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February 2003

FINANCIAL REGULATION

Review of Selected Operations of the Federal Housing Finance Board

GAO-03-364

February 2003

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GAO
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Highlights

Highlights of GAO-03-364, a report to the Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs; the Ranking Member, House Committee on Financial Services; and the Chairman, Subcommittee on Capital Markets

Why GAO Did This Study

The Federal Home Loan Bank System (System) faces additional risks due to the development of new products such as direct mortgage purchase programs. Responding to concern about the methods used for administrative decisionmaking, and the ability of the Federal Housing Finance Board (FHFB) to fulfill its critical mission to regulate the safety and soundness of the System, GAO was asked to (1) compare the FHFB chair's administrative authorities with those of other financial regulators and discuss the basis for that authority, (2) assess FHFB's compliance with selected statutes and regulations in connection with an August 2002 reduction-in-force (RIF) carried out as part of an agency reorganization, and (3) assess FHFB's progress in enhancing its FHLBank safety and soundness examination program.

What GAO Recommends

GAO recommends (1) that the FHFB board consider options that would help ensure full board participation in key administrative decisions, such as senior appointments and agency reorganizations and (2) FHFB comply with applicable federal age discrimination requirements in offering settlements during RIFs.

In written comments, FHFB said that the delegation of authority provides the best means to manage the agency. FHFB agreed with one finding regarding the settlements but disagreed with two others.

www.gao.gov/cgi-bin/getrpt?GAO-03-364.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Thomas J. McCool at (202) 512-8678 or mcoolt@gao.gov.

What GAO Found

FHFB's chair has greater authority to make key administrative decisions than the chairs at five of the six other financial regulators GAO reviewed. FHFB's chair has the authority to appoint and remove officials and reorganize the agency without a vote by the board. In contrast, statutes, regulations, and practices limit the chairs' authorities at most other regulators. In particular, the boards or commissions at these agencies approve most senior-level appointments and several boards approve major reorganizations. The basis for the FHFB chair's comparatively broad administrative authority is a delegation of authority, which the board passed in 1990 and 1993 (see excerpt below). The delegation allows the chair to make and implement key decisions without obtaining or benefiting from the views of all board members and has contributed to sometimes bitter conflicts among board members over the past 8 years.

Although FHFB provided significant financial compensation to staff subject to the RIF, its procedures were not fully consistent with all applicable federal age discrimination statutes and regulations. For example, FHFB presented a settlement agreement to separated staff that offered 3 to 6 months salary in exchange for, among other things, the employees agreeing to waive their rights to file charges, complaints, or appeals with the Equal Employment Opportunity Commission (EEOC). EEOC regulations implementing the Age Discrimination in Employment Act do not permit waivers of employees' rights to file charges or complaints with EEOC. In addition, FHFB did not advise the affected employees in writing to consult an attorney prior to signing the agreements as is required.

Although for several years FHFB did not take steps to correct weaknesses in its FHLBank examination program that GAO identified in a 1998 report, FHFB's current Chair has recently undertaken several steps to improve its examinations. In 1998, and again in 2002, GAO found that FHFB performed limited reviews of FHLBank functions that are critical in managing the banks' financial and operational risks. Among other changes announced in 2002, FHFB plans to increase the number of examiners from 10 to 24 and revise its examination approach to focus on the major risks and quality of controls at each FHLBank. Although these changes have the potential to improve FHFB's examination program, it is too soon to assess their effectiveness.

Excerpt from 1993 FHFB Delegation of Authority

> The Board hereby delegates to the Chairperson all authorities, powers, and responsibilities of the Board necessary to effect the overall management, functioning and organization of the Finance Board including, without limitation the authority to…appoint, remove, promote…Finance Board personnel.

Source: FHFB.

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Abbreviations

ADEA	Age Discrimination in Employment Act
CEO	Chief Executive Officer
CFTC	Commodity Futures Trading Commission
CRP	Center for Responsive Politics
EEOC	Equal Employment Opportunity Commission
Fed Board	Board of Governors of the Federal Reserve System
FHFB	Federal Housing Finance Board
FCA	Farm Credit Administration
FDIC	Federal Deposit Insurance Corporation
FEC	Federal Election Commission
FHLBank	Federal Home Loan Bank
FHLBank System	Federal Home Loan Bank System
FLSA	Fair Labor Standards Act
HUD	Department of Housing and Urban Development
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OFHEO	Office of Federal Housing Enterprise Oversight
OGC	Office of General Counsel
OIG	Office of Inspector General
OM	Office of Management
OPM	Office of Personnel Management
OPRA	Office of Policy, Research, and Analysis
OS	Office of Supervision
OTS	Office of Thrift Supervision
OWBPA	Older Workers Benefit Protection Act
RIF	Reduction-in-Force
SEC	Securities and Exchange Commission

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G A O
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

February 28, 2003

The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives

The Honorable Richard H. Baker
Chairman, Subcommittee on Capital Markets,
Insurance, and Government Sponsored Enterprises
Committee on Financial Services
House of Representatives

This report responds to your request that we review selected operations of the Federal Housing Finance Board (FHFB) and its ability to fulfill its critical mission to regulate the Federal Home Loan Bank System (FHLBank System). The FHLBank System consists of 12 Federal Home Loan Banks (FHLBanks), whose mission is to promote housing and community finance. To do so, the FHLBank System issues debt in the financial markets; and each of FHLBanks makes loans, also known as advances, to member financial institutions, such as thrift institutions and commercial banks, that are located in its district.[1] As of September 30, 2002, total FHLBank System outstanding debt obligations stood at $668 billion. Although due to conservative underwriting standards the FHLBank System has never experienced a loss on an advance, it faces additional risks due to the recent rapid growth of direct mortgage acquisition programs.[2] The direct acquisition of mortgages adds to the FHLBanks' interest rate and credit

[1]As of September 2002, there were about 8,000 members of the FHLBank System.

[2]Historically, FHLBank advances have been overcollateralized by assets such as securities or mortgages. Beginning in 1997, FHLBanks began to purchase mortgages directly from their member institutions. Total FHLBank System whole mortgage assets nearly tripled from $16 billion at the end of 2000 to $47 billion by September 30, 2002.

risks, and the banks have developed increasingly sophisticated systems to manage these risks.[3]

FHFB has a five-member board, of which no more than three members can be from the same political party. FHFB's primary mission is to help ensure that the FHLBanks operate in a safe and sound manner. FHFB is also responsible for ensuring that FHLBanks carry out their housing and community development mission and comply with applicable statutes and regulations. To fulfill its mission, FHFB conducts examinations of FHLBanks, and other supervisory activities. FHFB also appoints public interest directors to serve on the boards of each of the FHLBanks.[4]

In the past year, FHFB board members have been involved in several publicized disputes.[5] The current Chair (John T. Korsmo) has taken several key administrative initiatives, including reorganizing FHFB, which he believes are necessary to improve the agency's oversight.[6] However, FHFB's Democratic board members, who are currently in the minority on the board, have stated that the Chair acted unilaterally and did not adequately consult them about these administrative initiatives. Board members have also stated that they were not adequately consulted about other issues that are the responsibility of the FHFB, such as the appointment of public interest directors. Similar disputes between the FHFB chair and other board members periodically took place when Democratic Chair Bruce Morrison served from 1995 through 2000.

[3]Interest rate risk is the potential for loss due to fluctuations in interest rates while credit risk is the potential for loss from a borrower or counterparty failure to perform on an obligation. By holding mortgages on their books, FHLBanks increase both types of risks. FHLBank members retain the credit and interest rate risks for mortgage loans that they fund with FHLBank advances.

[4]FHFB appoints at least 6 directors to serve on the boards of the FHLBanks, whose boards each consist of at least 14 members. These appointed directors are commonly referred to as public interest directors. At least two of the public interest directors are designated as community interest directors because of their strong ties to the local community. Members of each of the 12 FHLBank districts elect the remaining directors.

[5]*American Banker*, March 15, 2002, *American Banker*, June 3, 2002, and *Dow Jones Newswire Column*, August 15, 2002.

[6]We define key administrative authorities as the appointment of senior agency officials and reorganizing an agency's structure.

As discussed with your staff, we assessed a range of issues relating to FHFB's operations and its abilities to fulfill its critical regulatory mission. Specifically, our report objectives are as follow:

- compare the FHFB chair's administrative authorities to those of the chairs of other financial regulators and discuss the basis for that authority;
- assess FHFB's compliance with selected applicable statutes and procedural requirements in connection with a reduction-in-force (RIF) that was carried out as part of an agency reorganization announced on August 7, 2002;
- assess FHFB's progress in enhancing its FHLBank safety and soundness examination program;
- provide historical data showing the political contributions of FHLBank public interest directors prior to their appointments; and
- compare FHFB's use of Schedule C appointments and the organization of its public and congressional affairs functions with the practices of other financial regulatory agencies. [7]

To address these objectives, we analyzed applicable statutes, regulations, and practices that determine the scope of authority of the FHFB chair and the authorities of the heads of six other federal financial regulatory agencies. These agencies are the Farm Credit Administration (FCA), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the National Credit Union Administration (NCUA), and the Board of Governors of the Federal Reserve System (Fed Board). We also (1) analyzed FHFB's RIF procedures, applicable statutes, Equal Employment Opportunity Commission (EEOC) and Office of Personnel

[7]Schedule C appointments are generally noncompetitive and noncareer appointments made without regard to the rules for competition that govern career appointments. Schedule C appointees receive noncompetitive appointments to positions graded GS-15 and below that involve determining policy or other key close, confidential relationship with the agency head or other key appointed officials of the agency. Agency heads or key appointed officials may dismiss Schedule C appointees at any time, and such appointees generally leave their positions at the end of an administration. OPM reviews and authorizes agency applications for use of Schedule C positions.

Management (OPM) regulations, and applicable administrative decisions; (2) updated our 1998 report on FHFB's FHLBank examination program;[8] (3) analyzed information from the Center for Responsive Politics (CRP) that shows the political contributions of FHLBank public interest directors prior to their appointments;[9] and (4) compared FHFB's use of Schedule C positions to the practices of the other six agencies.

We conducted our review from April 2002 through February 2003 in Washington, D.C., San Francisco, and Seattle in accordance with generally accepted government auditing standards. Appendix I contains a detailed description of the scope and methodology of our work.

Results in Brief

FHFB's chair has more power to make key administrative decisions than the chairs at five of the six other financial regulatory agencies that we reviewed.[10] Specifically, FHFB's chair has the authority to appoint and remove officials and reorganize the agency without a vote by the board. FDIC's chair has similar appointment and reorganization authority. In contrast, statutes, regulations, or practices limit the administrative authority of the chairs of the five other agencies. For example, the boards or commissions at these agencies either vote on or must give their approval for most senior-level appointments.[11] At three agencies, major reorganization proposals must be submitted to the board for a vote or approval, while at another agency, CFTC, chairs typically submit such proposals to a commission vote, as a matter of practice.[12] The basis for the FHFB chair's comparatively broad administrative authority is a delegation

[8] *Federal Housing Finance Board: Actions Needed to Improve Regulatory Oversight*, GAO/GGD-98-203 (Washington, D.C.: September 18, 1998).

[9] CRP is a nonpartisan, nonprofit research group based in Washington, D.C. that tracks money in politics and its effect on elections and public policy. Using data initially reported to the Federal Election Commission, CRP conducts computer-based research on campaign finance issues for the news media, academics, activists, and the public. We took steps to assess the reliability of CRP data and concluded that it is sufficiently reliable for our purposes. See appendix I for more information.

[10] See appendix II for a description of the seven regulatory agencies we reviewed.

[11] Some agency chairs appoint Schedule C officials to run certain staff offices, which is discussed later in this report.

[12] CFTC officials said that the chair has the authority to reorganize the agency without a commission vote, but the practice has been for the commission to vote on such proposals.

of authority that the board voted on in 1990 and 1993.[13] Under its terms, the delegation of authority remains in effect until revised or overturned by a majority board vote.[14] Although FHFB's delegation provides the chair with the authority to manage the agency, it allows the chair to make and implement key administrative decisions without obtaining or benefiting from the views of all board members, and it has contributed to the sometimes bitter conflicts that have periodically characterized relations among board members over the past 8 years.

During the August 2002 reorganization, FHFB took certain actions in conducting a RIF that were not fully consistent with federal age discrimination statutes and regulations. FHFB provided career transition assistance to the affected employees, paid required federal severance benefits, and presented a settlement agreement that offered up to an additional 6 months pay in exchange for the employees agreeing not to contest the RIF. Although the settlement agreements provided significant financial benefits to the affected employees, they include a provision that required employees who signed them to agree not to file a complaint, charge, or appeal with EEOC. This provision in the settlement agreement does not comply with EEOC regulations implementing the Age Discrimination in Employment Act (ADEA), which do not permit waivers of rights to file charges or complaints with EEOC. In addition, FHFB did not advise the employees in writing to consult an attorney prior to signing the agreements as is required by ADEA and EEOC regulations.

Although for several years FHFB had not taken actions to correct weaknesses in its FHLBank examination program that we identified in our 1998 report, FHFB's current Chair has recently undertaken several steps to improve the agency's examinations. In 1998, we found that FHFB performed limited reviews of FHLBank functions—including internal controls and corporate governance—that are critical in managing the banks' financial and operational risks. These functions continued to receive only limited reviews in examinations conducted from 1999 through 2001. FHFB's limited reviews of key functions raise questions about the agency's fulfillment of its safety and soundness oversight mission, particularly as interest rate and credit risks potentially increased in that

[13]Delegation of Authority to Chairperson, November 17, 1993, Resolution No. 93-92, and Delegation of Authority to Chairperson, December 18, 1990, Resolution No. 90-143.

[14]The FDIC chair also operates under a delegation of authority.

period through the rapid growth of direct mortgage acquisition programs. Although FHFB officials said in 1998 that a limited number of examiners (8 to 10) helped explain the agency's inability to review these areas completely, FHFB did not increase or announce plans to increase the examination staff until August 2002. In late 2002, FHFB began planning to increase the number of examiners from 10 to 24, base examiners in satellite locations to reduce examiner travel requirements, and revise the examination approach by focusing on the major risks facing each bank and the quality of systems and controls in place to manage those risks. FHFB's plans have the potential to significantly improve the FHLBank examination program, but it is too soon to assess their effectiveness.

According to CRP data, 50 (or 67 percent) of the 75 public interest directors that the FHFB appointed from January 1, 1998, through May 8, 2002, reported making one or more political donations prior to their initial appointments. [15] During that period, three FHFB chairs were in office (Morrison, Apgar, and Korsmo) when public interest directors were appointed.[16] The percentage of appointees who made political contributions prior to their initial appointments during the tenures of the three chairs ranged from 56 percent (Morrison) to 76 percent (Korsmo). CRP data also indicate that the median value of each contribution that the directors made prior to their appointments ranged from $3,250 (Apgar) to $8,364 (Korsmo).

[15]CRP's findings are reported in terms of "hard money" and "soft money." This analysis focuses on "hard money," which refers to contributions made for the purpose of influencing a federal election; these contributions are subject to the contribution limitations and prohibitions of the Federal Election Campaign Act. To ensure a standard comparison, we determined whether each director reported making a political contribution in the 8-year period prior to appointment. CRP officials said that their data are standardized from the 1990 election cycle to the present. Prior to the 1990 election cycle, it is difficult to extract data through automated procedures, so we analyzed appointments made in 1998 and after. Of the 25 directors listed as not having made contributions in the 8-year period prior to their appointments, 11 had reported making contributions more than 8 years prior to their initial appointment. The remaining 14 directors do not appear in the CRP database, which according to CRP officials indicates that they had not previously made political contributions. However, it is possible that these 14 individuals made contributions, but CRP was not able to match these individuals to its list of contributors. For example, one reason for this could be that contributors made political contributions under a different name. In addition, Federal Election Commission rules exempt contributions of less than $200 from reporting requirements. Thus, if these 14 individuals made contributions of less than $200, they would not appear on the CRP database.

[16]FHFB did not make public interest director appointments during the tenures of Chairs Allan I. Mendelowitz (December 29, 2000 to June 17, 2001) and J. Timothy O'Neill (June 18, 2001 to December 21, 2001).

FHFB's use of Schedule C positions is sometimes different from that of other financial regulators. FHFB and five of the six other financial regulatory agencies that we reviewed allot Schedule C positions to the chair and other board members.[17] Unlike FHFB, four of these five agencies also allot Schedule C positions to head a limited number of staff offices. FHFB, alone among the regulators, uses the chair's personal staff to head the agency's public and congressional affairs functions. At the other six agencies, Schedule C appointees, career staff, or noncareer executives head separate public or congressional affairs offices that are typically staffed by career employees.[18]

This report recommends that the FHFB board consider a range of options to ensure full board participation in key administrative decisions that have policy implications, such as senior appointments and major reorganizations. We also recommend that FHFB comply with all federal age discrimination requirements in offering settlement agreements to affected employees.

We provided a draft of this report to FHFB and individual board members for their review and comment. We also requested comments on relevant excerpts of the draft report from the six other regulatory agencies that we analyzed. We received official comments from FHFB and separate comments from FHFB's two Democratic board members, which are described later in this report and reprinted in appendix IV and V.[19] FCA's Chair also provided written comments, which are provided in appendix VI. We also received oral comments from representatives of the six other regulatory agencies.

FHFB stated in its comments that a majority of the board believes that the current delegation is the best means of managing the agency's operations

[17]The Fed Board does not use Schedule C positions.

[18]SEC, FCA, and NCUA appoint Schedule C officials to head these offices while the Fed Board and FDIC use career officials. CFTC appoints a noncareer executive to head its public and congressional affairs office; this individual does not hold a Schedule C appointment, which was the focus of our analysis.

[19]According to FHFB board members Franz S. Leichter and Allan I. Mendelowitz, the comments we received from FHFB do not constitute the agency's official comments because they were not voted on by the board. We did not attempt to resolve this difference between FHFB board members and staff and treated FHFB's comments as the official response of the agency. See the report section entitled "Agency Comments and Our Evaluation."

and that board members can state their views under the delegation.[20] FHFB also agreed with one of our findings regarding the settlement agreements offered to employees subject to the RIF but disagreed with two others. Among other statements, FHFB's Democratic board members stated that the delegation of authority was contrary to the intent of Congress, which vested agency management in the board rather than the chair and expressed concern about how the RIF was carried out. The FCA Chairman commented on the agency's Schedule C practices. In addition, representatives from all six regulatory agencies agreed with the draft report's findings regarding their agencies.

Background

Congress has authorized two different models for governing financial regulatory agencies: a single-director and board. Among financial regulators, single directors head the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), and the Office of Federal Housing Enterprise Oversight (OFHEO). In contrast, boards or commissions run FHFB, the Fed Board, NCUA, SEC, CFTC, FDIC, and FCA. Advantages and disadvantages exist for both models. In the single-director model, the director is responsible for making all the decisions at the agency, without the potential hindrance of having to consult or get the approval of board members. The primary advantage of the board model is that it provides the potential to benefit from the diverse perspectives and experiences of board members. However, one potential disadvantage of the board model is that consultation among board members could create inefficiencies in running the agency.

To overcome the potential inefficiencies associated with the board model, responsibilities for policy and day-to-day administration are divided between the board and chair at many regulatory agencies. Policy decisions include making rules and regulations or authorizing enforcement actions. Day-to-day administration might include directing staff, overseeing safety and soundness examinations, and expending funds as authorized by the board. Administrative responsibilities that are often considered to be more

[20]The delegation of authority allows two or more board members to call a board vote on actions taken under the delegation.

significant (that is, not day-to-day) include the hiring and removal of senior officials and restructuring the agency.[21]

FHFB has a five-member board of directors. The Secretary of the Department of Housing and Urban Development (HUD) serves as an ex officio member, and the remaining four full-time directors are appointed by the President with the advice and consent of the Senate for 7-year terms. Each of the four appointed directors must have experience or training in housing finance or a commitment to providing specialized housing credit. Not more than three of the five members can be from the same political party. The President designates one of the four appointed members to serve as chair. As discussed in this report, since 1990 the board has operated under a resolution that delegated most administrative functions to the chair.

The FHFB board operated with all appointed members serving on a full-time basis for the first time in December 2001.[22] From 1990 to 1993, the board operated with four appointed members who served on a part-time basis. Beginning in January 1994, FHFB board membership became full time. However, from 1994 through 2001, the board operated with at least one vacant seat and sometimes two or three. In December 2001, the President appointed FHFB's new chair, and the board operated with four full-time appointed members plus the HUD designee throughout 2002.

As of September 2002, FHFB's 104 staff members were organized into four program offices:

[21]The distinction between more significant administrative decisions and policy decisions is not always clear. For example, personnel decisions can have significant implications for how an agency carries out key responsibilities.

[22]This discussion excludes the HUD secretary or designee.

- Office of Supervision (OS) – The office is responsible for conducting on-site examinations of the FHLBanks and the FHLBank System's Office of Finance and conducting off-site monitoring and analysis.[23] OS is also responsible for overseeing the FHLBanks' implementation of their risk-based capital plans.[24] In addition, OS is responsible for providing expert policy advice and analyzing and reporting on the economic, housing finance, community investment, and competitive environments in which the FHLBank System and its members operate.

- Office of General Counsel (OGC) - The General Counsel is FHFB's chief legal officer and is responsible for advising the board, the chair, and other officials on interpretations of law and regulation. OGC prepares all legal documents on behalf of FHFB and prepares opinions, regulations, and memorandums of law. The office represents FHFB in all administrative adjudicatory proceedings before the board and in all other administrative matters involving FHFB. Also, OGC represents FHFB in judicial proceedings in which the agency's supervisory or regulatory authority over the FHLBanks is at issue.

- Office of Management (OM) - The OM director is the principal advisor to the FHFB chair on management and organizational policies and is responsible for the agency's technology and information systems, finance and accounting, budget, personnel, payroll, contracting and procurement, and facilities and property management.

- Office of Inspector General (OIG) - OIG is responsible for conducting and supervising audits and investigations of FHFB's programs and operations.

The costs of FHFB's operations are financed through assessments on the FHLBanks. In fiscal year 2003, FHFB's operating budget was about $27 million.

[23]The FHLBank System Office of Finance is responsible for borrowing funds in the capital markets—or issuing consolidated obligations on behalf of the system.

[24]Under the Gramm-Leach-Bliley Act of 1999, FHFB was required to establish capital standards for the FHLBanks that are based on the risks that they face, such as credit and interest rate risk. FHFB approved each of the 12 FHLBank plans in 2002 and is currently monitoring their implementation.

FHFB Chair Has Greater Authority to Make Key Administrative Decisions Than the Chairs of Most Other Financial Regulators

The FHFB chairs' authority to administer the agency is broader than that of the chairs of the other financial regulators included in our review, with the exception of the FDIC. Under a delegation of authority, the chair can make important administrative decisions that may have policy implications (such as appointing senior officials) without obtaining the approval of other board members. Over the years, some FHFB board members have complained that the delegation of authority allows the chair to act unilaterally, and it has been the source of disputes among board members. On January 29, 2003, the FHFB board considered and rejected by a 3 to 2 vote a proposal to revise the delegation and limit the chair's authority.

FHFB and FDIC Chairs Have Broad Administrative Powers

The FHFB and FDIC chairs have broader authority to make key administrative decisions than the chairs of other financial regulators (see fig. 1). Specifically, at FHFB and FDIC, the chairs can appoint senior officials without a board vote or approval. At each of the other financial regulators we reviewed, appointments of most senior officials require a vote or the approval of a majority of the board. However, in some cases, agency chairs can appoint Schedule C officials to run certain staff offices, which is discussed in more detail later in this report and in appendix II. We also note that at some agencies, such as CFTC, the chair or other senior career agency officials appoint staff responsible for carrying out the agencies' functions.

Figure 1: Authority of Financial Regulatory Agency Chairs to Make Key Administrative Decisions Without Board Approval

Agency	Appointment of senior officials/personnel decisions	Reorganizations
FHFB	●	●
FDIC	●	●
SEC	○	●
FCA	○	○
Fed Board	○	○
CFTC	○	●[a]
NCUA	○	○

Source: GAO.

● Chair has authority to make administrative decision without board approval.

○ Chair does not have authority to make administrative decision without board approval.

Note: Analysis of FHFB, FDIC, SEC, FCA, Fed Board, CFTC, and NCUA.

[a]CFTC officials said that the agency's practice is for the chair to submit reorganization proposals to the commission for a vote.

As also shown in figure 1, at four of the regulators we reviewed, including FHFB, the chair can reorganize the agency without seeking board approval.[25] While CFTC officials said that the chair has authority to reorganize the agency, the practice has been to submit such proposals to the commission for a vote. At three agencies, major reorganization proposals must be submitted to the board or commission for a vote or approval. For example, the Fed Board has a two-tier process by which reorganizations that meet specific criteria may require the approval of the entire board.[26] At FCA, the board must approve major organizational changes, but the chair has the authority to make organizational changes within particular units.

[25]Reorganizations entail shifting personnel, merging divisions, and, in some cases, creating or eliminating functions.

[26]Reorganizations that involve the appointing or removal of officers of the Fed Board require the approval of a majority of board members.

Delegations of Authority Serve as Basis for FHFB and FDIC Chairs' Powers

The basis for the FHFB chair's significant administrative power is a delegation of authority approved by the board in 1990 and 1993. According to former FHFB Chair, Dan Evans, the 1990 delegation of authority facilitated the administration of the agency due in part to the fact that board members served on a part-time basis. According to the FHFB former managing director who served under Evans, the agency's part-time board members spent most of their time in geographic locations across the United States and came to Washington several days each month to conduct the agency's business, particularly policy issues. According to Evans and the former managing director, the 1990 delegation facilitated the administration of FHFB as convening the part-time board members for administrative decisions was challenging. The 1990 delegation of authority authorizes the chair to ". . . effect the overall management, functioning, and organization . . ." of the FHFB.[27] Although FHFB's statute authorizes the board to employ and set the compensation of agency staff, the delegation of authority ceded appointment, removal, and pay authorities to the chair. The delegation of authority included a provision that allowed board members to challenge decisions made under the delegation, obligating the chair to call a special session of the board to consider any matter or business at the request of any two or more board members.

In November 1993, FHFB's part-time board made technical revisions to the 1990 delegation of authority that allowed the HUD secretary to serve as the chair in the absence of a chair or vice chair.[28] Otherwise, the terms of the 1993 delegation are substantially similar to the 1990 delegation and grant significant administrative authority to the FHFB chair (see fig. 2). According to a 1996 FHFB OGC memorandum that discusses the basis for the delegation and FHFB's former managing director, some of the part-time board members did not continue on the board as full-time members. The FHFB memorandum states that the part-time board members were concerned that the agency would not be able to function in the absence of

[27]The delegation was enacted at the first FHFB board of director meeting on December 18, 1990.

[28]This provision has been invoked twice, by HUD designee Nicolas Retsinas (Nov. 23, 1993 - May 31, 1995) and by HUD designee William Apgar (July 5, 2000 – Dec. 28, 2000). The board also removed language from the 1990 delegation of authority that required the chair to "consult" with other board members prior to making decisions.

the chair and other board members.[29] The 1993 delegation of authority has remained in effect because it has not been overturned by a majority vote of the board.

[29]Evans left the agency in November 1993 and two other board members resigned on January 1, 1994. FHFB operated with the HUD secretary or designee as the chair and one full-time board member throughout 1994 and the first half of 1995.

Figure 2: Text of FHFB's 1993 Delegation of Authority

WHEREAS, the Federal Housing Finance Board ("Finance Board") was created to succeed the former Federal Home Loan Bank Board as the regulator of the Federal Home Loan Banks ("Banks"); and

WHEREAS, section 2B of the Federal Home Loan Bank Act vests the management of the Finance Board in a five member Board of Directors ("Board"), but that, for ease of general operation, the Board desires to delegate to its Chairperson certain administrative authorities, powers and responsibilities of the Board;

NOW, THEREFORE, BE IT RESOLVED, that the Board hereby delegates to the Chairperson all authorities, powers and responsibilities of the Board necessary to effect the overall management, functioning and organization of the Finance Board including, without limitation, the authority to execute documents on behalf of the Board, including regulations, resolutions and orders duly passed by the Board, and to appoint, remove, promote, set compensation for, direct, evaluate and pay Finance Board personnel.

RESOLVED FURTHER, that the Chairperson may call the Board into regular or special session whenever any matter or business of the Finance Board so requires; Provided however: the Chairperson shall call a special session of the Board to consider any matter or business on the request of any two or more Board Directors.

RESOLVED FURTHER, that the Chairperson may, from time to time, further delegate to any member, officer, employee or Office of the Finance Board any function delegated to the Chairperson by this resolution or by law.

RESOLVED FURTHER, that in the event that there is no Chairperson or Acting Chairperson by virtue of absence, disability, or a vacancy, that all of the authority contained herein is delegated to the Secretary of Housing and Urban Development ("Secretary").

RESOLVED FURTHER, that this delegation is not personal to any Chairperson or to any Secretary and will neither abate nor lapse on the expiration of the term of any Chairperson or Board Director, unless revoked by the Board by resolution.

By the Federal Housing Finance Board

Daniel F. Evans, Jr.

Source: FHFB.

The FDIC board has also voted to give significant administrative authority to its chair through its bylaws and a delegation of authority. Through its bylaws, the FDIC board delegated certain appointment authority as well as reorganization authority to the chair. On January 29, 2002, the board

members voted unanimously to delegate additional authority to the chair. The delegation expanded the chairs' authority to appoint senior officials without a board vote.[30] In contrast to FHFB's delegation of authority, FDIC's delegation expires when the current chair leaves office and the rules for administrative decision making revert to the rules in place prior to the revised delegation.

FHFB Chairs' Exercise of Administrative Authority under Delegation Has Contributed to Conflicts among Board Members

Disagreements among board members about the chair's use of the delegation of authority to make unilateral administrative decisions have historically caused tensions between the chair and other board members. In a recent example of the disputes among FHFB board members, Democratic members stated that the current Chair did not consult them in any significant way prior to announcing a major agency reorganization on August 7, 2002 (the specifics of the reorganization are discussed later in this report). As done in 10 previous FHFB reorganizations under the delegation of authority, the Chair did not seek board approval.[31] According to the Chair, he notified other board members about the key points of the reorganization several weeks prior to the announcement. However, other board members have stated that they were not involved in the planning of the reorganization and did not receive details about the reorganization until it was announced. For example, at the September 2002 board meeting, one member stated ". . . we've just had a major restructuring that wasn't done by the board, that there wasn't advance notice, which had a real impact on the office."

FHFB board members who served under former Chair Morrison also stated that he used the delegation of authority to exclude other board members from key administrative decisions. For example, one board member stated that Morrison appointed senior officials and reorganized the agency without any consultation. The board member stated that he disagreed with these decisions and believed that they undermined FHFB's regulatory effectiveness. Morrison said that his actions were consistent with the administrative powers authorized to the chair under the delegation.

[30]Under the delegation passed on January 29, 2002, the FDIC chair can appoint senior officials (defined as corporate officers and Executive Schedule, level IV and above employees) without board approval. Under the previous delegation, these actions required board approval.

[31]The 10 previous restructurings included such activities as establishing, eliminating, and combining offices.

Morrison also said that he met frequently with other board members to explain his actions and that other board members never called special board meetings to question his decisions, as permitted under the delegation.

FHFB board members have also complained that chairs have used their delegated authority as the basis for unilateral actions on policy, which is the responsibility of the board as a whole. For example, two board members said that the current Chair acted unilaterally in selecting FHLBank public interest director candidates in 2002 and had minimal consultation on these selections with other board members. In past years, FHFB approved public interest director candidates by notational vote.[32] In 2002, these two board members requested that the vote on the candidates take place in an open meeting, and they expressed their concerns at this public meeting about not having been consulted. FHFB officials said that the current Chair has initiated actions to improve the selection of public interest directors. In particular, the Chair developed new criteria governing the appointment of public interest directors. The new criteria require public interest directors to have an understanding of such issues as finance, political awareness, and corporate governance. On January 29, 2003, the FHFB board voted unanimously to approve the appointment of 28 public interest directors.

Disputes about the FHFB's powers under the delegation of authority also took place during Chair Morrison's tenure, between 1995 and 2000. For example, in a letter sent to Members of Congress, a former board member alleged that "Mr. Morrison has used and expanded the delegation of authority to unilaterally implement his policy objectives by thwarting Board consideration of issues where there may be disagreement with the Chairman by the independent directors."[33] Morrison said that his decisions under the delegation were proper and did not stray into policy matters reserved for the board.

[32]In notational voting, board members voted on a list of candidates distributed to them rather than in a board meeting.

[33]Letter from Lawrence Costiglio to Senator Alfonse D'Amato and Senator Paul Sarbanes, March 12, 1998.

FHFB Board Considered and Rejected a Proposal to Revise the Delegation of Authority

On January 29, 2003, while a draft copy of this report was with FHFB for official comment, the board debated and rejected by a 3 to 2 party-line vote a proposal to revise the existing delegation of authority and limit the chair's administrative authorities.[34] FHFB's Chair placed the proposal on the agenda for meeting at the request of the agency's two Democratic board members. Although FHFB board members' staff said that they exchanged proposed language to revise the delegation of authority prior to the board meeting, they did not engage in substantive discussions over the proposal during that period. The proposed revisions to the delegation discussed at the January 29 board meeting would have allowed the FHFB board to approve the appointment of the agency's office directors and reorganizations down to the office level. A board member who proposed the revision said that the current delegation had been "misused" by FHFB chairs and used as a basis to usurp the policy-making responsibilities of the board. Among other statements, FHFB's Chair denied that he had "misused" his authority under the delegation and stated that the delegation was appropriate, among other reasons, because organizations need a single individual to direct operations to ensure efficient administration.

Certain FHFB Reduction-in-Force Actions Were Not Fully Consistent with Applicable Federal Age Discrimination Statutes and Regulations

On August 7, 2002, the FHFB Chair announced a major reorganization, and the agency sent RIF notices to nine staff members. Although FHFB provided significant financial compensation and career transition services to affected employees, certain FHFB actions in connection with the RIFs do not appear fully consistent with federal age discrimination statutes,

[34]We sent a draft of the report to FHFB for official comment on January 15, 2003. The draft report recommended that the FHFB board consider revising the delegation of authority to provide for board approval of senior agency officials and major reorganizations.

regulations, or court decisions.[35] We have informed EEOC of our findings in this area. In addition, FHFB placed each of the affected staff on administrative leave during the 60 day advance notice period (the period from the RIF notification on August 7 until actual separation from federal service). While OPM regulations require federal agencies to keep employees on active duty status during the advance notice period, FHFB officials said the agency had statutory authority to place the staff on administrative leave.

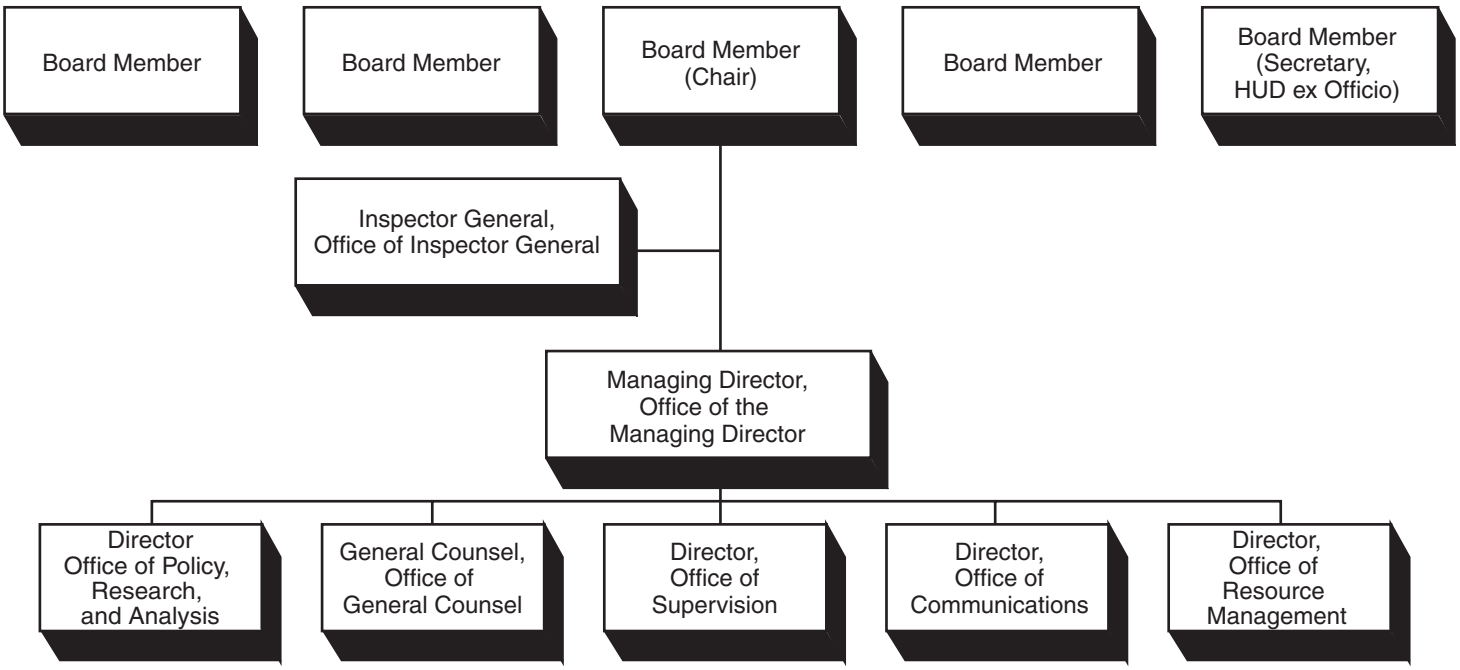
FHFB Reorganization Included a RIF

According to the FHFB Chair and Director of Management, the August 2002 reorganization was focused on improving supervision of the FHLBank System. Through a review of the organizational structure of FHFB, the Chair concluded that the agency dedicated too few resources to FHLBank supervision and too many resources to support functions and public and congressional relations. Accordingly, the Chair decided to eliminate the Office of Managing Director and the Office of Communications and merge OS with the Office of Policy, Research, and Analysis (OPRA) (see figs. 3 and 4). The Chair also decided to shift resources and positions from the eliminated offices to OS. In addition, FHFB changed the title of the Office of Resource Management to the Office of Management. The Chair and the Director of Management assumed responsibility for the day-to-day administrative duties formerly carried out by the Managing Director and, as is discussed later in this report, the Chair's personal staff assumed responsibility for the Office of Communication's public and congressional affairs functions.[36]

[35]The law governing RIFs at federal agencies is grounded in the Veterans' Preference Act of 1944, which states that "in any reduction in personnel in any civilian service of any Federal agency, competing employees shall be released in accordance with Civil Service Commission regulations which shall give due effect to tenure of employment, military preference, length of service, and efficiency ratings." The current version of the Veterans' Preference Act that pertains to RIFs is codified at 5 U.S.C. §3501-04. 5 U.S.C. §3502 sets forth the basic RIF principles and empowers OPM to promulgate regulations to carry them out. OPM's governmentwide regulations in part 351 of title 5, *Code of Federal Regulations* require that an agency undertaking a RIF meet certain specific procedural requirements and provide that an employee who has been separated or demoted by a RIF action may appeal to the Merit Systems Protection Board.

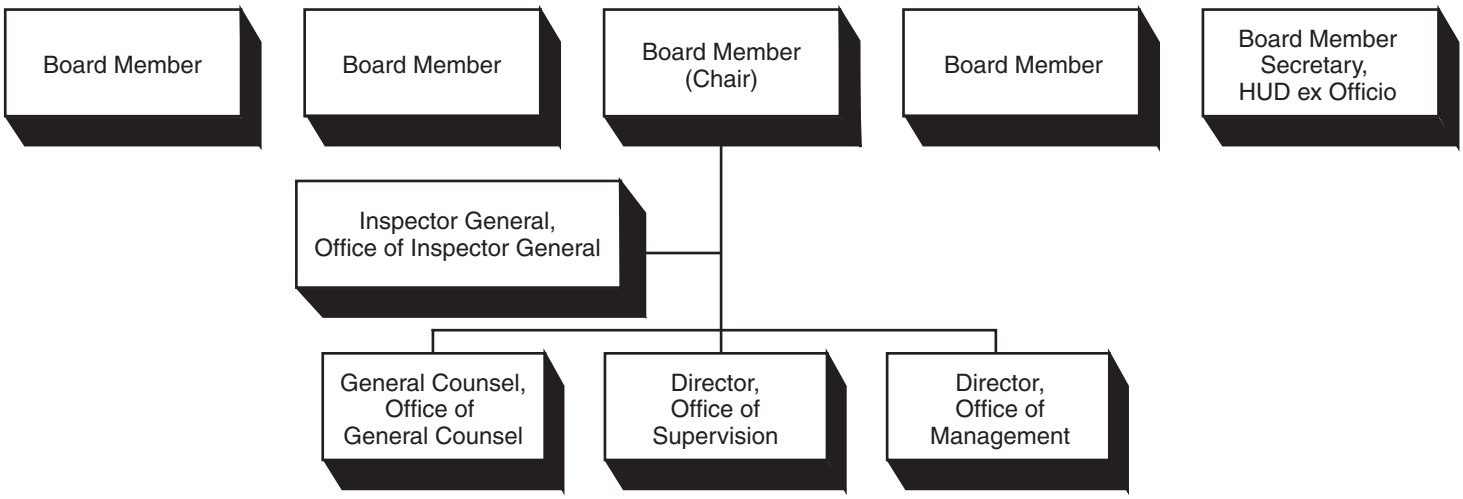
[36]Previously, the FHFB chair delegated day-to-day administrative authorities to the managing director.

Figure 3: FHFB Organization Chart (Pre-Reorganization)



Source: FHFB.

Figure 4: FHFB Organization Chart (Post-reorganization)



Source: FHFB.

As part of the reorganization, FHFB notified nine employees that they were subject to the RIF and that they would be separated from the federal service in 60 days (referred to as the advance notice period). To minimize the effect on the employees, FHFB hired an outplacement firm to help them prepare resumes and develop job search strategies. FHFB also notified each employee that he or she would receive federal severance and accrued annual leave benefits.[37] Further, FHFB presented each of the affected employees with a "Negotiated Settlement Agreement" that offered 3 to 6 months salary (depending upon employment status) in exchange for agreement not to file any administrative actions or lawsuits against the FHFB, its chair, directors, or employees in connection with the employees'

[37]An employee of an executive agency who is involuntarily separated from service is entitled to severance pay calculated on the basis of the employee's years of civilian service and an age adjustment allowance. 5 U.S.C. §5595 (c). An employee who is separated from service also is entitled to receive a lump-sum payment for accumulated and current accrued annual or vacation leave. 5 U.S.C. §5551(a).

employment with the agency or involuntary separation.[38] According to documentation provided by FHFB, the agency gave the affected employees 47 days to decide whether to sign the settlement agreement.[39] According to FHFB officials, eight of the nine affected employees signed the settlement agreements.

FHFB Settlement Agreement Waiver Provisions Not Fully Consistent with Age Discrimination Requirements

FHFB's settlement agreements included provisions that waived employees' rights to file lawsuits based on the Age Discrimination in Employment Act (ADEA), as amended.[40] Waivers of rights under ADEA are valid and enforceable only if the waiver is knowing and voluntary, and courts have generally required employers to strictly comply with ADEA standards regarding waivers. Although FHFB took steps to comply with ADEA and EEOC regulations, certain provisions in the settlement agreements are not consistent with requirements.[41] First, the settlement agreements required that employees waive their rights to file complaints, charges, or appeals with EEOC, which is not consistent with statutory and regulatory requirements. Second, FHFB did not advise each affected employee in writing to consult an attorney prior to signing the agreements and waiving

[38]Specifically, the separation agreement provided that the employee agreed not to "file any charges, complaints, grievances or appeals or requests for hearings before any administrative tribunal, including the Equal Employment Opportunity Commission, the Merit Systems Protection Board, the Office of Special Counsel, or under the (FHFB's) internal grievance procedures, relating to the facts and circumstances of the Employee's employment with the (FHFB) and involuntary separation." The separation agreement also provided that the employee agreed to "Not initiate a lawsuit or any other action against the (FHFB), the (FHFB) Chairman, its Directors, or any of the (FHFB's) employees or former employees under the Civil Rights Act of 1964, 42 U.S.C. §2000-16e, et seq.; the Age Discrimination in Employment Act of 1967, as amended, 29 U.S.C. §633a; the Civil Rights Acts of 1866 and 1871, 42 U.S.C. §§1981, 1983, and 1985; the U.S. Constitution; or any other state, local, or federal law, based on the facts and circumstances surrounding the employee's employment with the (FHFB) and involuntary separation."

[39]According to FHFB officials, 8 of the 9 affected staff, including 6 employees aged 40 or over, received notification on August 7, 2002. The standard settlement agreement provided by FHFB included a September 23, 2002, deadline to sign it.

[40]Congress enacted ADEA to promote the employment of older persons, based on ability rather than age, to prohibit arbitrary age discrimination and to help employers and employees resolve problems arising from the impact of age on employment. ADEA forbids arbitrary discrimination against workers, on the basis of age in hiring, promotion, terms of employment, and discharge.

[41]According to FHFB, six of the nine employees subject to the RIF were 40 years of age or older.

his or her ADEA rights. Third, FHFB did not provide required information to the affected employees to assist them in determining whether to waive their rights under ADEA.

The Older Workers Benefit Protection Act (OWBPA) includes detailed provisions that deal with the validity of releases and waivers under ADEA, and sets forth minimum requirements for a knowing and voluntary release of claims under the ADEA. EEOC regulations implementing OWBPA apply to waivers of rights and claims under ADEA, and the regulations provide specifically that they apply to all waivers of ADEA rights and claims, regardless of whether the employee is employed in the private sector or public sector, including federal employment. The statute and regulations require that the agreement be in writing, refer specifically to claims under ADEA, be given in exchange for consideration that is above and beyond any benefit to which the employee is already entitled, and give the employee adequate time to consider the waiver before signing it.

The settlement agreements appear designed to comply with several of these requirements. For example, employees were given 47 days to consider the waiver and the settlement agreement refers specifically to claims under ADEA.[42] As required by ADEA, the settlement agreements also provided affected employees over 40 years of age 7 days after signing the agreement to revoke the agreement. In addition, the settlement agreements included payments above and beyond what the employees were entitled to receive by statute. That is, FHFB agreed to pay each affected employee 3 to 6 months salary in exchange for agreeing to sign the settlement agreement.

However, a provision in the settlement agreements requiring employees to waive their rights to file charges, complaints, or appeals with EEOC does not appear to be consistent with OWBPA requirements and EEOC regulations. OWBPA provides that "No waiver agreement may affect the Commission's rights and responsibilities to enforce this chapter. No waiver may be used to justify interfering with the protected right of an employee to file a charge or participate in an investigation or proceeding conducted by the Commission."[43] The EEOC regulations provide that "no waiver agreement may include any provision prohibiting any individual from ". . .

[42]Employers must provide at least 45 days to consider waivers.

[43]29 U.S.C. §626(f)(4).

(i) Filing a charge or complaint, including a challenge to the validity of a waiver agreement, with EEOC, or (ii) Participating in any investigation or proceeding conducted by EEOC."[44]

The settlement agreements also do not appear consistent with OWBPA requirements and EEOC regulations that require employers to notify employees in writing to consult with an attorney prior to agreeing to waive their rights under ADEA. The courts have determined that employers must specifically advise employees to consult an attorney. In FHFB's settlement agreements, the relevant provision states that the "employee understands that he has had the opportunity to contact a representative of his choice to discuss the terms and conditions of this Negotiated Settlement Agreement. . ." An FHFB attorney stated that agency officials pointed out this statement in the settlement agreements to the affected employees. However, the settlement agreement does not advise the employees in writing to consult an attorney before agreeing to waive their rights under ADEA, and FHFB did not provide any other written advice for employees to consult an attorney.

In addition, FHFB did not provide information to the affected employees as is required under OWBPA and EEOC regulations. Employers that offer additional benefits to a group of involuntarily terminated employees in exchange for a waiver of claims under ADEA must satisfy additional requirements. These employers must provide detailed written information to employees describing the group termination program, including a listing of the job titles and ages of the employees selected for the program, and similar information for individuals who were not selected. This information is designed to permit older workers to make more informed decisions concerning waiver of ADEA rights. FHFB's settlement agreements were part of a group termination program (e.g., a RIF). However, FHFB officials said that while the names of the terminated employees were provided, written information on the job titles and ages of all employees who were offered the settlement agreement was not provided. According to FHFB, the EEOC regulations do not require that this information be provided if the employer decides to eliminate all of the positions in a particular unit, as FHFB did with respect to the Office of the Managing Director and the Office of Communications. However, OWBPA and EEOC regulations do not distinguish between situations where employers terminate selected positions in a particular unit and others where all positions are terminated.

[44]29 C.F.R. § 1625.22 (i).

Employers are required to provide information on employee ages and job titles under either circumstance.

FHFB Placed Staff Subject to the RIF on 60 Days of Administrative Leave

FHFB restricted the access of employees subject to the RIF to the agency's headquarters during the 60-day advance notice period—the period from the RIF notification on August 7, 2002, until actual separation from federal service—and placed them on administrative leave.[45] FHFB's decision to restrict staff access during the advance notice period was not consistent with OPM regulations, but FHFB officials said that the agency had statutory authority to take this action.

OPM regulations that apply to RIFs state that, when possible, employees should remain in active-duty status during the advance notice period. When in an emergency the agency lacks work or funds for all or part of the notice period, it may place employees on annual leave with or without their consent, leave without pay without their consent, or nonpay status without consent. While no statute governs the use of administrative leave, OPM regulations and federal administrative decisions have established standards for its use. These regulations and decisions have permitted agencies, in certain situations, to excuse an employee for brief periods without a loss of pay. However, agencies generally may not place employees on administrative leave for long periods unless their absence furthers an agency's mission.

FHFB officials said that the agency's authorizing statute provides authority to place employees on administrative leave during the advance notice period. FHFB officials said that the statute allows the agency to set the compensation of its employees without regard to the statutes affecting other agencies. FHFB officials said that all forms of leave, including administrative leave, are forms of compensation, and therefore, the agency was authorized to place the affected staff on administrative leave. Further, FHFB officials said that (1) placing the staff on administrative leave allowed them to take full advantage of the job placement services that the agency offered and (2) requiring the employees to report to the agency during the advance notice period when there was insufficient work for

[45]While the staff were not allowed to access their offices during the advance notice period, FHFB officials said that they could enter the building if they planned to enter a specific destination, checked in at the guard desk, and had the guard call the individuals that they planned to visit.

them to do was not cost effective. Although FHFB's statute provides broad authority to set compensation of its employees, we note that the scope of FHFB's authority and whether it appropriately supercedes OPM's RIF regulations has not been established.

FHFB Has Announced Plans to Improve Its FHLBank Examination Program

Although we identified weaknesses in FHFB's examination program in a 1998 report, FHFB did not address these weaknesses, and they persisted for several years.[46] In August 2002, FHFB announced plans that could significantly improve its examination program and more than double the number of examiners. However, because FHFB has just started to revise its examination program, it is too early to evaluate the effectiveness of these plans.

FHFB Did Not Fully Address Examination Program Weaknesses

Our 1998 report identified limitations in FHFB's examination program, which raised questions about the agency's ability to help ensure that FHLBanks operate in a safe and sound manner.[47] For example, the report found that FHFB examiners did not thoroughly review FHLBank internal control systems. Internal controls are defined as arrangements, such as procedures, organization structure, and technical methods, designed to provide reasonable assurance that (1) assets are protected from unauthorized use or disposition; (2) transactions are in compliance with law, regulation, FHFB policy, and the policy directives of the FHLBank's director and management; and (3) financial reporting is accurate. According to our report, in September 1996,[48] FHFB examinations stated that internal control reviews were "limited." FHFB officials cited the limited number of examiners, 8 to 10 individuals, as one explanation for not conducting thorough internal control evaluations.

From 1998 through 2001, FHFB did not develop an examination program to ensure that each FHLBank has established an adequate internal control system. We reviewed all 36 FHFB bank examinations conducted in 1999 to

[46] GAO-98-203.

[47] GAO-98-203.

[48] GAO-98-203.

2001.[49] Each of the 36 examinations stated that the review of internal controls was "limited in scope and did not involve a comprehensive review of the entire system of controls." As of late July 2002, FHFB had 10 examiners, or the same number as in 1998. Moreover, from 1998 through 2002, direct mortgage acquisition programs added risks to the FHLBank System and the FHLBanks developed increasingly complex approaches to manage these risks.

Further, our 1998 report[50] noted that FHFB examination workpapers did not adequately document corporate governance reviews or indicate that such reviews were conducted. Board of director and management oversight are essential elements of the corporate governance of financial institutions and financial and other risk management. At the September 2002 FHFB board meeting, discussion among board members suggested a concern about the lack of emphasis on corporate governance in the examinations.[51] One board member stated that he believes the FHLBanks' corporate governance is "uneven" and that FHFB's examinations have not devoted sufficient attention to this critical area. The Chair and the other board member discussed directing FHFB's examination staff to conduct an audit of corporate governance in the FHLBank System. The next section discusses this audit.

Our 1998 report[52] noted that off-site monitoring in the FHFB examination program was weak and conducted in an uncoordinated manner. Off-site monitoring involves the analysis of financial data to monitor bank financial performance and to identify risks. Off-site monitoring can serve as an effective means to supplement the work of examiners working on-site. Regular monitoring between examinations, which generally take place on an annual basis, is important because the FHLBanks' financial conditions and risks can change significantly in a short period. The 1998 report noted that OS off-site monitoring consisted of four periodic reports as well as monthly reviews of various bank information. While these reports were potentially beneficial, FHFB suspended them in 1997 due to staff

[49]Twelve FHLBank examinations over 3 years accounts for 36 examinations.

[50]GAO-98-203.

[51]FHFB board meeting transcript, open meeting, Thursday, September 12, 2002.

[52]GAO-98-203.

constraints in OS. The 1998 report also noted that coordination between OPRA and OS on off-site monitoring activities was lacking.

We found that FHFB's off-site monitoring program is still limited. For example, FHFB's OS director said that in July 2002 that only one individual performs off-site monitoring functions. Rather than assess the financial performance of the FHLBanks, the director said that the individual tracks FHLBank compliance with existing examination recommendations. Although this function is important, it does not provide FHFB with information about safety and soundness issues, such as changes in the FHLBanks' financial condition. A more comprehensive off-site monitoring program could help alert FHFB officials to the need for an on-site examination.

FHFB Has Initiated Steps to Significantly Revise the FHLBank Examination Program

In August 2002, FHFB's Chair announced that FHFB would significantly increase the resources devoted to OS. FHFB set the fiscal year 2003 budget for OS at $9.7 million, a $2.8 million increase from fiscal year 2002 funding levels. FHFB also hired a new OS director and deputy director, both of whom have experience in examinations at other financial regulatory agencies. FHFB also plans to increase the number of examination staff from 10 to 24 by fiscal year 2004 and to open satellite locations in different parts of the country in which to base examiners. Under the previous examination approach, 8 to 10 examination staff spent 6 to 7 months on travel each year. FHFB officials said satellite locations would reduce travel demands on the examination staff and aid in hiring and retaining qualified staff. At the time of our review, OS was in transition; however, FHFB had increased the number of examiners. As of February 5, 2002, there were 14 examiners on staff at FHFB, an increase of 4.

According to the OS Director, FHFB also plans to significantly change its approach to conducting examinations to obtain a fuller understanding of FHLBank operations as FHLBank System business becomes more complex. Prior to September 2002, FHFB assigned its examiners to teams that included 4 to 5 members. In general, each examiner was responsible for conducting annual examinations at 6 of the 12 FHLBanks. According to FHFB officials, the examination teams reviewed different banks from year to year, and their membership was rotated as well. Therefore, an FHFB examiner might work on a particular bank's examination one year but not the next. Moreover, FHFB examiners did not necessarily specialize in the areas (e.g., credit risk, interest rate risk, or affordable housing programs)

that are examined on an annual basis.[53] Instead, an examiner might review a bank's interest rate risk operations at one examination and review another bank's affordable housing program at the next examination.

The OS Director said that under the revised examination approach, by the fourth quarter of fiscal year 2003, FHFB plans to have three examination teams in place. Each team will consist of 8 members, with each team responsible for 4 of the 12 FHLBanks for 3 to 4 years. In addition, each examiner will focus on a particular area, such as interest rate risk or affordable housing compliance, at each of the four FHLBank examinations for which the individual is responsible annually. For example, the OS Director said that two recent hires on the examination staff have expertise in the area of corporate governance. According to FHFB, as of February 2003, OS had completed ten targeted corporate governance reviews at the FHLBanks, and expects to complete a final report on all 12 banks' corporate governance by March 2003.

The OS Director also said that FHFB plans to develop a proactive and risk-based management approach to conducting FHLBank examinations. Prior to FHFB's recently announced changes to its examination program, examiners might examine a particular FHLBank as of June 30 of a particular year. The examiners would then assess whether the bank was operated in a safe and sound manner and complied with all laws and regulations as of that date. Under the new risk management approach, the OS director said that the examination staff would try to identify the future risks facing each FHLBank and develop plans to help ensure that FHLBank management establish systems and controls to adequately manage those risks.

Overall, FHFB's planned examination program is similar to the examination program of OFHEO, which regulates Fannie Mae and Freddie Mac. Fannie Mae and Freddie Mac are large government-sponsored, privately owned and operated corporations chartered by Congress to enhance the availability of mortgage credit across the nation during good and bad economic times. Similar to FHFB's proposed examination program, OFHEO has established a risk-based examination program that

[53]Each of the 12 FHLBanks is required to contribute at least 10 percent of its annual earnings to support the Affordable Housing Program. These funds may be in the form of a grant or a below-market interest rate on an advance to a member and subsidize the cost of owner-occupied or rental housing for very low-income, low-income, or moderate-income groups.

assesses the controls Fannie Mae and Freddie Mac use to manage significant risks. In addition, OFHEO assigns staff with specialized skills, such as interest rate risk management, to its examination teams. OCC, FDIC, OTS and the Fed Board have also implemented similar risked-based examination programs.[54]

FHFB has plans to expand off-site monitoring. Specifically, as of October 21, 2002, an FHLBank analyst was assigned to each FHLBank in an effort to enhance the OS off-site monitoring program. According to the OS Director, the recently announced merger between OS and OPRA (see figs. 3 and 4) provides opportunities for FHFB to enhance its off-site monitoring capability. In particular, examination and OPRA staff will now work in the same unit, which should allow better coordination of their activities.

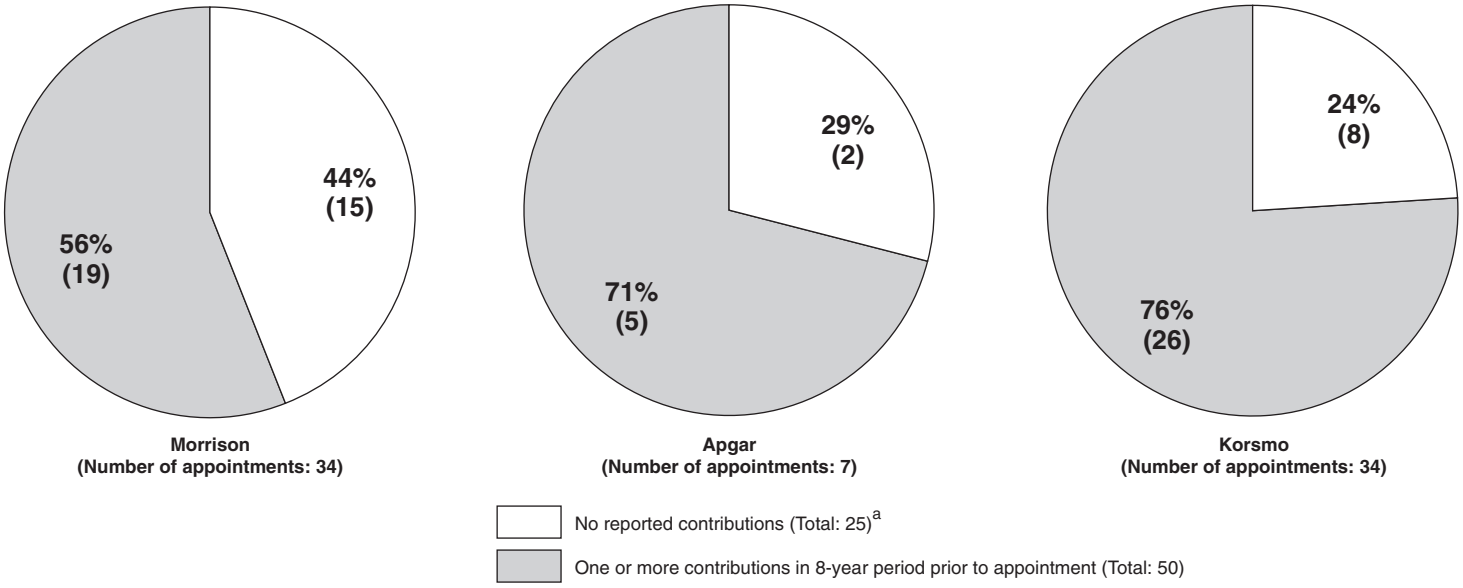
Majority of FHLBank Public Interest Directors Made Political Contributions Prior to Their Initial Appointments

Available data indicate that 50 (67 percent) of the 75 public interest directors that FHFB appointed for the first time from January 1, 1998, through May 8, 2002, made one or more political contributions in the 8-year period prior to their initial appointments (see fig. 5). We obtained public interest director appointment data from FHFB and contribution data from CRP. CRP provided data that covers all federal election cycles from 1990 through 2002. We organized and presented the CRP contribution data to cover the tenures of the three FHFB chairs who were in office when FHFB made public interest director appointments during 1998 to 2002: Bruce Morrison, June 1995 to July 2000; William Apgar, July 2000 to December 2000; and John T. Korsmo, December 2001 to present. We focused our analysis on the 8-year period prior to each public interest director's appointment to ensure a standard means of comparison between the three FHFB chairs.[55]

[54]*Risk-Focused Examinations: Regulators of Large Banking Organizations Face Challenges*, GAO/GGD-00-48 (Washington, D.C.: January 24, 2000).

[55]CRP data are not reliable prior to the 1990 election cycle. We chose the 8-year period to ensure that FHFB's appointments during the tenures of each of the three chairs would be standardized. For example, since FHFB made appointments under Korsmo for the first time in 2002, available data cover seven federal election cycles (1990, 1992, 1994, 1996, 1998, 2000, and 2002). In contrast, CRP could only provide reliable data for five election cycles for appointments made under Morrison in 1998 (1990, 1992, 1994, and 1996, and 1998).

Figure 5: Number and Percentage of FHLBank Public Interest Directors That Reportedly Made Political Contributions during the 8-year Period Prior to Their Initial Appointment, by FHFB Chair (January 1, 1998 through May 8, 2002)



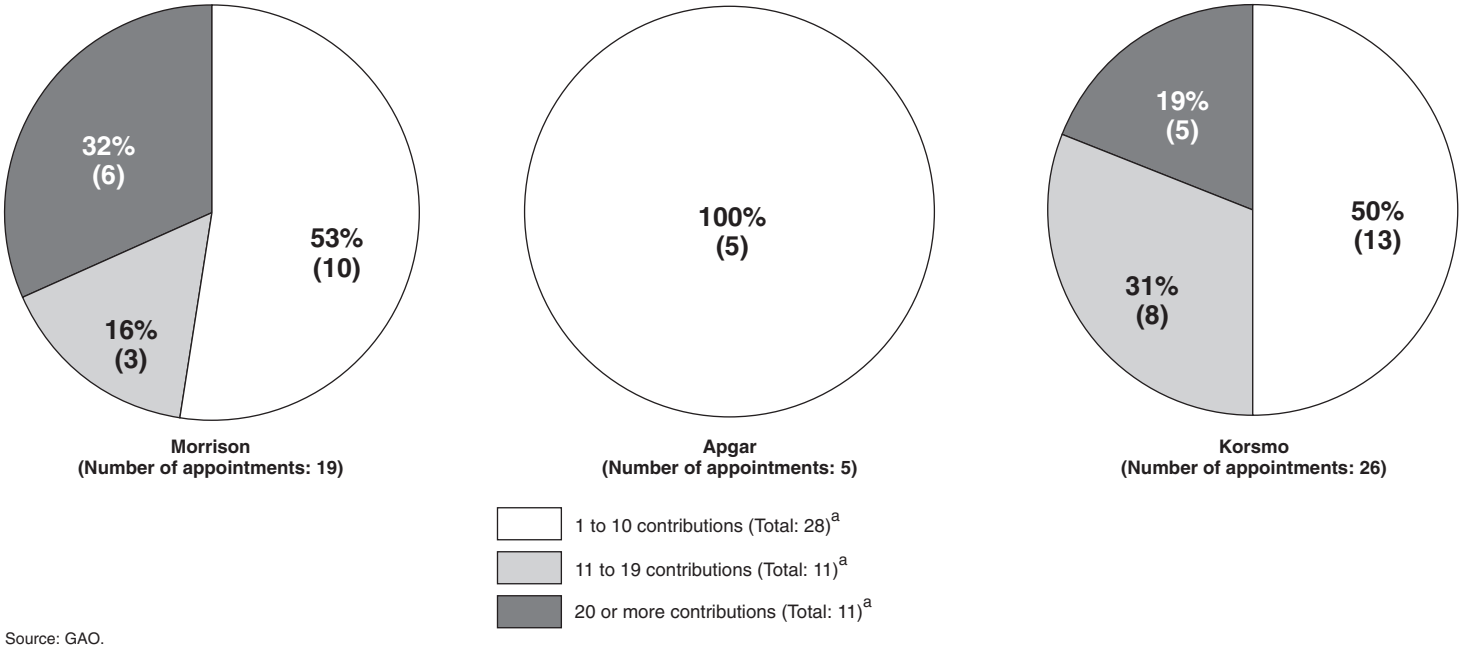
Source: GAO.

Note: Analyis of FHFB and CRP data.

[a]Of the 25 appointees, 11 had reported making contributions more than 8 years prior to their appointments. The remaining 14 directors do not appear in the CRP database, which according to CRP officials indicates that they had not previously made political contributions.

Figure 6 shows that 28 (or 56 percent) of the public interest directors who reported making contributions prior to their appointments had done so 1 to 10 times while 22 (44 percent) had done so 11 or more times. Of the 5 directors appointed during Apgar's tenure, all reported making 1 to 10 donations. The public interest directors appointed during the Morrison and Korsmo tenures were generally divided equally between those who reported 1 to 10 donations and those who reported giving 11 or more contributions.

Figure 6: Frequency of FHLBank Public Interest Director Political Contributions Prior to Initial Appointment, by FHFB Chair (January 1, 1998 through May 8, 2002)



Source: GAO.

Note: Analysis of FHFB and CRP data.

[a]Based on contributions made in the 8-year period prior to each director's initial appointment.

Table 1 summarizes the number of contributions and the total amount of those contributions that each FHFB public interest director appointee made prior to his or her appointment. When we totaled each director's contributions, we found the median value of those totals ranged from $3,250 for the 5 appointments made during Apgar's tenure to $8,364 for the 26 appointments made during Korsmo's tenure.

Table 1: Median Dollar Value of Total Preappointment Political Contributions made by each FHLBank Public Interest Director, by FHFB Chairman (appointed January 1, 1998 through May 8, 2002)

Tenure of chair	Number of first time appointees	Median amount[a]	Median number of contributions
Morrison	19	$4,500	7
Apgar	5	$3,250	4
Korsmo	26	$8,364	10

Source: GAO.

Note: Analysis of FHFB and CRP data.

[a]Based on contributions made in the 8-year period prior to each director's initial appointment. Dollar amounts are not shown in constant dollars.

As shown in table 2, during the Morrison and Korsmo tenures, FHFB did not appoint public interest directors who give exclusively to the party that is not the party of the chair. That is, FHFB did not appoint any public interest directors who had made contributions exclusively to the Republican Party during Morrison's tenure, nor did FHFB appoint any public interest directors who gave exclusively to the Democratic Party during Korsmo's tenure. However, during the Morrison and Korsmo tenures, FHFB appointed public interest directors who gave to both parties. During Apgar's tenure, FHFB appointed three individuals who gave exclusively to the Democratic Party, one who gave exclusively to the Republican Party, and one who gave to both parties.

Table 2: Allocation of Newly Appointed FHLBank Public Interest Director Campaign Contributions, by Recipient and by FHFB Chairman (January 1, 1998 through May 8, 2002)

Tenure of chair	Democratic recipients[a]	Republican recipients[a]	Democratic and Republican recipients[a]	PAC/other recipients[a]	Total
Morrison (Democrat)	15	0	4	0	19
Apgar (Democrat)	3	1	1	0	5
Korsmo (Republican)	0	16	9	1	26

Source: GAO.

Note: Analysis of FHFB and CRP data.

[a]Based on contributions made in the 8-year period prior to each director's initial appointment.

We also analyzed data obtained from Fannie Mae and Freddie Mac to determine the political contributions of members of their boards of directors who are appointed by the President.[56] Using CRP data, we determined the political contributions of Fannie Mae and Freddie Mac directors appointed from January 1, 1998, through 2002. Our analysis shows that 18 of the 19 (95 percent) of the Fannie Mae and Freddie Mac directors appointed during that period had made political contributions in the 8-year period prior to their initial appointments.[57] The median value of the total number of contributions for an individual was 11, and the median of the total preappointment donations was $7,000.

[56]As specified in their charters, Fannie Mae and Freddie Mac each have 18-member boards of directors. The President appoints 5 of the directors at each company while shareholders elect the other 13. The boards of directors shall at all times have members appointed by the President that fall into the following categories (1) at least one person from the home-building industry, (2) at least one from the mortgage lending industry, (3) at least one from the real estate industry, and (4) at least one from an organization that has represented consumer or community interests for not less than 2 years or one person who has demonstrated a career commitment to the provision of housing for low-income households.

[57]One board member did not appear in the CRP database, which according to CRP officials indicates that they had not previously made political contributions. However, it is possible that this individual made contributions, but CRP was not able to match the individual to its list of contributors. In addition, Federal Election Commission rules exempt contributions of less than $200 from reporting requirements. Thus, if the individual made contributions of less than $200, they would not appear on the CRP database.

FHFB's Use of Schedule C Positions Sometimes Differs from the Practices of Other Financial Regulators

In some cases, FHFB's use of Schedule C positions differs from the practices of other financial regulators. At FHFB and five of the six other financial regulatory agencies that we reviewed, the agencies allot Schedule C positions to the chair and other board members.[58] Unlike FHFB, four of these five agencies appoint Schedule C officials to head certain staff offices, such as Office of Policy or the Office of General Counsel. The FHFB chair's personal staff, including a Schedule C appointee, are responsible for the agency's public and congressional affairs functions, a practice unique among the regulatory agencies that we reviewed.

FHFB Schedule C Positions Are Allotted to the Chair and Other Board Members

Schedule C appointees at FHFB and five other agencies work directly for the agencies' policymakers: the chair and other board members (see table 3). Unlike FHFB and CFTC, the other four agencies allot Schedule C positions to head some staff offices. For example, FCA has Schedule C appointees in positions such as Director of the Office of Congressional and Public Affairs, Director of the Office of Policy and Analysis, and Chief Operating Officer.[59] SEC has Schedule C appointees for three director positions: Director of the Office of Communications, Director of the Office of Legislative Affairs, and the Director of Office of Public Affairs. SEC also allots Schedule C positions to several nondirector-level positions within the organization.

[58]The Fed Board does not use Schedule C positions.

[59]While FCA's Chief Operating Officer is a Schedule C appointee, FCA officials said that the board approved the appointment.

Table 3: Allotment of Schedule C Positions at Financial Regulators

Financial regulatory agency	Positions allocated to chair and board	Positions allocated to program offices[a]	Total
FHFB	Special advisors to the chair (3) 1 special assistant per board member (4)		7
SEC	Confidential assistants to the chair (2) Senior advisor to the chair (1) 1 confidential assistant per commissioner (4)	Director, Office of Communications (1) Director and 1 advisor, Office of Legislative Affairs (2) Director, Office of Public Affairs (1) Office of General Counsel (1) Office of Chief Accountant (1) Division of Corporate Finance (1) Division of Investment Management (1) Division of Enforcement (1) Division of Market Regulation (2)	18
FCA	Office of the chair (2) 2 special assistants per board member (4)	Chief Operating Officer (1) Secretary to the board (1) Director, Office of Congressional and Public Affairs and two specialists (3) Director, Office of Policy and Analysis (1)	12
CFTC	Office of the chair (2) 2 special assistants per commissioner (8)		10
NCUA	Chief of Staff and Counsel to the chair (1) Special assistant to the chair (1) 1 executive assistant per board member (3)	Director and 1 special assistant, Office of Public and Congressional Affairs (2)	7
FDIC	Chief of Staff (1) Deputy to the chair (1) Special advisor to the chair (1) Secretary to the board (1)	General Counsel, Office of General Counsel (1)	5

Source: GAO.

Note: Analysis of FHFB, SEC, FCA, CFTC, NCUA, and FDIC data.

[a]Unless otherwise noted (i.e., Director, Chief Operating Officer, General Counsel), positions included in the table are staff-level positions within the program office listed.

FHFB Chair's Staff is Responsible for Public and Congressional Affair Functions

We compared FHFB's approach to managing its public and congressional affairs functions to the approaches of the six other financial regulatory agencies. Unlike FHFB, each of these six agencies has a separate public and congressional affairs office, typically staffed by full-time career employees. At SEC, FCA, and NCUA, the chairs appoint Schedule C officials to run these offices; while career officials run the offices at the Fed

Board and FDIC. At CFTC, a noncareer and non-Schedule C executive heads the public and congressional affairs office.[60]

Since FHFB's August 7, 2002, reorganization, the Chair's personal staff has been responsible for the agency's public and congressional affairs functions. Specifically, FHFB officials said that a Schedule C appointee from the Chair's staff has assumed responsibility for managing media relations and a career staff member who is also on the Chair's staff is responsible for congressional relations. According to the FHFB officials, the Chair's personal staff have been able to incorporate the public and congressional affairs functions into their normal duties. FHFB officials said that the Chair's staff have been able to assume these responsibilities because, with about 100 employees, FHFB is a comparatively small agency with limited congressional and public affairs responsibilities.

Conclusions

Due to the delegation of authority, the FHFB chair has relatively broad administrative power, compared with most financial regulatory chairs, to appoint senior officials and reorganize the agency without obtaining a board vote or approval. The delegation prevents the full board from participating in key administrative decisions that have potential policy implications. At a January 29, 2003, FHFB board meeting, the board in a close 3 to 2 vote along party lines rejected a proposal to revise the delegation of authority that would have required board approval for senior appointments and major agency reorganizations. Although FHFB board member staff exchanged proposed language to revise the delegation of authority prior to the meeting, there was little collaboration among the staff. While the FHFB board has determined that the delegation remains the most efficient means to administer the agency, we continue to believe that the decision potentially frustrates one of Congress' objectives in establishing a board to regulate the FHLBank System. That is, the board structure is designed to help ensure that key decisions benefit from the experiences and perspectives of all board members. In addition, the FHFB board's decision will likely result in the continuation of the sometimes bitter conflicts that have periodically characterized the relationships among board members over the past 8 years.

[60]The appointee holds a position higher than GS-15 grade, which is the highest grade for Schedule C appointees.

Going forward, the FHFB board would benefit from considering a range of options that would involve all board members in key administrative decisions. Some of these options may not involve any changes to the current delegation of authority. For example, the chair could notify and brief other board members of key administrative decisions prior to their implementation and seek other board members' advice and counsel on these decisions. Or, the FHFB board could consider practices at other financial regulatory agencies that provide for board or commission involvement in key administrative decisions. At CFTC, for instance, the chair's authority to reorganize the agency is similar to that of the FHFB chair, but CFTC's practice has been for the chair to submit major reorganization proposals to the commission for a vote. In addition, board members and their staffs could work together to determine if there are any areas of agreement on approaches—including revising the delegation of authority—that would increase board participation in key administrative decisions while preserving the chair's authority to administer the agency on a day-to-day basis. While there is no requirement or guarantee that FHFB board members agree on all key administrative decisions, establishing processes and practices to ensure full board participation could enhance the quality of such decisions and improve relations among board members.

FHFB offered significant financial compensation to staff that received RIF notices during the August 2002 reorganization. However, provisions in the settlement agreements do not appear fully consistent with federal age discrimination statutes and regulations. For example, a provision in the settlement agreements that required employees to waive their rights to file charges, complaints, or appeals with EEOC is not consistent with ADEA's prohibition against waivers of these rights. FHFB also (1) did not include required language in the settlement agreements advising employees in writing to consult with an attorney prior to signing the settlement agreements and waiving their ADEA rights and (2) failed to provide the affected staff with information on the job titles and ages of staff, as required under ADEA and EEOC regulations. We have informed the EEOC about our findings regarding the FHFB settlement agreement provisions pertaining to the waiver of ADEA rights.

FHFB did not take actions in a timely way to address FHLBank examination program weaknesses that we identified in a 1998 report.[61] However, in 2002, current FHFB Chair Korsmo announced plans and

[61] GAO-98-203.

initiated actions, such as hiring more examiners that have the potential to improve the quality of the agency's safety and soundness oversight. Continued FHFB management focus on the examination program is essential over the next several years to ensure that the reforms are fully implemented and their effectiveness evaluated.

We also note that FHFB's Chair, initiated these changes to the examination program under the delegation of authority. While these changes hold out the potential for improving FHFB's examination program, the unilateral manner in which they were carried out resulted in further disputes among board members. Permitting greater board involvement in such key decisions would provide greater opportunity for consensus without necessarily delaying any changes. Decisions that have the potential to affect the critical means by which FHFB ensures FHLBank safety and soundness merit the attention and consideration of the full board.

Recommendations

To ensure full board participation in key administrative decisions that have policy implications, such as senior appointments and major reorganizations, we recommend that the FHFB board consider a range of options that could be implemented within the current delegation of authority. These options include the chair (1) notifying, briefing, and/or soliciting input from other board members on major administrative decisions prior to their implementation and (2) submitting key administrative decisions to the board for a vote or approval. We also recommend that board members and their staffs hold discussions on approaches—including potential revisions to the delegation of authority—that would ensure board participation in key administrative decisions while preserving the chair's authority to administer the agency on a day-to-day basis.

We also recommend that FHFB fully comply with applicable federal age discrimination statutes and regulations in offering settlement agreements to employees subject to RIFs.

Agency Comments and Our Evaluation

We received FHFB's comments on a draft of this report from the Director of the Office of Management and written comments from FHFB board members Franz S. Leichter and Allan I. Mendelowitz, which are reprinted in appendix IV and V, respectively. We also provided relevant excerpts from a draft of this report to the six other financial regulatory agencies that we

reviewed (SEC, FDIC, NCUA, Fed Board, CFTC, and FCA). FCA's Chair provided written comments, which are reprinted in appendix VI. Representatives from all six regulatory agencies that we contacted provided oral comments and we received technical comments, which we have incorporated as appropriate.

FHFB disagreed that the board should revise the delegation of authority to allow for board participation in key administrative decisions. FHFB agreed with one of our findings regarding the settlement agreements offered to employees subject to the 2002 RIF but disagreed with two others. FHFB also commented on the draft report's findings regarding the examination program, public interest director appointments, and Schedule C positions. Among other statements, Leichter and Mendelowitz agreed with our recommendation regarding the delegation of authority and expressed concern about how the agency conducted the RIF. The FCA Chairman's comments related to the number of Schedule C positions that are filled at the agency. Representatives from each of the six agencies that we contacted agreed with the draft report's findings regarding their agency's operations. The following summarizes FHFB's comments and, where appropriate, our evaluation for the five report sections: (1) the delegation of authority, (2) FHFB's compliance with age discrimination requirements in connection with the RIF, (3) FHFB's examination program, (4) public interest director appointments, and (5) Schedule C positions at financial regulatory agencies. We also summarize the comments of Leichter, Mendelowitz, and the FCA Chairman.

FHFB Comments and Our Evaluation

Delegation of Authority

FHFB noted that at the January 29, 2003, meeting the board had considered, as we recommended in the draft report, and rejected a proposal to revise the delegation of authority that would have required board approval for senior appointments and major reorganizations. FHFB stated that a majority of the board believes that vesting broad administrative responsibility in the chair is the best method to manage the agency's day-to-day operations. However, we continue to believe that full board participation in key administrative decisions is essential.

FHFB also made several points to support its view that the board should not revise the delegation of authority. First, FHFB stated that the current

delegation of authority allows individual board members to propose items to the board for action. Second, FHFB stated that we did not provide sufficient evidence to support the assertion that there was tension and conflict among board members regarding the delegation of authority. FHFB also stated that Congress intended for tension to exist in creating FHFB—due to the divided partisan composition of the board—and that such tension can serve a "constructive purpose." Third, FHFB stated that we made an error in figure 1 of the draft report " . . . in asserting that the appointment of senior officials and personnel decisions at the Securities and Exchange Commission must be made with board approval." FHFB stated that reorganization and top-level appointments at SEC do not require a board vote. In addition, FHFB included a lengthy attachment to its official agency comments, which has not been included in this report. The attachment discussed a range of issues, including a history of the delegation of authority, theories on management and delegations of authority at other agencies, and information on FHFB's examination and supervision program for the FHLBanks.

Regarding FHFB's first point, we believe that the provision in the delegation allowing board members to call board meetings to challenge the chair's key administrative decisions does not provide for enhanced board collegiality and consultation. Rather, the delegation of authority allows the chair to make and implement such decisions without consulting other board members and requires any board members who oppose these decisions to marshal a majority vote to overturn the decision. In our view, board member collaboration would be enhanced if consultations and votes or approvals took place before key administrative decisions were made and implemented. While there is no requirement or guarantee that all board members would agree to vote for or approve key administrative decisions, full board participation in the process could serve to improve the decisions and enhance collegiality.

We disagree with FHFB's second point and believe that this report offers significant evidence of tensions and conflicts between board members resulting from the delegation. Such tension and conflicts have periodically characterized the board member relations over the past 8 years. We acknowledge that tension and conflict are inevitable at any board with divided representation and that such tension can in some cases be beneficial. However, we note that at FHFB, unlike most other financial regulatory agencies, there is no appropriate process or forum for board members to consider key administrative decisions before they are made and implemented.

We also disagree with FHFB's final assertion that our report incorrectly described the process for appointing senior officials at SEC. The report draft stated that at most other financial regulators boards either vote on or must give approval for senior appointments. The relevant authority regarding SEC—Reorganization Plan No. 10 of 1950—states that the commission is responsible for approving senior appointments. The commission has established a practice to fulfill this responsibility whereby the chair obtains the approval of other commissioners prior to making senior appointments. SEC officials agreed with our report's statements regarding the agency's appointment process.

FHFB's Compliance with Age Discrimination and Other Requirements in Connection with the RIF

FHFB said it agreed with one of our findings regarding the settlement agreements but disagreed with two others. FHFB said it concurs that the settlement agreements should have advised employees to consult with an "attorney" rather than a "representative" prior to signing. However, FHFB also stated that the language in the settlement agreements was not intended to interfere with EEOC's enforcement authority. FHFB stated that any employee was clearly free to challenge the settlement agreement at a later date. FHFB also stated that it disagreed with a statement in the draft report that it was required to provide the names, ages, and positions of employees who were not selected for separation from the agency. FHFB also stated that since it abolished all of the positions in the former Office of Communications and the Office of Managing Director, OWBPA and EEOC requirements on providing information to employees who were offered the settlement agreement did not apply. Additionally, FHFB disagreed with a statement in the draft report that FHFB's decision to place staff subject to the RIF on administrative leave during the advance notice period was inconsistent with OPM regulations. FHFB said that its statute authorizes the agency to pay the compensation of its employees without regard to the laws affecting federal employees, and that administrative leave is a form of compensation.

While FHFB agreed with our findings regarding advising employees to consult with an attorney prior to signing the agreements, we need to clarify that the problem with the separation agreements was not confined to the use of the term "representative" rather than the term "attorney." OWBPA and EEOC regulations require that the employer advise the employee in writing to consult an attorney prior to waiving their ADEA rights. FHFB's settlement agreements were deficient in that they did not directly advise or recommend that employees consult with an attorney prior to signing them. Rather, the settlement agreements used more passive language stating that each employee had the opportunity to contact a representative to discuss

the terms and conditions of the agreements, which the courts have held does not meet the statutory requirements. If FHFB had replaced the word "representative" in the settlement agreement with the word "attorney," the agreements still would not have been consistent with OWBPA and EEOC requirements.

We disagree with FHFB that the settlement agreement provisions pertaining to EEOC and information requirements were consistent with applicable requirements. EEOC regulations clearly prohibit any agreement that interferes with an individual's right to file a complaint with EEOC or affects the EEOC's rights and responsibilities to enforce the ADEA. While FHFB asserts that employees were clearly free to challenge the agreements at a later date, the broad language of the settlement agreement states that employee agrees not to file a complaint or appeal with the EEOC. Such a broad prohibition could deter an individual from contesting the agreement and the validity of the waiver of ADEA rights. Additionally, the draft report stated that FHFB did not provide information on the job titles and ages of staff offered settlement agreements to all such staff. The draft report did not state that FHFB should have provided such information for staff who were not subject to separation. There is also no requirement that employers provide names of employees, and the draft report did not state that FHFB should have done so. Nonethless, FHFB's failure to provide information on the job titles and ages of employees subject to the RIF to all such employees was inconsistent with EEOC regulations. While the EEOC regulations define the scope of the information requirement, the regulations do not suggest that when all of the positions in a particular office are eliminated, no information needs to be supplied. The purpose for providing the information is for employees to have the opportunity to assess the viability of an age discrimination claim and whether or not to waive their rights to pursue such a claim. FHFB employees were not provided with the information necessary to make such a decision.

Regarding FHFB's comments on placing staff on administrative leave, we have added language to the report stating that FHFB believes it has statutory authority to disregard OPM regulations requiring staff to be kept on active status during the advance notice period. However, we note that the scope of FHFB's authority and whether it appropriately supercedes OPM's RIF regulations has not been established.

FHFB's FHLBank Examination Program

FHFB stated that Chair Korsmo initiated significant changes to enhance the capabilities of the agency's FHLBank examination program and that the draft report did not sufficiently recognize that he was responsible for these

initiatives. FHFB stated that at the start of Korsmo's tenure in December 2001, the agency's Office of Supervision was understaffed and insufficiently focused on the FHLBanks' risk assessment processes, internal control systems, and systems of corporate governance. FHFB also listed the steps that the Chair initiated to improve supervision, including hiring experienced management for OS and increasing the number of examiners. FHFB also stated that while it agrees with our assertion that these changes have the potential to improve the agency's examination program, it believes that the changes have already resulted in significant progress.

We agree that Chair Korsmo has initiated important steps to improve its examination program and have added language to the report describing these initiatives. However, we continue to believe that additional time and management oversight is needed to ensure that this critical FHLBank examination function is improved.

Public Interest Director Appointments

FHFB stated that the draft report had a narrow focus on the political contributions of FHLBank public interest directors and that this narrow focus resulted in an incomplete portrayal of the selection process, recent improvements in that process, and the critical roles played by public interest directors. FHFB also stated that the draft report's focus called into question the integrity of the appointment process and that political contributions are a determining factor in the appointment process. FHFB stated that public interest directors are now appointed in public votes and that the Chair instituted new criteria for the selection of public interest directors. FHFB also noted that the board voted unanimously to approve 28 public interest directors at the January 29, 2003, board meeting.

We were asked to provide an analysis of the political contributions of public interest directors prior to their initial appointments. We did not conduct a broader review of the appointment process or the qualifications and capabilities of public interest directors. Our review was not intended to call into question the appointment process or the integrity or qualifications of individual public interest directors. We have added language to this report discussing the Chair's criteria for appointing public interest directors and the January 29, 2003, board meeting.

Schedule C Positions

FHFB noted that the report did not identify any Schedule C practices at FHFB that violated OPM rules and that Chair Korsmo has instituted changes to correct past practices that improperly categorized employees who should have had Schedule C appointments. FHFB stated that all of the agency's Schedule C officials serve as confidential advisers to board

members. FHFB also reiterated that the small size of the agency serves as an appropriate basis for assigning its public and congressional affairs functions to the Chair's personal staff.

Comments of Board Members Leichter and Mendelowitz

In their comments, Leichter and Mendelowitz said that because the FHFB board did not consider or vote on an agency response to our draft report, there is no official agency response to the report. We have not attempted to resolve this dispute among FHFB officials, and we treat the response from FHFB's Director of Management as the agency's official response.

Regarding the major issues discussed in the draft report, Leichter and Mendelowitz made the following comments:

- Delegation of Authority: Leichter and Mendelowitz stated that the delegation of authority (1) resulted in conflicts between board members; (2) was contrary to FHFB's authorizing legislation, which vests agency management in the board rather than the chair; and (3) was "anachronistic" because it was enacted when the board had a part-time membership. In response to a comment from Leichter and Mendelowiz regarding changes that the FHFB board made to the delegation of authority in 1993, we have added language to the report.

- FHFB Actions in Connection with the RIF: Leichter and Mendelowitz said that they were "deeply concerned" about the way in which FHFB conducted the RIF and expressed concern about the elimination of the Office of Managing Director because the action impeded communication between board members and agency staff. They also raised concern that the draft report did not discuss other procedures that FHFB followed in conducting the RIF. Such an analysis was outside the scope of this review.

- Public Interest Director Appointments: Leichter and Mendelowitz said that the appointment of public interest directors has become increasingly "political,"and they expressed concerns that public interest directors lack expertise in the FHLBanks increasingly sophisticated financial practices. As discussed previously, our review was limited to an analysis of public interest director political contributions prior to their initial appointments.

- Schedule C Practices: Leichter and Mendelowitz questioned whether it was "appropriate" for one board member's staff to perform functions

that the former Office of Communications previously performed for the entire board. While the FHFB Chair's staff currently performs these functions, we note that at other agencies (SEC, CFTC, NCUA) the chairs can appoint and remove the Schedule C officials who run public or congressional affairs offices. Therefore, it is not clear that the FHFB Chair exercises greater control over these functions than is the case at the other agencies.

Comments of the FCA Chairman

The FCA Chairman stated that of the agencies' 12 Schedule C positions, 6 are currently held by career staff.

We will send copies of this report to Chairman of the Senate Committee on Banking, Housing and Urban Affairs; the Chairman of the House Financial Services Committee; and the Ranking Minority Member of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the House Committee on Financial Services. We will also send copies to FHFB, NCUA, FCA, CFTC, SEC, FDIC, and the Fed Board. We will also make copies available to others upon request. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov.

Please contact Mathew J. Scire at (202) 512-6794 if you or your staff have any questions concerning this report. Key contributors to this report were Rachel M. DeMarcus, M'Baye Diagne, Nadine Garrick, Ayeke Messam, Marc W. Molino, Andy Pauline, Wesley M. Phillips, Mitchell B. Rachlis, and Barbara M. Roesmann.

Thomas J. McCool
Managing Director Financial Markets
and Community Investment

Objectives, Scope, and Methodology

As discussed with your staff, our report objectives are to (1) compare the Federal Housing Finance Board (FHFB) chair's administrative authorities to those of the chairs of other financial regulators and discuss the basis for that authority; (2) assess FHFB's compliance with selected applicable statutes and procedural requirements in connection with a reduction-in-force (RIF) that was carried out as part of an agency reorganization announced on August 7, 2002; (3) assess FHFB's progress in enhancing its Federal Home Loan Bank (FHLBank) safety and soundness examination program; (4) provide data showing the political contributions of FHLBank public interest directors prior to their appointments; and (5) compare FHFB's use of Schedule C appointments and the organization of its public and congressional affairs functions with the practices of other financial regulatory agencies.

To study the source of the FHFB chairs' administrative authorities and how they compare to those of other financial regulators, we reviewed the Federal Home Loan Bank Act, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and FHFB's delegation of authority to its chair. We also reviewed the legislation, regulations, delegations of authority, and other legal documents that govern or describe the scope and limitations of each chair's authority at six other selected financial regulators.[1] We interviewed officials from each of the selected financial regulators, including former FHFB officials, to obtain their views on the authorities of chairs and board members at each of these entities. Using this information, we compared the FHFB chairs' administrative authorities to those of the selected financial regulators.

To study FHFB's compliance with required Reduction-in-Force (RIF) and other procedures, we reviewed the Age Discrimination in Employment Act, as amended, the Older Workers Benefits Protection Act, applicable Equal Employment Opportunity Commission (EEOC) and Office of Personnel Management (OPM) regulations, and case law. We also contacted senior FHFB officials regarding the RIF. Our review did not include an analysis of the "bumping rights" procedures that FHFB followed in carrying out the RIF.[2]

[1]The Farm Credit Administration, Securities and Exchange Commission, Commodities Futures Trading Commission, Federal Deposit Insurance Corporation, National Credit Union Administration, and Board of Governors of the Federal Reserve System.

[2]Under federal statutes and OPM regulations, employees subject to RIFs may have the right to take (or "bump") the positions of other employees who have less seniority.

To study FHFB's progress in enhancing its FHLBank safety and soundness examination program, we assessed whether FHFB addressed recommendations about its examination program that we made in a 1998 report.[3] We reviewed 1999 to 2001 examination reports for the 12 FHLBanks. We also interviewed FHFB officials, as well as officials at OFHEO, to which we compared FHFB's examination program.

To study the data showing the political contributions of FHLBank public interest directors prior to their appointments, we obtained public interest director appointment data from FHFB for 1998 to 2002 and contribution data from the Center for Responsive Politics (CRP) for 1990 to 2002. CRP organizes and provides political contribution data that is initially reported to the Federal Election Commission (FEC). To ensure a standard comparison, we determined whether directors made a political contribution in the 8-year period prior to their appointment. [4] We matched and merged the two data sets and analyzed the data to determine the number of public interest directors who made contributions prior to their initial appointments. We also collected data from Fannie Mae and Freddie Mac on the names and appointment dates of board members who received their initial presidential appointments from 1998 through 2002. We obtained data from CRP to determine the Fannie Mae and Freddie Mac directors' political contributions in the 8-year period prior to their appointments.

We took several steps to assess the reliability of the CRP data and concluded that the data were sufficiently reliable for our purposes. First, we interviewed CRP officials to determine their data management procedures and the approach that they followed to match the list of public interest directors that we provided to the CRP contribution database. Second, we reviewed the matched data set that CRP provided and corrected erroneous matches between directors and contributors. Third, in performing our analysis, we conducted basic tests on the data we used. In performing our analysis, however, we did not verify the accuracy of the FEC political contribution data on which CRP records are based. Our review did not include an analysis of FHFB's appointment process or the integrity and qualifications of individual board members.

[3]GAO-98-203.

[4]CRP officials said that data prior to the 1990 election cycle is not necessarily reliable, so we chose appointments starting in 1998 as the beginning point of our analysis.

To study FHFB's use of Schedule C appointments and organization of the public and congressional affairs functions and compare it with the other financial regulatory agencies, we interviewed agency officials at each of the selected financial regulators, and reviewed documents that described the allocation of Schedule C appointments, as well as the management and staffing structure of the agencies' public and congressional functions.

We conducted our review in Washington, D.C., San Francisco, and Seattle from April 2002 through February 2003 in accordance with generally accepted government auditing standards.

Administrative Powers of Financial Regulatory Chairs

We compared FHFB to six other regulatory boards and commissions. We reviewed each board or commission's statute and policies relating to the administrative authority of the chair. We focused on two administrative areas: appointment of senior officials and reorganization decisions. In cases where the chair is authorized to make key administrative decisions without board approval, we also determined whether board members had authority to review decisions made by a chair in these circumstances.

We reviewed the following seven agencies:

- Commodity Futures Trading Commission (CFTC),
- Farm Credit Administration (FCA),
- Federal Deposit Insurance Corporation (FDIC),
- Federal Housing Finance Board (FHFB),
- Board of Governors of the Federal Reserve System (Fed Board),
- National Credit Union Administration (NCUA), and
- Securities and Exchange Commission (SEC).

Commodity Futures Trading Commission

The commission consists of five members, appointed by the President with the advice and consent of the Senate, and each serve staggered 5-year terms.

General Administrative Powers of the Chair:

According to the statute that established CFTC, the chair is the chief administrative officer. Executive and administrative functions are generally exercised solely by the chair, according to budget categories, plans, programs, and priorities established and approved by the commission.

Key Administrative Powers of the Chair:

Appointment of Senior Officials: According to the statute establishing CFTC, the chair's appointment of heads of major administrative units is subject to approval of the commission.

Reorganizations: While the chair is generally authorized to reorganize the staff of the agency pursuant to his or her power over executive and administrative functions, as a practice the commission votes on agency reorganizations.

Farm Credit Administration

The board consists of three members, appointed by the President with the advice and consent of the Senate, and each serve staggered 6-year terms.

General Administrative Powers of the Chair:

The President designates one of the members as chairman, and the chairman serves as the agency's chief executive officer (CEO). The powers of the chair as CEO that are necessary for day-to-day management may be exercised and performed by the chairman through such other officers and employees of the FCA as the chair shall designate. Policy Statement 64, originally adopted by the board of FCA in 1994 and revised as recently as September 24, 1999, provides rules for the transaction of business (Rules) and operational responsibilities of the board.[1]

Key Administrative Powers of the Chair:

Appointment of Senior Officials: According to the statute that established the FCA, the appointment of the heads of major administrative divisions is subject to the board's approval. Under Policy Statement 64, the board interprets "heads of major administrative divisions" to mean the chief operating officer and career office directors. However, in some cases, such as the Director of the Office of Congressional and Public Affairs, the chair can appoint Schedule C officials to run these offices.

Reorganizations: Under Policy Statement 64, the board approves the FCA organizational chart down to the office level along with relevant functional statements for each office. Under Policy Statement 64, the authority to make organizational changes within any division rests with the CEO.

[1] *Rules for the Transaction of Business and Operational Responsibilities of the Farm Credit Administration Board*, FCA-PS-64, revised September 24, 1999.

Review of Decisions Made by Chair:

As noted in Article V and Article IX of Policy Statement 64, Special Meetings of the board may be called:

1. by the Chairman;

2. by any two members; or

3. if there is at the time a vacancy on the board, by any member.

Any call for a Special Meeting shall set forth the business to be transacted and shall state the place and time of such a meeting. Except with the unanimous consent of all members, no business shall be brought before a Special Meeting that has not been specified in the notice of call of such a meeting.

Section 1. The business of the Board shall be transacted in accordance with these Rules (Policy Statement 64) as the same may be amended from time to time: Provided, however, that upon agreement of at least two members convened in a duly called meeting, the Rules may be waived in any particular instance, except that action may be taken on items at a Special Meeting only in accordance with Article V, Section (3) b, hereof.

Section 2. These Rules may be changed or amended by the concurring vote of at least two members upon notice of the proposed change or amendments having been given at least 30 days before such vote.

Federal Deposit Insurance Corporation

The President with the advice and consent of the Senate appoints three members of the five-member board for a term of 6 years. In addition to the three appointive directors, there are two ex officio members of the FDIC board: the Comptroller of the Currency and the Director of the Office of Thrift Supervision.

General Administrative Powers of the Chair:

One of the appointive directors shall be designated by the President, with the advice and consent of the Senate, to serve as chair of the board for a term of 5 years. The chair serves as the CEO. The board has delegated to the chair the authority to manage the FDIC's day-to-day operations and the

general powers and duties usually vested in the office of the CEO of a corporation.

Key Administrative Powers of the Chair:

Appointment of Senior Officials: A delegation of authority to chair, approved on January 29, 2002, gave authority to the chair to appoint and remove senior officers.

Reorganizations: Under the delegation of authority, the chair has authority to reorganize the agency.

Challenging Administrative Decisions Made under Delegation:

Two or more board members may initiate a review of any decision made under the delegation of authority.

Federal Housing Finance Board

The board consists of four members appointed by the President with the advice and consent of the Senate and each serve staggered 7-year terms, and the fifth member is an ex-officio member, the Secretary of Housing and Urban Development.

General Administrative Powers of the Chair:

The President designates an appointed director as chair. The board has adopted a delegation of authority that authorizes the chair to effect the overall management, functioning, and, organization of the board.

Key Administrative Powers of the Chair:

Appointment of Senior Officials: Under the delegation of authority, a chair can appoint agency personnel without a board vote or obtaining board approval.

Reorganizations: Under the delegation of authority, a chair can reorganize the agency without a board vote or consent.

Challenging Administrative Decisions Made under Delegation:

Under the delegation of authority, the chair must call a special session of the board to consider any matter of business on the request of any two or more board members.

Board of Governors of the Federal Reserve System

The board consists of seven members appointed by the President with the advice and consent of the Senate. The full term of a board member is 14 years, and the seven terms are staggered so that one expires in each 2-year period.

General Administrative Powers of the Chair:

The chair, subject to board supervision, serves as its "active executive officer."

Key Administrative Powers of the Chair:

Appointment of Senior Officials: The board votes on the appointment of senior officials.

Reorganizations: The board votes on major administrative reorganizations, which are defined as those that involve changing officers (appointing or removing an officer).

National Credit Union Administration

The NCUA has a full-time, three-member board, which is appointed by the President with the advise and consent of the Senate.

General Administrative Powers of the Chair:

The Federal Credit Union Act provides that the chair is the spokesperson for the board and implements policies and regulations adopted by the board.

Key Administrative Powers of the Chair:

Appointment of Senior Officials: The board votes on the appointment of senior officials. However, in some cases, such as the directors of the Office

of Congressional and Public Affairs, the chairs can appoint Schedule C officials to run it.

Reorganizations: The board votes on reorganizations of the agency.

Securities and Exchange Commission

Five members serve staggered 5-year terms, and are appointed by the President with the advice and consent of the Senate.

General Administrative Powers of the Chair:

There is no statutory reference to the selection of a chair. However, under section 3 of the Reorganization Plan No. 10 of 1950, the function of the commission, with respect to choosing a chair from among the members was transferred to the President. The Reorganization Plan also transferred to the chair from the commission the administrative and executive functions of the commission, including appointment and supervision of personnel, the distribution of business, and the use and expenditure of funds. Appointment by the chair of the heads of the major administrative units is subject to the approval of the commission. However, in some cases, such as the Director of the Office of Public Affairs, the chair can appoint Schedule C officials to run these offices.

Key Administrative Powers of the Chair:

Appointment of Senior Officials: Under Reorganization Plan No. 10 of 1950, the board approves the appointment of senior officials.

Reorganizations: Under Reorganization Plan No. 10, the chair can reorganize the agency.

Waivers of Rights Under the Age Discrimination in Employment Act

While employees generally may agree to waive rights to pursue employment related claims if the waiver is knowing and voluntary, special considerations apply to waivers of rights under the Age Discrimination in Employment Act (ADEA).[1] Title VII of the Civil Rights Act of 1964 (Title VII)[2] does not include age as a basis for illegal discrimination in the workplace. However, in 1967, Congress enacted the ADEA to promote the employment of older persons based on their ability rather than age, to prohibit arbitrary age discrimination, and to help employers and employees find ways of meeting problems arising from the impact of age on employment. The ADEA forbids arbitrary discrimination against workers on the basis of age in hiring, promotion, terms of employment and discharge. The ADEA was enacted with characteristics of both Title VII and the Fair Labor Standards Act of 1928 (FLSA);[3] while Title VII's substantive prohibitions on discrimination were included, the enforcement mechanisms of FLSA were also incorporated.

This structure caused controversy over waivers of rights under ADEA because Title VII waivers are treated differently from FLSA waivers. Title VII rights may be waived without government supervision so long as the waiver is knowing and voluntary.[4] In contrast, rights provided by the FLSA cannot be waived without government supervision. Waivers must be supervised by the Secretary of Labor or under a federal court-supervised settlement of a lawsuit filed pursuant to FLSA.

On August 27, 1987, EEOC issued a final rule that allowed unsupervised waivers if the waiver was knowing and voluntary and provided that a valid ADEA waiver may not release prospective claims and may not be in exchange for consideration that includes employee benefits to which the employee was already entitled.[5] The EEOC rule also listed several factors

[1]29 U.S.C. §§621-634. The ADEA was amended in 1974 to extend to federal employees the protection of older workers against discrimination in the workplace based on age. 29 U.S.C. §633a.

[2]42 U.S.C. §2000e et seq.

[3]29 U.S.C. §§201-219.

[4]*Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974). The Supreme Court found that an employee might waive his rights under Title VII as part of a voluntary settlement, so long as the employee's consent to the waiver is knowing and voluntary.

[5]Legislative Regulation and Administrative Exemption Allowing for Non-EEOC Supervised Waivers Under the ADEA, 29 C.F.R Pt. 1927, 52 Fed.Reg. 32293 (August 27, 1987).

as being relevant to determining whether a waiver is knowing and voluntary. These factors included whether the employee was encouraged to consult with an attorney. However, Congress suspended the rule, citing concerns that the rule was contrary to public policy and, in the spring of 1988, held hearings concerning waivers of ADEA rights and EEOC's regulation.

In October 1990, the Older Workers Benefit Protection Act (OWBPA) amended ADEA to add specific requirements for releases of ADEA claims. The legislative history of OWBPA provides that the legislation is intended to protect individuals covered by ADEA, and it further provides that the legislation establishes minimum requirements that must be satisfied before a court can proceed to determine factually whether a waiver was knowing and voluntary. All of the requirements are necessary independent of the knowing and voluntary considerations. The informational requirements are designed to permit older workers to make more informed decisions and to determine whether an employment termination program gives rise to a valid claim under ADEA.

OWBPA requires that no individual may waive any right or claim under ADEA unless the waiver is knowing and voluntary. OWBPA specifies the minimum requirements for a knowing and voluntary release of claims under ADEA. The waiver must, at a minimum, comply with the following requirements:

1. Be written in a manner calculated to be understood by the average individual eligible to participate,

2. Specifically refer to rights and claims arising under ADEA,

3. Not waive rights and claims that may arise after the date the waiver is executed;

4. Provide for consideration in addition to anything of value to which the individual already is entitled,

5. Advise the individual in writing to consult with an attorney prior to executing the waiver,

6. Give an individual a period of at least 21 days within which to consider the agreement, and

7. Provide that the individual may revoke the agreement for a period of at least 7 days following the agreement's execution.[6]

A waiver in settlement of a charge filed with EEOC or a court action must meet the first five factors listed above, and the individual must be given a reasonable period of time within which to consider the agreement. Additional informational requirements apply in the case of a waiver requested in connection with an exit incentive or other employment termination program offered to a group or class of employees. The employer must inform the individual in writing as to the following:

1. Any class or group of individuals covered by the program, and

2. The job titles and ages of all individuals, eligible or selected for the program, and the ages of all individuals in the same job classification or organizational unit who are not eligible or selected for the program.

In addition, the individual must be given at least 45 days within which to consider the agreement. These additional requirements were added because, in the case of group termination programs, additional protections are required for individuals from whom a waiver is sought. More time is provided to weigh options, understand the program, and consult with an attorney. Employers are required to provide detailed, written information describing the group termination program.

The OWBPA also mandates that a waiver not affect EEOC's rights and responsibilities to enforce ADEA and further states that "[no] waiver may be used to justify interfering with the protected right of an employee to file a charge or participate in an investigation or proceeding conducted by the Commission." [7]

In June 1998, [8] EEOC published final regulations that provide guidance on all waivers of ADEA rights and claims, regardless of whether the employee

[6]29 U.S.C. §626(f)(1)(A)-(G).

[7]29 U.S.C. §626(f)(4).

[8]Waiver of Rights and Claims Under the Age Discrimination in Employment Act (ADEA), Equal Employment Opportunity Commission, 29 C.F.R. Pt. 1625, 63 Fed. Reg. 30624 (June 5, 1998). In one case decided prior to the publication of the regulations, *Juhola v. Secretary of the Army,* 1994 WL 740459 (E.E.O.C.), EEOC applied OWBPA waiver requirements to a settlement agreement entered into by a federal agency and an individual employee.

is employed in the private or public sector, including employment by the United States.[9]

OWBPA Compliance Requires Strict Adherence to Terms of Statute

The requirements of the OWBPA were enacted to set out threshold standards for waivers of ADEA rights. Courts applying the requirements of OWBPA have found that strict adherence is necessary. The Supreme Court considered the operation of the ADEA requirements in *Oubre v. Entergy Operations, Inc.*, 522 U.S. 422, 118 S.Ct. 838 (1998), where the Court determined that an employee who executed a waiver that failed to meet the requirements of OWBPA could bring an ADEA claim without first repaying the benefits she had received in exchange for the release. The Court described the purpose of the OWBPA as protecting the rights and benefits of older workers, and observed that

> "The OWBPA implements Congress' policy via a strict, unqualified statutory stricture on waivers, and we are bound to take Congress at its word. Congress imposed specific duties on employers who seek releases of certain claims created by statute. Congress delineated these duties with precision and without qualification: An employee 'may not waive' an ADEA claim unless the employer complies with the statute . . . The OWBPA governs the effect under federal law of waivers or releases on ADEA claims and incorporates no exceptions or qualifications."[10]

Other courts have used similar language in describing the operation of OWBPA. "Since the OWBPA establishes minimum or threshold requirements, absolute technical compliance with its provisions is required. The absence of even one of the OWBPA's requirements invalidates a waiver." *Butcher v. Gerber Products Company*, 8 F. Supp. 2d 307, 314 (S.D.N.Y. 1998). "Under the OWBPA, a release cannot be deemed knowing and voluntary unless all of the requirements of the OWBPA have first been satisfied." *Collins v. Outboard Marine Corp.*, 808 F.Supp. 590, 594 (N.D. Ill. 1992). "When an employee signs a purported release of claims arising under the ADEA, that release will not bar an ADEA claim unless the release strictly complies with the statutory requirements of the OWBPA." *Thiessen*

[9]29 C.F.R. §1625.22(a)(4). EEOC regulations apply OWBPA waiver requirements to employment by federal government. *But cf. Lehman v. Nakshian*, 453 U.S. 156 (1981) (interpreting 29 U.S.C. §633a(f), which provides that federal personnel actions covered by §633a are not subject to any other section of the ADEA, as evidence that Congress did not intend to grant the right to a jury trial to federal employees suing the government under ADEA.)

[10]*Oubre*, 522 U.S. at 425.

v. General Electric Capital Corporation, 232 F.Supp.2d 1230, 1233 (D. Kan. 2002).

Waiver of the Right to File an EEOC Complaint

While an employee can waive the right to recover from an employer based on a claim of age discrimination under ADEA, OWBPA provides that a waiver may not affect the EEOC's rights and responsibilities to enforce ADEA. In addition, no waiver may be used to justify interfering with the protected right of an employee to file a charge or participate in EEOC investigations or proceedings.[11] EEOC regulations also provide that no waiver agreement may include any provision imposing any limitation adversely affecting any individual's right to file a charge or complaint, including a challenge to the validity of the waiver, with the EEOC.[12]

According to EEOC guidance, the OWBPA language is evidence that Congress reaffirmed the public policy against interference with EEOC enforcement efforts. EEOC's guidance cites the legislative history of OWBPA, which states that the provision is intended as a clear statement of support for the principle that the elimination of age discrimination in the workplace is a matter of public as well as private interest, and that no waiver agreement may be permitted to interfere with the achievement of that goal.[13]

In connection with the OWBPA's statutory prohibition, the Senate Committee report expresses support for the holding and reasoning of the Fifth Circuit in *EEOC v. Cosmair, Inc.*, 821 F. 2d 1085 (5th Cir. 1987).[14] In *Cosmair*, the court found that a waiver of the right to file a charge with the EEOC is void as against public policy in part because the public interest in private dispute settlement is outweighed by the public interest in EEOC

[11]29 U.S.C. §626(f)(4).

[12]29 C.F.R. §1625.22(i)(2).

[13]*Waivers Under the Civil Rights Laws*, EEOC guidance effective April 10, 1997. EEOC notes that although the guidance addresses the issues primarily in the context of the private sector, the principles and considerations discussed are equally applicable to the federal sector.

[14]S. Rep. 101-263 (1990), The Older Workers Benefit Protection Act, April 4, 1990, 1990 U.S.C.C.A.N. 1509,1532.

enforcement of ADEA. Allowing the filing of charges to be obstructed by enforcing a waiver of the right to file a charge could impede EEOC enforcement of the civil rights laws. The court found that the EEOC depends on the filing of charges to notify it of possible discrimination. The court determined that an employer and an employee cannot agree to deny to the EEOC the information it needs to advance the public interest in preventing employment discrimination. However, an employee can waive the underlying cause of action and the right to recover from the employer in a lawsuit.

Employee Must be Advised in Writing to Consult an Attorney

Both the OWBPA and EEOC regulations provide that an employee must be advised in writing to consult an attorney. Courts analyzing waivers have applied the requirement strictly. In *American Airlines v. Cardoza-Rodriguez*, 133 F. 3d 111 (1st Cir. 1998), the court considered a waiver of rights offered to certain employees in connection with an early retirement program. The First Circuit found that language contained in the release that stated "I have had reasonable and sufficient time and opportunity to consult with an independent legal representative of my own choosing before signing this . . . [release]" was insufficient because employer did not advise employees to consult with counsel before executing the release.

In *Thiessen*, the court considered a release stating "the Company *advised* the employee in writing to consult with a lawyer before signing this Agreement." The court found that this language suggests that the Company, at some previous time, advised the employee to consult with an attorney and determined that this language, standing alone, does not comply with OWBPA's requirement that an employer advise the employee in writing to consult an attorney prior to executing the release. The court also said, however, that the employee could have complied with the statute by providing the employee with prior written advice so that the statement in the release was factually accurate.

In *Cole v. Gaming Entertainment, L.L.C.*, 199 F. Supp. 2d 208 (D. Del. 2002), the court considered a provision in a written release of employment claims that the "[e]mployee acknowledges that he/she has been advised to consult with an attorney prior to executing this Agreement." The court found that the language was insufficient to satisfy the requirements of ADEA. Citing *American Airlines*, the court found that the passive language used by the release was insufficient under current case law. However, the court found that the release language might have met OWBPA standards if

the employer's representatives had advised the employee of his right to counsel as contemplated by the release language.

OWBPA Informational Requirements

The OWBPA provides that a waiver cannot be considered knowing and voluntary unless, at a minimum, if the waiver is requested in connection with an exit incentive or other employment termination program offered to a group or class of employees, the employer informs the individuals in writing in a manner calculated to be understood by the average individual eligible to participate, as to (1) any class, unit, or group of individuals covered by the program; any eligibility factors for such program; and any time limits applicable to such program and (2) the job titles and ages of all individuals eligible or selected for the program and the ages of all individuals in the same job classification or organizational unit who are not eligible or selected for the program.[15]

The EEOC regulations provide that "other employment termination program" as set out in OWBPA usually means a group or class of employees who were involuntarily terminated and who are offered additional consideration in return for their decision to sign a waiver. The regulations go on to state that the existence of a program will be determined based upon the facts and circumstances of each case. A "program" exists when an employer offers additional consideration for the signing of a waiver pursuant to an exit incentive or other employment termination (e.g., a reduction in force) to two or more employees. The regulations also state that typically, an involuntary termination program is a standardized formula or package of benefits that is available to two or more employees. The terms of the program are generally not subject to negotiation between the parties. The regulations make clear that the number and identity of employees who must be provided with the information will depend on how the employer chose persons who would be offered consideration for signing a waiver. In some cases, the information requirement extends to all employees within a certain job category; and in some cases, extends to all employees within a particular division or to all employees in the employer's facility.

The legislative history of OWBPA indicates that group termination programs raise additional issues and require additional protection for

[15] 29 U.S.C. §626(f)(1)(H).

individuals from whom a waiver is sought. These informational requirements are designed to permit older workers to make more informed decisions in group termination programs. The employees affected by these programs have little or no basis to suspect that action is being taken based on their individual characteristics. The Senate Report[16] explains that the principal difficulty encountered by older workers in these circumstances is their inability to determine whether the program gives rise to a valid claim under ADEA and that the need for adequate information and access to advice before waivers are signed is especially acute.

[16]S. Rep. No. 101-263, 1990 U.S.C.C.A.N. 1509, 1539.

Comments from the Federal Housing Finance Board

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February 5, 2003

Thomas J. McCool
Managing Director
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United States General Accounting Office
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Washington, DC 20548

Dear Mr. McCool:

This letter forwards the official response of the Federal Housing Finance Board (FHFB) to the draft General Accounting Office (GAO) report entitled "Financial Regulation: Operations of the Federal Housing Finance Board," transmitted to the Finance Board January 15, 2003. Detailed responses to each element of the draft report are included below. Comments offered by individual FHFB Directors are not included or addressed in this official agency response.

The Finance Board expresses its sincere appreciation for the GAO's rapid and responsible action in disclaiming the unauthorized release of the draft report and the false impression created by suggestions that GAO had adopted a position in favor of a matter recently before the Finance Board for a vote. The improper distribution of the draft report is particularly regrettable because the Finance Board believes the report is in need of some revision.

In 1998, the GAO produced a report that offered sound recommendations for improving the supervision of Federal Home Loan Banks (FHLBanks) by the Finance Board. On being appointed, Chairman Korsmo adopted the 1998 report as an initial guide in determining reforms needed to enhance the supervisory capabilities, independence, and professional stature of this agency.

For a variety of reasons, earlier chairmen had ignored GAO's analysis and suggestions. The current draft report, however, makes no distinction between previous chairmen, who did not act on GAO recommendations, and the current chairman, who did. This is a point of professional pride to the highly motivated and

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talented men and women of the Finance Board staff who believe the current report should reflect their efforts to refocus operations of the agency on safety and soundness. These efforts have achieved significant, positive change in a short period of time.

The following comments are made in response to particular questions raised in the draft report.

I. DELEGATION OF AUTHORITY TO THE CHAIRMAN

The section of the draft report entitled "FHFB Chair Has Greater Authority to Make Key Administrative Decisions Than the Chairs of Most Other Financial Regulators" recommends that the Finance Board consider a revision to the current delegation. That consideration was given at the January 29, 2003, public meeting of the Board when two Directors proposed a new delegation placing some limitations on the administrative responsibility now granted the chair. The proposal was discussed at length and rejected by the Board.

As demonstrated by the Board's January 29 discussion and vote, the current delegation of authority does not prevent any Director from proposing items to the Board for action. The Board's ratification of the existing delegation reflects a belief on the part of the majority of the current Board that investing in the Chairman broad responsibility to administer the agency is the best method of managing the Finance Board's day-to-day operations.

The GAO draft report asserts that the delegation of authority that has been in place at the Finance Board since 1990 causes "tension" and contributes to conflicts among Board members. It is not possible to constructively comment on GAO's observation because no support is offered for the assertion. Neither is evidence offered that a different delegation would reduce "tension." The GAO merely notes the existence of conflict and refers to individual Director disagreements with actions taken by the current chairman and previous chairmen.

It should be noted in this context that Congress created the Board in 1989 as a five-member body with divided partisan representation. Clearly, Congress anticipated or even intended "tension" to exist within the Board and for that "tension" to serve a constructive purpose.

In addition, the GAO draft report makes a variety of comparisons of the FHFB's delegation of authority to those of other financial regulatory agencies. In this discussion, the GAO makes an error of fact in Table 1, asserting that the appointment of senior officials and personnel decisions at the Securities and Exchange Commission must be made with board approval. This is not the case. Current staff and former SEC Commissioner and Acting Chairman Laura

Unger confirm that reorganization and top-level staffing decisions are made by the chairman, without a Commission vote. (See Appendix 1, which discusses in depth research on this issue conducted by FHFB staff.)

Finally, on page 46 of the draft report, the GAO mistakenly asserts that the FHFB's delegation of authority defines the titles of senior officers.

II. PROGRESS MADE TO IMPROVE FHLBank SUPERVISION

The section of the draft report entitled "FHFB Has Announced Plans to Improve Its FHLBank Examination Program" is correct in concluding that, prior to appointment of the current FHFB Chairman in December 2001, inadequate progress had been made in addressing the recommendations of GAO's 1998 report. As of December 2001, the Office of Supervision was understaffed and insufficiently focused on the Banks' risk assessment processes, internal control systems, and systems of corporate governance.

On assuming office, Chairman Korsmo immediately set out to rectify those problems by bringing new leadership to the Office of Supervision, allocating additional resources for the Office of Supervision, and making organizational changes designed to provide more streamlined and responsible management. These changes are already demonstrating real results and are outlined in Appendix 2.

The first priority in improving and enhancing the Finance Board's examination and supervision functions was to bring experienced and accomplished leadership to the Office of Supervision. A national search was conducted which resulted in the selection of a new director and a new deputy director – who between them have more than 40 years of federal bank regulatory experience.

The second priority was to enhance the resources allocated to the supervision function. Since December 2001, the FHFB has hired five experienced examiners, increasing the examination staff to 14 full-time bank examiners. The increased staffing has already allowed the Office of Supervision to conduct more thorough examinations, establish standards for more timely communication of examination results to the Banks, and move away from "point-in-time" examinations and toward regular, ongoing safety and soundness supervision of the FHLBanks.

The third priority was to focus supervision efforts on the Banks' risk management practices and controls. Examinations previously emphasized compliance with Finance Board regulations, rather than assessing a Bank's risk and the quality of its risk management.

The fourth priority was to improve the coordination between bank supervision policy and bank supervision. The reorganization in 2002 materially improved the

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coordination between policy formation and bank supervision and has had the collateral benefit of streamlining and flattening organizational structure.

The fifth priority was to improve assessments of board governance at the FHLBanks. To that end, an interdisciplinary team of an attorney, a financial analyst, and two experienced bank examiners was deployed to review the effectiveness of the program of board governance at each of the 12 FHLBanks. Those targeted reviews began in September 2002. To date, targeted board governance reviews have been completed at 10 of the 12 Banks. A final report on board governance in the FHLBanks should be available in March of this year. The board governance audit plan is attached as Appendix 3.

The sixth priority was to enhance off-site analysis of the FHLBanks. The Office of Supervision hired a senior risk analyst and a senior mortgage analyst to oversee supervision of interest rate and credit risk of the Banks. OS also designated an analyst for each of the 12 Banks. These analysts are responsible for maintaining a current record of that Bank's financial results and trends and working with the Examiners in Charge (EIC) of the Bank to identify concerns that warrant attention at on-site examinations. The analysts also regularly update an internal profile analysis maintained on each of the 12 Banks.

Enhancing the program of bank supervision at the FHFB is the agency's overriding objective. While the agency agrees with the GAO's assertion that recent changes at the FHFB have the "potential" to improve the FHFB's examination program, the FHFB also believes that the changes have already yielded results and significant progress has been made in addressing shortcomings in the Finance Board's bank supervision program.

III. REORGANIZATION TO ENHANCE RESOURCES OF OFFICE OF SUPERVISION

The portion of the draft report entitled "Certain FHFB Reduction-In-Force Actions Were Not Fully Consistent with Applicable Federal Statutes and Regulations" implies a conclusion not supported by the text of the report.

The draft report does not identify any deficiencies in the planning or execution of a Reduction-In-Force undertaken by the Finance Board in August 2002. Furthermore, analysis included in the report does not take into account the compensation flexibilities provided by statute to the Federal Housing Finance Board.

The Reorganization

In August 2002, the agency implemented a reorganization that accomplished two critical objectives. First, all professional and technical expertise required to carry

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out both examinations and ongoing supervision of the FHLBanks was consolidated under management of the Director of Supervision. Second, additional staffing was allocated to the Office of Supervision by shifting resources from low-priority and low-workload support positions and eliminating a redundant executive layer. As a result, the number of bank examiners has grown from eight to 14 and is slated to further increase to 24 by the end of the calendar year. The total number of examiners, accountants, analysts, economists, and other professionals assigned to the Office of Supervision (OS) has increased from 39 to 47, with a goal of 62 when the reorganized office is fully staffed.

Both critical objectives were in full accord with the recommendations found in GAO's 1998 report.

Reduction-in-Force

It became clear that the necessary reorganization would result in a number of Finance Board employees being separated from federal service. To minimize the effects of the reorganization on the affected employees, the Finance Board utilized its compensation flexibility to provide additional compensation incentives and private-sector outplacement services.

In criticizing the Finance Board's use of administrative leave for employees to utilize the outplacement service, the draft report overlooks the fact the Finance Board has flexibility in compensating employees that most Federal agencies do not have. Specifically, the Finance Board has independent compensation-setting authority as set out in 12 U.S.C. § 1422b(b). This section of the Finance Board's authorizing legislation states:

> Subject to title IV of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Board may employ, direct, and **fix the compensation** and number of employees, attorneys and agents of the Federal Housing Finance Board. .... Such compensation shall be paid **without regard to the provisions of other laws** applicable to officers or employees of the United States... (Emphasis supplied).

Because all forms of leave, including administrative leave, are elements of compensation, the Finance Board has the right to grant administrative leave to Finance Board employees to accomplish any legitimate purpose, including assisting employees who are scheduled for separation due to a RIF.

Within the context of a RIF premised, in part, on lack of work, a decision to require employees to continue to report to empty desks rather than allowing them to seek future employment was determined to be neither good personnel management nor cost-effective.

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Compensation Offered to Separated Employees

The draft report concludes that the settlement agreement the Finance Board offered to the employees scheduled for separation is deficient. The FHFB concurs that the settlement agreement should have advised the employees to consult with an "attorney" rather than a "representative" prior to signing the agreement.

The GAO claims that the Finance Board's settlement agreement was also deficient, however, in that it interfered with the EEOC's enforcement authority and did not provide the employees scheduled for separation with the names, ages, and positions of employees not scheduled for separation.

The language of the Finance Board's settlement agreement does not, nor was it intended to, interfere with the EEOC's enforcement authority. Any employee who signed a settlement agreement was clearly free to challenge the agreement at a later date.

The Finance Board disagrees that it was required to provide the employees scheduled for separation with the names, ages, and positions of those not selected for separation. Since the Finance Board abolished all the positions in the Office of Communications and the Office of the Managing Director, this regulatory requirement was not applicable to the Finance Board's RIF.

IV. FHFB'S PROPER USE OF SCHEDULE C AUTHORITY

The draft report section entitled "FHFB's Use of Schedule C Positions Sometimes Differs From the Practices of Other Financial Regulators" observes that the FHFB and other financial regulators, while sharing some similarities in utilization of Schedule C hiring authority, also differ in how some Schedule Cs are used. Each of the agencies discussed are subject to Office of Personnel Management regulations governing use of Schedule C appointing authority. While the report notes differing practices from agency to agency, it does not suggest that any of the practices employed at the Finance Board violate OPM rules.

In the final report, GAO should note that the current Chairman corrected past practices that improperly categorized employees who should have been – and are now – placed in Schedule C positions. For the first time since creation of the Finance Board, Schedule C hiring authority is used by the FHFB for all confidential policy advisors to Board Directors.

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The draft report's second principal observation in this section, "FHFB Chair's Staff Are Responsible for Public and Congressional Affairs Functions," appears to focus on the Finance Board's decision to eliminate the agency's Office of Communications and divide public affairs and congressional affairs functions between one Schedule C employee and one career federal employee as ancillary responsibilities. It draws no conclusion and makes no recommendation. Given the size of the agency and the workload associated with those functions, the Finance Board believes the current assignment of responsibilities is appropriate and complies with OPM regulations.

V. REFORM OF PUBLIC INTEREST DIRECTOR SELECTION PROCESS

The section of the draft report entitled "Majority of FHLBank Public Interest Directors Made Political Contributions Prior to Their Initial Appointments" narrowly focuses on the single issue of political contributions made by public interest director (PID) appointees to the boards of the Federal Home Loan Banks. This narrow focus results in an incomplete portrayal of the process used in selecting public interest directors, the recent and substantial improvements in that process, and the critical role that PIDs serve in the governance of the Federal Home Loan Bank System.

As written, the draft report may inadvertently call into question the integrity of the appointment process and create the false impression that contributions are a determining factor in the appointment process.

In the past, the selection of PIDs was conducted by notational vote: Names of candidates were circulated privately among the Directors and a slate was approved out of the public view. This practice may have led to political "horse-trading" of candidates, an activity not conducive to the selection of the best-qualified candidates as public interest directors.

The process was significantly improved in 2002 with the decision to conduct all votes on public interest directors at a public Board meeting with separate votes on each candidate.

At the January 29, 2003, meeting of the Finance Board, Chairman Korsmo recommended 28 nominees for appointment as public interest directors. No other Director offered nominees for consideration. Each of the Chairman's nominees received unanimous support from the five members of the Finance Board.

Chairman Korsmo used the following criteria in selecting his nominees in 2002 and 2003, criteria that he again communicated to fellow Board directors during the most recent selection process. The factors were developed from recommendations contained in a governance study conducted by the FHLBank of Pittsburgh. These criteria were provided to GAO during its review.

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1. An understanding of Finance. Directors should be financially literate. Directors should know how to read a financial statement and understand financial ratios. Directors should have a working familiarity with basic finance and accounting practices.
2. Political Awareness. Directors should possess an awareness of the importance of the political process to the FHLBank and the FHLBank System.
3. Experience in Corporate Governance. A Director needs to be able to monitor corporate management. Directors should understand general management best practices in the banking industry.
4. Diversity. Directors should represent many different aspects of their communities, bringing a variety of perspectives to the Boards on which they serve.
5. A demonstrated interest in the mission of the FHLBank. Directors should have in-depth industry-specific knowledge, including experience or background in housing, community/economic development, and/or banking.
6. Ability to work with other directors as a board. Directors need to possess empowerment skills and be able to motivate high-performing talent.
7. Geographic balance. Candidates should be drawn from various regions within the Federal Home Loan Bank district. The Finance Board should strive for balance among states and between rural and urban areas.

In summary, the selection process for public interest directors has undergone significant improvement during the past two selection cycles, making it more transparent and responsive to the public and interested parties. Most importantly, the selection process now serves to identify and appoint well-qualified candidates to the boards of the 12 Federal Home Loan Banks. The final GAO report would be incomplete if it failed to note these improvements.

Finally, the Finance Board has been informed that the GAO staff is considering amending the title of the study for the final report. Given the narrow focus of the issues discussed in the report, the current title, "Financial Regulation: Operations of the Federal Housing Finance Board," appears overly broad. The Finance Board believes the title "Review of Administrative Issues at the Federal Housing Finance Board" would more appropriately reflect the scope of the report.

The Federal Housing Finance Board, as well as the entire staff of the agency, welcomed this project and hoped it would help identify areas of FHFB management, regulation, and examination that require improvement. The Finance Board continues to believe GAO can be of assistance to the agency's efforts to reform its operations and can make a positive contribution with this report if it is revised to reflect these comments.

Thank you very much for the extraordinary cooperation in dealing with the unauthorized distribution of the draft report, for the opportunity to help improve the

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draft, and for taking steps to convert this exercise into one which adds value to the work of enhancing the supervisory capabilities and independence of the Federal Housing Finance Board.

Respectfully,

Judith L. Hofmann, Director
Office of Management

Enclosures: 3 Appendices

CC: John T. Korsmo
Chairman, Federal Housing Finance Board

Franz S. Leichter
Director, Federal Housing Finance Board

Allan I. Mendelowitz
Director, Federal Housing Finance Board

J. Timothy O'Neill
Director, Federal Housing Finance Board

John C. Weicher
Director, Federal Housing Finance Board

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Comments from FHFB Board Members Franz S. Leichter and Allan I. Mendelowitz

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February 5, 2003

Thomas J. McCool
Managing Director
Financial Markets and Community Investment
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441 G Street, NW
Washington, DC 20548

Dear Mr. McCool:

As you are aware, the Standards of Conduct unanimously adopted by the Board of Directors of the Federal Housing Finance Board (FHFB) states that no individual member of the Board of Directors (including the Chairman) may speak for the Finance Board. Each Director may speak only for him or herself. Because the Finance Board has neither considered nor approved an agency response to your draft report, there is no agency response and each Board member must provide his or her own comments. To reduce the amount of paperwork that you have to handle, we have decided to consolidate our individual comments into a common set that we both support.

We address four issues raised in your report: the delegation of authority to the Chairman of the FHFB; the recent Reduction-in-Force; the use of Schedule C authority at the FHFB; and the 2002 class of Public Interest Directors to the Boards of the Federal Home Loan Banks.

DELEGATION OF AUTHORITY

We agree with the GAO's analysis of the inherent problems associated with the Federal Housing Finance Board's current delegation of authority to the Chairman.

As the GAO notes, the Board of Directors of the FHFB is currently operating under a resolution adopted over nine years ago that delegates broad authority to the Chairman to carry out certain administrative functions for the ease of general agency operation. This resolution has been used by the current and past Chairmen to exercise control of the Board's major management responsibilities.

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The GAO rightly acknowledges that the "exercise of the FHFB chairs' administrative authorities under a relatively broad delegation of authority has contributed to conflicts between board members who have not been permitted to vote or otherwise officially agree or disagree with key administrative decisions." The GAO is also correct in noting that the delegation not only "has served to undermine collegiality and collaboration among FHFB board members," but also "has meant that important FHFB decisions have not benefited from the views of all its members."

However, the GAO does not mention that the FHFB's delegation significantly limits the role of the Board of Directors in the oversight and governance of the agency as specifically intended by Congress when it stated "the management of the Board shall be vested in a Board of Directors consisting of 5 directors" (12 U.S.C. 1422a (b)(1)). The FHFB's delegation, therefore, is not just unwise. It is also overreaching and appears to be contrary to the intent of Congress.

As the GAO recognizes, the FHFB's delegation is anachronistic. The November 1993 delegation under which the Finance Board is operating is based in large part on a broad 1990 delegation of authority to the Chairman that was adopted when the Board of Directors served only in a part-time capacity. In late 1993, when the Finance Board was transitioning from a part-time to a full-time Board of Directors, it was clear that the Chairman would, and the Directors might, resign rather than accept full-time status.

The ostensible purpose of the 1993 delegation was to ensure that the Finance Board would continue to function if the President did not immediately appoint a replacement Chairman by designating an Acting Chairman, or the HUD Secretary in the absence of an Acting Chairman, as Chairman.

The GAO analysis, however, fails to point out that the 1993 delegation also broadened the powers of the Chairman by deleting provisions from the 1990 delegation requiring the Chairman to consult "with other members of the Board as appropriate" before exercising delegated authorities. This was removed because it was not clear that there was or would be any Board for the Chairman to consult with during the transition period from a part- to a full-time Board.

Both the 1990 delegation, and the 1993 delegation under which the Board continues to operate, were enacted to allow the Finance Board to function during particularly unique historical circumstances. The GAO is correct in noting that the "circumstances under which the board originally deemed the delegation necessary no longer apply."

In addition, the GAO's analysis of the more limited senior staff appointment and reorganization powers of the Chairmen at other federal financial regulatory agencies confirmed what our own research found. None of the agencies examined cedes to its Chairman "all authorities, powers and responsibilities of the Board necessary to effect the overall management, functioning and organization" of the agency, as the Finance Board's current delegation does. The Finance Board is clearly out-of-step with its peers when it

comes to delegation of key agency management and, by implication, policymaking authority.

In this time of increased focus on corporate responsibility and accountability in both the private and public sectors, it is appropriate that the full Board of Directors of the Finance Board governs the agency in the most democratic, transparent, and open manner possible. As the GAO highlights, "decisions that have the potential to affect the critical means by which FHFB ensures FHLBank safety and soundness" (and we would add, mission compliance) "merit the attention and consideration of the full board."

At the January 29th meeting of the Board of Directors of the FHFB, we offered a resolution revising the Board's delegation of authority to the Chairman (a copy of which follows). Having attempted to place this item on the Board's agenda for several months, we were pleased to finally have the opportunity to debate this issue.

Our revised delegation included the following key provisions:

1) Clarification that "the Finance Board exercises its rulemaking and adjudicatory functions only through the Board," and that "individual Board Directors shall neither represent nor give the appearance of speaking or acting on behalf of the Finance Board, absent specific direction from the Board." This language was taken directly from the Finance Board's recently adopted Standards of Conduct.

2) Affirmative statements that "the appointment of the Directors of Finance Board Offices shall be subject to the approval of the Board," and that the Board "shall approve the Finance Board's organizational chart down to the Office level along with relevant functional statements for each Office." This would ensure consistency between the Finance Board and its peer agencies in the rightful role that Board Directors must play in the appointment of senior officials and agency reorganizations.

3) Clear language indicating that the Board's delegation of authority to the Chairman "does not include the authority to establish policy and promulgate rules and regulations, or any delegation expressly prohibited by statute," and that "except as otherwise expressly provided, the Board does not delegate its authority."

As the GAO report recommends, our revised delegation would have given individual Board members "the opportunity to vote on the appointment of senior agency officials and major reorganizations while preserving the Chair's authority to manage the agency on a day-to-day basis." Decisions in each of the aforementioned areas, as the GAO itself comments, "can have policy implications for how the agency carries out its key responsibilities"—responsibilities that are not delegable.

Unfortunately, our resolution was defeated in a 3-2 vote (a full transcript of the proceedings can be found at http://www.fhfb.gov/PressRoom/Pressroom_BDTrans.htm).

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But, we hope that on reflection and based on a clear recommendation by the GAO, the Board will reconsider this action and will also, as stated in your draft report, "review the delegation of authority with some regularity to consider the appropriateness of the delegation to particular circumstances of the board."

REDUCTION-IN-FORCE (RIF) AND REORGANIZATION OF THE FHFB

We are deeply concerned about the fact that you state the recent RIF conducted at the FHFB was not consistent with all federal statutes. We were neither consulted before nor briefed during or after this RIF. We were first notified that a RIF was being imposed after the action had been taken and after the Chairman had briefed Congressional committees about the RIF.

During our meetings with GAO staff, we expressed our concern about this lack of consultation. In fact, our concern over this unilateral reorganization contributed to our decision to offer a modified delegation of authority.

It is unfortunate that the scope of GAO's review did not include a review of the retreat and bumping rights of the workers who were adversely affected by the RIF. This is an important element of the reorganization and RIF and we have no basis for knowing if it was done in a way that is consistent with law and regulation.

Some aspects of the reorganization and the reallocation of resources have our support and addressed concerns that we have raised over the past two years. Other aspects of the reorganization are troubling. For example, with the elimination of the Managing Director position, the Chairman has assumed more direct operational authority. There is no longer a senior career official to supervise the staff and serve as the interface between the staff and the Board of Directors. This has complicated prioritizing staff work.

USE OF SCHEDULE C AUTHORITY

In addition, a by-product of the RIF we find alarming is the use of the Chairman's personal staff, including Schedule C appointees, to perform certain Board functions. As you state in the draft report, "the FHFB chair's personal staff, including a Schedule C appointee, are responsible for the agency's public and congressional affairs functions, a practice unique among the regulatory agencies that we reviewed." Not only do we find this practice "unique," but it also raises concerns about the appropriateness of one board member's staff performing duties that were once performed for the entire board.

SELECTION OF PUBLIC INTEREST DIRECTORS

It is our opinion that the process of selecting Public Interest Directors (PIDs) to serve on the Boards of Directors of the Federal Home Loan Banks has become increasingly political. While there may be advantages to having PIDs with experience in partisan political activities, there is a concern that too many new PIDs lack the financial expertise

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to effectively oversee the complex balance sheets of their respective Federal Home Loan Banks. This is increasingly important in today's environment.

The Federal Home Loan Banks are taking on more complex risks than ever before, and the boards of directors have now been given far greater corporate governance responsibilities to assure the safety and soundness of the FHLBanks. During the January 29, 2003 meeting of the Federal Housing Finance Board, Director Mendelowitz raised this issue with members of the Board of Directors. It was generally agreed that the Finance Board would undertake to amend existing regulations regarding PIDs to require that at least one PID at each FHLBank have sufficient expertise in financial markets, derivatives, and mortgage instruments to insure each Board would have the requisite expertise for competent corporate governance in the system.

Sincerely,

Allan I. Mendelowitz
Director

Franz S. Leichter
Director

cc: John T. Korsmo, Chairman, FHFB
John C. Weicher, Director, FHFB
J. Timothy O'Neill, Director, FHFB

No.:
Date:

FEDERAL HOUSING FINANCE BOARD

Delegation of Authority to Chairperson

WHEREAS, the Federal Housing Finance Board ("Finance Board") is the regulator of the Federal Home Loan Banks ("Banks"); and

WHEREAS, section 2B of the Federal Home Loan Bank Act vests the management of the Finance Board in a five member Board of Directors ("Board"), but that, for ease of general operation, the Board desires to delegate to its Chairperson certain administrative authorities, powers and responsibilities of the Board; and

WHEREAS, as stated in the Standards of Conduct adopted by the Board (Resolution 02-51, September 12, 2002), the Finance Board exercises its rulemaking and adjudicatory functions only through the Board, acting jointly; accordingly, individual Board Directors shall neither represent nor give the appearance of speaking or acting on behalf of the Finance Board, absent specific direction from the Board.

NOW THEREFORE, BE IT RESOLVED, that Resolution 93-92 (November 17, 1993) is hereby rescinded.

RESOLVED FURTHER, that the Board hereby delegates to the Chairperson the authorities, powers and responsibilities of the Board necessary to effect the day-to-day management and logistical functioning of the Finance Board including the authority to execute documents on behalf of the Board, including regulations, resolutions and orders duly passed by the Board.

RESOLVED FURTHER, that the Board hereby delegates to the Chairperson authority to direct Finance Board personnel matters; Provided however: the appointment of the Directors of Finance Board Offices shall be subject to the approval of the Board.

RESOLVED FURTHER, that the Board, consistent with the authority to approve the appointments outlined above, shall approve the Finance Board's organizational chart down to the Office level along with relevant functional statements for each Office.

RESOLVED FURTHER, this delegation of authority does not include the authority to establish policy and promulgate rules and regulations, or any delegation expressly prohibited by statute.

RESOLVED FURTHER, that except as otherwise expressly provided, the Board does not delegate its authority.

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RESOLVED FURTHER, that the Chairperson may call the Board into regular or special session whenever any matter or business of the Finance Board so requires; Provided however: the Chairperson shall call a special session of the Board to consider any matter or business on the request of any two or more Board Directors if the Board contains four or more Directors. Should the Board be comprised of fewer than four Directors, the Chairperson shall call a special session of the Board to consider any matter or business on the request of any one or more Board Directors.

RESOLVED FURTHER, that the Chairperson may, from time to time, further delegate to any member, officer, employee or office of the Finance Board any function delegated to the Chairperson by this resolution or by law.

RESOLVED FURTHER, that in the event that there is no Chairperson or Acting Chairperson by virtue of absence, disability, or a vacancy, that all of the authority contained herein is delegated to the Secretary of Housing and Urban Development ("Secretary").

RESOLVED FURTHER, that this delegation is not personal to any Chairperson or to any Secretary and will neither abate nor lapse on the expiration of the term of any Chairperson or Board Director, unless revoked by the Board by resolution.

By the Board of Directors of the
Federal Housing Finance Board

John T. Korsmo, Chairman

Comments from the Farm Credit Administration

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

February 4, 2003

Mr. Thomas J. McCool
Managing Director
Financial Markets and Community Investment
General Accounting Office
441 G. Street, NW
Washington, DC 20548

Dear Mr. McCool:

Thank you for the opportunity to review and comment on excerpts from the General Accounting Office's (GAO) draft report entitled Financial Regulation: Operations of the Federal Housing Finance Board (Report). While the Report (Table 4) correctly reflects that six Schedule C positions are allotted to the Farm Credit Administration's (FCA) Board members (one executive assistant and one special assistant for each of the three Board members), it should be noted that five of these six positions are currently filled by FCA career employees, not Schedule C appointees. These assistants are selected at each Board member's discretion and may be either Schedule C appointees or career employees.

Additionally, the information in Table 4 does not reflect the following:

- The position of Secretary to the Board. While a Schedule C appointee has filled this position in the past, it has been converted to a career position.
- Two Schedule C appointees that are assigned to the Office of Congressional and Public Affairs. One of these appointees is a Congressional and Public Affairs Specialist and the other is a Public Affairs Specialist.

Consequently, although Table 4 may show 12 Schedule C positions, only six of these positions are filled by Schedule C appointees and the remaining six are filled by career employees.

Technical comments were provided to GAO separately. We hope these comments are helpful in GAO's development of its final Report. If you have any questions, please do not hesitate to call me at 703-883-4005 or James Ritter at 703-883-4252.

Sincerely,

Michael M. Reyna
Chairman and Chief Executive Officer

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