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**DEPARTMENT OF THE TREASURY**

**Office of Thrift Supervision**

**12 CFR Parts 544 and 552**

**[No. 2001-15]**

**RIN 1550-AB39**

**Federal Savings Association Bylaws; Integrity of Directors**

**AGENCY:** Office of Thrift Supervision**,** Treasury.

**ACTION:** Final rule.

**SUMMARY:** The Office of Thrift Supervision (OTS) is issuing a final rule changing its regulations concerning corporate governance to create a class of preapproved optional bylaw provisions that federally chartered savings associations may adopt. The final rule decreases regulatory burden on federal savings associations by permitting them to adopt certain bylaws expeditiously without prior OTS review. In addition, OTS is issuing the first preapproved optional bylaw. If adopted by a federal savings association, the bylaw will preclude persons who, among other things, are under indictment for or have been convicted of certain crimes, or are subject to a cease and desist order entered by any of the banking agencies, from being members of the association's board of directors. The preapproved bylaw is intended to permit federal savings associations to better protect their

business from the adverse effects that are likely to result when the reputation of its board members does not elicit the public's trust.

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

**FOR FURTHER INFORMATION CONTACT:** Aaron B. Kahn, Special Counsel (202) 906-6263, Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552.

**SUPPLEMENTARY INFORMATION:**

## I. Background

On November 2, 2000, OTS published a proposed rule amending its corporate governance rules for federally chartered savings associations to create a class of preapproved optional bylaw provisions that those savings associations may adopt without prior OTS review. 65 FR 66166. The proposal was intended to decrease regulatory burden on federal savings associations by permitting them to adopt certain bylaws expeditiously. In addition, OTS proposed the first preapproved optional bylaw. The proposed bylaw was intended to permit federal savings associations to better protect their business from the adverse effects that are likely to result when the reputation of its board members does not elicit the public's trust.

## II. Summary of Comments and Description of Final Rule and Preapproved Bylaw

A. Discussion of the Comments on the Rule

The public comment period on the proposed rule and proposed preapproved bylaw closed on January 2, 2001. Three trade associations and two attorneys filed comments.

OTS requires federal savings associations to operate under bylaws that meet certain regulatory requirements and has drafted a set of "model" bylaws that would satisfy those requirements. The text of this set of model bylaws for federal savings associations is located in the Application Processing Handbook (Handbook). Federal savings associations may adopt this set of model bylaws without prior notice to OTS, provided that they notify OTS within 30 days after their adoption.

The proposal would provide additional preapproved "optional" bylaws that federal savings associations may adopt with a post-adoption notice to OTS.[1] Federal savings associations are not required to adopt the optional bylaws. The amendment simply reduces the regulatory burden on federal savings associations desiring to adopt one or more of the specific optional bylaw provisions. The preapproved optional bylaws will be published in the Handbook in a manner that will differentiate them from the model bylaws.

Two trade associations supported the creation of a class of optional bylaws. One of the associations stated that it "will enable OTS-chartered institutions to more effectively address corporate governance issues while reducing attendant regulatory burdens." No other comments directly addressed the proposal that there should be a class of optional bylaws. Accordingly, the proposed rule is adopted without change.[2]

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[1] Mutual Holding Companies may also adopt any preapproved optional bylaw. See 12 CFR 575.9(a)(4).

[2] Under section 302(b)(1)(A) of the Riegle Community Development Act, 12 U.S.C. 4802(b)(1)(A), OTS finds good cause for this rule to become effective thirty days after publication in the Federal Register rather than the first day of a calendar quarter. The rule reduces regulatory burdens and does not impose additional reporting requirements on savings associations.

B. Discussion of the Comments on the Preapproved Bylaw

In addition to seeking comment on the proposal to include preapproved optional bylaws in the Handbook, OTS also requested comment on the first proposed preapproved bylaw. This bylaw provides standards for the integrity of directors of those federal savings associations that choose to adopt it. The bylaw focuses particularly on actions against an individual predicated on serious dishonesty, breach of fiduciary duty or willful violation of financial regulatory law. These matters directly relate to the trustworthiness of persons who are overseeing the operation of savings associations.

The wording of the optional bylaw dealing with directors' integrity is as follows:

> A person is not qualified to serve as a director if he or she: (1) is under indictment for, or has ever been convicted of, a criminal offense involving dishonesty or breach of trust and the penalty for such offense could be imprisonment for more than one year, or (2) is a person against whom a banking agency has, within the past ten years, issued a cease and desist order for conduct involving dishonesty or breach of trust and that order is final and not subject to appeal, or (3) has been found either by a regulatory agency whose decision is final and not subject to appeal or by a court to have (i) breached a fiduciary duty involving personal profit or (ii) committed a willful violation of any law, rule or regulation governing banking, securities, commodities or insurance, or any final cease and desist order issued by a banking, securities, commodities or insurance regulatory agency.

The optional bylaw permits federal savings associations to assure themselves that persons subject to adverse actions concerning their fiduciary integrity or compliance with financial regulatory laws do not become board members.

It is important that the directors of savings associations be persons of good character and integrity. They oversee management and they have the ultimate responsibility for the operations of the savings association. In addition, directors of savings associations are expected to assist their institutions in attracting and retaining business. Their reputations in the community or communities served by the savings association reflect on the institution and affect their ability to help the institution attract and retain business. People must be able to trust the institution that holds their money. Moreover, people may be wary of contracting with an institution that they do not trust. Thus, a director who has an exemplary reputation may be a valuable asset to the association. Conversely, a director whose reputation is tainted, for example because a court has found he or she personally profited from a breach of his or her fiduciary duties, may injure an institution just by being a member of the board.

The optional bylaw does not bar anyone from the industry. Rather, the optional bylaw merely permits an individual federal savings association to set qualifications for board membership for that institution. Federal savings associations that adopt the preapproved bylaw amendment will not have to provide prior notice to OTS, but will have to file notice of the adoption of the bylaw within 30 days after adopting the bylaw.[3]

[3] Federal savings associations that wish to adopt a bylaw addressing director qualifications that does not conform to the preapproved bylaw amendment must still obtain prior approval from OTS.

Two trade associations commented that the initial optional bylaw was appropriate. One association also stated that it believed the bylaw should not be expanded to prevent ineligible persons from nominating otherwise eligible candidates for director positions. It reasoned that such a broad provision would be burdensome on regulated institutions and that the "important factor is that directors themselves be individuals of integrity." OTS agrees that the primary focus should be on the integrity of the individual directors. In the absence of any reasoned support for a broader provision, OTS will not expand the wording of the preapproved bylaw to encompass nominees of persons covered by the terms of the bylaw.

Both attorneys and one trade association recommended that the bylaw not be adopted. The trade association stated that the proposal was unnecessary. One attorney asserted that the available data did not support a conclusion that a savings association had ever suffered any adverse consequence due to a director having been subject to a cease and desist order. The comment did not cite any studies supporting its position. In our view, trust is fundamental to the banking industry and a lack of trust in the managers of institutions will adversely affect their businesses. However, the magnitude of such an effect may be difficult to ascertain in any particular instance.

The trade association and the two attorneys argued that the bylaw exceeds the agency's legal authority. All three relied principally on Atherton v. FDIC, 519 U.S. 213 (1997), where the Supreme Court held that there was no federal common law of fiduciary duty applicable to federally chartered savings associations. However, Atherton is inapposite. First, OTS is not imposing any requirements. All OTS is doing by adopting the optional bylaw is permitting private parties who desire to have integrity requirements

for their boards of directors to do so without first requesting OTS approval. Second, the bylaw does not purport to create any substantive fiduciary duties. Rather, the bylaw, if adopted by a savings association, would prevent an individual who violated a fiduciary duty found elsewhere in the substantive law from serving as a director. Third, even if OTS was deemed to be creating a substantive fiduciary duty by permitting savings associations to adopt the bylaw, OTS's action would be proper. The Court in Atherton indicated that "federal regulations validly promulgated pursuant to statute" could provide a federal standard of conduct. Atherton, 519 U.S. at 219, see also 218, 225. OTS has broad statutory authority to promulgate regulations prescribing the organization and operation of federal savings associations. See 12 U.S.C. 1464(a). Thus, although OTS does not consider the bylaw to constitute a regulation, if it is a rule, the Atherton decision would not provide a basis for objection to the bylaw.

Furthermore, one trade association's and the two attorneys' comments assumed that the analysis of the propriety of the bylaw was not affected by its "voluntary" nature, apparently because they believe that institutions will not really be free to choose whether or not to adopt it. From that premise they asserted that the agency cannot properly impose integrity standards that are more restrictive than those specifically adopted by Congress for precluding persons from involvement in the affairs of institutions. First, contrary to the view expressed by those comments, adoption of the preapproved bylaw will be completely voluntary. Each federal savings association will be able to choose whether to adopt the preapproved bylaw. OTS will not require any association to adopt it. Second, in any event, the specific statutory preclusion provisions were not intended to be the only authority for either a federal savings association or OTS to take action to

insure the integrity of the persons controlling the institution. While Congress provided that the banking agencies could preclude certain persons, Congress did not require savings associations to accept all others as qualified to serve on their boards. In addition, as noted above, Congress gave OTS very broad authority to provide regulations governing the organization and operation of federally chartered savings associations. Indeed, OTS and its predecessor agency have long provided in their regulations and model bylaws for the removal of directors for cause, and have defined cause in a manner that is similar to the optional bylaw. See 12 CFR 544.5(b)(11), 552.6-1(f)(1), 563.39(b)(1). Congress has conducted major reviews of and amended the Home Owners' Loan Act without indicating that those regulations are improper.[4] Therefore, it should be presumed that Congress has acknowledged the agency's authority to promulgate regulations in this area.

Moreover, even assuming a federal savings association adopts the optional bylaw, the bylaw only prevents an affected person from serving on that particular association's board. The bylaw does not prohibit anyone from otherwise becoming involved in the affairs of the savings association and only affects relations with the particular association that chooses to adopt it. Finally, as the comments demonstrate, there is no way to know how many institutions will adopt the bylaw.[5] For these reasons, the provision is not

[4] As noted in the preamble to the proposed regulation and bylaw, Congress has also repeatedly expressed concern specifically about the need for integrity in running savings associations. 66 FR 66116-17. In doing so, however, Congress did not overturn OTS's regulation in this area.

[5] One comment suggested that it is improper for OTS to authorize federal savings associations to adopt a provision that is not available to state chartered institutions. It is not improper. See 12 U.S.C. 1464(a). Absent safety and soundness concerns, OTS's corporate governance authority is generally limited to federal savings associations. Nothing in this rule in any way precludes a state from choosing to permit state chartered institutions to have comparable bylaws.

comparable to the statutory provisions for removal and prohibition of institution affiliated parties.

Both attorneys asserted that the bylaw would be an impermissible retroactive provision because it could affect persons based on their past conduct. However, we know of no principle that prevents a private corporation from changing its requirements for board membership. Even assuming that by permitting institutions to adopt the bylaw, OTS has affected persons based on their past conduct, the action is permissible. The purpose of the bylaw is remedial, not punitive. The bylaw is designed to protect the institution that adopts it. Nor does the bylaw impact persons who engaged in conduct that was proper when the conduct occurred. Therefore, we believe the bylaw is proper.

Similarly, one attorney suggested that the provision might constitute a bill of attainder because he assumed that it is directed at either one or only a few persons. That suggestion is unfounded. Again, OTS is not imposing the bylaw on anyone. Moreover, OTS does not know and cannot know how many persons may ultimately be affected by the bylaw. However, OTS has issued cease and desist orders to over 300 persons since January 1, 1992, and many of those orders related to conduct involving dishonesty or breach of trust. Thus, it is clear that the bylaw does not constitute a bill of attainder.

In addition, the attorneys raised questions concerning the applicability of the bylaw to persons who consented to cease and desist orders. The provision could affect persons who entered into consent cease and desist orders. The fact that the bylaw's restriction on board membership may be an additional and possibly unforeseen consequence of a cease and desist order does not make the provision improper.

One attorney noted that the bylaw would apparently debar a person even where the cease and desist order had been vacated by the agency that issued it. Generally, even if an agency vacates or lifts a cease and desist order before the ten-year period is over, the bylaw provision would still apply. The public perception that the person lacks the requisite trustworthiness to be on an institution's board would still exist because of the violation that was the basis of the order. However, if an agency vacates an order because it finds that it was improperly entered, that acknowledgement should be sufficient to prevent any harm to an institution and, therefore, the cease and desist order should be disregarded.

Finally, one of the attorneys raised questions concerning how a savings association will be able to determine whether a cease and desist order was actually issued for conduct involving dishonesty or breach of trust when the order itself does not indicate the reasons for its issuance. When both the notice of charges and the order are silent on the issue, a savings association should not assume that the order was issued for conduct involving dishonesty or breach of trust.

## III. REGULATORY FLEXIBILITY ACT

Pursuant to section 605(b) of the Regulatory Flexibility Act, OTS certifies that this rule will not have a significant impact on a substantial number of small entities. The rule reduces regulatory burden on federal savings associations, including small federal savings associations, by permitting them to adopt certain bylaws without providing prior notice to OTS. The rule does not require any savings association to modify its bylaws and all federal savings associations currently can request permission to adopt such bylaws, if they choose to do so. Accordingly, a regulatory flexibility analysis is not required.

## IV. EXECUTIVE ORDER 12286

The Director of OTS has determined that this regulation does not constitute a "significant regulatory action" for purposes of Executive Order 12866.

## V. UNFUNDED MANDATES REFORM ACT OF 1995

OTS has determined that this rule will not result in expenditures by state, local and tribal governments, or by the private sector, of $100 million or more in any one year. Therefore, OTS has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered. The rule simply reduces regulatory burden on federal savings associations by permitting them to adopt certain bylaws without having to first request permission from OTS.

List of Subjects

12 CFR Part 544

Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 552

Reporting and recordkeeping requirements, Savings associations, Securities.

Accordingly, the Office of Thrift Supervision amends title 12, Chapter V, of the Code of Federal Regulations as set forth below:

## PART 544 -- CHARTER AND BYLAWS

1. The authority citation for part 544 continues to read as follows:

**Authority**: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 2901 *et seq.*

2. Section 544.5 is amended by revising paragraph (c)(1)(iii) to read as follows:

**§ 544.5 Federal mutual savings association bylaws.**

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(c) * * *

(1) * * *

(iii) For purposes of this paragraph (c), bylaw provisions that adopt the language of the model or optional bylaws in OTS's Application Processing Handbook, if adopted without change, and filed with OTS within 30 days after adoption, are effective upon adoption.

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**PART 552 – INCORPORATION, ORGANIZATION, AND CONVERSION OF FEDERAL STOCK ASSOCIATIONS**

3. The authority citation for part 552 continues to read as follows:

**Authority**: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a.

4. Section 552.5 is amended by revising paragraph (b)(1)(iii) to read as follows:

**§ 552.5 Bylaws.**

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(b) * * *

(1) * * *

(iii) Bylaw provisions that adopt the language of the model or optional bylaws in OTS's Application Processing Handbook, if adopted without change, and filed with OTS within 30 days after adoption, are effective upon adoption.

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**DATED:** March 8, 2001

By the Office of Thrift Supervision.

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Ellen Seidman
Director