



August 6, 2021

**Submitted Electronically**

Federal Housing Finance Agency  
Office of the Director  
Tenth Floor  
400 Seventh Street, S.W.  
Washington, DC 20219

Dear Acting Director Thompson:

The Federal Home Loan Bank of San Francisco (Bank) appreciates the opportunity to provide feedback on the Federal Housing Finance Agency's (Finance Agency) Request for Input on Executive Compensation at the Regulated Entities (RFI). The Chair of the FHLBanks and the Office of Finance have submitted a joint letter (System Letter) on behalf of the FHLBanks that provides a consolidated and united response to the RFI, which the Bank fully supports.

Our letter supplements the System Letter and reinforces this Bank's views on:

- (i) our Board of Directors' (Board) ultimate responsibility for making executive compensation decisions;
- (ii) Board oversight responsibility for ensuring the safe and sound operation of the Bank; and
- (iii) the importance of not limiting or prohibiting the Bank from designing customized benchmarks, peer groups, and comparators that recognize significant regional labor market differences that exist between major metropolitan areas, such as the San Francisco Bay Area, and other parts of the country.

**Our Board's ultimate responsibility for making executive compensation decisions**

With respect to the Board's responsibility in setting executive compensation, we recognize that the Director of the Finance Agency has statutory responsibility for prohibiting the FHLBanks (and Fannie Mae and Freddie Mac) from providing compensation to their executive officers that is not reasonable or comparable for employment in other similar businesses involving similar duties and responsibilities. However, the Finance Agency's exercise of this responsibility should not infringe upon nor impair the Board's own statutory responsibility (and common law duties) to appropriately establish compensation of its executive officers.

Aside from the Finance Agency acting as conservator of Fannie Mae and Freddie Mac and succeeding to the powers of those entities' boards including setting executive compensation, the Finance Agency is subject to the statutory prohibition on setting executive compensation of the FHLBanks and therefore, the Finance Agency in exercising its supervisory responsibilities over the FHLBanks should not adopt or subscribe to a supervisory review practice that obstructs our Board's exercise of its responsibilities on setting executive compensation.

In particular, it is our view that the Finance Agency should not step into the shoes of the Board and usurp the powers of the Board by imposing, mandating, or prescribing activities that are clearly within the Board's province, such as the appointment and use of a particular compensation consultant (see e.g., the requirements of the NYSE and NASDAQ listing standards regarding the appointment of compensation consultants). To do so in the case of compensation consultants would improperly embolden compensation consultants, raise independence issues, and limit this Board's flexibility with regard to using its judgement in discharging its obligation to select and engage independent compensation consultants to assist the Board in setting compensation. Furthermore, the Board needs this flexibility to make judgements that comply with its fiduciary duties and to avoid second guessing by courts reviewing our executive compensation.

We believe that in the supervisory review of the reasonableness and comparability of the Bank's executive officers' compensation, the Finance Agency should neither mandate particular comparators or peer groups to be used by all of the FHLBanks, nor should it impose a specific cap on the level of compensation.<sup>1</sup> By doing so, the Finance Agency would be usurping the responsibilities of the Board and exceeding its statutory authority to review the reasonableness and comparability of the Bank's executive compensation.

We note that the Finance Agency has recognized the concern about possibly infringing on the Board's responsibilities for setting executive compensation in the supplementary information preamble to the adoption of the Finance Agency's executive compensation final rule, where the FHFA states: "*[the] FHFA avoided translating this requirement [of comparability] into specific mandates to create a certain peer group of a certain size, or even use of a certain process to create the group of comparators, which could have limited the flexibility of the Banks in implementing the mandate. FHFA reviews comparability while also respecting the Banks' processes for setting compensation.*"<sup>2</sup>

In the exercise of the Board's fiduciary responsibilities with regard to setting executive compensation, the Board observes the guidance in the Finance Agency's Advisory Bulletin 2009-AB-02, which sets forth principles for sound incentive compensation practices. We also note that the bulletin goes on to state "the FHFA Director will consider the extent to which an executive's compensation is consistent with these principles." In its supervisory review of the reasonableness and comparability of the Bank's executive compensation, we believe that the Finance Agency can discharge its supervisory responsibilities, and avoid stepping into the shoes of the Board, by reviewing the processes and procedures the Board follows in setting executive compensation consistent with the bulletin and avoiding any supervisory directive that is tantamount to setting executive compensation, including imposing caps.

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<sup>1</sup> For example, the Finance Agency has issued supervisory guidance on the payout of incentive compensation, which, when applied in its regulatory review, imposes a cap on incentive compensation payout of 1x the current base salary of the executive. In addition to the statutory prohibition of the Finance Agency setting executive compensation, the cap on the payout of the incentive compensation's deferred component limits the return on the deferred compensation already earned (but not vested), which is arguably outside the Finance Agency's authority.

<sup>2</sup> In the supplementary information in the preamble to the adoption of the final rule on executive compensation, the Finance Agency states "It appears clear that a statutory requirement of comparability would need to operate as a check on compensation that materially exceeds compensation for comparable duties and responsibilities at comparable institutions. Even so, FHFA avoided translating this requirement into specific mandates to create a certain peer group of a certain size, or even use of a certain process to create the group of comparators, which could have limited the flexibility of the Banks in implementing the mandate. FHFA reviews comparability while also respecting the Banks' processes for setting compensation. This review results in no specific level of compensation, nor a range, communicated from FHFA to the regulated entities or OF, in practice or in effect." See 79 Fed. Reg. 4389, 4390 (January 28, 2014).

*Board oversight responsibility for ensuring the safe and sound operation of the Bank*

As part of the Board's responsibilities for oversight with regard to the safe and sound operation of the Bank, the Board is responsible for ensuring that there is a qualified, competent, and skilled management team, which requires the ability to attract, hire, and retain executive talent. Any exercise of the Finance Agency's review authority should not inhibit or limit the Board in discharging this responsibility, because to do so would impact the Board's ability to ensure the safe and sound operation of the Bank.

Management turnover at the FHLBanks is a supervisory concern that we have discussed with the Finance Agency's supervisory staff in the past. The Board's authority and ability to determine and provide competitive executive compensation packages is critical to hiring and retaining high performing talent that can ensure the safe and sound operation of the Bank.

The Board's responsibilities in this regard are grounded in its fiduciary and regulatory duties to attract, hire, and retain executives who will protect the Bank's capital and operate the Bank's business in a prudent, safe and sound manner while providing an appropriate rate of return to our members. We believe that the Finance Agency should give deference to the Board's use of and reliance on outside experts (and their benchmarking reports) to find qualified executives and inform determination of appropriate compensation. In its supervisory review role, we believe that the Finance Agency should focus on the processes and procedures by which the Board makes its compensation decisions rather than second guessing the views and rationales of our industry compensation experts and substituting its own views as to the proper benchmark or comparator group.

*Importance of not limiting or prohibiting the Bank from designing customized benchmarks, peer groups, and comparators that recognize the significant regional labor market differences that exist between major metropolitan areas, such as the San Francisco Bay Area, and other parts of the country*

In the exercise of its responsibilities, the Board's compensation committee engages competent and professional compensation and benefits experts to help design formal peer groups and comparator models that are used to benchmark executive compensation and support decisions for salary actions that we disclose in our SEC annual reports. This process has been developed in concert with the Finance Agency, over more than a decade since passage of the Housing and Economic Recovery Act of 2008 (HERA). We do not believe that circumstances at the FHLBanks have changed to an extent that would warrant challenging the validity of this process and the Board's reliance on compensation experts to benchmark and guide the design of executive compensation.

With respect to any Finance Agency's directive around the use of an aggregate FHLBank benchmark for all the FHLBanks, we have previously expressed concerns (and are reiterating them here) that mandating specific comparator institutions and requiring that comparable compensation be at or below the median compensation for a given position at similar institutions would have the practical effect of prescribing or setting a specific level or range of compensation which, as stated above, the Finance Agency is statutorily prohibited from doing and would encroach on the primary governance role of the Board.

Specifically, we continue to believe that the Finance Agency should refrain from prescribing a primary peer group that includes all the FHLBanks, or a specific asset size of commercial peers. We note that overreliance on the FHLBanks as the primary peer group results in an inaccurate and overly narrow reflection of the breadth, in terms of industry and geography, of organizations from which the Bank recruits, and to which it loses talent.

Requiring the Board to use a limited, primary peer group of all FHLBanks also ignores the significant regional labor market, and cost-of-living and pay differentials that exist in the San Francisco Bay Area and other major metropolitan areas. Further, mandating a peer group limited to all FHLBanks could have the effect of inadvertently inflating salaries in low-cost areas and depressing salaries in high-cost areas.

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The Board's compensation committee recognizes that, because of the special nature of our business and our cooperative ownership structure, comparing our compensation practices to a group of other financial services and banking firms that are similar in total assets presents some challenges, and it is because of these challenges the Board engages outside compensation experts to support the Board's executive compensation decisions.

Since 2014, the Board's compensation committee has used McLagan Partners, Inc. (McLagan), a leading global management consulting firm that offers consulting and benchmarking services for the financial services industry, to provide competitive market compensation benchmarking to the Board's compensation committee.

With market data collected from its compensation surveys and publicly available proxy data, McLagan uses standardized peer group data to create peer groups that are customized and specific to the Bank, taking into consideration many factors, including geographical market differences. In its work on peer groups, McLagan has included FHLBanks located in the major metropolitan areas (e.g., Atlanta, Chicago, and New York) as comparators for the Bank. Data for the remaining FHLBanks is used as a reference point. We believe this approach is reasonable, given that the market for talent within the financial services industry in the San Francisco Bay Area is small, compensation levels are significantly above the national average, and, over the years, large banks in the San Francisco Bay Area have named this Bank as one of their competitors for talent.

To further support the rationale for the Board to maintain the ability to use and rely on customized peer groups that factor in regional geographical differences, as opposed to being required by the Finance Agency to use an all FHLBank primary peer group, we note that information from publicly available reports using metropolitan statistical areas (MSAs) to determine geographic pay and cost of living differentials demonstrate the significant disparity in paid compensation that exists in the San Francisco Bay Area, with the highest market wage levels in the U.S. and highest cost of living of all FHLBank MSAs relative to other metropolitan areas.

Thank you for the opportunity to provide input and feedback on this important topic.

Sincerely,



F. Daniel Siciliano  
Chair of the Board

cc: Scott Syphax - Chair, Compensation and Human Resources Committee, Board of Directors  
Teresa Bryce Bazemore - President and Chief Executive Officer