EXECUTIVE COMPENSATION AT THE REGULATED ENTITIES

REQUEST FOR INPUT

June 2021

Office of the Director

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Introduction

The Federal Housing Finance Agency (FHFA or the Agency) is seeking information on executive compensation at the regulated entities: Fannie Mae and Freddie Mac (the Enterprises) and the Federal Home Loan Banks (the FHLBanks).[1] This information will strengthen FHFA's ability to fulfill its statutory responsibilities to ensure that the regulated entities operate in a safe and sound manner and fulfill their statutory missions while providing compensation to executive officers that is reasonable and comparable, considering relevant factors including their status as government-sponsored enterprises, their public missions, and their obligation to operate and carry out their activities in the public interest. Commenters are encouraged to note, as appropriate, distinctions and similarities between the Enterprises and FHLBanks and between the current and post-conservatorship status of the Enterprises.

Public Input Instructions

FHFA invites interested parties to provide written comments on all aspects of this Request for Input (RFI) and the questions set out below no later than 60 DAYS FROM PUBLICATION. Comments can be submitted electronically using the response form at https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx (select "Executive Compensation at the Regulated Entities" in the pull-down) or via mail to the Federal Housing Finance Agency, Office of the Director, 400 7th Street SW, 10th Floor, Washington, D.C. 20219. All comments received will be made public with any personal information that you provide, including your name, address, email address and phone number, and posted to FHFA's website. Generally, all comments will be posted without changes; however, commenters that would like FHFA to consider any portion of their response exempt from disclosure must attach that portion separately and clearly mark it "confidential commercial information." The procedures for identifying "confidential commercial information" can be found in FHFA's regulations at 12 CFR § 1202.8, available on FHFA's website.

[1] References made in this document to a "FHLBank" or the "FHLBanks" include the Office of Finance, a joint office of the FHLBank System that is subject to FHFA's general regulatory authority, 12 U.S.C. § 4511(b)(2), including authority to oversee compensation provided to executive officers. Common Securitization Solutions, LLC, an affiliate of each Enterprise, is included in FHFA's supervisory authority over the Enterprises, 12 U.S.C. § 4502(20).

Background

Authorities with regard to compensation. In general, the board of directors of each Enterprise and FHLBank is authorized to fix the compensation of its executive officers.[2] That authority is overseen by FHFA pursuant to statutes that differ, in some cases, as between the FHLBanks and Enterprises. In each case, however, FHFA is statutorily required to prohibit each of its regulated entities from providing compensation to any executive officer that is not reasonable and comparable with compensation for employment in other similar businesses involving similar duties and responsibilities.[3] In carrying out that duty, FHFA may consider any factor determined to be relevant but is prohibited from prescribing or setting a specific level or range of compensation.[4] For this purpose, "compensation" is defined as "any payment of money or the provision of any other thing of current or potential value in connection with employment."[5]

FHFA implements its statutory responsibility through a regulation, orders and guidance.[6] FHFA's Executive Compensation Rule (Rule) defines statutory terms including "reasonable" and "comparable"; prohibits the regulated entities from providing compensation to their executive officers that is not reasonable and comparable; establishes a prior review requirement for certain types of compensation actions (such as, for example, entering into written agreements for a term of employment or to provide incentive compensation or compensation on termination, increasing compensation, paying some types of compensation, and establishing compensation for a newly-hired executive officer); and generally prohibits a regulated entity from taking a compensation action for which FHFA review is required during that period of review unless FHFA provides non-objection or approval.[7] FHFA's Order on Submission of Information with Respect to Compensation sets forth information that the Enterprises and FHLBanks must provide to FHFA when requesting review of a compensation action subject to the Rule.[8]

[2] 12 U.S.C. §§ 1432(a), 1452(c), and 1723a(d)(2).
[3] 12 U.S.C. § 4518(a).
[4] *Id.*, § 4518(b) and (d).
[5] *Id.*, § 4502.
[6] In the case of the Enterprises while in conservatorship, as conservator of each Enterprise, FHFA succeeded to the powers of its board of directors and may take any action necessary to carry on the business of the Enterprise, 12 U.S.C. § 4617(b)(2)(A) and (D). In that capacity, FHFA is authorized to set compensation for Enterprise executive officers and is not subject to the prohibition at 12 U.S.C. § 4518(d).
[7] *See generally*, 12 C.F.R. Part 1230. Should FHFA determine, based on comments responsive to this Request for Input or otherwise, that changes to the Rule are warranted, amendments to the Rule would be made in accordance with the Administrative Procedure Act, 5 U.S.C. § 553.
[8] *See, e.g.*, https://www.fhfa.gov/SupervisionRegulation/LegalDocuments/Documents/Orders/FNMOrder2018-OR-FNMA-2.pdf. (Order provided to Fannie Mae.) There are three Orders, one for each Enterprise and one for all FHLBanks, but the Orders are substantively identical.

Compensation structure at the regulated entities. Enterprise and FHLBank compensation programs are intended to attract and retain executive officers to fulfill the regulated entities' core mission responsibilities in a safe and sound manner that protects taxpayers and financial stability. Through its actions as supervisor of all of the regulated entities and as conservator of the Enterprises, FHFA has worked with Enterprise and FHLBank boards of directors (including Compensation Committees) and management to ensure that the regulated entities' compensation programs also balance the regulated entities' obligations to operate in a safe and sound manner and foster competitive, liquid, efficient, and resilient national housing finance markets.

The compensation structures in place at the Enterprises and the FHLBanks are similar in some respects to those of publicly held financial institutions and other financial services companies. Unlike many of those companies, however, FHFA's regulated entities provide all compensation as cash; they do not provide any compensation in stock, stock options, or any other type of equity-based award. The FHLBanks are not authorized to provide equity-based compensation due to their statutory structure as member-owned cooperatives, and the Enterprises are not authorized to provide equity-based compensation while in conservatorship.

Enterprises. Currently the Enterprises provide compensation to executive officers pursuant to an executive compensation plan developed by FHFA as conservator in 2012.[9] As conservator, FHFA is subject to requirements in each Enterprise's charter act which require that a significant portion of potential compensation of all executive officers of the Enterprise must be based on performance of the Enterprise.[10] All Enterprise executive officers other than the Chief Executive Officer (CEO) are eligible to receive total direct compensation (TDC) in two components, base salary and deferred salary. Base salary cannot exceed $600,000 per year, and is earned and paid bi-weekly. Deferred salary is divided into two components: "at-risk" deferred salary and fixed deferred salary. Currently, at-risk deferred salary is equal to 30% of an executive officer's TDC, and is deferred for a one- to two-year period. One-half of at-risk deferred salary (15% of TDC) is subject to reduction based on the Enterprise's performance against the Conservatorship Scorecard[11] as determined by FHFA, and the remainder (also 15% of TDC) is subject to reduction based on corporate and individual performance as evaluated by the CEO and the Enterprise board of directors. At-risk deferred salary is earned in each quarter, accrues interest, and is paid in the corresponding quarter of the first or second year following the period in which it was earned (depending on the executive officer's date of hire). Fixed deferred salary is earned in each quarter, accrues interest, and is paid in the corresponding quarter of the first year following the period in which it was earned.

9 *See* https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/ExecComp3912F.pdf.
10 12 U.S.C. §§ 1452(c) and 1723a(d)(2).
11 *See, e.g.*, https://www.fhfa.gov/AboutUs/Reports/Pages/2020-Scorecard-for-Fannie-Freddie-and-CSS.aspx.

By statute, during conservatorship, compensation for Enterprise CEOs may not exceed an annual rate of $600,000[12] and executive officers (including the CEOs) may not receive bonuses.[13] Additional detailed compensation information for certain executive officers can be found in the Enterprises' respective annual (Form 10-K) filings with the Securities and Exchange Commission.[14]

FHLBanks. Currently FHLBank executive officers are eligible to receive TDC in two components, base salary and incentive compensation.[15] Base salary is used as a basis to calculate an executive officer's annual incentive award. Incentive compensation is awarded based on the achievement of performance goals approved by the board. Half of the award is paid shortly after the end of the performance year and the other half is deferred for a period of three years. Additional performance measures applied during the deferral period may increase or decrease the incentive compensation actually provided. Similar to FHFA's Conservatorship Scorecard, goals developed by FHLBank boards and set forth in FHLBank incentive plans provide a mechanism to communicate priorities and encourage appropriate focus by executive officers. Deferral encourages executive officers to consider their actions over a term longer than a one-year performance period (particularly when deferred compensation is subject to additional performance measures).

FHFA review of compensation. On receiving notice of a compensation action covered by the Rule, FHFA undertakes a review to determine if the proposed compensation should be prohibited because it is not "reasonable" and "comparable." FHFA has defined "reasonable" compensation as compensation that, "taken in whole or in part, . . . would be appropriate for the position and based on a review of relevant factors including, but not limited to, (i) the duties and responsibilities of the position; (ii) compensation factors that indicate added or diminished risks, constraints, or aids in carrying out the responsibilities of the position; and (iii) performance of the regulated entity, the specific employee, or one of the entity's significant components with respect to achievement of goals, consistency with supervisory guidance and internal rules of the

[12] 12 U.S.C. § 4518 (note). FHFA interprets the statutory limitation on CEO compensation to supersede Enterprise charter act and Safety and Soundness Act provisions related to composition of compensation (*i.e.*, that a significant portion of an executive officer's pay be based on performance of the Enterprise) and comparability of compensation.

[13] *Id.*, § 4518a. For this purpose, FHFA defines "bonus" as a payment that rewards an employee for work performed, where details of the award (such as the decision to grant it or its amount) are determined after the performance period using discretion or inherently subjective measures. In contrast, "incentive compensation" is compensation that is variable and at risk, where the amount actually earned is determined following a defined performance period, based on an assessment of the degree to which the employee, individually or as a member of a group, performed against performance metrics that were established by management and communicated to the employee prior to or early in the performance period. For the Enterprises, "at-risk" deferred compensation is similar to incentive compensation.

[14] *See* https://www.sec.gov/ix?doc=/Archives/edgar/data/310522/000031052221000156/fnm-20201231.htm (Summary Compensation Table on pg. 211); https://www.sec.gov/ix?doc=/Archives/edgar/data/1026214/000102621421000033/fmcc-20201231.htm (Summary Compensation Table on pg. 316).

[15] For the FHLBanks, TDC is the sum of base compensation plus incentive compensation at "target." "Target" refers to a performance measure and aligns with a specified level of incentive compensation payment. Incentive plans are often structured with measures of threshold, target, and maximum, with potential payment increasing from threshold to maximum.

[regulated] entity, and compliance with applicable law and regulation."[16] Compensation is "comparable" if, taken in whole or in part, it "does not materially exceed compensation paid at institutions of similar size and function for similar duties and responsibilities."[17]

To apply these standards, positions at the regulated entities are compared to positions involving similar duties and responsibilities in other similar businesses (including privately held financial institutions and other major financial services companies). The regulated entities' respective comparator groups and the appropriate benchmarking of individual executive roles are thus critical to FHFA's review. Given the unique businesses and public charters of the Enterprises and the FHLBanks, there is no ideal peer for a government-sponsored enterprise. FHFA looks forward to receiving comments related to determining appropriate peer groups and benchmarks.

Currently, the Enterprises share a comparator group of 24 public companies, which was developed and approved by FHFA and the Enterprises' Compensation Committees. FHLBanks generally consider commercial banks and other financial institutions as peers, as well as other FHLBanks. With respect to the FHLBanks, FHFA considers larger, more complex commercial peers to be inappropriate for use as comparators in public proxy data.

Safety and soundness and mission. As government-sponsored enterprises, FHFA's regulated entities were established with public purposes and to carry out public missions: they must foster national housing finance markets that protect taxpayers, promote liquidity through economic cycles, and support sustainable homeownership and affordable rental housing. FHFA believes executive compensation should be managed by Enterprise and FHLBank boards of directors and overseen by FHFA in a manner that reflects their government-sponsored enterprise status. Consequently, each regulated entity must carefully balance the need to attract and retain executive talent with the obligation to operate in a safe and sound matter and focus on its core mission responsibilities, considering its federally chartered status.

Request for Input

As set forth in the questions below, FHFA is seeking input that could enhance its ability to assess whether executive compensation paid by the regulated entities is consistent with all relevant supervisory considerations, including FHFA's obligations to prohibit compensation that is not reasonable and comparable, ensure that the regulated entities are operated in a safe and sound manner and carry out their public missions and operate in the public interest. FHFA is also seeking input on aspects of Enterprise executive compensation in light of the Enterprise conservatorships.

[16] 12 C.F.R. § 1230.2.
[17] *Id*.

Questions

I. Enterprises

Compensation structure

1. Is the current compensation structure of the Enterprises, which has largely been in place since 2012, appropriate? Does the structure provide appropriate mechanisms for communicating and achieving priorities, incentivizing performance, and attracting and retaining executive officers?

2. Currently, FHFA assesses Enterprise achievement of mission-oriented objectives by assessing performance against the Conservatorship Scorecard. How should achieving mission-oriented objectives, such as the Affordable Housing Goals and Duty to Serve be tied to compensation?

3. What are the best metrics to assess compensation at the Enterprises? Is TDC the right metric or should the Enterprises consider other metrics (for example, those reported in annual public filings)?

4. How, if at all, should FHFA incorporate into its assessment of compensation for executive officers who report directly to a CEO the fact that, while in conservatorship, Enterprise CEO pay is statutorily limited to $600,000? How, if at all, should FHFA incorporate into its assessment of compensation for Enterprise CEO direct reports the fact that Enterprise CEOs may not earn or receive deferred compensation?

5. What goals should be used to assess and pay out at-risk deferred compensation?

6. What percentage of TDC should be deferred to be considered reasonable and comparable? What percentage of deferred salary should be "at risk" (versus fixed) and subject to reduction based on company and individual performance? What length of deferral period(s) is appropriate for Enterprise executive compensation? Should the deferral periods match those for the FHLBanks?

7. What percentage of an executive officer's deferred compensation should be made contingent upon corporate performance and what percentage should be made contingent upon the executive officer's individual performance? What percentage of deferred salary should be awarded based on performance as determined by FHFA versus as determined by the Enterprise?

8. To what extent should incentive compensation be tied to achieving diversity and inclusion objectives, such as fulfilling the Enterprises' diversity and inclusion strategic plans? How much, at what levels, and why?

9. At what rate, if any, should deferred compensation earned by Enterprise executive officers accrue interest?

10. Under what circumstances, if any, should FHFA and/or the Enterprises be entitled to clawback or recoup any portion of accrued and/or previously paid compensation amounts? From which executive officers?

Interpretation and application of statutory terms

11. How should FHFA interpret "compensation" with respect to Enterprise executive officers?

12. What factors should FHFA consider, when determining whether compensation is "reasonable" and "comparable"? Should FHFA consider factors other than those specifically set forth in the Rule? If so, what are such factors? Which factors should FHFA consider when determining whether employment involves "similar duties and responsibilities" in "other similar businesses"?

13. In determining whether compensation is "reasonable" and "comparable" with compensation for employment in other similar businesses involving similar duties and responsibilities, what methodologies, variables, assumptions, and measurement tools should be used?

14. How should FHFA interpret corporate performance, when ensuring that a significant portion of potential compensation of executive officers is based on performance of the Enterprise? What types of performance – for example, financial performance, performance against standards or goals established by FHFA, or other performance measures – should FHFA consider?

15. Which companies are the most appropriate comparators for purposes of comparing executive compensation to the Enterprises? For executive job positions that are not unique to the financial services sector, such as information technology, human resources, and operations, what are the most appropriate comparators?

16. How should compensation of Enterprise executive officers be affected, if at all, by the fact that each Enterprise remains in conservatorship? To what extent should FHFA consider that executive officers are not subject to return objectives and similar shareholder demands while in conservatorship?

17. What should a post-conservatorship executive compensation framework look like for the Enterprises? Should Enterprise executive officers continue to be prevented from earning bonuses after exiting conservatorship?

II. Federal Home Loan Banks

FHFA invites public input on any of the foregoing issues (*e.g.*, compensation framework, fixed versus deferred compensation, interest on deferred compensation, incentive compensation and relevant comparators) specifically in the context of the FHLBanks, reflecting their different size, structure, statutory framework, and risk profile versus those of the Enterprises. In particular, FHFA also invites comments on the following:

18. How, if at all, should FHFA consider the fact that the FHLBanks generally have a monolithic business model, extending collateralized advances and purchasing mortgages that are also credit enhanced, when compared to their commercial peers? Currently, FHFA considers the other FHLBanks to be the primary comparator group when evaluating a FHLBank's compensation requests. Do you agree or disagree with this approach? Why or why not?

19. What is the appropriate role of incentive compensation for FHLBank executive officers? Are there metrics or limits that would be appropriate for FHFA to consider in evaluating FHLBank incentive compensation structures, for example, to avoid incentivizing excessive risk-taking?

20. How should the FHLBanks' cooperative ownership structure affect FHFA's review of compensation proposals? How should FHFA weigh deference to compensation decisions proposed by a FHLBank's board of directors (which are presumed to represent the views of its customer/owners) against its statutory mandate to prevent any compensation that is not reasonable or comparable?

21. Which factors should the Director consider when determining whether FHLBank employment involves "similar duties and responsibilities" in "other similar businesses"?

22. To what extent should incentive compensation be tied to achieving diversity and inclusion objectives, such as fulfilling the FHLBanks' diversity and inclusion strategic plans? How much, at what levels, and why?

23. How should incentive compensation for the FHLBanks be tied to their mission-related activities (these activities include, but are not limited to, the Affordable Housing Program (AHP), Community Investment Program (CIP), the Community Investment Cash Advance Program (CICA) and Housing Goals)?

III. General Considerations

24. Are there any topics related to executive compensation that should be considered that these questions have not addressed?

25. With respect to the foregoing questions, FHFA invites interested parties to submit any qualitative or quantitative information, research, studies, or data that supports a commenter's response or is otherwise relevant to the regulated entities' executive compensation policies.