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FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1278

RIN 2590-AA37

Voluntary Mergers of Federal Home Loan Banks

AGENCY: Federal Housing Finance Agency

ACTION: Final Rule

SUMMARY: Section 1209 of the Housing and Economic Recovery Act of 2008 (HERA) amended section 26 of the Federal Home Loan Bank Act (Bank Act) to permit any Federal Home Loan Bank (Bank) to merge with another Bank with the approval of its board of directors, its members, and the Director of the Federal Housing Finance Agency (FHFA). This final rule establishes the conditions and procedures for the consideration and approval of voluntary Bank mergers.

DATES: The final rule is effective on [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Background

A. The Federal Home Loan Bank System

The 12 regional Banks are instrumentalities of the United States organized under the Bank Act.[1] The Banks are cooperatives; only members of a Bank may purchase the capital stock of a Bank, and only members or certain eligible housing associates (such as state housing finance agencies) may obtain access to secured loans, known as advances, or other products provided by a Bank.[2] Each Bank is managed by its own board of directors and serves the public interest by enhancing the availability of residential mortgage and community lending credit through its member institutions.[3] Any eligible institution (generally a federally insured depository institution or state-regulated insurance company) may become a member of a Bank if it satisfies certain criteria and purchases a specified amount of the Bank's capital stock.[4]

B. HERA Provisions Addressing Voluntary Mergers

Section 1209 of HERA added new paragraphs (b)(1) and (b)(2) to section 26 of the Bank Act to address voluntary mergers of Banks. Section 26(b)(1) authorizes any Bank to merge voluntarily with another Bank with the approval of the Director of FHFA

[1] See 12 U.S.C. 1423, 1432(a).
[2] See 12 U.S.C. 1426(a)(4), 1430(a), 1430b.
[3] See 12 U.S.C. 1427.
[4] See 12 U.S.C. 1424; 12 CFR part 1263.

(Director) and the boards of directors of the Banks involved in the merger. Section 26(b)(2) requires FHFA to promulgate regulations establishing the conditions and procedures for the consideration and approval of voluntary mergers, including approval by Bank members.[5] The HERA amendments do not provide any further details about the terms on which Banks may merge or on which FHFA may approve such mergers.

As required by section 26(b)(2), the final rule establishes the conditions and procedures for the consideration and approval of voluntary mergers of Banks. The rule does not relate to liquidations, reorganizations, conservatorships, or receiverships undertaken by the Director pursuant to the authority set forth at section 26(a) of the Bank Act and section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act).[6]

C. The Proposed Rule

On November 26, 2010, FHFA published in the Federal Register a proposed rule to implement section 26(b) of the Bank Act by adding to FHFA's regulations a new part 1278 to govern voluntary mergers of Banks.[7] The 60-day comment period closed on January 25, 2011.

The proposed rule would have established procedures for Banks to follow in order to consummate a merger, including: execution of a written merger agreement that has been authorized by each merging Bank's board of directors; joint submission of a merger application to FHFA by the merging Banks; preliminary approval of the terms of the merger by the Director; ratification of the merger by the merging Banks' member

[5] See 12 U.S.C. 1446(b)(1), (2).
[6] See 12 U.S.C. 1446(a), 4617.
[7] See 75 FR 72751 (Nov. 26, 2010).

institutions; and final approval by the Director. In developing the proposed rule, FHFA looked for guidance to governance practices that are common under general principles of corporate law, disclosure practices that are required under the federal securities laws, and the approval standards required under federal banking laws relating to mergers of insured depository institutions.

D. Considerations of Differences between the Banks and the Enterprises

Section 1313 of the Safety and Soundness Act, as amended by HERA, requires the Director, when promulgating regulations relating to the Banks, to consider the following differences between the Banks and the Enterprises (Fannie Mae and Freddie Mac) with respect to the Banks' cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability.[8] In preparing this final rule, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors, and determined that the rule is appropriate. No commenters raised any issues relating to this statutory requirement.

II. The Final Rule

FHFA received six comment letters in response to the proposed rule. All twelve Banks jointly submitted one comment letter which addressed the issues raised in the proposed rule in a comprehensive manner. Three Banks submitted individual comment letters to supplement the Banks' joint letter, and two trade associations also provided comments. All six of the comment letters expressed general support for the proposed

[8] See 12 U.S.C. 4513.

rule, although there were a number of recommendations regarding changes to be made in the final rule.

FHFA considered all of the comments in developing the final rule, which establishes merger conditions and procedures that are substantially similar to those that were proposed, except that the two-step preliminary/final FHFA approval process embodied in the proposed rule has been replaced with a single-step approval in the final version, as suggested by some commenters. FHFA has made a number of minor revisions to the rule in order to address concerns raised by commenters, as well as to provide greater clarity. Specific comments, FHFA's responses, and changes adopted in the final rule are described in greater detail below in the sections describing the relevant rule provisions.

A. Section 1278.1—Definitions

Proposed § 1278.1 set forth definitions of terms used in proposed part 1278. With two minor exceptions, all of these definitions have been adopted as proposed and are set forth in § 1278.1 of the final rule. A definition for the term "Financial Statements" has been added to the final rule to refer to statements of condition, income, capital, and cash flows, with explanatory notes, in such form as the Banks are required to include in their filings made under the Securities and Exchange Act of 1934 (Exchange Act).[9] In addition, definitions for the terms "GAAP" (referring to accounting principles generally accepted in the United States as in effect from time to time) and "Record Date" (referring to the date established by a Bank's board of directors for determining the members that

[9] 15 U.S.C. 78a, et seq.

are entitled to vote on the ratification of a merger agreement) have been added. A definition for the term "Office of Finance," which was inadvertently omitted from the proposed rule, has also been added. The terms "Record Date" and "Financial Statements," as well as comments received on certain proposed definitions and revisions to the definitions of the terms "Disclosure Statement" and "Effective Date" are discussed below in the context of the relevant substantive provisions of the final rule.

B. Section 1278.2—Authority

Section 1278.2 of the proposed rule would have authorized any two or more Banks to merge, provided that they satisfied the various procedural and substantive requirements of proposed part 1278 relating to the merger agreement, merger application, approval by the Director, ratification by the members, and final consummation of the merger. Proposed § 1278.1 defined the words "merge" and "merger" broadly to include not only a traditional merger (where one surviving entity absorbs another disappearing entity), but also a consolidation, a purchase and assumption transaction, and any other type of business combination that could occur between or among Banks. The intent behind proposed § 1278.2 was to permit each Bank wide latitude to pursue beneficial business combinations with other Banks, subject to the proviso that any such combination could be consummated only with the express approval of the Director, obtained in accordance with the conditions and procedures set forth in proposed part 1278. The Banks expressed support for the broad definition of "merge" and "merger," and no commenters opposed the definition, which the final rule retains without change.

In the final rule, the introductory paragraph of § 1278.2 has been revised to make clear that the provisions of part 1278 apply only to voluntary mergers undertaken

pursuant to section 26(b) of the Bank Act.[10] Part 1278 is not intended to govern liquidations and reorganizations of Banks carried out by the Director under section 26(a) of the Bank Act.[11] Paragraphs (a) through (e) of § 1278.2 have also been revised, principally to reflect the decision to replace the two-step FHFA approval process with a single-step approval, but also to provide greater clarity. Except for the revisions relating to the changes in the approval process, the substance of the provisions remains the same. Thus, the final rule continues to authorize any two or more Banks to merge provided that they satisfy the procedural and substantive requirements of part 1278.

C. Section 1278.3—Merger Agreement

Section 1278.3 of the proposed rule would have required that any merger of Banks be consummated only pursuant to a written merger agreement meeting the requirements of paragraphs (a) and (b) of that section, which addressed the authorization of the agreement by the Constituent Banks' boards of directors and the contents of the agreement, respectively.[12]

Specifically, proposed § 1278.3(a) would have required that a merger agreement be authorized by the affirmative vote of a simple majority of a quorum of the board of directors of each Constituent Bank at a meeting on the record and that it be executed by authorized signing officers of each Constituent Bank. FHFA requested comment upon whether a standard other than a majority vote of a quorum of the boards of directors would be appropriate. The Banks opposed the imposition of a regulatory standard for

[10] 12 U.S.C. 1446(b).
[11] 12 U.S.C. 1446(a).
[12] In this Supplementary Information, as in the rule, the term "Constituent Bank" refers to a Bank that is proposing to merge with one or more other Banks, and the term "Continuing Bank" refers to a Bank that will continue following the merger of two or more Constituent Banks.

board authorization of a merger agreement, preferring instead that each Bank be permitted to establish board voting requirements under its bylaws, which they asserted is consistent with the approach taken by most state corporation statutes. One commenter questioned the sufficiency of a simple majority of a quorum of the board of directors to authorize a merger agreement, and advocated that the final rule instead require a supermajority of the full board of each Constituent Bank.

As discussed in the proposed rule, section 26(b) of the Bank Act, while requiring a board vote as part of the merger process, does not address specific requirements with respect to such a vote. Although the absence of statutory requirements would allow FHFA to include in the final rule either of those suggestions, FHFA has decided to retain this provision as proposed. As a matter of policy, FHFA believes that a uniform standard for board authorization is preferable to allowing each Bank to set its own approval standard. Unlike general business corporations, all of the Banks are very similar in business model and operations, as governed by the Bank Act and the regulations adopted thereunder, and they were created to further uniform purposes. Given those circumstances, FHFA believes that each Bank should also be subject to the same approval standards in determining whether to enter into a merger agreement. In addition, FHFA has concluded that the appropriate uniform standard is one that corresponds with the manner in which board decisions currently are made under the bylaws of all of the Banks–that is, by vote of a majority of a quorum of the board. Although a supermajority requirement may be permissible under state corporate laws for mergers, FHFA does not believe that it is appropriate in the case of cooperative institutions such as the Banks, and does not believe that the comments suggesting the adoption of a supermajority standard

have provided persuasive reasons for doing so. Moreover, the required ratification by each Banks' members, the required approval of the Director, and the other detailed requirements of the rule provide for sufficient deliberation by the various constituencies.

Proposed § 1278.3(b) addressed the minimum content for a merger agreement. It would have required generally that the agreement set forth all material terms and conditions of the merger, and would have further required that the agreement include provisions addressing nine specified matters. FHFA proposed to require agreement on those matters early in the merger process because, in the agency's judgment, they would be the central issues to be negotiated between Constituent Banks under most merger scenarios, and are matters of major regulatory concern to the agency. The nine matters enumerated in the proposed rule were: (1) the proposed Effective Date of the merger; (2) the proposed organization certificate and bylaws of the Continuing Bank; (3) the proposed capital structure plan for the Continuing Bank; (4) the proposed size and structure of the board of directors for the Continuing Bank; (5) the formula to be used to exchange the stock of the Constituent Banks for the stock of the Continuing Bank; (6) any conditions that must be satisfied prior to the Effective Date of the proposed merger; (7) a statement of any representations or warranties; (8) a description of any legal opinions or rulings; and (9) a statement that the board of directors of a Constituent Bank can terminate the merger agreement before the Effective Date upon a determination that certain events have occurred. FHFA's intent in including these provisions in the proposed rule was to ensure that a merger agreement reflects the understandings that the Banks have reached with respect to each of these critical matters. The agency did not

intend to require that the documents that may be necessary to implement these understandings be prepared at the same time as the merger agreement.

FHFA received a number of comments regarding the nine specific matters to be addressed in a merger agreement. The agency has made some minor revisions to § 1278.3(b) in response to some of these comments, which are discussed below, and has also made a few minor wording changes for greater clarity and consistency.

Paragraph (1) of proposed § 1278.3(b) would have required that a merger agreement set forth the proposed Effective Date of the merger. In the proposed rule, the term "Effective Date" was defined as the date on which the Constituent Banks consummate the merger, or, in the case of a merger encompassing two or more component transactions, the date on which the relevant Constituent Banks consummate each component transaction. As discussed below, § 1278.7 has been revised in order to provide greater specificity as to the time that the organization certificate of the Continuing Bank, and consequently the consummation of the merger, becomes legally effective. In conjunction with this change, the definition of "Effective Date" has been revised to refer to the date on which the organization certificate of the Continuing Bank (or Banks) becomes effective as provided under § 1278.7. As stated in the Supplementary Information to the proposed rule, the proposed Effective Date need not be stated as a specific date, but should be described in a manner such that the date can be reasonably determined—for example, as within a specified period after the occurrence of a particular event.

In the final rule, paragraph (1) of § 1278.3(b) has been revised to require that, in addition to the proposed Effective Date, the merger agreement set forth the proposed

acquisition date for purposes of accounting for the transaction under GAAP, if that date is to be different from the Effective Date. Under GAAP, a business combination is recorded as of the "acquisition date." Thus, among other things, the fair value of the assets acquired, liabilities assumed, and consideration exchanged is measured as of that date. The acquirer also begins to consolidate the acquired entity's financial position, results of operations, and cash flows as of that date. Under GAAP, the "acquisition date" is considered to be the date on which the acquirer obtains control of the acquiree. Typically, this would be the date on which the acquirer legally transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree—i.e., the Effective Date in the case of a voluntary Bank merger under part 1278. However, for various reasons, control of the acquiree may pass to the acquirer on a date that is either earlier or later than the date on which the legal transfers occur.[13] In a case where the Constituent Banks intend to effect a transfer of control on a date other than the Effective Date, this proposed acquisition date must be set forth in the merger agreement. As with any aspect of a Bank merger, the establishment of a separate GAAP acquisition date is subject to the approval of the Director under § 1278.5 of the final rule.[14]

Paragraphs (2) and (3) of proposed § 1278.3(b) would have required that a merger agreement describe, respectively, the proposed organization certificate and bylaws, and the proposed capital structure plan, for the Continuing Bank. In their joint comment letter, the Banks stated that the rule should not require descriptions of these items, but should instead require the items to be attached to the merger agreement. FHFA has

[13] For example, this may be done by written agreement in order to establish an acquisition date that is on the last day of a financial reporting period.
[14] See generally, FASB ASC 805-10-25-6 and 25-7.

considered this suggestion, but has decided to adopt these requirements in their proposed form. In all cases, the types of material understandings that are required to be addressed in the merger agreement must precede the preparation of the detailed documents that are intended ultimately to implement those understandings. Although, in practice, the Constituent Banks may choose to negotiate the specifics of the capital structure plan, organization certificate, and bylaws prior to executing a final merger agreement, FHFA can discern no compelling reason to require these documents to be prepared contemporaneously with the agreement. In a legal sense, the understandings memorialized in the merger agreement will determine the scope and content of these implementing documents. FHFA believes that the better approach is the one embodied in the proposed rule, which requires that the merger agreement reflect the material understandings that the Banks have reached with respect to each of these matters. That approach allows the Banks the opportunity to prepare related documents contemporaneously with the merger agreement if they so desire, but also affords them the flexibility to agree in principle as part of the merger agreement how certain matters, such as the organization certificate, bylaws, or capital structure plan, are to be addressed, but leave the drafting of those documents to a later date.

The final rule requires that a merger agreement set forth all material terms and conditions of the merger. As reflected by their inclusion in the non-exclusive list of issues that must be addressed in the merger agreement, FHFA considers the major features of the organization certificate, bylaws, and capital structure plan of the Continuing Bank to be among the material terms of any Bank merger. Therefore, even if these documents have not been finalized at the time the merger agreement is executed,

descriptions of their material features must be included in the agreement. If the Constituent Banks have developed these documents contemporaneously with the merger agreement, the Banks may fulfill the requirements of paragraphs (b)(2) and (3) of § 1278.3 of the final rule by attaching the documents as appendices to the agreement, so long as the documents are made part of the agreement. For example, a merger agreement may state that "the capital structure plan for the Continuing Bank shall be as set forth in Attachment X."

Proposed § 1278.3(b)(4) would have required that a merger agreement address the proposed size and structure of the board of directors for the Continuing Bank. The proposed rule also requested comments on how best to address the transition from the separate boards of the Constituent Banks to the combined board of the Continuing Bank, and the manner in which FHFA should establish the size and composition of the board for the Continuing Bank. In their joint comment letter, the Banks requested that Constituent Banks be permitted to include in either a merger agreement or a merger application their proposals as to the size and composition of the board immediately following the merger, and as to the gradual reduction in size of the board over time through FHFA's annual designation of Bank directorships process. The Banks opposed the imposition of any requirement to provide a detailed long-term plan regarding such matters as the number and composition of board committees and the responsibilities to be delegated to those committees, stating that they wish to preserve the flexibility to allow more detailed governance matters to evolve over time. Another commenter also agreed that any reduction in post-merger directorships should be a gradual process effected through the annual designation process.

FHFA has considered these comments and has decided to carry over the language of proposed § 1278.3(b)(4) without change. Final § 1278.3(b)(4) allows the Banks some flexibility with respect to the level of detail that must be included in the merger agreement. At a minimum, the merger agreement must include the Banks' proposal for the size and composition of the board of directors, i.e., the number of directorships and their allocation among the states, of the Continuing Bank immediately after the merger. The language is sufficiently broad, however, to allow the Banks also to include in the agreement their proposal for the longer term restructuring of the board of the Continuing Bank if they choose to do so. If the Banks do not address their proposal for the longer term board size and composition as part of the merger agreement, FHFA expects that they will do so as part of the merger application, which is consistent with the Banks' comment letter. In this regard, FHFA has included a conforming revision to § 1278.4(a)(1)(vi) of the final rule making clear that if the size and composition of the board over the longer term are not addressed in the merger agreement, they must be addressed in the merger application submitted to FHFA.

Ultimately, the size and composition of the board of the Continuing Bank will be determined by the Director. Section 7 of the Bank Act generally requires the Director to establish the size and structure of the board of directors of each Bank and gives the Director additional discretion to adjust the board size in connection with any Bank merger.[15] In order for the Director to make an informed decision about the appropriate size and composition of the board of the Continuing Bank, both immediately after the

[15] 12 U.S.C. 1427(a), (c).

merger and over the longer term, the Director should have the benefit of the Banks' views on those matters, and thus the final rule requires the Banks to provide that information. However, the rule does not require the Constituent Banks to address, in either the merger agreement or merger application, such details as the number and composition of board committees and the responsibilities to be delegated to those committees.

Proposed § 1278.3(b)(7) would have required that a merger agreement contain a statement of the representations or warranties, if any, made or to be made by any Constituent Bank, or its officers, directors, or employees. In their joint letter, the Banks requested clarification that any representations and warranties made by Bank officers, directors, or employees would not be signed in their individual capacities, but on behalf of their respective Banks. The proposed provision was not intended to require that any individual or Bank make any particular representations or warranties in connection with a merger, or to address the capacity in which any individual might make such representations or warranties. Instead, it was intended merely to require that the merger agreement set forth any representations or warranties made by any of the parties in connection with the merger. In recognition of the fact that the parties to the merger agreement will be the Constituent Banks as corporate entities, and in order to avoid any implication that Banks directors, officers, or employees should be making representations or warranties in their individual capacities, as opposed to doing so as a representative of his or her Bank, FHFA has revised § 1278.3(b)(7) in the final rule to remove the reference to Banks' "officers, directors, or employees." Thus, the text of final § 1278.3(b)(7) requires that the merger agreement include "a statement of the representations or warranties, if any, made or to be made by any Constituent Bank."

Section 1278.3(b)(8) of the proposed rule would have required that a merger agreement describe any legal opinions or rulings that have been obtained or furnished by any party in connection with the proposed merger. In their joint comment letter, the Banks stated that if legal opinions are required in connection with a merger, they are frequently conditions to consummation and, therefore, are not available until after the merger agreement is signed. Consequently, the Banks suggested that FHFA modify the provision to require that a merger agreement include descriptions of any legal opinions that are required to be obtained as a condition to the consummation of the merger, as well as those that have already been completed at the time the agreement is executed. The Banks further suggested that the rule require that a merger agreement describe any accounting opinions obtained or furnished in connection with the merger. FHFA has accepted both of these suggestions and has revised final § 1278.3(b)(8) to require that a merger agreement describe the legal or accounting opinions or rulings, if any, that are required to be obtained or furnished by any party in connection with the proposed merger.

Section 1278.3(b)(9) of the proposed rule would have required that a merger agreement contain a statement that the board of directors of a Constituent Bank may terminate the agreement before the Effective Date of the merger upon a determination by the Bank, with the concurrence of FHFA, that: (i) the information disclosed to members contained material errors or omissions; (ii) material misrepresentations were made to members regarding the impact of the merger; (iii) fraudulent activities were used to obtain members' approval; or (iv) an event occurred between the time of the members' vote and the merger that would have a significant adverse impact on the future viability

of the Continuing Bank. In their joint comment letter, the Banks expressed concern that this requirement could be interpreted as limiting the circumstances under which a merger agreement may be terminated prior to the Effective Date, but questioned whether this was the intent of the proposed provision. The Banks requested that FHFA clarify this provision to make clear that Constituent Banks may negotiate termination rights in addition to those enumerated. The Banks also opposed requiring the concurrence of FHFA before a merger agreement may be terminated, stating that the decision to terminate should be made by the parties.

In the final rule, FHFA has removed the requirement for FHFA concurrence with a termination decision, but has otherwise retained the substance of the proposed provision. The intent behind the proposed requirement of FHFA concurrence was primarily to aid FHFA in carrying out its supervisory duties, and to a lesser extent, to decrease the likelihood of a Bank alleging the existence of fraud as a pretext for terminating a merger agreement. FHFA acknowledges that the language of the proposed rule lacked standards for the agency's concurrence, and thus could be construed as authorizing it to compel an unwilling Bank to consummate a merger that the statutory regime intends to be voluntary, even if one of the Banks has concluded that grounds for termination exist, although such a result was not intended.

As in the proposed rule, final § 1278.3(b) states that a written merger agreement must set forth all material terms and conditions of the merger, including, "without limitation," provisions addressing each of the matters enumerated in paragraphs (b)(1) through (b)(9). While, under paragraph (b)(9), the Constituent Banks are required to include within the merger agreement a provision authorizing a Bank to terminate the

agreement for the reasons enumerated in the regulation, nothing in the language of § 1278.3 precludes the Banks from including in the agreement other grounds for termination that may be agreed upon by the respective boards and, in the case of a termination occurring after the member votes, by the members themselves. Thus, to the extent that Banks wish to include within a merger agreement provisions specifying additional grounds for termination of the agreement, they are free to do so under the final rule.

D. Section 1278.4—Merger Application

Section 1278.4 of the proposed rule addressed the application process to be followed in order to obtain FHFA approval for any merger of Banks. Proposed § 1278.4(a) would have required that the Constituent Banks submit to FHFA a merger application addressing all material aspects of the merger including, at a minimum: (1) a written statement summarizing the material features of the proposed merger and addressing certain enumerated issues; (2) a copy of the executed merger agreement and certified copies of the board resolutions authorizing the merger agreement; (3) a copy of the proposed organization certificate of the Continuing Bank; (4) a copy of the proposed bylaws of the Continuing Bank; (5) a copy of the proposed capital structure plan of the Continuing Bank; (6) the most recent annual audited financial statements for each Constituent Bank; and (7) pro forma financial statements for the Continuing Bank. No commenter objected to these proposed application requirements, but there were several comments regarding particular aspects of the requirements. Section 1278.4(a) of the final rule retains the proposed requirements, with some minor revisions as noted below.

As a general matter, the Banks expressed concern over the treatment of confidential commercial information that may be included in a merger application and requested that the final rule permit the submission of confidential information in a separate binder, specify that such information is exempt from disclosure under the Freedom of Information Act (FOIA), and give examples of types of information that would be considered confidential. FHFA has adopted only the first of these suggestions. The introductory clause of final § 1278.4(a) has been revised to include a new sentence specifying that a Bank may submit separately any portions of the merger application that it believes contain confidential or privileged trade secrets or commercial or financial information, and that such information will be handled in accordance with FHFA's FOIA regulations set forth at 12 CFR part 1202.

The procedures for the handling of information submitted to FHFA that the submitter believes to be confidential commercial information protected from FOIA disclosure under 5 U.S.C. 552(b)(4) and 12 CFR 1202.4(a)(4) are set forth in 12 CFR 1202.8. Section 1202.8(b) specifies that submitters of commercial information should use good-faith efforts to designate, by appropriate markings, either at the time of submission or at a reasonable time thereafter, those portions of the information they deem to be protected. Once so designated, such information may be released only pursuant to the procedures set forth in 12 CFR 1202.8(c) through (i), which provides in most cases for prior notice to the submitter and an opportunity for the submitter to object to the release of the information. Because the handling of confidential commercial information is addressed directly by FHFA's FOIA regulations, FHFA has declined to address

separately in final part 1278 the FOIA status of any materials or information submitted as part of the merger application process.

With regard to the contents of the merger application, proposed § 1278.4(a)(1) would have required a written statement including: (i) a summary of the material features of the proposed merger; (ii) the reasons for the proposed merger; (iii) the effect of the proposed merger on the Constituent Banks and their members; (iv) the planned Effective Date of the merger; (v) a summary of the material features of any related transactions and the bearing that the consummation of, or failure to consummate, the related transactions is expected to have upon the merger; (vi) the names of the persons proposed to serve as directors and senior executive officers of the Continuing Bank; (vii) a description of all proposed material operational changes; (viii) information demonstrating that the Continuing Bank will comply with all applicable capital requirements after the Effective Date; (ix) a statement explaining all officer and director indemnification provisions; and (x) an undertaking that the Constituent Banks will continue to disclose all material information, and update all items, as appropriate. The topics required to be addressed in the application statement under § 1278.4(a)(1) of the final rule are substantially the same as those that were proposed, although the final version reflects a few minor additions and clarifications.

The first of these appears in paragraph (a)(1)(iv), which has been revised to require the statement to include, in addition to the proposed Effective Date: the Record Date established by each Constituent Bank's board of directors for purposes of determining the rights of member institutions to participate in the merger ratification vote (discussed in detail below); and the GAAP acquisition date (discussed in detail above), if

that date is to be different from the Effective Date, including an explanation of the reasons for establishing an acquisition date that is different from the Effective Date.

Second, paragraph (a)(1)(vi), which as proposed would have required the names of the persons to serve as directors and senior officers of the Continuing Bank, has been revised to require the Banks also to include in the merger application information regarding their proposal for the ultimate size and composition of the board of directors, i.e., the size and composition of the board for the longer term, along with their proposed transition plan for reducing the size of the board, if that matter is not addressed in the merger agreement. If the merger agreement includes provisions dealing with the Banks' proposals for both the immediate and long-term size and composition of the board, that information need not be resubmitted as part of the merger application. The final rule also retains the proposed requirement that the Banks identify the persons who will serve as directors and executive officers immediately after the merger.

Third, paragraph (a)(1)(vii), which in its proposed form would have required that the application statement address any staff reductions as part of a discussion of anticipated material operational changes, has been revised to require that the statement address such reductions only to the extent such information is known. This revision was made in response to the Banks' comment that it may be more prudent to defer decisions about specific reductions in staff until after the merger has occurred and management of the Continuing Bank has assessed its staffing needs and that, therefore, the Banks should not be required to provide such specific information at the time the merger application is filed. The fourth revision appears in paragraph (a)(1)(x), and is meant to clarify that the

Constituent Banks' undertaking to update "all items," as appropriate, applies specifically to items required to be included in the merger application.

FHFA has declined to make a requested change to proposed paragraph (a)(1)(vi), which would have required that the merger application set forth the names of the persons proposed to serve as directors and senior executive officers of the Continuing Bank. In their joint comment letter, the Banks expressed concern that the identity of the directors and senior executive officers of the Continuing Bank may not yet be determined at the time that the merger application is submitted, and requested that the rule permit this information to be added later as a supplement to the application. Although FHFA believes that the better practice would be for the Banks to file a complete merger application as a single submission, the rule does not require the Banks to do so, and therefore would allow the Banks to file portions of the required materials as a supplement to their initial merger application. Thus, if the Constituent Banks have not reached agreement as to the identity of the persons who will serve as directors and senior executives of the Bank when they initially file the merger application, they may submit this information as a supplement to the initial merger application. However, if they choose to do so, FHFA will not deem the application to be complete, and the time periods for FHFA review prescribed under § 1278.5 will not commence, until all information required by the final rule has been submitted. Corporate governance of the Continuing Bank is a critical issue, and the Director must know the identity of these individuals in order to determine whether the Continuing Bank will have adequate managerial resources—a factor that the Director is required to consider as part of the decision to approve or deny a merger request under § 1278.5(a).

Paragraphs (2) through (7) of proposed § 1278.4(a) addressed the additional items to be included as part of the merger application. Paragraph (a)(2) would have required that a merger application include a copy of the executed merger agreement, accompanied by a certified copy of the resolution of the board of directors of each Constituent Bank authorizing the execution of the merger agreement. In addition, paragraphs (a)(3) through (a)(5) would have required the Banks to provide, respectively, copies of the proposed organization certificate, the proposed bylaws, and the proposed capital structure plan of the Continuing Bank. These paragraphs have been carried over unchanged in the final rule. As discussed previously, if the items addressed in paragraphs (a)(3) through (a)(5) have already been attached to the merger agreement, additional copies need not be provided so long as the application makes clear that they are so attached.

Proposed paragraph (a)(6) would have required that the Banks include as part of a merger application the most recent annual audited financial statements for each Constituent Bank. In the final rule, this provision has been revised to require that the Banks also provide their quarterly financial statements for the current year-to-date. The most current available financial information for each of the Constituent Banks will obviously be a critical element of the official record to be reviewed by the Director, and the omission of this requirement from the proposed rule was an oversight. As mentioned above, FHFA also has added a definition of the term "Financial Statements" to § 1278.1 to clarify that these are to comprise statements of condition, income, capital, and cash flows, with explanatory notes, in such form as the Banks are required to include in their filings made under the Exchange Act.

Paragraph (a)(7) of proposed § 1278.4 would have required the Banks to include

as part of a merger application pro forma financial statements for the Continuing Bank in such form as would be required to be included in the Disclosure Statement that the Banks must provide to their members in connection with the member vote under proposed § 1278.6—i.e., those that would be required in completing a Form S-4 promulgated by the United States Securities and Exchange Commission (SEC) (as discussed in more detail below).[16] In the Supplementary Information to the proposed rule, FHFA stated that the Form S-4 provides merging entities with the option to include either purely historical pro forma statements, or pro forma statements including forecasted results for up to twelve months following the date of the most recent statement of condition, and stated that it was considering whether it should require the Constituent Banks to provide as part of the merger application pro forma forecasted results for as many as three years following the date of the most recent statement of condition.

In their joint comment letter, the Banks asserted that Regulation S-X[17] (which is incorporated, in part, into the Form S-4) does not permit inclusion of forward-looking pro forma statements in a Form S-4 where historical pro forma information is required under Generally Accepted Accounting Principles (GAAP), as they assert is the case with the Banks. For this reason, the Banks believe that the pro forma statements required to be included in the Disclosure Statement should be historical only. The Banks therefore supported the language of the proposed rule, which, based on their reading of the Form S-4 and GAAP requirements, would not have required forward-looking pro forma statements to be included in either the merger application or in the Disclosure Statement.

[16] See 17 CFR 239.25.
[17] See 17 CFR part 210.

The Banks further stated that, if FHFA decided to require any pro forma forecasts to be prepared under the final rule, such forecasts should be limited to twelve months, should be required as part of the merger application only, and should remain confidential.

Having concluded that the Form S-4 requirements are the appropriate template upon which to base the requirements for the Disclosure Statement under part 1278, and given the detailed nature of the Form (including the SEC regulations cross-referenced), FHFA has further concluded that it is best to minimize any variations therefrom with respect to the Disclosure Statement requirements. Accordingly, the final rule continues to require only that the pro forma statements included in the Disclosure Statement correspond with those that would be required under the Form S-4. If a Constituent Bank and its attorneys and accountants conclude that the Form S-4 would require inclusion of only historical pro forma information in a particular case, then it should provide that information in the Disclosure Statement.

However, in order to approve any merger application under § 1278.5 of the final rule, the Director must be provided with information to establish that the Continuing Bank will be viable and will be able to serve its members effectively immediately following the merger and for some period thereafter. The agency also recognizes that the longer the time period covered by a pro forma forecast, the less accurate the forecast is likely to be. With this in mind, the agency has decided to revise § 1278.4(a)(7) to require the Banks to include forward looking pro forma financial statements for the Continuing Bank for each of at least two years following the date of the most recently filed quarterly statement of condition for the Constituent Banks. In order to establish a baseline for these forecasts, final paragraph (a)(7) also requires that the merger application include

pro forma financial statements for the Continuing Bank as of the date of the most recently filed quarterly statement of condition for the Constituent Banks. FHFA requires Banks to provide two-year forward looking pro forma statements when they apply for approval of amendments to their capital structure plans,[18] and a similar approach is warranted in the case of a merger. The agency retains the right to request pro forma forecasts covering a longer period under § 1278.4(b) if it concludes that this information is necessary to assess the merger application.

Section 1278.4(b) of the proposed rule would have authorized FHFA to require the Constituent Banks to submit any additional information that the agency determined was necessary to assess a particular merger. Under the proposed rule, if the agency had determined a merger application to be complete under § 1278.4(c), FHFA could have required the Constituent Banks to submit additional information only with respect to matters derived from or prompted by the materials already submitted, or matters of a material nature that were not reasonably apparent previously. Under proposed § 1278.4(b), FHFA would have been permitted to use a Constituent Bank's failure to provide the required information in a timely manner as grounds to deny a merger application. No commenters objected to these provisions and § 1278.4(b) has been adopted as proposed.

Section 1278.4(c) of the proposed rule addressed the timing for determining whether a merger application is complete. As proposed, FHFA would have had 30 days after the receipt of a merger application to determine whether it was complete or whether

[18] See Federal Housing Finance Board Advisory Bulletin 03-4 (Mar. 18, 2003).

any additional information was required. The proposed rule would have required FHFA to inform the Constituent Banks in writing if the agency determined that an application was complete and that it had all information necessary to evaluate the proposed merger, and also if it determined that an application was incomplete or that it required additional information. In the latter case, FHFA would have been required to specify the number of days within which the Constituent Banks must provide any additional information or materials, and within 15 days of receipt of such information or materials, to again determine whether a merger application is complete and so inform the Banks. Again, no commenters objected to this provision and it has been adopted as proposed.

E. Section 1278.5—Approval by Director

Under the proposed rule, the review and approval of a merger by the Director would have been a two-step process. The first step, addressed by proposed § 1278.5, would have encompassed a review of all substantive aspects of a proposed merger, followed by either a preliminary approval or a denial of the merger application. Merger transactions that had been granted preliminary approval, and which had been ratified by the members of each Constituent Bank, would then have been subject to a final review and approval under § 1278.7 of the proposed rule. At the final review step, the Director would have been permitted to deny final approval of a merger only for limited reasons.

The Banks opposed this two-step process as being overly lengthy and burdensome. They recommended that the rule be revised to provide for a process similar to that which they asserted is employed by the federal depository institution regulators—i.e., a single approval is granted prior to the member ratification vote, but is made subject to written conditions that must be met and certified to the agency before the merger may

be consummated. FHFA has adopted this suggestion and has revised the rule to provide for a single-step approval process. However, as discussed below, § 1278.7 of the final rule continues to provide that no merger may be consummated until the Director accepts the organization certificate of the Continuing Bank pursuant to the receipt of satisfactory evidence that the conditions of the approval under § 1278.5 have been met.

Final § 1278.5(a), which establishes standards for approving a merger, has been adopted as proposed and provides that, in deciding whether to approve or deny a merger application, the Director must take into consideration the financial and managerial resources of each of the Constituent Banks, the future prospects of the Continuing Bank, and the effect of the proposed merger on the safety and soundness of the Continuing Bank and the Bank System. These standards are similar to those used by the federal depository institution regulators in considering mergers and acquisitions of federally insured depository institutions.[19] No commenters objected to the use of these standards as the basis for merger decisions made by the Director under the rule and § 1278.5(a) has been adopted substantially as proposed, save for a minor wording change made for better clarity and consistency.

Section 1278.5(b) of the proposed rule addressed procedural aspects of the merger application process. As proposed, § 1278.5(b) would have permitted the Director 30 days after determining the merger application to be complete to consider the information and materials provided in the application and either grant or deny preliminary approval of the merger. The proposed provision would have required that FHFA provide written notice

[19] See 12 U.S.C. 1467a(e)(2) (acquisitions of savings associations); 12 U.S.C. 1817(j)(7)(C),(D) (bank change in control); 12 U.S.C. 1828(c)(5) (bank mergers).

to each Constituent Bank, as well as to each other Bank and the Office of Finance in the case of either a preliminary approval, or a denial, of the merger application. A notice of preliminary approval would have been required to set forth any conditions to the approval, while a notice of denial would have been required to state the reasons for the denial.

In the final rule, § 1278.5(b) has been revised, and a new § 1278.5(c) has been added, to reflect the new one-step approval process. Final § 1278.5(b) continues to require that, within 30 days of FHFA's determination that a merger application is complete, the Director either approve or deny the merger application. This section has been revised to provide that an approval of a merger application may include any conditions the Director determines to be appropriate. While FHFA has not included in the final rule a requirement that the Banks must submit their Disclosure Statements to the agency for review prior to sending the document to their members, the Director will have the ability to require such a review as a condition of approval.

Final § 1278.5(b) also provides that, in every case, approval will be conditioned on each Constituent Bank demonstrating that it has obtained the members' ratification of the merger agreement in accordance with the requirements of § 1278.6 by submitting to FHFA: (1) a certified copy of the members' resolution ratifying the merger agreement, on which the members cast their votes; and (2) a certification of the member vote from the Bank's corporate secretary or from an independent third party. These materials, as well as any others necessary to prove that all conditions of approval have been met, must be provided to FHFA before the Director may effect the consummation of the merger by

accepting the organization certificate of the Continuing Bank under § 1278.7 of the rule (discussed below).

Final § 1278.5(c) contains the same notice requirements that appeared in § 1278.5(b) of the proposed rule. Thereunder, FHFA must provide written notice to each Constituent Bank, as well as to each other Bank and the Office of Finance, in the case of either an approval or a denial. As in the proposed rule, a notice of approval must set forth any conditions to that approval and a notice of denial must state the reasons for the denial.

F. Section 1278.6—Ratification by Bank Members

Section 1278.6 of the proposed rule addressed the requirements for the ratification of a merger agreement by vote of the Constituent Banks' member institutions. This section has been adopted substantially as proposed, with the exceptions discussed below.

Proposed § 1278.6(a) would have required that no merger of Banks be consummated unless the merger agreement had been ratified by the members of each Constituent Bank in a voting process meeting the requirements of paragraphs (a)(1) through (a)(4) of that section. As proposed, paragraph (a)(1) would have required that each Constituent Bank deliver a ballot and a Disclosure Statement to each of its members. As defined in § 1278.1 of the proposed rule, a Disclosure Statement would have been required to contain all of the items that the Constituent Bank providing the statement would be required to include in a Form S-4 Registration Statement promulgated by the SEC under the Securities Act of 1933 (or any successor form promulgated by the SEC governing disclosure required for securities issued in business combination transactions) when prepared as a prospectus as directed in Part I of the

Form. In addition, proposed paragraph (a)(1) would have required that the Disclosure Statement establish a closing date for the Bank's receipt of completed ballots that was no earlier than 30 days after the date that the ballot and Disclosure Statement were delivered to its members.

In the final rule, paragraph (a)(1) has been revised slightly to require that the enumerated items be delivered to "each institution that was a member as of the Record Date," as opposed to merely "its members." This change was made to reflect the fact that the eligibility of an institution to participate in the merger vote is to be determined as of the record date established by the Constituent Bank's board of directors (discussed in more detail below) and that, consequently, it is the institutions that are so eligible that must receive the ballot and the Disclosure Statement.

In addition, the definition of "Disclosure Statement" has been modified slightly in the final rule. In their joint comment letter, the Banks agreed that the Form S-4 is a useful and widely-accepted model for comprehensive shareholder disclosure in a merger transaction. However, the Banks asserted that a number of the Form S-4 requirements are clearly not applicable to the Banks, and requested that the rule make clear that the Form S-4 prospectus information needs to be included only to the extent applicable. Similarly, the Banks asserted that, pursuant to various statutory provisions and SEC no-action letters, the Banks are not required to comply with certain requirements that would otherwise apply in the preparation of their Annual Reports on Form 10-K. They requested that the rule also make clear that, to the extent that these Form 10-K requirements are also Form S-4 requirements, these items need not be included in the Disclosure Statement.

FHFA recognizes that, due to the unique corporate and capital structure of the Banks, certain items regarding the Banks or the transactions that are required to be disclosed in the Form S-4 will be inapplicable. The agency also recognizes that the Banks have been exempted by statute and through SEC no-action letters from a number of disclosure requirements that would otherwise be applicable. The Form S-4 and the SEC regulations that are cross-referenced therein make clear in several places that information need only be furnished to the extent appropriate.[20] However, for clarity, the definition of "Disclosure Statement" in § 1278.1 of the final rule has been revised to refer to a written document that contains, "to the extent applicable," all of the items that a Bank would be required to include in a Form S-4. This additional clause is intended to make clear that, the Form S-4 requirements notwithstanding, a Bank need not include in its Disclosure Statement information that is not appropriate given the unique structure of the Banks or that they are not required to provide as part of their disclosures made under the Exchange Act. FHFA will provide formal or informal guidance as necessary with regard to the preparation of the Disclosure Statement.

In discussing proposed § 1278.6 in the Supplementary Information to the proposed rule, FHFA stated that, under the terms of the Form S-4, the Banks would be permitted to supply much of the required information through incorporation by reference of their Form 10-Ks and other periodic SEC filings. The Banks supported this option, but pointed out that the incorporation by reference into a Form S-4 is permitted under the

[20] See, e.g., Form S-4, General Instruction D.2 (stating that where the Form directs the registrant to furnish information required by Regulation S-K and the item of Regulation S-K so provides, information need only be furnished to the extent appropriate).

SEC's regulatory authority, which would not extend to the Disclosure Statement. They therefore requested that the rule state expressly that such filings may be incorporated by reference in the Disclosure Statement. FHFA has declined to make the suggested change to the final rule. The final rule requires that a Constituent Bank follow the Form S-4 requirements, to the extent applicable, in preparing its Disclosure Statement. The Form S-4 permits the incorporation by reference of various SEC filings, including the Form 10-K, under certain circumstances. Therefore, where those circumstances apply and the referenced filing is one that the Bank is required to prepare, the Bank is permitted under the final rule to incorporate that filing by reference in the manner prescribed by the Form S-4.

Paragraph (a)(2) of proposed § 1278.6 addressed the voting rights of shareholders of the Constituent Banks and the requirements for the casting of ballots. With respect to the latter, proposed paragraph (a)(2) would have required that each voting entity cast all of its votes either for or against the ratification of the merger agreement or to abstain with respect to all of its votes, and that each entity's vote be made by resolution of its governing body, either authorizing the specific vote or delegating to an individual the authority to vote. Both of these requirements, which mirror requirements that apply to the election of Bank directors, have been carried over unchanged in the final rule.[21]

However, the approach to the determination of the voting rights of each member of a Constituent Bank in a vote to ratify a merger agreement has been modified from that which appeared in the proposed rule. As proposed, paragraph (a)(2) stated that each

[21] See 12 CFR 1261.8.

member of each Constituent Bank would be entitled to cast the same number of votes that the member may cast in that year's election of Bank directors. By statute, in the election of Bank directors, a member is entitled to cast one vote for each share of Bank stock the member was required to hold as of the record date (set by statute at December 31 of the prior year in the case of elections for Bank directors[22]), subject to a cap which is equal to the average number of shares of Bank stock required to be held by all members located in the same state.

Most commenters supported tying members' merger voting rights closely to those that apply to the election of Bank directors, although one requested that the rule permit each Bank to amend its bylaws to govern members' merger voting rights in a way that the Bank's board believes is appropriate. One commenter expressly supported the application of the cap on the number of shares that a member may vote, explaining that this will ensure that small members will continue to have a voice in Bank governance. Another commenter supported the voting cap in theory, but opined that in the case of a district-wide merger vote the cap should be applied uniformly for all of the members within the Bank's district and not on a state-by-state basis, as is done in the case of the election of directors.

FHFA has considered these comments and believes, on balance, that the requirements for the merger voting process should be closely tied to those that are established by statute for the election of Bank directors. This is because the voting process enshrined in the Bank Act is the only manifestation of general Congressional

[22] See 12 U.S.C. 1427(b)(1).

intent on the subject of member voting, and because it is consistent with the cooperative structure of the Bank System and will reduce the possibility that a few large stockholders will control the outcome of a vote on a merger. However, in the light of the comments received, the agency has reconsidered the application of the vote cap and has determined that because a merger ratification vote would be a district-wide "at large" election, the cap on the number of votes that may be cast by a member institution should be calculated based upon the average number of shares held by all members in the Bank's district, as opposed to the average number held by all members within the state in which that member institution is located.

FHFA recognizes that this will result in certain large Bank members being eligible to cast more or fewer votes—in some cases by significant margins—than the member would be eligible to cast in the election of directors. However, it is the agency's view that, as a matter of equity and appropriate corporate governance, the final rule should not permit a result where one Bank member is authorized to vote a materially different number of shares than another similarly-sized member that is located within a different state in the same Bank district. Therefore, paragraph (a)(2) has been revised in the final rule to provide that each member of each Constituent Bank shall be entitled to cast one vote for each share of Bank stock that the member was required to own as of the Record Date, provided that the number of votes that any member may cast shall not exceed the average number of shares of Bank stock required to be held by all members of that Bank, calculated on a district-wide basis, as of the Record Date.

In the Supplementary Information to the proposed rule, FHFA explained that the effect of applying the statutory and regulatory requirements governing the election of

Bank directors to the merger ratification vote is that not all Bank stock would carry the right to vote in such an election. For example, stock controlled by a non-member institution as a result of the acquisition of a Bank member, and stock held by a member in excess of the statutory cap applicable to that member's state, could not be voted in a director election and, therefore, could not have been voted in a merger election under the proposal. In their joint comment letter, the Banks expressed concern about both of those examples, pointing out that the long-standing policy of both FHFA and the former Federal Housing Finance Board (Finance Board) has been that: (1) if a non-member institution acquires a Bank member after the record date, but prior to the election, the acquiring non-member may vote the acquired member's shares, despite the fact that it is not a Bank member; and (2) if a member that is subject to the statutory cap in a particular state acquires another member in the same state subsequent to the record date, but prior to the election, the acquiring member is permitted to cast the eligible votes for the acquired member, as well as its own votes, in that year only.[23]

FHFA did not intend to imply in the Supplementary Information to the proposed rule that these policies would not apply also to a merger vote under part 1278. The counter-examples given by the Banks apply to particular situations that may occur due to the fact that voting rights are determined as of the record date (December 31 in the case of director elections), whereas the vote itself may not occur until many months later. During the interim, stock that is eligible to be voted by a member as of the record date may be transferred to another entity—which could be a member or non-member—

[23] See 63 FR 65683, 65685-86 (Nov. 30, 1998) (Supplementary Information to final rule governing the election of Bank directors).

through the acquisition of the member by the other entity. In these cases, the acquiring entity may vote the shares that were deemed eligible as of the record date as the successor to the disappearing member. Because these voting rights are those of the disappearing member, the status of the acquirer as a non-member or the fact the acquirer may be a member whose own voting power is limited by the vote cap have no bearing on its ability to vote the shares of the acquired member. For the same reasons, these policies would apply also to merger ratification votes undertaken pursuant to final part 1278. That is, the determinative factor will be whether the stock was owned by a member as of the Record Date established by the board of directors of the Constituent Bank. If so, the stock will have voting rights that may be exercised by the current holder, regardless of the holder's membership status or whether all of the shares held by the holder would currently be eligible to be voted.

Paragraph (a)(3) of proposed § 1278.6 addressed the Constituent Banks' handling of ballots and the determination of the results of the ratification vote. It would have prohibited each Constituent Bank from reviewing any ballot until after the closing date of the election, counting any ballot received after the closing date, or disclosing how any member voted, while requiring each to tabulate the ballots immediately after the closing date and to retain all ballots for at least two years after the date of the election. Importantly, as proposed, paragraph (a)(3) provided that a merger agreement would be considered to be ratified if a majority of votes cast in the election have been cast in favor of the merger. One commenter, while otherwise supporting the parallel to the director election process, advocated requiring the approval of a supermajority of members for any proposed merger. FHFA has declined to adopt that suggestion because it interprets

section 26(b) of the Bank Act as having the purpose of facilitating the ability of the Banks to voluntarily merge, and the imposition of a supermajority requirement would not further that purpose. Accordingly, paragraph (a)(3) has been adopted as proposed.

Paragraph (a)(4) of proposed § 1278.6 would have required that, within 10 calendar days of the election closing date, a Constituent Bank deliver to its members, to each Constituent Bank with which it proposes to merge, and to FHFA a statement of: the total number of eligible votes; the number of members voting in the election; and the total number of votes cast both for and against ratification of the merger agreement, as well as those that were eligible to be cast by members that abstained and by members who failed to return completed ballots. No commenters objected to any aspect of this provision, and it has been adopted as proposed.

Section 1278.6(b) of the proposed rule stated that, in connection with a proposed merger, no Bank, or any director, officer, or employee thereof, shall make any statement, written or oral, which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statement not false or misleading, or necessary to correct any earlier statement that has become false or misleading. No commenter objected to this provision, and it has also been adopted as proposed.

G. Section 1278.7—Consummation of the Merger

Section 1278.7 of the final rule governs the process for the consummation of a merger after the members of each Constituent Bank have voted to ratify the merger agreement. As proposed, § 1278.7 would have governed the second step of the preliminary/final approval process that was provided for in the proposed rule. The

proposed provision would have required that the Director grant a second, final, approval prior to consummation of the merger, and would have provided the Director with limited authority to deny approval of the merger in cases where: the member vote was not carried out in accordance with the requirements of § 1278.6; one or more Constituent Banks failed to fulfill a condition of the preliminary approval; or an event had occurred since the time of the preliminary approval that would have had a significant adverse impact on the future viability of the Continuing Bank.

For the reasons discussed above, the final rule now requires only one approval by the Director to be obtained, prior to the member votes under § 1278.6. However, because this approval is conditional, § 1278.7 has been retained in revised form as a procedural mechanism to ensure that the merger cannot be consummated until the Director has received satisfactory evidence that the conditions of the approval have been met. Section 1278.7 has also been revised to provide for greater certainty as to the time that the merger becomes effective.

Section 1278.7(a) of the final rule addresses the materials that the Constituent Banks are required submit after their respective member institutions have voted to ratify the merger. Final § 1278.7(a)(1) requires that the Constituent Banks submit to FHFA evidence acceptable to the Director that all conditions imposed in connection with the approval of the merger application have been satisfied, which shall in all cases include for each Bank a certified copy of its members' resolution ratifying the merger agreement and a certification of the member votes from the corporate secretary or from an independent third party. Final § 1278.7(a)(2) requires that the Constituent Banks also submit an organization certificate for the Continuing Bank, "in such form as FHFA may

specify" that has been executed by the individuals who will constitute the board of directors of the Continuing Bank. Although FHFA currently has no regulations or guidelines governing the form of a Bank's organization certificate, final § 1278.4(a)(3) requires that the Constituent Banks submit a proposed organization certificate as part of the merger application, and the agency anticipates that it will provide appropriate guidance as to the form and content of the final certificate as part of the merger approval process.[24]

Final § 1278.7(b) governs the method of acceptance and timing of the effectiveness of the Continuing Bank's organization certificate. Under the proposed rule, after obtaining the Director's final approval, the Constituent Banks would have been required to submit to FHFA an organization certificate for the Continuing Bank and, upon its acceptance by the agency, the corporate existence of the Continuing Bank would have commenced "as of the Effective Date." This approach lacked clarity in a number of respects. First, as discussed above, the proposed rule defined "Effective Date" to mean "the date on which the Constituent Banks consummate the merger," but left unclear what actions were required for the Banks to consummate the merger. In addition, while the proposed rule would have required FHFA to provide notice of its final approval to all of the Banks, it neither specified any particular overt action to be taken by FHFA to signify

[24] Section 12(a) of the Bank Act requires each Bank to make and file with the Director an "organization certificate" upon the establishment of the Bank, but leaves the form and content of the certificate to the discretion of the Director. See 12 U.S.C. 1432(a). Of the 12 existing Banks, eight are still operating under their original 1932 organization certificates and four are operating under more recent versions. All of these certificates (the contents of which are set forth in the Banks' respective Form 10-12g Registration Statements filed with the SEC) follow the same format and FHFA expects that it would require any organization certificate that becomes effective in the future to be substantially similar to those currently in effect.

"acceptance" of the Continuing Bank's organization certificate, nor provided for any prior or subsequent notice of the fact or timing of such acceptance, or of the Effective Date of the new organization certificate.

Final § 1278.7(b) is intended to provide the specificity that the proposed rule lacked. It states that, upon determining that all conditions of the Director's approval have been satisfied and that the organization certificate has been properly executed and is in the required form, the Director shall accept the organization certificate by endorsing it with the date of acceptance and the Effective Date. Paragraphs (1) and (2) of § 1278.7(b) govern the method by which the Director shall determine the Effective Date. If the merger agreement states a proposed Effective Date (whether expressed in terms of a specific date or a specific number of days after a particular event) and that date has not passed, the Director shall establish that date as the Effective Date. If the merger agreement sets forth a proposed range of dates within which the Effective Date may occur (e.g., "within thirty days of the ratification of the merger by the members of both Constituent Banks") and that range of dates has not expired, the Director shall establish an Effective Date that is within that range of dates. If the Effective Date set forth in the merger agreement (in whatever form it is expressed) has passed, the Director shall establish the tenth business day following the date of acceptance as the Effective Date. However, if the merger agreement provides that the agreement will terminate if the merger has not become effective by a particular date, and that termination date is fewer than 10 business days following the date of acceptance, the Director shall establish the latest possible business-day prior to the date on which the merger agreement will terminate as the Effective Date.

Final §§ 1278.7(c)(1) and (2) provide that, after the Director has accepted the organization certificate as provided under § 1278.7(b), the Continuing Bank shall, as of the commencement of the Effective Date specified on the certificate, become or remain a body corporate (depending on the type of transaction) operating under such organization certificate with all powers granted to a Bank under the Bank Act, and shall succeed to all rights, titles, powers, privileges, books, records, assets, and liabilities of the Constituent Bank or Banks, as provided in the merger agreement. In the proposed rule, § 1278.7(b) stated that, after acceptance of the organization certificate, the Continuing Bank would "be a body corporate operating under the new organization certificate." The Banks expressed concern about this phrasing because they believed that such language may imply that a new corporate entity has been formed even in the case of a traditional merger (where an existing Bank absorbs a disappearing Bank). In response, FHFA has specifically provided in final § 1278.7(c) that, after acceptance of the organization certificate, the Continuing Bank shall "become or remain a body corporate (depending on the type of transaction) operating under such organization certificate." This phrasing is intended to address both those business combinations where the Continuing Bank is a continuation of one of the existing Constituent Banks, as well as those where the Continuing Bank is considered to be an entirely new entity. Regardless of the form of the transaction, FHFA will not consider the merger to have been legally consummated until the new or revised organization certificate becomes effective.

In addition, final § 1278.7(c)(3) provides that the corporate existence of any Constituent Bank that is not a Continuing Bank shall cease as of the Effective Date of the organization certificate of the Continuing Bank, except as provided in the merger

agreement. The latter clause is intended to provide for those cases in which it may be useful or necessary for a disappearing Constituent Bank to continue in existence for a short period following the consummation of a merger—for example, where a "shell" Bank that has transferred its territory and most of its assets and liabilities to another Bank may need time wind down its affairs, or where the disappearing Bank is being acquired by two or more other Banks and the transactions are not to be consummated simultaneously. Section 25 of the Bank Act provides that each Bank shall have succession until dissolved by the Director (or by Act of Congress) and final § 1278.7(c)(3) is intended to make clear that the Director's approval of the merger application and endorsement of the new organization certificate are sufficient to dissolve any non-Continuing Banks without further action in cases where the merger agreement does not provide for the temporary continuation of a disappearing Constituent Bank. In the case of a shell Bank that is winding down its affairs, the Director will issue a separate order of dissolution at the appropriate time. Under the rule, any Constituent Bank that is a party to a merger (as that term is broadly defined in the rule) that continues in existence after the consummation of the merger without specific provision for its eventual disposition (either through dissolution or another merger) will be considered to be a Continuing Bank and will be subject to all applicable requirements.

Final § 1278.7(d) provides that, after the Director accepts the organization certificate for the Continuing Bank, FHFA shall provide prompt written notice of that fact to the Constituent Banks, as well as to each other Bank and the Office of Finance. This notice must include the date of acceptance and the Effective Date of the organization certificate for the Continuing Bank.

III. Paperwork Reduction Act

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

IV. Regulatory Flexibility Act

The final rule applies only to the Banks, which do not come within the meaning of small entities as defined in the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Therefore in accordance with section 605(b) of the RFA, FHFA certifies that this final rule will not have significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 1278

Banks, banking, Federal home loan banks, mergers.

For the reasons stated in the Supplementary Information, the Federal Housing Finance Agency hereby amends chapter XII of title 12 of the Code of Federal Regulations by adding new part 1278 to subchapter D to read as follows:

PART 1278—VOLUNTARY MERGERS OF FEDERAL HOME LOAN BANKS

Sec.

Authority: 12 U.S.C. 1432(a), 1446, 4511.

§ 1278.1 Definitions.

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

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

Constituent Bank means a Bank that is proposing to merge with one or more other Banks. Each Bank entering into a merger is a Constituent Bank, regardless of whether it is also a Continuing Bank.

Continuing Bank means a Bank that will exist as the result of a merger of two or more Constituent Banks, and when used in the singular shall include the plural.

Director, written in title case, means the Director of FHFA or his or her designee.

Disclosure Statement means a written document that contains, to the extent applicable, all of the items that a Bank would be required to include in a Form S-4 Registration Statement under the Securities Act of 1933 (or any successor form promulgated by the United States Securities and Exchange Commission governing disclosure required for securities issued in business combination transactions) when prepared as a prospectus as directed in Part I of the form, if the Bank were required to provide such a prospectus to its shareholders in connection with a merger.

Effective Date means the date on which the organization certificate of the Continuing Bank becomes effective as provided under § 1278.7.

FHFA means the Federal Housing Finance Agency.

Financial Statements means statements of condition, income, capital, and cash flows, with explanatory notes, in such form as the Banks are required to include in their filings made under the Securities and Exchange Act of 1934.

GAAP means accounting principles generally accepted in the United States as in effect from time to time.

Merge or Merger means:

(1) A merger of one or more Banks into another Bank;

(2) A consolidation of two or more Banks resulting in a new Bank;

(3) A purchase of substantially all of the assets, and assumption of substantially all of the liabilities, of one or more Banks by another Bank or Banks; or

(4) Any other business combination of two or more Banks into one or more resulting Banks.

Office of Finance means the Office of Finance, a joint office of the Banks established under part 1273 of this chapter.

Record Date means the date established by a Bank's board of directors for determining the members that are entitled to vote on the ratification of the merger agreement and the number of ballots that may be cast by each in the election.

§ 1278.2 Authority.

Any two or more Banks may merge voluntarily under authority of section 26(b) of the Bank Act, provided that each of the following requirements has been satisfied:

(a) The Constituent Banks have executed a written merger agreement that satisfies all requirements of § 1278.3;

(b) The Constituent Banks have jointly filed a merger application with FHFA that satisfies all requirements of § 1278.4;

(c) The Director has approved the merger application in accordance with the requirements of § 1278.5;

(d) The members of each Constituent Bank have ratified the merger agreement as provided under § 1278.6; and

(e) The Director has determined that the Constituent Banks have satisfied all conditions imposed in connection with the approval of the merger application, and has accepted the properly executed organization certificate of the Continuing Bank, as provided under § 1278.7.

§ 1278.3 Merger agreement.

A merger of Banks under the authority of § 1278.2 shall require a written merger agreement that:

(a) Has been authorized by the affirmative vote of a majority of a quorum of the board of directors of each Constituent Bank at a meeting on the record and has been executed by authorized signing officers of each Constituent Bank; and

(b) Sets forth all material terms and conditions of the merger, including, without limitation, provisions addressing each of the following matters—

(1) The proposed Effective Date and the proposed acquisition date for purposes of accounting for the transaction under GAAP, if that date is to be different from the Effective Date;

(2) The proposed organization certificate and bylaws of the Continuing Bank;

(3) The proposed capital structure plan for the Continuing Bank;

(4) The proposed size and structure of the board of directors for the Continuing Bank;

(5) The formula to be used to exchange the stock of the Constituent Banks for the stock of the Continuing Bank, and a provision prohibiting the issuance of fractional

shares of stock;

(6) Any conditions that must be satisfied prior to the Effective Date, which must include approval by the Director and ratification by the members of the Constituent Banks;

(7) A statement of the representations or warranties, if any, made or to be made by any Constituent Bank;

(8) A description of the legal or accounting opinions or rulings, if any, that are required to be obtained or furnished by any party in connection with the proposed merger; and

(9) A statement that the board of directors of a Constituent Bank may terminate the merger agreement before the Effective Date upon a determination that:

(i) The information disclosed to members contained material errors or omissions;

(ii) Material misrepresentations were made to members regarding the impact of the merger;

(iii) Fraudulent activities were used to obtain members' approval; or

(iv) An event occurred subsequent to the members' vote that would have a significant adverse impact on the future viability of the Continuing Bank.

§ 1278.4 Merger application.

(a) Contents of application. Any two or more Banks that wish to merge shall submit to FHFA a merger application that addresses all material aspects of the proposed merger. As provided in § 1202.8 of this chapter, a Bank may submit separately any portions of the application that it believes contain confidential or privileged trade secrets or commercial or financial information, which portions will be handled in accordance

with FHFA's Freedom of Information Act regulations set forth in part 1202 of this chapter. The application shall include, at a minimum, the following:

(1) A written statement that includes—

(i) A summary of the material features of the proposed merger;

(ii) The reasons for the proposed merger;

(iii) The effect of the proposed merger on the Constituent Banks and their members;

(iv) The proposed Effective Date, the proposed acquisition date for purposes of accounting for the transaction under GAAP, if that date is to be different from the Effective Date (including the reasons for designating a different acquisition date), and the Record Date established by each Constituent Bank's board of directors;

(v) If the Constituent Banks contemplate that the proposed merger will be one of two or more related transactions, a summary of the material features of any related transactions and the bearing that the consummation of, or failure to consummate, the related transactions is expected to have upon the proposed merger;

(vi) If not addressed by the merger agreement, the Banks' proposal for the ultimate size and composition of the board of directors for the Continuing Bank and their plan for reducing the board to its ultimate size and composition, as well as the names of the persons proposed to serve as directors and senior executive officers of the Continuing Bank immediately after the merger;

(vii) A description of all proposed material operational changes including, but not limited to, reductions in the existing staffs of the Constituent Banks (to the extent such

information is known), whether and how Bank operations will be combined, and whether any Constituent Bank will continue to operate as a branch of the Continuing Bank;

(viii) Information demonstrating that the Continuing Bank will comply with all applicable capital requirements after the Effective Date;

(ix) A statement explaining all officer and director indemnification provisions; and

(x) An undertaking that the Constituent Banks will continue to disclose all material information, and update all items of the application, as appropriate;

(2) A copy of the executed merger agreement and a certified copy of the resolution of the board of directors of each Constituent Bank authorizing the merger agreement;

(3) A copy of the proposed organization certificate of the Continuing Bank;

(4) A copy of the proposed bylaws of the Continuing Bank;

(5) A copy of the proposed capital structure plan of the Continuing Bank;

(6) The most recent annual audited Financial Statements, and any interim quarterly financial statements for the year-to-date, for each Constituent Bank; and

(7) Pro forma Financial Statements for the Continuing Bank as of the date of the most recent statement of condition supplied under paragraph (a)(6) of this section, and forecasted pro forma Financial Statements for each of at least two years following such date.

(b) Additional information. FHFA may require the Constituent Banks to submit any additional information FHFA deems necessary to evaluate the proposed merger. If FHFA has determined a merger application to be complete as provided in paragraph (c)

of this section, FHFA may require the Constituent Banks to submit additional information only with respect to matters derived from or prompted by the materials already submitted, or matters of a material nature that were not reasonably apparent previously, including matters concealed by the Constituent Banks or relating to developments that arose after the determination of completeness. If the Constituent Banks fail to provide the additional information in a timely manner, the Director may deem the failure to provide the required information as grounds to deny the application.

(c) Completion of application. Within 30 days of the receipt of a merger application, FHFA shall determine whether the application is complete and whether FHFA has all information necessary for the Director to evaluate the proposed merger.

(1) If FHFA determines that the application is complete and that it has all information necessary to evaluate the proposed merger, it shall so inform the Constituent Banks in writing.

(2) If FHFA determines that the application is incomplete, or that it requires additional information in order to evaluate the application, it shall so inform the Constituent Banks in writing, and shall specify the number of days within which the Constituent Banks must provide any additional information or materials. Within 15 days of receipt of the additional information or materials, FHFA shall inform the Constituent Banks in writing whether the merger application is complete.

§ 1278.5 Approval by Director.

(a) Standards. In determining whether to approve a merger of Banks under the authority of § 1278.2, the Director shall take into consideration the financial and managerial resources of the Constituent Banks, the future prospects of the Continuing

Bank, and the effect of the proposed merger on the safety and soundness of the Continuing Bank and the Bank system.

(b) Determination by Director. After FHFA determines that a merger application is complete, as provided in § 1278.4(c), the Director shall, within 30 days, either approve or deny the merger application. An approval of a merger application may include any conditions the Director determines to be appropriate, and shall in all cases be conditioned on each Constituent Bank demonstrating that it has obtained its members' ratification of the merger agreement in accordance with the requirements of § 1278.6 by submitting to FHFA:

(1) A certified copy of the members' resolution ratifying the merger agreement, on which the members cast their votes; and

(2) A certification of the member vote from the Bank's corporate secretary or from an independent third party.

(c) Notice. If the Director approves the merger application, FHFA shall provide written notice of the approval and any conditions to each Constituent Bank, as well as to each other Bank and the Office of Finance. If the Director denies the merger application, FHFA shall provide written notice of the denial to each Constituent Bank, as well as to each other Bank and the Office of Finance, and the notice to the Constituent Banks shall include a statement of the reasons for the denial.

§ 1278.6 Ratification by Bank Members.

(a) Requirements for member vote. No merger of Banks under the authority of § 1278.2 may be consummated unless a merger agreement meeting the requirements of §

1278.3 has been ratified by the affirmative vote of the members of each Constituent Bank in a voting process that meets the following requirements:

(1) Notice of vote. Each Constituent Bank shall submit the authorized merger agreement to its members for ratification by delivering to each institution that was a member as of the Record Date—

(i) A ballot that permits the member to vote for or against the ratification of the merger agreement, or to abstain from such vote; and

(ii) A Disclosure Statement that establishes a closing date for the Bank's receipt of completed ballots that is no earlier than 30 days after the date that the ballot and Disclosure Statement are delivered to its members.

(2) Voting rights and requirements. In the vote to ratify the merger agreement, each member of each Constituent Bank shall be entitled to cast one vote for each share of Bank stock that the member was required to own as of the Record Date, provided that the number of votes that any member may cast shall not exceed the average number of shares of Bank stock required to be held by all members of that Bank, calculated on a district-wide basis, as of the Record Date. A member must cast all of its votes either for or against the ratification of the merger agreement, or may abstain with respect to all of its votes. Each member's vote shall be made by resolution of its governing body, either authorizing the specific vote, or delegating to an individual the authority to vote.

(3) Determination of result. No Constituent Bank shall review any ballot until after the closing date established in the Disclosure Statement or include in the tabulation any ballot received after the closing date. A Constituent Bank shall tabulate the votes cast immediately after the closing date. The members of a Constituent Bank shall be

considered to have ratified a merger agreement if a majority of votes cast in the election have been cast in favor of the ratification of the merger agreement. The Constituent Bank, or the Continuing Bank, as appropriate, shall retain all ballots received for at least two years after the date of the election, and shall not disclose how any member voted.

(4) Notice of result. Within 10 days of the closing date, a Constituent Bank shall deliver to its members, to each Constituent Bank with which it proposes to merge, and to FHFA a statement of—

(i) The total number of eligible votes;

(ii) The number of members voting in the election; and

(iii) The total number of votes cast both for and against ratification of the merger agreement, as well as those that were eligible to be cast by members that abstained and by members who failed to return completed ballots.

(b) False and misleading statements. In connection with a proposed merger, no Bank, nor any director, officer, or employee thereof, shall make any statement, written or oral, which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statement not false or misleading, or necessary to correct any earlier statement that has become false or misleading.

§ 1278.7 Consummation of the merger.

(a) Post-approval submissions. After the members of each Constituent Bank have voted to ratify the merger agreement, the Constituent Banks shall submit to FHFA:

(1) Evidence acceptable to the Director that all conditions imposed in connection with the approval of the merger application under § 1278.5 have been satisfied, including

the items specified in §§ 1278.5(b)(1) and (2); and

(2) An organization certificate for the Continuing Bank, in such form as FHFA may specify, that has been executed by the individuals who will constitute the board of directors of the Continuing Bank.

(b) Acceptance of organization certificate. Upon determining that all conditions have been satisfied and that the organization certificate meets the requirements of § 1278.7(a)(2), the Director shall accept the organization certificate of the Continuing Bank by endorsing thereon the date of acceptance and the Effective Date, which date shall be:

(1) The proposed Effective Date set forth in the merger agreement or, if the merger agreement expresses the proposed Effective Date in terms of a range of dates, a date within the applicable range of dates; or

(2) If the proposed Effective Date set forth in the merger agreement has passed, the earlier of:

(i) The 10th business day following the date of acceptance of the organization certificate by the Director; or

(ii) The last business day preceding any date specified in the merger agreement by which the merger agreement will terminate if the merger has not become effective.

(c) Effectiveness of merger. After the Director has accepted the organization certificate of the Continuing Bank as provided in § 1278.7(b), and as of the commencement of the Effective Date specified on such organization certificate:

(1) The Continuing Bank shall become or remain a body corporate (depending on the type of transaction) operating under such organization certificate with all powers granted to a Bank under the Bank Act;

(2) The Continuing Bank shall succeed to all rights, titles, powers, privileges, books, records, assets, and liabilities of the Constituent Banks, as provided in the merger agreement; and

(3) The corporate existence of any Constituent Bank that is not a Continuing Bank shall cease, unless otherwise provided in the merger agreement.

(d) Notice. After accepting the organization certificate for the Continuing Bank, the Director shall provide to the Constituent Banks, and to each other Bank and the Office of Finance, prompt written notice of that fact, which shall include the date of acceptance and the Effective Date of the organization certificate.

_____ Dated: November 17, 2011

Edward J. DeMarco,
Acting Director, Federal Housing Finance Agency.

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