S.C. 1430(j). The purpose of the program is to enable Bank members to finance homeownership for low- or moderate-income households and the purchase, construction or rehabilitation of rental projects that benefit very low-income households.

As government-sponsored enterprises (GSEs), the Banks are granted certain privileges under federal law. In light of those privileges and their status as GSEs, the Banks typically can borrow funds at a modest spread over the rates on U.S. Treasury securities of comparable maturity. The Banks pass along a portion of their GSE funding advantage to their members—and ultimately to consumers—by providing advances and other financial services at rates that would not otherwise be available to their members. Some of the Banks also have acquired member asset (AMA) programs whereby they acquire fixed-rate, single-family mortgage loans from participating member institutions.

Consolidated obligations, consisting of bonds and discount notes, are the principal funding source for the Banks. The Office of Finance issues all consolidated obligations on behalf of the twelve Banks.[2] Although each Bank is primarily liable for the portion of consolidated obligations corresponding to the proceeds received by that Bank, each Bank is also jointly and severally liable with the other eleven Banks for the payment of principal of, and interest on, all consolidated obligations. *See* 12 CFR 966.9.

C. Capital Requirements for the Banks

The Bank Act defines the types of capital that the Banks must hold—specifically permanent and total capital—and establishes the Banks' minimum leverage and risk-based capital requirements. The Bank Act defines ''permanent capital'' as the amounts paid for Class B stock by members plus the Bank's retained earnings as determined in accordance with generally accepted accounting principles (GAAP), and defines ''total capital'' as permanent capital plus the amounts paid by members for Class A stock, any general allowances for losses held by a Bank under GAAP (but not any allowances or reserves held against specific assets or specific classes of assets) and any other amounts from sources available to absorb losses that are determined by regulation to be appropriate to include in total capital.[3] *See* 12 U.S.C. 1426(a)(5). However, because the Banks have no general allowances for losses and no additional sources have been determined to be appropriate to include in total capital, a Bank's total capital currently consists of its permanent capital plus the amounts, if any, paid by its members for Class A stock.[4]

The Bank Act provides that each Bank must hold total capital equal to at least 5 percent of its total assets, provided that in determining compliance with this ratio, a Bank's total capital shall be calculated by multiplying its permanent capital by 1.5 and adding to this product any other component of total capital. *See* 12 U.S.C. 1426(a)(2). *See also* 12 CFR 932.2(b). The Bank Act also requires that when total capital is calculated without application of the multiplier of 1.5, a Bank's total capital must equal at least 4 percent of its total assets.[5] *See* 12 U.S.C. 1426(a)(2)(B). *See*

[1] Each Bank is generally referred to by the name of the city in which it is located. The twelve Banks are located in: Boston, New York, Pittsburgh, Atlanta, Cincinnati, Indianapolis, Chicago, Des Moines, Dallas, Topeka, San Francisco, and Seattle.

[2] Since June 2000, the Banks have been issuing consolidated obligations under section 11(a) of the Bank Act (12 U.S.C. 1431(a)) and 12 CFR 966.2(b). Section 11(a) allows the Banks to issue debt subject to such rules, regulations and conditions imposed by their regulator while 12 CFR 966.2(b) allows the Banks only to issue consolidated obligations jointly and which are the joint and several obligation of all Banks. Prior to June 2000, the Finance Board issued consolidated obligations on which the Banks were jointly and severally liable on behalf of the Banks under section 11(c) of the Bank Act (12 U.S.C. 1431(c)). HERA amended section 11(c) of the Bank Act to remove the authority of the Banks' regulator to issue debt on behalf of the Banks. *See* § 1204(3)(B), Pub. L. No. 110–289, 122 Stat. 2785–86 (amending 12 U.S.C. 1431(c)).

[3] Class B stock is defined by the Bank Act as stock that is redeemable (subject to certain exceptions) five years after a member files notice of its intent to have the stock redeemed, while Class A stock is defined as stock redeemable (subject to the same exceptions) six months after a member files such a notice. *See,* 12 U.S.C. 1426(a)(5). *See also* 12 CFR 931.1. The Chicago Bank is the only Bank that has not converted to the Class A/Class B capital structure required under the Gramm-Leach Bliley Act (GLB Act) amendments to the Bank Act and thus, does not issue either Class A or Class B stock. Instead, the Chicago Bank still issues stock as defined in the Bank Act prior to its amendment by the GLB Act.

[4] Only two Banks, Topeka and Seattle, have issued both Class A and Class B stock. Nine Banks, Boston, New York, Pittsburgh, Atlanta, Cincinnati, Indianapolis, Des Moines, Dallas, and San Francisco, issue only Class B stock, while, as already noted, the Chicago Bank has yet to issue either Class A or Class B stock.

[5] HERA defines these two leverage ratios as the ''minimum capital level'' for a Bank. *See* § 1111, Pub. L. No. 110–289, 122 Stat. 2666–67. As already noted, the Act states that the capital classifications for the Banks should be based on among other things ''the minimum capital * * * levels for the [B]anks.'' HERA also provides the Director with authority to require an increase in a Bank's minimum capital level by order, if the increase is to be temporary, and to promulgate regulations to

also, 12 CFR 932.2(a). Each Bank also must fulfill a risk-based capital requirement under which it must hold sufficient permanent capital to meet its market, credit and operations risk, as measured under current regulations.[6] *See* 12 U.S.C. 1426(a)(3) and 12 CFR 932.3.

The above requirements apply to the eleven Banks that have converted to the GLB Act capital structure, but do not apply to the Chicago Bank. The Chicago Bank is currently subject to capital requirements set forth in a 2007 Cease & Desist Order, as amended (Order), and remains the only Bank subject to capital requirements under § 966.3(a) of the rules.[7] *See* 12 CFR 966.3(a). Under the Order, the Chicago Bank must maintain a leverage ratio of the sum of the paid-in value of its capital stock, plus retained earnings, plus the face value of includable, outstanding subordinated debt instruments to total assets of at least 4.5 percent, and an aggregate amount of at least $3,600,000 in outstanding capital stock and includable subordinate debt. The includable amount of subordinated debt used to determine compliance with these requirements is 100 percent of the face value of the outstanding debt for the five years beginning on June 13, 2006, the date the debt was issued; thereafter, the included amount of outstanding debt shall be reduced by 20 percentage points annually.[8] The capital requirements under the Order, rather than those of § 966.3(a), currently are binding on the Chicago Bank.

In addition, the Bank Act imposes certain restrictions on Banks should they fail to meet any applicable capital requirement. These restrictions are separate and distinct from any restrictions or requirements imposed by the PCA provisions that apply to the Banks under HERA. Under the Bank Act, the Banks are prohibited from redeeming or repurchasing any stock if after doing so the Bank would fail to meet any minimum capital requirement. *See* 12 U.S.C. 1426(f). The Bank Act also prohibits a Bank from making any distribution of retained earnings if following such distribution the Bank would fail to meet any capital requirement. *See* 12 U.S.C. 1426(h)(3).

Finally, the Bank Act and regulatory provisions restrict Bank activity if the value of a Bank's stock is impaired by losses, whether or not the Bank meets its regulatory capital requirements. Specifically, the Bank Act prohibits a Bank from redeeming or repurchasing stock without the written permission of the Director if the Bank is experiencing, or is likely to experience, losses that will result in charges against capital. *See* 12 U.S.C. 1426(f). Current regulations define the phrase ''charges against capital'' to mean losses that would cause a Bank's total equity to fall below the par value of outstanding Bank stock on an other than temporary basis. *See* 12 CFR 930.1. Current regulations also prohibit a Bank from declaring or paying a dividend if the par value of the Bank's stock is impaired or is projected to become impaired after payment of the dividend. *See* 12 CFR 917.9(b).

D. Considerations of Differences Between the Banks and the Enterprises

Section 1201 of HERA requires the Director, when promulgating regulations relating to the Banks, to consider the following differences between the Banks and the Enterprises: cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability. *See* § 1201 Public Law 110–289, 122 Stat. 2782–83 (amending 12 U.S.C. 4513). The Director also may consider any other differences that are deemed appropriate. In preparing this interim final rule, the FHFA considered the differences between the Banks and the Enterprises as they relate to the above factors. The FHFA requests comments from the public about whether differences related to these factors should result in a revision to the interim final rule.

III. The Interim Final Rule

The interim final rule adds new subpart A of part 1229 to 12 CFR chapter XII, subchapter B. The new provision clarifies and provides details on how the FHFA intends to implement sections 1363 through 1369D of the Safety and Soundness Act, as these provisions have been amended and made applicable to the Banks by HERA. Where appropriate, the rule also incorporates and makes clear that restrictions on capital distributions established under the Bank Act and its implementing regulations apply to Banks that do not meet their capital requirements or have suffered from charges against their capital, in addition to any of the PCA restrictions applicable under the Safety and Soundness Act. *See e.g.*, 12 U.S.C. 1426(f) and (h)(3); 12 CFR 917.9(b). The provisions adopted under new subpart A of part 1229 apply only to the Banks. The capital classification and PCA provisions applicable to the Enterprises are contained at 12 CFR part 1777.

Analysis of the Interim Final Rule

Section 1229.1. Section 1229.1 sets forth definitions that will be applicable to subpart A of part 1229. Many of the terms are specific to the Banks. Most of these Bank-specific terms are defined with reference to the Bank Act or adopt definitions that are set forth in the Bank Act or that were previously adopted by the Finance Board in part 900 of its rules. 12 CFR part 900. Such terms include ''class A stock,'' ''class B stock,'' ''consolidated obligations,'' ''permanent capital'' and ''total capital.'' As discussed below, the definition of ''total capital,'' however, has been expanded from the definition in the Bank Act to ensure that it applies to all Banks and not just those that have converted to the GLB Act capital structure. *See* n.10, *infra.*

The definition for the term ''consolidated obligations'' in § 1229.1 has been altered slightly from the definition previously set forth in part 900 of the Finance Board's rules to reflect the fact the HERA amendment to section 11 of the Bank Act to remove authority from the Banks' regulator to issue debt on behalf of the Banks and to authorize the Banks, themselves, through their agent, the Office of Finance, to issue debt that would be the joint and several liability of all the Banks. *See* § 1204, Public Law 110–289, 122 Stat. 2785–86 (amending 12 U.S.C. 1431(b) and (c)). Nevertheless, the new definition recognizes that some of the outstanding consolidated obligations may have been issued by the Finance Board on behalf of the Banks, and it is meant to encompass all outstanding obligations issued under section 11 (either before or after its amendment by HERA) on which the Banks are jointly and severally liable, whether such obligations were issued by the Finance Board or jointly by the Banks.

The section also provides a definition of ''capital distribution'' that applies only to the Banks. The Safety and Soundness Act defines ''capital

require a permanent, higher minimum capital level for the Banks. *Id.*

[6] HERA amended the risk-based capital provision to provide the Director more flexibility to adopt new risk-based capital standards if desired. *See* § 1110, Pub. L. No. 110–289, 122 Stat. 2675–76 (amending 12 U.S.C. 1426(a)(3)). The current risk-based capital rules are contained at 12 CFR 932.4, 932.5, & 932.6.

[7] Once a Bank converts to the GLB Act capital structure and first complies with the capital requirements under Part 932 of the rules, it is no longer subject to § 966.3(a). *See,* 12 CFR 931.9(b).

[8] In effect, 80 percent of the face value of outstanding subordinated debt will be used to calculate compliance beginning June 13, 2012, 60 percent beginning June 13, 2013, etc. The subordinate debt comes due June 13, 2016. The face value of the subordinated debt issued by Chicago Bank was $1 billion, all of which remains outstanding.

distribution'' but only in terms of payments made by, or with respect to shares of, an Enterprise, so that the statutory definition would not apply to the Banks. *See* 12 U.S.C. 4502(2). Nevertheless, the definition of ''capital distribution'' adopted in § 1229.1 covers the same types of transactions covered by the statutory provision to the extent that such transactions are undertaken by the Banks. The definition also makes clear that the payment of dividends in the form of stock is considered a capital distribution for the Banks even though this type of transaction is specifically excluded from the statutory definition of ''capital distribution'' for the Enterprises. In this respect, the Bank Act and regulations applicable to the Banks prohibit a Bank from declaring or paying a dividend in any form if it does not comply with any of its capital requirements or would not do so after paying the dividend. *See* 12 U.S.C. 1426(h)(3); 12 CFR 931.4(b). To assure that these restrictions are captured in the PCA provisions, capital distributions for a Bank are defined to include dividends paid in the form of stock.

Section 1229.1 defines the ''minimum capital requirement'' with reference to section 6(a)(2) of the Bank Act (12 U.S.C. 1426(a)(2)), which establishes the minimum leverage and total capital requirement for Banks that have converted to the stock structure required by the GLB Act, as such requirements may be modified by the Director. This is consistent with HERA which specifically defines these two requirements as the ''minimum capital level'' for the Banks and allows the Director to raise these requirements either permanently or temporarily. *See* n.5, *supra.* In addition, the definition adopted in § 1229.1 states that the minimum capital requirement shall include ''any similar requirement [to those under section 6(a)(2) of the Bank Act] established for a Bank by regulation, order, written agreement or other action.'' This wording captures the fact that the Chicago Bank has not yet converted to the GLB Act capital structure and is therefore not subject to the leverage requirements in section 6(a)(2) of the Bank Act, although it is subject to leverage requirements under the Cease and Desist Order and applicable regulations. *See* 12 CFR 966.3(a).[9] The FHFA does not believe that HERA intended to exclude the Chicago Bank from PCA coverage just because it has not converted to the GLB Act capital structure, and thus has adopted a definition of ''minimum capital requirement'' that encompasses the leverage requirements applicable to Chicago.[10] The wording also recognizes that the Director could subject any Bank to higher minimum leverage requirements through an enforcement action and will assure that such requirements will be considered a minimum capital requirement for PCA purposes.

Section 1229.1 defines the phrase ''tangible equity'' to mean ''for a Bank, the paid-in value of its outstanding capital stock plus its retained earnings calculated in accordance with generally accepted accounting principles in the United States (GAAP) less the amount of any assets that would be intangible assets under GAAP.'' HERA adds references to ''tangible equity'' in certain PCA provisions but does not otherwise define the term.[11] *See* § 1143, Pub. L. No. 110–289, 122 Stat. 2732 (amending 12 U.S.C. 4615). The definition adopted is based on that used by banking regulators, adjusted to reflect the capital structure of the Banks. Other regulators generally include as ''tangible equity'' retained earnings, all forms of non-redeemable stock such as common stock and perpetual preferred stock less amounts of non-tangible assets. *See e.g.,* 12 CFR 565.3(f) (Office of Thrift Supervision (OTS) definition). Tangible equity generally does not include debt instruments such as subordinated debt.

The Banks, however, are only allowed to issue stock as defined in the Bank Act. The Bank Act specifically defines all Bank stock as redeemable, although the Bank Act also prohibits redemption of the stock if it is needed to maintain a Bank's compliance with its risk-based and minimum capital requirements. *See* 12 U.S.C. 1426. Given this statutorily-imposed capital structure, it does not seem reasonable to exclude redeemable stock from the definition of ''tangible equity'' for the Banks. Therefore, the definition of ''tangible equity'' in § 1229.1 includes the paid-in value of stock and retained earnings less intangible assets. As with the definition adopted by other regulators, this definition does not include subordinated debt instruments in ''tangible equity.''

Finally, as required by § 1141(a) of HERA, the FHFA establishes and defines the critical capital level for the Banks in this section. *See* § 1141(a), Public Law No. 110–289, 122, Stat. 2730 (adopting 12 U.S.C. 4613(b)). The critical capital level for a Bank is established as 2 percent of its total assets. This threshold is addressed below as part of the discussion of the criteria for classifying a Bank as ''critically undercapitalized.''

Section 1229.2. Section 1229.2 of the interim final rule generally implements the requirements of section 1364(d) of the Safety and Soundness Act, as that provision was amended and re-designated by § 1142 of HERA. As set forth in the statute, the interim final rule requires the Director to determine the capital classification of each Bank no less often than once every quarter. The rule makes clear, however, that the Director may make such a determination more often than once a quarter and that the Director can make a determination at any time for one or more Banks without making a determination for all Banks. The rule also requires that the quarterly determination be made in accordance with the procedural requirements set forth in § 1229.12 of the rule, a provision which implements § 1368 of the Safety and Soundness Act. 12 U.S.C. 4618. The rule also requires a Bank to provide written notification to the FHFA within ten calendar days of any event that causes its permanent or total capital to fall below the level necessary to maintain the capital classification provided in the most recent notice from, or determination by, the Director. For purposes of this requirement, a notice would include one provided to the Bank under § 1229.12(a) of this interim final rule. This requirement is similar to those currently imposed on the Enterprises, and the FHFA finds no reasons that the Banks should be treated differently in this respect. *See* 12 CFR 1777.21(b).

Section 1229.3. Section 1229.3 sets forth the criteria for classifying the Banks as adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, as required by § 1142 of HERA. § 1142 Public Law No. 110–289, 122 Stat. 2730–31 (amending 12

[9] This aspect of the regulation only applies to the Chicago Bank and does not apply to any of the other Banks, all of which have converted to the GLB Act capital structure and made the transition to complying with the GLB Act's capital requirements. *See* 12 CFR 931.9(b)(1).

[10] Similarly, the definition of total capital in § 1229.1 states that for a Bank that has not issued either Class A or Class B stock, total capital ''will be the measure of capital used to determine compliance with its minimum capital requirement.'' This wording applies only to the Chicago Bank and recognizes that the Chicago Bank's regulatory total capital (used to meet its applicable leverage requirements) is defined by the current Order and by Finance Board resolution. *See* Fin. Brd. Res. No. 2006–06 (Apr. 18, 2006).

[11] The term ''tangible equity'' is used in a PCA provision added by HERA restricting asset growth for undercapitalized regulated entities. The term ''regulated entity'' is defined in HERA to mean any Enterprise or any Bank. *See* § 1002(a), Public Law No. 110–289, 122 Stat.2659 (adopting 12 U.S.C. 4502(20)). Section 1229.6(a)(4) of this interim final rule implements the provision restricting asset growth for undercapitalized Banks.

U.S.C. 4614). As required by HERA, these categories are defined in terms of the risk-based and minimum capital requirements established for the Banks under the Bank Act and other applicable law, after taking due consideration of the classifications established for the Enterprises. *Id.* The rule also makes clear that the criteria are only applicable to the extent that the Director has not exercised authority to reclassify the Bank based on factors other than the capital levels of the Bank, such as that provided in § 1142 of HERA and implemented in § 1229.4 of this rule. *See* § 1142 Public Law No. 110–289, 122 Stat. 2730–31 (adopting 12 U.S.C. 4614(c)).

Under the rule, a Bank will be adequately capitalized only if it holds sufficient capital to meet both its risk-based and minimum capital requirements.[12] This is consistent with the provision in HERA that the Banks' capital classifications be based on the amount and types of capital held by the Banks and the risk-based and minimum capital requirements for the Banks. It is also consistent with the general approach under existing Bank Act provisions that a Bank must remain in compliance with all its capital requirements, and that a Bank itself becomes subject to restrictions, similar to those under the PCA provisions of HERA, when it is not in compliance with any one of its capital requirements. *See* 12 U.S.C. 1426(c)(1)(D), (f)(1) and (h)(3).

The rule states that a Bank will be undercapitalized if it fails to meet any one of its minimum or risk-based capital requirements. This approach is slightly different from that established for the Enterprises under the Safety and Soundness Act, which provides that an Enterprise is undercapitalized only if it does not meet its total capital requirement. *See* 12 U.S.C. 4614(a)(2). As previously noted, the Bank Act already imposes restrictions on a Bank's activity when a Bank fails to comply with either the risk-based or minimum capital requirement that are similar to those imposed on undercapitalized Banks under these PCA provisions. Thus, it would appear reasonable to define an undercapitalized Bank by references to both risk-based and minimum capital requirements and conform the approach in this regulation to that generally mandated by the Bank Act.

The rule establishes the threshold at which the Bank would become significantly undercapitalized at 75 percent of the capital levels needed for the Bank to meet either its risk-based or minimum capital requirements. This threshold is reasonable given that the Banks have the obligation to adjust the amount of capital stock members are required to buy when they face a capital shortfall; a case where a Bank was facing a greater-than-25 percent shortfall in capital would suggest the Bank was having problems raising capital or was beginning to show serious structural or financial difficulties. The greater number of supervisory options available under the PCA provision with regard to significantly undercapitalized Banks would appear valuable in this case. At the same time, the threshold is still high enough that in most circumstances the Bank would have capital sufficient to operate safely, especially in light of the additional restrictions and safeguards that may be imposed under the PCA provisions, while action is taken to try to correct its capital problems. This threshold is also similar to how other banking regulators define the significantly undercapitalized category in their regulations. *See, e.g.,* 12 CFR 565.4(b)(4) (OTS regulation).

Finally, a Bank would be critically undercapitalized whenever its total capital is 2 percent or less of its total assets. The threshold equals one-half of the 4 percent minimum total capital requirement established for the Banks under § 6(a)(2)(B) of the Bank Act. This approach is broadly similar to that defining critical capital for the Enterprises under the Safety and Soundness Act, although the approach adopted in this rule recognizes that the Banks do not issue or guarantee mortgage-backed securities or hold significant off-balance-sheet items; no charges are added for these items. *See* 12 U.S.C. 4613(a) and 4614(a)(4); 12 CFR 1777.20(a)(4).[13] The FHFA also believes the two percent of total asset threshold is appropriate for the Banks. If a Bank's total capital reached this low level, it would indicate that the Bank was having serious problems raising additional capital from members either because a significant portion of the membership were no longer interested in, or were not in a financial condition to be capable of, doing business with the Bank or were no longer willing or able to buy capital stock to support that business. Such a situation, no matter what the cause, would suggest either that the Bank's cooperative business model was not working or that members were not capable of capitalizing a Bank and justify the intervention by the FHFA under the PCA provisions applicable to a critically undercapitalized regulated entity or other similar situations. The threshold adopted in this rule is similar to the critically undercapitalized category in the banking regulations. *See, e.g.,* 12 CFR 565.4(b)(5) (OTS regulation).

Section 1229.4. Section 1229.4 implements the authority provided in § 1142(a)(4) of HERA, allowing the Director discretionary authority to reclassify a Bank's capital classification for reasons other than the amount of capital held by a Bank, such as those related to the condition of the Bank or the quality of the assets or collateral held by a Bank. *See* § 1142 Public Law No. 110–289, 122 Stat. 2730–31 (adopting 12 U.S.C. 4614(c)).

This section of the interim final rule closely adheres to the text of the statutory provision. The grounds for reclassifying a Bank are set forth in § 1229.4(b) of the interim final rule. Under this provision the Director can reclassify the Bank upon a written determination that the Bank is engaging in conduct that could result in a rapid depletion of its capital, or that the value of collateral pledged to the Bank or the value of property subject to mortgages owned by the Bank has decreased significantly. The Director can also reclassify a Bank if the Director determines the Bank is in an unsafe and unsound condition. Before making this determination, however, the rule states that the Director will provide the Bank with notice and an opportunity for an informal hearing before the Director during which the Bank can present information or testimony about its

[12] The Chicago Bank is not yet subject to the risk-based capital provisions under section 6(a)(3) of the Bank Act. Further, there are no (and have not been) statutory or regulatory risk-based capital requirements applicable to a Bank that has not converted to the GLB Act capital structure. Thus, until the Chicago Bank completes its transition to the GLB Act capital structure, it will not have to meet the risk-based requirement for purposes of the capital classification—unless further regulatory or supervisory action result in the adoption of a risk-based capital requirement for it.

[13] Under both the Safety and Soundness Act and applicable regulations, an Enterprise would be critically undercapitalized if its core capital were less than the critical capital level. The term ''core capital,'' however, is not defined or used in the Bank Act or any regulation applicable to the Banks. An Enterprise's core capital is similar to total capital for a Bank in that each is used to meet a leverage type requirement. On the other hand, the Bank Act specifically requires that the Bank's permanent capital be used to meet its risk-based capital requirements while an Enterprise's total capital is used to meet its risk-based capital requirements. Thus, whenever comparisons need to be made between the types of capital held by the Banks and the core capital and total capital of the Enterprises or provisions in HERA implemented by this interim final rule refer to core capital and total capital of a regulated entity, these terms generally have been interpreted as or compared to, respectively, a Bank's total capital and permanent capital.

condition. The process contemplated is based on and similar to that used by other banking regulators before reclassifying regulated banks on similar grounds. *See* 12 CFR 308.202(a), 325.103(d) (Federal Deposit Insurance Corporation regulations); 12 CFR 565.8 (OTS regulations). Finally, the Director can reclassify a Bank if the Director has found, in accordance with § 1371(b) of the Safety and Soundness Act, that the Bank is engaging in an unsafe and unsound practice because the Bank's asset quality, management, earnings or liquidity were found to be less than satisfactory during the most recent examination and any deficiency has not been corrected.

As required by statute, § 1229.4(c) of the interim final rules provides that the capital reclassification of a Bank is subject to the notice and procedural requirements under § 1368 of the Safety and Soundness Act, as that provision is implemented by § 1229.12 of this rule. Section 1229.4(d) makes clear that any condition, action or inaction by a Bank that results in a reclassification of a Bank under this section can be the basis for a subsequent reclassification action, as long as the Bank has not rectified the original problem or condition. Finally, § 1229.4(e) states that nothing in § 1229.4 will prevent the Director from exercising any other authority available under the Bank Act, the Safety and Soundness Act or any other regulation to reclassify a Bank or take any other action against a Bank.

Section 1229.5. Section 1229.5 of the interim final rule implements the provision added by § 1142(a)(5) of HERA addressing capital distributions by adequately capitalized regulated entities. *See id.* (adopting 12 U.S.C. 4614(e)). The provision prohibits an adequately capitalized Bank from making a capital distribution if, after doing so, the Bank would be undercapitalized. The provision also makes clear that an adequately capitalized Bank cannot make any capital distribution if it would violate any restriction in section 6 of the Bank Act or any other applicable regulation.

Section 1142(a)(5) of HERA allows the Director to grant an exception to the new restriction on capital distributions and permit a regulated entity to redeem, repurchase or retire stock if such transaction is in connection with the issuance of additional shares or obligations in an equivalent amount to those shares retired, will reduce the regulated entity's financial obligations or otherwise improve its financial conditions. Section 1229.5(b) of the interim final rule implements this exception as applied to the Banks, but makes clear that any transaction permitted under this exception must be consistent with and not violate any restriction in the Bank Act or other regulation that prohibits redemption or repurchase of Bank stock.

Section 1229.6 and Section 1229.7. Sections 1229.6 and 1229.7 of the interim final rule implement § 1365 of the Safety and Soundness Act as amended by HERA, which sets forth the mandatory and discretionary actions applicable to a Bank classified as undercapitalized. *See* 12 U.S.C. 4615, as amended by § 1143, Public Law No. 110–289, 122 Stat. 2732–33. Section 1229.6(a) sets forth the mandatory actions that a Bank must take and the restrictions that are applied to a Bank once it is deemed to be undercapitalized. These provisions closely follow the wording in the statute. The regulation requires an undercapitalized Bank to submit a capital restoration plan that meets with the approval of the Director within the timeframe required under § 1229.11 of this regulation, and carry out all commitments made in that plan. The regulation also restricts an undercapitalized Bank's quarterly asset growth and its ability to engage in any new business activity or acquire any entity. The rule clarifies that for purposes of the restriction on asset growth, the calculation of a Bank's average total assets for a quarter will be based on the daily total assets held by the Bank in the quarter.[14] As required under the statute, § 1229.6(a) also prohibits an undercapitalized Bank from making any capital distribution that would cause it to become significantly or critically undercapitalized, but the regulation also makes clear that the undercapitalized Bank cannot make any capital distribution that would violate any additional restrictions in the Bank Act or other regulations related to the payment of dividends or the repurchase or redemption of stock.

Section 1229.6(b) implements the changes made by § 1143 of HERA which require the Director to reclassify an undercapitalized Bank as significantly undercapitalized if the Bank fails to submit a capital restoration plan which the Director can approve within the time limits established under the interim final rule or fails to implement any approved capital restoration plan in any material respect. Finally, § 1229.6(c) implements the statutory requirements that the Director monitor the undercapitalized Bank's condition and its compliance with the requirements and obligations imposed on it under the PCA provisions.

Section 1229.7 implements the provision in § 1143 of HERA which allows the Director the discretion to take any action with respect to an undercapitalized Bank which the Director may take pursuant to § 1366 of the Safety and Soundness Act against a significantly undercapitalized Bank, ''if the Director determines that such actions are necessary to carry out the purpose of this subtitle [C].'' § 1143(6), Public Law No. 110–289, 122 Stat. 2733 (amending 12 U.S.C. 4615(c)). The wording of § 1229.7 reflects the FHFA's belief that the purposes of the PCA provisions contained in subtitle C of HERA are to assure the safe and sound operations of a Bank, for both its own benefit and the benefit of its members and the financial system, and its compliance with its risk-based and minimum capital requirements within a reasonable period of time.[15] This provision of the rule also makes clear that, as required by § 1368 of the Safety and Soundness Act, the Director will provide notice to an undercapitalized Bank about any potential discretionary action under § 1299.7 and allow the Bank the opportunity, as set forth in § 1229.12(c) of this interim final rule, to provide information relevant to the proposed action before the Director makes a final determination.

Section 1229.8 and Section 1229.9. Sections 1229.8 and 1229.9 implement § 1366 of the Safety and Soundness Act as amended by HERA, which sets forth the mandatory and discretionary actions applicable to a Bank classified as significantly undercapitalized. *See* 12 U.S.C. 4616, as amended by § 1144, Public Law No. 110–289, 122 Stat. 2733–34. Section 1229.8 sets forth the mandatory actions and restrictions on activities that will apply to a Bank found to be significantly

[14] Each month, each Bank reports its daily average total assets held during that month. These reported figures are then used to calculate a quarterly average.

[15] Similarly, § 1143 of HERA allows the Director to exempt an undercapitalized Bank from the prohibition on its engaging in new business activities or acquiring other entities if among other conditions, the Director determines the ''proposed action will further purposes of this subtitle [C]'' and provides that the Director shall monitor the restrictions and requirement imposed on an undercapitalized Bank to determine whether they are achieving ''the purposes of this section [1143].'' These statutory provisions are implemented by § 1229.6(a)(5)(ii) and § 1229.6(c) of the interim final rule respectively. The wording employed for these two regulatory provisions reflects the FHFA's view that the purposes of the PCA provisions are to help to assure that a Bank will operate in a safe and sound fashion, for both its own benefit and the benefit of its members and the financial system, and return within a reasonable period of time to compliance with its risk-based and minimum capital requirements.

undercapitalized, while § 1229.9 sets forth discretionary actions that the Director may take with regard to any significantly undercapitalized Bank.

Sections 1229.8(a) and (b) of the interim final rule require a significantly undercapitalized Bank to submit a capital restoration plan consistent with the requirements of § 1229.11 of this rule, receive the Director's approval for this plan, and fulfill all terms, conditions, and obligations contained in the approved plan. Sections 1229.8(c) and (d) implement restrictions on the capital distributions that a significantly undercapitalized Bank may make. Specifically, § 1229.8(c) prohibits a significantly undercapitalized Bank from making any capital distribution if the distribution would result in the Bank becoming critically undercapitalized or would otherwise violate restrictions on the declaration or payment of a dividend or the repurchase or redemption of stock set forth in section 6 of the Bank Act or any other applicable regulation. To the extent that a capital distribution is not already prohibited by § 1229.8(c), § 1229.8(d) provides that the Bank can make the distribution only with the prior approval of the Director. The Director may provide such approval only upon a determination that the capital distribution will enhance the ability of the Bank to meet its capital requirements promptly, contribute to the long-term financial safety and soundness of the Bank or otherwise be in the public interest.

Finally, § 1229.8(e) and § 1229.8(f) of the interim final rule establish limits on the bonuses and compensation that a significantly undercapitalized Bank may pay to any executive officer. Section1229.8(e) prohibits a significantly undercapitalized Bank from paying any bonus to an executive officer without the prior written approval of the Director. For purposes of this provision, a bonus includes any amounts paid or accruing to the executive officer under any profit sharing arrangement established by the Bank. Section 1229.8(f) prohibits a significantly undercapitalized Bank from paying an executive officer at a rate of compensation that is higher than the average rate paid to that officer during the twelve month period immediately prior to the month the Bank became significantly undercapitalized, without first receiving the prior written approval from the Director. As set forth in HERA, the rule states that the average rate of compensation does not include bonuses or profit sharing paid or accruing to the officer during the twelve month period.[16] A definition for ''executive officer'' is provided in § 1229.1 of the interim final rule.

Section 1229.9 of the interim final rules sets forth the discretionary actions the Director may take with regard to a significantly undercapitalized Bank. Section 1229.9(a) provides that the Director shall carry out this section by taking any one or more of the listed action with regard to a significantly undercapitalized Bank. These actions can include requiring the Bank to reduce, or limit the growth of any obligation, class of obligation, asset or class of assets held by the Bank. The Director also can require a Bank to acquire new capital in such form and amount determined by the Director, which can include requiring the Bank to increase its retained earnings by specific amounts. The Director can also require a significantly undercapitalized Bank to modify, limit or terminate any activity that the Director determines creates excessive risk to the Bank.

Section 1229.9(a) also allows the Director to take actions to improve the management and corporate governance of a significantly undercapitalized Bank. Under this provision the Director may take any or all of the following actions: ordering the Bank to hold new elections for its board of directors under such procedures established by the Director at the time of the order, ordering the Bank to dismiss particular directors or executive officers, and/or ordering the Bank to hire qualified executive officers. As set forth in § 1144 of HERA, § 1229.9(a)(7) provides that the removal of a director or executive officer under this provision is separate and distinct from a removal action under § 1377 of the Safety and Soundness Act (12 U.S.C. 4636a) and shall not be subject to any procedural requirements adopted to implement § 1377. As with other discretionary actions taken under § 1229.9, however, removal of a director or executive officer under § 1229.9(a)(7) would be subject to the notice and procedural requirements applicable to supervisory actions set forth in § 1229.12. This section also makes clear that the Director may require the significantly undercapitalized Bank to get the Director's approval before hiring any new executive officer, whenever the Director has ordered the Bank to hire qualified executive officers.

Finally, section 1229.9(a) provides that the Director, in his or her discretion, may reclassify a significantly undercapitalized Bank as critically undercapitalized if a Bank fails to submit a capital restoration plan within the time frame required by regulation, to receive the Director's approval of such plan or to carry out any obligation under an approved plan. The provision makes clear that the Director may assert the stated grounds as a basis for reclassification to the critically undercapitalized category even if the same grounds previously formed the basis for reclassification of the Bank from undercapitalized to significantly undercapitalized, if the Bank has not acted to rectify the original problem.

Section 1229.9(b) provides that the Director may take actions not specifically listed elsewhere in § 1229.9, if the Director determines that such action will better help ensure the safe and sound operation of a significantly undercapitalized Bank and the Bank's prompt compliance with its minimum and risk-based capital requirements. This provision implements the part of § 1144 of HERA which allows the Director to require a significantly undercapitalized Bank ''to take any other action that the Director determines will better carry out the purpose of this section [1144].'' *Id.* (adopting 12 U.S.C. 4616(b)(7)). The wording adopted in § 1229.9(b) reflects the FHFA's belief, as noted above, that the purposes of the PCA provisions are to help ensure the safe and sound operations of the Banks and a Bank's prompt compliance with its required capital levels, and thus, § 1229.9(b) uses references to such goals to implement the quoted language of HERA.

Section 1229.10. Section 1229.10 of the interim final rule implements various provisions of § 1145 of HERA which relate to critically undercapitalized Banks. *See* § 1145(a), Public Law No. 110–289, 122 Stat. 2734–36 (amending 12 U.S.C. 4617). Under § 1229.10(a) of this rule, the Director is authorized to appoint the FHFA as conservator or receiver as soon as final action is taken to classify or reclassify a Bank as critically undercapitalized.

Section 1229.10(b)(1) of this rule requires the Director to make a determination at least once every 30 calendar days, beginning on the date a final determination is first made that a Bank is critically undercapitalized, as to whether the Bank's assets during the previous 60 calendar day period were less than the Bank's obligations, or the

[16] While the HERA provision also excludes stock options from the calculation of average compensation, the Banks do not provide stock options to their executive officers; nor can the Banks provide such options to officers as the Bank Act only allows member institutions to purchase Bank stock and prevents individuals from buying Bank stock. Thus, the interim final rule does not need to exclude stock options from the calculation of compensation for executive officers of a Bank.

Bank is not currently, or had not been during the previous 60 calendar day period, paying its debts as such debts became due. For purposes of this determination, the rule clarifies that a Bank's obligations include only that portion of outstanding consolidated obligations for which the Bank is primary obligor or for which the Bank has been ordered to make payments of principal or interest by the Director or for which the Bank is actually making such payments on behalf of another Bank. Similarly, a Bank's debts do not include any unpaid amounts that are subject of a *bona fide* dispute.

If the Director determines that a critically undercapitalized Bank's obligations are greater than its assets or the Bank has not been paying its debts, § 1229.10(b)(2) requires the Director immediately to appoint the FHFA as receiver for the Bank. The appointment of the FHFA as receiver under § 1229.10(b)(2) terminates any conservatorship established for the Bank and ends the requirement for future determinations by the Director under § 1229.10(b)(1) for the pendency of the receivership.

Section 1229.10(c) of the interim final rule provides that a Bank may seek judicial review of an action under § 1229.10(a) or § 1229.10(b)(2) to appoint the FHFA as conservator or receiver, as allowed under HERA. *See* § 1145(a), Public Law No. 110–289, 122 Stat. 2736 (adopting 12 U.S.C. 4617(a)(5)). Finally, § 1229.10(d) of the interim final rule makes clear that until the FHFA is appointed conservator or receiver of a critically undercapitalized Bank, the Bank is subject to all mandatory restrictions and obligations applicable to significantly undercapitalized Banks under the PCA provisions, any restrictions or obligations previously placed on the Bank by the Director under the PCA authority, or any restrictions or obligations imposed on the Bank by an approved capital restoration plan.

Section 1229.11. Section 1229.11 of the interim final rule implements § 1369C of the Safety and Soundness Act, as that provision is made applicable to the Banks by HERA, which sets forth the requirements for capital restoration plans that are required by various provisions of this interim final rule. *See* 12 U.S.C. 4622 (as amended by § 1145(b)(2), Public Law No. 110–289, 122 Stat. 2767). Section 1229.11(a) describes the minimum information that must be contained in each capital restoration plan. This information includes a description of any changes to members' stock purchase requirements that a Bank intends to make to raise capital. As already noted, the Bank Act specifically requires each Bank's board of directors to monitor the Bank's capital levels and adjust its member's stock purchase requirements to assure a Bank maintains compliance with all capital requirements. Given that a change in members' stock purchase requirements will be a major method for a Bank to raise capital, it is reasonable for the Bank to explain how it will adjust these requirements as part of its capital restoration plan.

Section 1229.11(b) of the interim final rule establishes that a Bank must submit a capital restoration plan within ten calendar days after the Bank learns that it is required to submit such a plan, but allows the Director to extend the deadline in writing if needed. The FHFA will consider that a Bank knows that it must submit a capital restoration plan if the Bank receives final notification that its capital classification is undercapitalized, significantly undercapitalized or critically undercapitalized, given that submission of a plan is mandatory in these situations, or if the Director otherwise informs the Bank that it must submit such a plan. While the Safety and Soundness Act provides that the Director may establish a deadline for submission of a capital restoration plan of no more than 45 days, it also allows the Director to establish a shorter deadline. The ten day period established in § 1229.11(b) appears reasonable given the need for a Bank to act promptly to restore its capital levels and the possibility that the Director can extend the deadline if needed. Ten calendar days for submission of a plan is also consistent with the deadline established for the Enterprises under current regulations, and the FHFA sees no reason why the Banks and the Enterprises should be treated differently with regard to this requirement. *See* 12 CFR 1777.23(a).

Section 1229.11(c) and (d) sets forth the requirements and deadlines for the Director's review of a capital restoration plan submitted by a Bank and for the Bank's submission of a new plan should the Director not approve the original submission. These provisions closely follow the requirements set forth in the Safety and Soundness Act. *See* 12 U.S.C. 4622(c) and (d). Section 1229.11(e) provides that the Director may approve amendments to a previously approved capital restoration plan if, after consideration of changes in market conditions or other relevant factors, the Director determines that the amendments are consistent with the Bank's achieving an adequately capitalized classification in a reasonable period of time and operating in a safe and sound manner.

Section 1229.11(f) of the interim final rule makes clear that a Bank is obligated to implement and fulfill all provisions of an approved capital restoration plan, and remains obligated under the provisions of an approved capital restoration plan until such provision is terminated as may be specifically stated in the plan or is otherwise amended or terminated in writing by the Director. Finally, § 1229.11(g) implements provisions added to the Safety and Soundness Act by § 1145 of HERA which provide that the Director may appoint the FHFA as conservator or receiver of a Bank if the Bank fails to submit an acceptable capital restoration plan within the time frame established under the regulations or materially fails to implement any provision or fulfill any obligation arising under an approved capital restoration plan. *See* § 1145(a), Public Law No. 110–289, 122 Stat. 2735 (adopting 12 U.S.C. 4617(a)(3)(J)(iii) and (iv)).

Section 1229.12. Section 1229.12 of the interim final rule implements the provisions of § 1368 of the Safety and Soundness Act as these provisions are made applicable to the Banks by HERA. *See* 12 U.S.C. 4618 (as amended by § 1145(b)(1), Public Law No. 110–289, 122 Stat. 2767). Section 1368 of the Safety and Soundness Act requires the Director to provide a Bank notice before finalizing any decision to classify or reclassify a Bank within a particular capital classification under § 1364 of the Safety and Soundness Act or before taking any discretionary action pursuant to the PCA authority set forth in §§ 1365 or 1366 of the Safety and Soundness Act and allow the Bank an opportunity to submit information that would be relevant to the final decision. The cited statutory provisions with regard to capital classification or reclassification and discretionary PCA authority are implemented by §§ 1229.2, 1229.4, 1229.7 and 1229.9 of this interim final rule.

Section 1229.12 adheres to the time frames and requirements set forth in the statute. It provides that a notice to classify or reclassify a Bank within a particular capital classification may be combined with the notice to require a Bank to take a particular action or adhere to a particular restriction under the Director's discretionary PCA authority. Additionally, the Director may combine a notice that the Bank has been classified in one capital classification category based on the amount of capital held or other factors with a simultaneous determination to reclassify the Bank to the next lower

category. The rule allows a Bank thirty calendar days from the date the Bank is provided initial notice of the proposed action to provide information to the Director that may be relevant to such action. It also provides that the Director may make a final determination with regard to the proposed action at the end of the comment period or after receipt of the information provided by the Bank, whichever is earlier. The provision requires the Director to provide written notice to the Bank of final decisions and the reasons for making such decisions. Consistent with section 1369D of the Safety and Soundness Act (12 U.S.C. 4623), the regulation also provides that any Bank that is not classified as critically undercapitalized may seek judicial review of a final action taken under §§ 1229.2, 1229.4, 1229.7 and 1229.9 of this interim final rule, in accordance with the procedures and requirements set forth in that statutory provision. The rule also provides that any final decision that a Bank take action, refrain from action or comply with any other requirement that was the subject of a notice issued under this section shall constitute an final order under the Safety and Soundness Act and can be enforced by the Director by application to the relevant United States district court or be the subject of an administrative enforcement action.

Issue for Further Consideration and Comment

The interim final rule adopts criteria defining the four capital classification categories specifically identified in, and made applicable to the Banks by, HERA. FHFA requests comments on all aspects of the interim final rule, including these criteria. In addition, the FHFA is requesting comments on whether adopting a fifth capital classification category of ''well-capitalized'' would be a useful and appropriate way to encourage Banks to hold more than the minimum amounts of capital. Adopting a well-capitalized category would be similar to the approach used by banking regulators. *See, e.g.*, 12 CFR 103(b) (capital categories for FDIC PCA rule). The criteria for a well-capitalized category could be specified as a percentage of a Bank's minimum leverage and risk-based capital requirements, such as 110 percent of these requirements, and/or incorporate specific retained earnings or market value of equity/par value of capital stock (MVE/PVCS) targets.

The FHFA believes that introducing a retained earnings target or an MVE/PVCS target into such a regulation, or as a separate capital regulation, may be especially helpful in encouraging the Banks to maintain levels of retained earnings that would help prevent impairment of the par value of their stock. Impairment of the par value of a Bank's stock could have consequences for the members' willingness to continue to buy capital and do business with the Bank and for the Bank's ability to raise funds. Thus, defining criteria that would provide incentives to protect the par value of the stock would be an important consideration for the FHFA if it were to adopt a well-capitalized category or a separate retained earnings regulation.[17]

The FHFA recognizes that the market incentive for an individual Bank to achieve and maintain a well-capitalized classification may be mitigated by the fact that the Banks generally fund themselves through issuance of consolidated obligations. Because this debt is the joint and several obligation of the Banks collectively and is not marketed in the name of an individual Bank, a well-capitalized Bank may not fully capture the funding advantage that could be associated with achieving this classification. Nevertheless, having a well-capitalized rating may provide advantages to the Bank in its dealings with counterparties and perhaps in other transactions in which the Bank engages in its own name.

Additional incentives for a Bank to become well-capitalized could be created by restricting certain activities of Banks that have not achieved a well-capitalized rating. Such restrictions could include limiting new business activities, preventing the Bank from repurchasing a member's excess stock prior to the end of the statutory redemption period, or placing some restrictions on the payment of dividends. While neither the PCA provisions in the Safety and Soundness Act as amended by HERA, nor the Bank Act contains these types of restrictions on Banks that otherwise meet their capital requirements,[18] the FHFA could adopt such restrictions pursuant to its general supervisory authority, especially its authority to oversee the prudential operations of the Banks, ensure that the Banks operate in a safe and sound manner and ensure that the manner in which the Banks operate is in the public interest. *See* § 1102, Public Law No. 110–289, 122 Stat. 2663–64 (amending 12 U.S.C. 4513). Similarly, the FHFA considers this authority to provide a basis for adopting a well-capitalized classification as part of the capital classification/PCA rules even though such category is not specifically identified in the Safety and Soundness Act as amended by HERA.

While the FHFA has not adopted a well-capitalized category as part of this interim final rule, it is specifically seeking comments on all aspects of introducing such a category into the regulation. It is especially interested in comments on:

1. Would a well-capitalized classification category provide incentives to the Banks to hold more than the minimum amounts of capital and increase retained earnings as a percentage of capital?

2. What criteria may be appropriate to define such a category?

3. Would a MVE/PVCS or a retained earnings target be appropriate in defining a well-capitalized category, and if so, what should the targets be?

4. What restrictions on adequately capitalized Banks may be appropriate to create an incentive to Banks to achieve and maintain a well-capitalized rating?

5. Alternatively, should the FHFA adopt a MVE/PVCS and/or retained earnings requirement as a separate risk-based capital rule that would be applied to the Banks in addition to the current risk-based capital requirement in 12 CFR 932.3, and incorporate this new requirement into the criteria for defining either the adequately capitalized category or a new well-capitalized category? Should MVE/PVCS or retained-earnings targets be adopted other than as part of the risk-based capital structure?

6. Are there any changes to the current risk-based capital requirements that should be considered in light of the PCA provisions that are being added by this interim final rule? Should MVE/PVCS or retained-earnings targets be adopted other than as part of the risk-based Capital structure?

In addition to seeking comments on the above questions, the FHFA is also interested in comments on all other aspects of the interim final rule as adopted.

[17] If the economic value of a Bank's equity base, defined as the market value of equity (MVE), falls below the par value of the Bank's capital stock (PVCS), then any redemptions or repurchases at par value will dilute the economic value of the remaining shares, causing a Bank's ratio of MVE/PVCS to decline further. Moreover, should the MVE per share of a Bank's stock fall significantly below its par value, members may decide not to purchase additional shares in the Bank. In the extreme, members may exit the System.

[18] The exception is a Bank that has experienced a charge against capital so that the par value of its stock is impaired. In this situation, the Bank Act and existing regulations would prohibit the Bank from redeeming or repurchasing any stock without the permission of the Director or from declaring or paying a dividend, even if the Bank is otherwise adequately capitalized. *See* 12 U.S.C. 1426(f); 12 CFR 917.9(b).

IV. Notice and Public Participation

The FHFA finds for good cause that the notice and comment procedure required by the Administrative Procedure Act is impracticable or contrary to the public interest in this instance. *See* 5 U.S.C. 553(b)(3)(B). The rule is necessary to provide the details on how the FHFA will implement the capital classification and PCA provisions made applicable to the Banks by HERA. These authorities are critical to assuring the safe and sound operations of the Bank System and prompt intervention to address troubled Banks, should such a situation arise. The PCA authority is especially important during the current period of market stress when conditions are volatile and the financial conditions of a Bank could be subject to sudden change. Thus, the FHFA believes immediate adoption of this rule would be in the public interest, but nevertheless believes public comments on this rule would be valuable. The FHFA will consider all comments received on or before April 30, 2009 in promulgating a final rule.

V. Effective Date

For the reasons stated in part IV above, the FHFA for good cause finds that the interim final rule should become effective on January 30, 2009. *See* 5 U.S.C. 553(d).

VI. Paperwork Reduction Act

The rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). Therefore, the FHFA has not submitted any information to the Office of Management and Budget for review.

VII. Regulatory Flexibility Act

The FHFA is adopting this regulation in the form of an interim final rule and not as a proposed rule. Therefore, the provisions of the Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) do not apply. *See* 5 U.S.C. 601(2) and 603(a).

List of Subjects in 12 CFR Part 1229

Capital, Federal home loan banks, Government-sponsored enterprises, Reporting and recordkeeping requirements.

■ For the reasons stated in the preamble, the Federal Housing Finance Agency is amending 12 CFR chapter XII, subchapter B, by adding new Part 1229 to read as follows:

PART 1229—CAPITAL CLASSIFICATIONS AND PROMPT CORRECTIVE ACTION

Subpart A—Federal Home Loan Banks

Sec.

Authority: 12 U.S.C. 1426, 4513, 4526, 4613, 4614, 4615, 4616, 4617, 4618, 4622, 4623.

Subpart A—Federal Home Loan Banks

§ 1229.1 Definitions.

For purposes of this subpart:

Bank written in title case, means a Federal Home Loan Bank established under section 12 of the Bank Act (12 U.S.C. 1432).

Bank Act means the Federal Home Loan Bank Act, as amended (12 U.S.C. 1421 through 1449).

Capital distribution means any payment by the Bank, whether in cash or stock, of a dividend, any return of capital or retained earnings by the Bank to its shareholders, any transaction in which the Bank redeems or repurchases capital stock, or any transaction in which the Bank redeems, repurchases or retires any other instrument which is included in the calculation of its total capital.

Class A stock means capital stock issued by a Bank, including subclasses, that has the characteristics specified in section 6(a)(4)(A)(i) of the Bank Act (12 U.S.C. 1426(a)(4)(A)(i)) and related regulations.

Class B stock means capital stock issued by a Bank, including subclasses, that has the characteristics specified in section 6(a)(4)(A)(ii) of the Bank Act (12 U.S.C. 1426(a)(4)(A)(ii)) and related regulations.

Consolidated obligations means any bond, debenture or note on which the Banks are jointly and severally liable and which was issued under section 11 of the Bank Act (12 U.S.C. 1431) and any implementing regulations, whether or not such instrument was originally issued jointly by the Banks or by the Federal Housing Finance Board on behalf of the Banks.

Critical capital level for a Bank means an amount equal to 2 percent of the Bank's total assets.

Director means the Director of the Federal Housing Finance Agency or his or her designee.

Executive officer means for a Bank any of the following persons, provided that the Director may from time to time add or remove persons, positions, or functions to or from the list (individually for one or more Banks or jointly for all the Banks) by communication to the affected Banks:

(1) Executive officers about whom the Banks must publicly disclose detailed compensation information under Regulation S–K, 17 CFR part 229, issued by the Securities and Exchange Commission;

(2) Any other executive who occupies one of the following positions or is in charge of one of the following subject areas:

(i) Overall Bank operations, such as the Chief Operating Officer or an equivalent employee;

(ii) Chief Financial Officer or an equivalent employee;

(iii) Chief Administrative Officer or an equivalent employee;

(iv) Chief Risk Officer or an equivalent employee;

(v) Asset and Liability Management officer, or an equivalent employee;

(vi) Chief Accounting Officer or an equivalent employee;

(vii) General Counsel or an equivalent employee;

(viii) Strategic Planning officer or an equivalent employee;

(ix) Internal Audit officer or an equivalent employee; or

(x) Chief Information Officer or an equivalent employee; or

(3) Any other individual, without regard to title:

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

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

FHFA means the Federal Housing Finance Agency.

Minimum capital requirement means the leverage and total capital requirements established for a Bank under section 6(a)(2) of the Bank Act (12 U.S.C. 1426(a)(2)) and related regulations, as such requirements may be revised by the Director, or any similar requirement established for a Bank by regulation, order, written agreement or other action.

New business activity means any activity undertaken by a Bank that requires approval from the FHFA under part 980 of this title.

Permanent capital means the retained earnings of a Bank, determined in accordance with generally accepted accounting principles in the United States (GAAP), plus the amount paid-in for the Bank's Class B stock.

Risk-based capital requirement means any capital requirement established for a Bank under section 6(a)(3) of the Bank Act (12 U.S.C. 1426(a)(3)) and related regulations that ensures a Bank will hold sufficient permanent capital and reserves to support the risks that arise from its operations.

Safety and Soundness Act means the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 *et seq.*) as amended.

Tangible equity means, for a Bank, the paid-in value of its outstanding capital stock plus its retained earnings calculated in accordance with generally accepted accounting principles in the United States (GAAP) less the amount of any assets that would be intangible assets under GAAP.

Total capital means the sum of the Bank's permanent capital, the amount paid-in for its Class A stock, the amount of any general allowances for losses, and the amount of any other instruments indentified in a Bank's capital plan that the Director has determined to be available to absorb losses incurred by such Bank. For a Bank that has issued neither Class A nor Class B stock, the Bank's total capital shall be the measure of capital used to determine compliance with its minimum capital requirement.

§ 1229.2 Determination of a Bank's capital classification.

(a) *Quarterly determination.* The Director shall determine the capital classification for each Bank no less often than once a quarter based on the capital classifications in § 1229.3 of this subpart. The Director may make a determination with regard to a capital classification for a Bank more often than the minimum required under this paragraph or make a determination for one or more Banks without making a determination for all the Banks.

(b) *Notification to a Bank.* Before finalizing any action to classify a Bank under this section, the Director shall provide a Bank written notice describing the proposed action and an opportunity to submit information that the Bank considers relevant to the proposed action in accordance with § 1229.12 of this subpart.

(c) *Notification to the FHFA.* A Bank shall provide written notification within ten calendar days of any event or development that has caused or is likely to cause its permanent or total capital to fall below the level necessary to maintain its capital classification at the level assigned in the most recent capital classification or reclassification determination by the Director or that is contained in the most recent notice of a proposed capital classification or reclassification provided under § 1229.12(a) of this subpart.

§ 1229.3 Criteria for a Bank's capital classification.

(a) *Adequately capitalized.* Except where the Director has exercised authority to reclassify a Bank, a Bank shall be considered adequately capitalized if, at the time of the determination under § 1229.2(a) of this subpart, the Bank has sufficient permanent and total capital, as applicable, to meet or exceed its risk-based and minimum capital requirements.

(b) *Undercapitalized.* Except where the Director has exercised authority to reclassify a Bank, a Bank shall be considered undercapitalized if, at the time of the determination under § 1229.2(a) of this subpart, the Bank does not have sufficient permanent or total capital, as applicable, to meet any one or more of its risk-based or minimum capital requirements but such deficiency is not of a magnitude to classify the Bank as significantly undercapitalized or critically undercapitalized.

(c) *Significantly undercapitalized.* Except where the Director has exercised authority to reclassify a Bank, a Bank shall be considered significantly undercapitalized if, at the time of the determination under § 1229.2(a) of this subpart, the amount of permanent or total capital held by the Bank is less than 75 percent of what is required to meet any one of its risk-based or minimum capital requirements but the magnitude of the Bank's deficiency in total capital is not sufficient to classify it as critically undercapitalized.

(d) *Critically undercapitalized.* Except where the Director has exercised authority to reclassify a Bank, a Bank shall be considered critically undercapitalized if, at the time of the determination under § 1229.2(a) of this subpart, the total capital held by the Bank is less than or equal to the critical capital level for a Bank as defined under § 1229.1 of this subpart.

§ 1229.4 Reclassification by the Director.

(a) *Discretionary reclassification.* Where the Director determines that any of the grounds described in paragraph (b) of this section exist, the Director may reclassify a Bank as:

(1) Undercapitalized, if it is otherwise classified as adequately capitalized;

(2) Significantly undercapitalized, if it is otherwise classified as undercapitalized; or

(3) Critically undercapitalized if it is otherwise classified as significantly undercapitalized.

(b) *Grounds for discretionary reclassification.* Notwithstanding any other provision of this subpart, the Director may at any time reclassify a Bank under this section if:

(1) The Director determines in writing that:

(i) The Bank is engaging in conduct that could result in the rapid depletion of permanent or total capital;

(ii) The value of collateral pledged to the Bank has decreased significantly; or

(iii) The value of property subject to mortgages owned by the Bank has decreased significantly.

(2) The Director determines, after notice to the Bank and opportunity for an informal hearing before the Director, that a Bank is in an unsafe and unsound condition; or

(3) The Director finds, under § 1371(b) of Safety and Soundness Act (12 U.S.C. 4631(b)), that the Bank is engaging in an unsafe and unsound practice because the Bank's asset quality, management, earnings or liquidity were found to be less than satisfactory during the most recent examination, and any deficiency has not been corrected.

(c) *Procedures.* Before finalizing any action to reclassify a Bank under this section, the Director shall provide a Bank written notice describing the proposed action and an opportunity to submit information that the Bank considers relevant to the Director's proposed action in accordance with § 1229.12 of this subpart.

(d) *Duration.* Any condition, action or inaction by a Bank that is the basis for a decision to reclassify a Bank under this section or under any other authority provided the Director may be considered by the Director and form the basis of further, subsequent actions to reclassify the Bank until such time as the Bank remedies such condition or takes necessary action to correct such situation to the satisfaction of the Director.

(e) *Reservation of authority.* Nothing in this section shall prevent the Director from exercising any other authority under the Safety and Soundness Act, the Bank Act or any regulation to reclassify a Bank for reasons not set forth in paragraph (b) of this section or to take any other action against a Bank.

§ 1229.5 Capital distributions for adequately capitalized Banks.

(a) *Restriction.* An adequately capitalized Bank may not make a capital distribution if after doing so the Bank's capital would be insufficient to maintain a classification of adequately capitalized. A Bank may not make a capital distribution if such distribution would violate any restriction on the redemption or repurchase of capital stock or the payment of a dividend set forth in section 6 of the Bank Act (12 U.S.C. 1426) and any other applicable regulation.

(b) *Exception.* Notwithstanding the restriction in paragraph (a) of this section, the Director may permit a Bank to repurchase or redeem its shares of stock if the transaction is made in connection with the issuance of additional Bank shares or obligations in at least an equivalent amount to the shares that are redeemed or repurchased and will reduce the Bank's financial obligations or otherwise improve its financial condition. Any transaction under this paragraph also must conform with any restriction on the redemption or repurchase of Bank stock set forth in section 6 of the Bank Act (12 U.S.C. 1426) and in any other applicable regulation.

§ 1229.6 Mandatory actions applicable to undercapitalized Banks.

(a) *Mandatory Actions by the Bank.* A Bank that is classified as undercapitalized shall:

(1) Submit to the Director for approval a capital restoration plan that complies with the the requirements and procedures established by § 1229.11 of this part and receive approval from the Director for such plan;

(2) Fulfill all terms, conditions and obligations contained in the capital restoration plan as approved by the Director;

(3) Not make any capital distribution that would result in the Bank being reclassified as significantly undercapitalized or critically undercapitalized, nor make a capital distribution if such distribution would violate any restriction on the redemption or repurchase of capital stock or the declaration or payment of a dividend set forth in section 6 of the Bank Act (12 U.S.C. 1426) or in any other applicable regulation;

(4) Not permit its average total assets in any calendar quarter to exceed its average total assets during the preceding calendar quarter, where such average is calculated based on the total amount of assets held by the Bank for each day in a quarter, unless:

(i) The Director has approved the Bank's capital restoration plan; and

(ii) The Director determines that:

(A) The increase in total assets is consistent with the approved capital restoration plan; and

(B) The ratio of tangible equity to the Bank's total assets is increasing at a rate sufficient to enable the Bank to become adequately capitalized within a reasonable time and consistent with any schedule established in the capital restoration plan; and

(5) Not acquire, directly or indirectly, any interest in any entity nor engage in any new business activity unless:

(i) The Director has approved the Bank's capital restoration plan, the Bank is implementing the capital restoration plan and the Director determines that proposed acquisition or activity will further achievement of the goals set forth in that plan; or

(ii) The Director determines that the proposed acquisition or activity will be consistent with the safe and sound operation of the Bank and will further the Bank's compliance with its risk-based and minimum capital requirements in a reasonable period of time.

(b) *Mandatory reclassification by the Director.* The Director shall reclassify an undercapitalized Bank as significantly undercapitalized if:

(1) The Bank does not submit a capital restoration plan that is substantially in compliance with § 1229.11 of this subpart and within the time frame required.

(2) The Director does not approve the capital restoration plan submitted by the Bank; or

(3) The Director determines that the Bank has failed in any material respect to comply with its approved capital restoration plan or fulfill any schedule for action established by that plan.

(c) *Monitoring.* The Director shall monitor the condition of any undercapitalized Bank and monitor the Bank's compliance with the capital restoration plan and any restrictions imposed under this section or § 1229.7 of this subpart. As part of this process, the Director shall review the capital restoration plan and any restrictions or requirements imposed on the undercapitalized Bank to determine whether such plan, restrictions or requirements are consistent with the safe and sound operation of the Bank and will further the Bank's compliance with its risk-based and minimum capital requirements in a reasonable period of time.

§ 1229.7 Discretionary actions applicable to undercapitalized Banks.

(a) *Discretionary safeguards.* The Director may take any action with regard to an undercapitalized Bank that may be taken with regard to a significantly undercapitalized Bank under section 1366 of the Safety and Soundness Act (12 U.S.C. 4616) or § 1229.7 or § 1229.8 of this subpart if the Director determines that such action is necessary to assure the safe and sound operation of the Bank and the Bank's compliance with its risk-based and minimum capital requirements in a reasonable period of time.

(b) *Procedures.* Before finalizing any action under this section, the Director shall provide a Bank written notice describing the proposed action or actions and an opportunity to submit information that the Bank considers relevant to the Director's decision to take such action in accordance with § 1229.12 of this subpart.

§ 1229.8 Mandatory actions applicable to significantly undercapitalized Banks.

A Bank that is classified as significantly undercapitalized:

(a) Shall submit to the Director for approval a capital restoration plan that complies with the requirements and procedures established by § 1229.11 of this part and receive approval from the Director for such plan;

(b) Fulfill all terms, conditions and obligations contained in the capital restoration plan once the plan is approved by the Director;

(c) Shall not make any capital distribution that would result in the Bank being reclassified as critically undercapitalized or that would violate any restriction on the redemption or repurchase of capital stock or the payment of a dividend set forth in section 6 of the Bank Act (12 U.S.C. 1426) or any applicable regulation;

(d) Shall not make any capital distribution not otherwise prohibited under paragraph (c) of this section absent the prior written approval of the Director, provided that the Director may approve such distribution only if the Director determines that:

(1) The capital distribution will enhance the ability of the Bank to meet its risk-based and minimum capital requirements promptly;

(2) The capital distribution will contribute to the long-term financial safety and soundness of the Bank; or

(3) The capital distribution is otherwise in the public interest;

(e) Shall not without prior written approval of the Director pay a bonus to any executive officer, provided that for purposes of this paragraph a bonus shall

include any amount paid or accruing to an executive officer under a profit sharing arrangement; and

(f) Shall not without the prior written approval of the Director compensate an executive officer at a rate exceeding the average rate of compensation of that officer during the 12 months preceding the calendar month in which the Bank became significantly undercapitalized, provided however, that for purposes of calculating the executive officer's average rate of compensation, such compensation shall not include any bonus or profit sharing paid or accruing to the officer during the 12 month period.

§ 1229.9 Discretionary actions applicable to significantly undercapitalized Banks.

(a) *Actions by the Director.* The Director shall carry out this section by taking, at any time, one or more of the following actions with respect to a significantly undercapitalized Bank:

(1) Limit the increase in any obligations or class of obligations of the Bank, including any off-balance sheet obligations. Such limitation may be stated in an absolute dollar amount, as a percentage of current obligations or in any other form chosen by the Director;

(2) Reduce the amount of any obligations or class of obligations held by the Bank, including any off-balance sheet obligations. Such reduction may be stated in an absolute dollar amount, as a percentage of current obligations or in any other form chosen by the Director;

(3) Limit the increase in, or prohibit the growth of any asset or class of assets held by the Bank. Such limitation may be stated in an absolute dollar amount, as a percentage of current assets or in any other form chosen by the Director;

(4) Reduce the amount of any asset or class of asset held by the Bank. Such reduction may be stated in an absolute dollar amount, as a percentage of current obligations or in any other form chosen by the Director;

(5) Acquire new capital in the form and amount determined by the Director, which specifically may include requiring a Bank to increase its level of retained earnings;

(6) Modify, limit or terminate any activity of the Bank that the Director determines creates excessive risk;

(7) Take steps to improve the management at the Bank by:

(i) Ordering a new election for the Bank's board of directors in accordance with procedures established by the Director;

(ii) Dismissing particular directors or executive officers, in accordance with section 1366(b)(5)(B) of the Safety and Soundness Act (12 U.S.C. 4616(b)(5)(B)), who held office for more than 180 days immediately prior to the date on which the Bank became undercapitalized, provided further that such dismissals shall not be considered removal pursuant to an enforcement action under section 1377 of the Safety and Soundness Act (12 U.S.C. 4636a) and shall not be subject to the requirements necessary to remove an officer or director under that section; or

(iii) Ordering the Bank to hire qualified executive officers, the hiring of whom, prior to employment by the Bank and at of the option of the Director, may be subject to review and approval by the Director; or

(8)(i) Reclassify a significantly undercapitalized Bank as critically undercapitalized if:

(A) The Bank does not submit a capital restoration plan that is substantially in compliance with § 1229.11 of this part and within the time frame required;

(B) The Director does not approve the capital restoration plan submitted by the Bank; or

(C) The Director determines that the Bank has failed to make reasonable, good faith efforts to comply with its approved capital restoration plan and fulfill any schedule established by that plan.

(ii) Subject to paragraph (c) of this section, the Director may reclassify a significantly undercapitalized Bank under paragraph (a)(8)(i) of this section at any time the grounds for such action exist, notwithstanding the fact that such grounds had formed the basis on which the Director reclassified a Bank from undercapitalized to significantly undercapitalized.

(b) *Additional safeguards.* The Director may require a significantly undercapitalized Bank to take any other action not specifically listed in this section if the Director determines such action will help ensure the safe and sound operation of the Bank and the Bank's compliance with its risk-based and minimum capital requirements in a reasonable period of time more than any action specifically authorized under paragraph (a) of this section.

(c) *Procedures.* Before finalizing any action under this section, the Director shall provide a Bank written notice describing the proposed action or actions and an opportunity to submit information that the Bank considers relevant to the Director's decision to take such action in accordance with § 1229.12 of this subpart.

§ 1229.10 Actions applicable to critically undercapitalized Banks.

(a) *Appointment of conservator or receiver.* Notwithstanding any other provision of federal or state law, the Director may appoint the FHFA as conservator or receiver of any Bank at any time after the Director determines that the Bank is, or the Director otherwise exercises authority to reclassify the Bank as, critically undercapitalized.

(b) *Periodic determination*—(1) *Determination.* Not later than 30 calendar days after the Director first determines that a Bank is, or the Director otherwise exercises authority to reclassify the Bank as, critically undercapitalized, and a least once during each succeeding 30-day calendar period, the Director make a determination in writing as to whether:

(i) The assets of the Bank are, and during the preceding 60 calendar days have been, less than its obligations to its creditors and others, provided that the Director shall consider as an obligation only that amount of outstanding consolidated obligations for which the Bank is primary obligor or for which the Bank has been ordered to make payments of principal or interest on behalf of another Bank, or is actually making payments of principal or interest on behalf of another Bank; or

(ii) The Bank is not, and during the previous 60 calendar days has not been paying its debts on a regular basis as such debts become due, provided that this provision does not apply to any unpaid debts that are the subject of a *bona fide* dispute.

(2) *Mandatory receivership.* If the Director determines that the conditions described in either paragraph (b)(1)(i) or (b)(1)(ii) of this section applies to a Bank, the Director shall appoint the FHFA as receiver for the Bank. The appointment of the FHFA as receiver under this paragraph shall immediately terminate any conservatorship established for the Bank.

(3) *Determination not required.* A determination under paragraph (b)(1) of this section shall not be required during any period in which the FHFA serves as receiver for a Bank.

(c) *Judicial review.* If the Director appoints the FHFA as conservator or receiver of a Bank under paragraph (a) or (b)(2) of this section, the Bank may within 30 days of such appointment bring an action in the United States district court for the judicial district in which the Bank was established pursuant to section 3 of the Bank Act (12 U.S.C. 1423) or in the United States District Court for the District of Columbia, for an order requiring the

FHFA to remove itself as conservator or receiver.

(d) *Other applicable actions.* Until such time the FHFA is appointed as conservator or receiver for a critically undercapitalized Bank, a critically undercapitalized Bank shall be subject to all mandatory restrictions or obligations applicable to significantly undercapitalized Bank under § 1229.8 of this subpart and will remain subject to any on-going restrictions that the Director may have placed on the Bank under § 1229.7 or § 1229.9 of this subpart, or any restrictions or obligations that are applicable to the Bank under the terms of an approved capital restoration plan.

§ 1229.11 Capital restoration plans.

(a) *Contents.* Each capital restoration plan submitted by a Bank shall set forth a plan to restore its permanent and total capital to levels sufficient to fulfill its risk-based and minimum capital requirements within a reasonable period of time. Such plan must be feasible given general market conditions and the conditions of the Bank and, at a minimum, shall:

(1) Describe the actions the Bank will take, including any changes that the Bank will make to member stock purchase requirements, to assure that it will become adequately capitalized within the meaning of § 1229.3(a) of this subpart;

(2) Specify the level of permanent and total capital the Bank will achieve and maintain;

(3) Specify the types and levels of activities in which the Bank will engage during the term of the plan, including any new business activities that it intends to begin during such term;

(4) Describe any other actions the Bank intends to take to comply with any other requirements imposed on it under this subpart A of part 1229;

(5) Provide a schedule which sets forth dates for meeting specific goals and benchmarks and taking other actions described in the proposed capital restoration plan, including setting forth a schedule for it to restore its permanent and total capital to levels necessary for meeting its risk-based and minimum capital requirements; and

(6) Address such other items that the Director shall provide in writing in advance of such submission.

(b) *Deadline for submission.* A Bank must submit a proposed capital restoration plan no later than 10 calendar days after it receives written notification that such a plan is required either because the notice specifically states that the Director has required the submission of a plan or the notice indicates that the Bank's capital classification or reclassification is to a category for which a capital restoration plan is a mandatory action required of the Bank. The Director may extend this deadline if the Director determines that such extension is necessary. Any such extension shall be in writing and provide a specific date by which the Bank must submit its proposed capital restoration plan.

(c) *Review of the plan by the Director.* The Director shall have 30 calendar days from the date the Bank submits a proposed capital restoration plan to approve or disapprove the plan. The Director may extend the period for consideration of a capital restoration plan for a single 30 calendar day period by providing the Bank with written notification that the decision deadline has been extended. The Director shall provide the Bank with written notification of the decision to approve or not approve a proposed capital restoration plan. If the Director does not approve the capital restoration plan, the written notification of such decision shall provide the reasons for the disapproval.

(d) *Resubmission.* If the Director does not approve the Bank's proposed capital restoration plan, the Bank shall submit a new capital restoration plan acceptable to the Director within 30 calendar days of the date that the Bank was notified of the disapproval. The Director may extend the period for the Bank's submission of a new acceptable capital restoration plan upon a determination that such extension is in the public interest. The Director shall provide the Bank written notice of the extension and include in such notice the date by which the Bank must submit an acceptable plan.

(e) *Amendments.* The Director, in his or her sole discretion, may approve amendments to an approved capital restoration plan if, after consideration of changes in conditions of the Bank, changes in market conditions and other relevant factors, the Director determines that such amendments are consistent with the restoration of the Bank's capital to levels necessary to meet its risk-based and minimum capital requirements in a reasonable period of time and with the safe and sound operations of the Bank.

(f) *Effectiveness of provisions.* A Bank is obligated to implement and fulfill all provisions of an approved capital restoration plan. Unless expressly addressed by the terms of the capital restoration plan, a Bank remains bound by each and every obligation and requirement set forth in the approved capital restoration plan until such requirement or obligation is amended under paragraph (e) of this section or terminated in writing by the Director.

(g) *Appointment of conservator or receiver.* Notwithstanding any other provision of federal or state law, the Director may appoint the FHFA as conservator or receiver of any Bank that is classified as undercapitalized or significantly undercapitalized if the Bank fails to submit a capital restoration plan acceptable to the Director within the time frames established by this section or if the Bank materially fails to implement any capital restoration plan that has been approved by the Director. A Bank may within 30 days of such appointment bring an action in the United States district court for the judicial district in which the Bank is established pursuant to section 3 of the Bank Act (12 U.S.C. 1423) or in the United States District Court for the District of Columbia, for an order requiring the FHFA to remove itself as conservator or receiver.

§ 1229.12 Procedures related to capital classification and other actions.

(a) *Classification or reclassification of a Bank.* Before finalizing any decision to classify a Bank under § 1229.2(a) of this subpart or reclassify the Bank under § 1229.4(a) of this subpart, the Director shall provide the Bank with written notification of the proposed action that states the reasons for the proposed action and describes the information on which the proposed action is based. The notice required under this paragraph may be combined with the notice of a proposed supervisory action required under paragraph (b) of this section. The Director also may combine a notice informing the Bank of its capital classification and simultaneously informing the Bank that the Director intends to reclassify a Bank to a lower capital classification category.

(b) *Notice of a supervisory action.* Before finalizing any action or actions authorized under § 1229.7 or § 1229.9 of this subpart, the Director shall provide the Bank with written notification of the proposed action that states the reasons for the proposed action and describes the information on which the proposed action is based. The notice required under this paragraph may be combined with the notice of a proposed action to classify or reclassify the Bank required under paragraph (a) of this section.

(c) *Bank response.* During the 30 calendar day period beginning on the date that the Bank is provided notice under paragraph (a) or (b) of this section of a proposed action or actions, a Bank may submit to the Director any information that the Bank considers relevant or appropriate for the Director

to consider in determining whether to finalize the proposed action. The Director may, in his or her sole discretion, convene an informal hearing with representatives of the Bank to receive or discuss any such information. The Director, in his or her sole discretion, also may extend the period in which the Bank may respond to a notice for an additional 30 calendar days for good cause, or shorten such comment period if the Director determines the condition of the Bank requires faster action or a shorter comment period or if the Bank consents to a shorter comment period. The Director shall inform the Bank in writing, which may be provided as part of the notice required under paragraphs (a) or (b) of this section, of any decision to extend or shorten the comment period. The failure of a Bank to provide information during the allotted comment period will waive any right of the Bank to comment on the proposed action.

(d) *Final action.* At the earlier of the completion of the comment period established under paragraph (c) or the receipt of information provided by the Bank during such period, the Director shall determine whether to take the proposed action or actions that were the subject of the notice under paragraphs (a) or (b) of this section, after taking into consideration any information provided by the Bank. Such notice shall respond to any information submitted by the Bank. Any final order that the Bank take action, refrain from action or comply with any other requirement that was the subject of a notice under paragraph (b) of this section shall take effect upon the Bank's receipt of the notice required under this paragraph, unless a different effective date is set forth in this notice, and shall remain in effect and binding on the Bank until terminated in writing by the Director or until any terms and conditions for termination, as set forth in the notice, have been met.

(e) *Final actions under this section.* Any final decision that the Bank take action, refrain from action or comply with any other requirement that was the subject of a notice under paragraph (b) of this section shall constitute an order under the Safety and Soundness Act. The Director in his or her discretion may apply to the United States District Court for the District of Columbia or to the United States district court for the judicial district in which the Bank in question is established pursuant to section 3 of the Bank Act (12 U.S.C. 1423) for the enforcement of such order, as allowed under § 1375 of the Safety and Soundness Act (12 U.S.C. 4635) . In addition, a Bank or any executive officer or director of a Bank can be subject to enforcement action, including the imposition of civil monetary penalties, under § 1371, § 1372 or § 1376 of the Safety and Soundness Act (12 U.S.C. 4631, 4632, or 4636) for failure to comply with such an order.

(f) *Judicial review.* A Bank that is not classified as critically undercapitalized may obtain judicial review of any final capital classification decision or of any final decision to take supervisory action made by the Director under § 1229.2, § 1229.4, § 1229.7 or § 1229.9 in accordance with the requirements and procedures set forth in § 1369D of the Safety and Soundness Act (12 U.S.C. 4623).

Dated: January 26, 2009.

James B. Lockhart III,

Director, Federal Housing Finance Agency.

[FR Doc. E9–2083 Filed 1–29–09; 8:45 am]

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FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1252

RIN 2590–AA22

Portfolio Holdings

AGENCY: Federal Housing Finance Agency.

ACTION: Interim final rule; request for comments.

SUMMARY: The Federal Housing Finance Agency is issuing an interim final regulation to govern the portfolio holdings of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Comments on the issues and questions set forth in the preamble are requested, and the agency will amend the rule as appropriate after considering comments.

DATES: *Effective Date:* January 30, 2009.

Comment Date: Written comments must be submitted on or before June 1, 2009.

ADDRESSES: You may submit your comments, identified by ''Portfolio Holdings IFR/RFC, [RIN 2590–AA22],'' by any of the following methods:

• *U.S. Mail, United Parcel Post, Federal Express, or Other Mail Service:* The mailing address for submitting comments is: Alfred M. Pollard, General Counsel, Attention: Comments ''Portfolio Holdings IFR/RFC, [RIN 2590–AA22],'' Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

• *Hand Delivery/Courier:* The hand delivery address for submitting comments is: Alfred M. Pollard, General Counsel, Attention: Comments ''Portfolio Holdings IFR/RFC, [RIN 2590–AA22],'' Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.

• *E-mail:* Comments may be submitted via electronic mail at *RegComments@FHFA.gov* addressed to Alfred M. Pollard, General Counsel. Please include ''Portfolio Holdings IFR/RFC, [RIN 2590–AA22]'' in the subject line of the message.

• *Federal eRulemaking:* Instructions on comment submission are also available on the eRulemaking portal at *http://www.regulations.gov*.

The Federal Housing Finance Agency (FHFA) requests that comments submitted in hard copy also be accompanied by the electronic version in Microsoft Word or in a portable document format (PDF) on 3.5'' disk or CD–ROM, and identify the comments as pertaining to the Portfolio Holdings Interim Final Rule.

FOR FURTHER INFORMATION CONTACT: Ming-Yuen Meyer-Fong, Office of the General Counsel, (202) 414–3798, or Valerie Smith, Office of Policy Analysis and Research, (202) 414–3770, Federal Housing Finance Agency, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Deaf is (800) 877–8339. For more information on this Interim Final Regulation, see the **SUPPLEMENTARY INFORMATION** section of this document.

SUPPLEMENTARY INFORMATION:

I. Comments and Access

Instructions: FHFA requests that comments submitted in hard copy also be accompanied by the electronic version in Microsoft® Word or in a portable document format (PDF) on 3.5'' disk or CD–ROM, and identify that comments pertain to ''Portfolio Holdings IFR/RFC, [RIN 2590–AA22].''

Statement of Availability: This Interim Final Regulation as well as any comments posted may be accessed via the internet. Users can access the FHFA web page at *http://www.fhfa.gov*; select Supervision and Regulations Tab; select Regulations, Notices and Public Comments; then, select the link titled ''Portfolio Holdings'' or via the worldwide eRulemaking portal at *http://www.regulations.gov*. User can also access Exhibits A to F referenced in this interim rule document. Specifically, Exhibit A (Amended and Restated Senior Preferred Stock Purchase