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July 23, 2009

VIA EMAIL TO REGCOMMENTS@FHFA.GOV

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Federal Housing Finance Agency
Fourth Floor
1700 G Street, N.W.
Washington, D.C. 20552
Attention: Comments/RIN 2590-AA12

Re: Proposed Rule on Executive Compensation, RIN 2590-AA12

Dear Mr. Pollard:

As the Chairman of the Board of Directors and the Chairman of the Compensation and Human Resources Committee of the Board of Directors, respectively, of the Federal Home Loan Bank of Dallas (the "Dallas Bank"), we are writing on behalf of the Dallas Bank's Board of Directors to comment on the Federal Housing Finance Agency's ("FHFA") proposed rule on executive compensation (the "Proposal"), which was published on June 5, 2009.[1] The Proposal contains proposed executive compensation regulations that would implement sections 1113 and 1117 of the Housing and Economic Recovery Act of 2008 ("HERA") with respect to the Federal Home Loan Banks ("FHLBanks"). We welcome this opportunity to comment on the Proposal.

I. The FHFA Should Not Identify Comparators and Should Limit its Role to Reviewing Rather than Establishing or Guiding the Establishment of FHLBank Executive Compensation

As discussed below, we believe that the Proposal, as currently drafted, would inappropriately insert the FHFA into the FHLBanks' executive compensation determinations such that the FHFA would be, in effect, making executive compensation determinations, including the determination of comparator institutions, for the FHLBanks. We believe that the proper role of the FHFA is rather to review the FHLBanks' executive compensation determinations and the processes that led to those determinations to decide whether the determinations and processes are reasonable and comparable as required by HERA.

A. The Proposal Appears to Usurp the Authority and Responsibility of the FHLBanks' Boards of Directors with Regard to Establishing Executive Compensation

The FHFA's approach to implementing the compensation oversight role provided by HERA, as reflected in the preamble and the text of the Proposal, would effectively take control

[1] 74 Fed. Reg. 26989 (2009) (to be codified at 12 C.F.R. pt. 1230).

of the FHLBanks' executive compensation process, thereby displacing the business judgment of the FHLBanks' boards of directors and compensation committees. This result is neither legally permissible under 12 U.S.C. § 4518(d), as enacted by section 1113 of HERA,[2] nor warranted as a matter of appropriate corporate governance or regulation of the FHLBanks.

The FHLBanks' boards of directors must have the ability to implement compensation arrangements that allow the FHLBanks to attract and retain highly qualified executives who are able to ensure the effective operation of an FHLBank and the achievement of its statutory mission. Each board of directors is subject to well-established fiduciary obligations to protect the interests of the shareholders of the FHLBank, and directors must be free to exercise their business judgment in the area of executive compensation if they are to discharge those fiduciary responsibilities. In doing so, board members must balance the need for competitive executive compensation with the financial interests of the shareholders. The balancing of these competing considerations is a quintessential example of the business judgment that is exercised by the boards of directors of the FHLBanks and the best form of market discipline.

The Proposal's approach also fails to recognize that the unique cooperative structure of the FHLBanks ensures that the boards of directors of the FHLBanks consistently set executive compensation at a market-driven level that balances the need to attract and retain talented individuals to manage large, complex financial institutions with the interests of their shareholders and the mission of the FHLBanks. Additionally, the structure of the FHLBanks' boards of directors, with all directors being independent in the sense that none is a member of the FHLBank's management, provides additional assurance that FHLBank directors will establish executive compensation that is reasonable and comparable and in the best interests of the FHLBanks' shareholders and overall mission. It is beyond the scope of applicable law for the FHFA to substitute its judgment regarding compensation for the judgment of a board of directors statutorily constructed to represent the interest of shareholders.

The Federal Housing Finance Board ("FHFB"), the predecessor to the FHFA with respect to the FHLBanks, made it clear that a key responsibility of an FHLBank's board of directors was to "hire and retain competent management."[3] In that regard, the FHFB indicated that an FHLBank's board of directors would be evaluated based on, among other things, its oversight of management's performance and compensation, including "the establishment and periodic review of compensation which is reasonable in view of an officer's performance and the condition, operating performance and risk profile of the FHLBank."[4]

Under the Proposal as currently drafted, the FHFA would effectively be dictating an outcome to the FHLBanks' boards of directors, thereby assigning to the FHFA the role that is properly assigned to the FHLBanks' boards of directors. As proposed, it appears that the Proposal would extend beyond the legal framework and limitations for the FHFA specified by Congress. A more appropriate approach would be for the FHFA to *review* the reasonableness of the outcome of an individual FHLBank's compensation committee's or board of director's compensation process against the statutory standard of reasonableness and comparability with "other similar businesses

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[2] Nor is the FHFA's intended approach permitted under proposed section 1230.3(d), which repeats the compensation setting prohibition contained in 12 U.S.C. § 4518(d).

[3] FHFB Office of Supervision Examination Manual April 2007 at 6.2.

[4] Id. at 6.29.

(including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities."[5]

B. The Proposal Appears to Violate the Statutory Prohibition on the FHFA Setting FHLBank Executive Compensation

We believe that the practical effect of the Proposal is to violate the prohibition in 12 U.S.C. § 4518(d), which provides that the FHFA Director "*may not prescribe or set a specific level or range of compensation.*" (emphasis added). Two elements of the Proposal lead to this conclusion.

First, the preamble to the Proposal contains the following statement:

> ". . . in order to take into account the [FHL]Banks' size and structure, FHFA may consider *the Federal Reserve Banks and the Farm Credit Banks as examples of appropriate comparators* to assess the reasonableness and comparability of executive compensation provided by the [FHL]Banks."[6] (emphasis added).

Second, proposed section 1230.2, which, among other things, establishes a definition of "comparable," provides that:

> "FHFA generally considers *comparable to be at or below the median compensation* for a given position at similar institutions. In particular circumstances, consideration as described in paragraph (1) of this definition, may indicate the appropriateness of higher or lower benefit amounts to which FHFA would not object."[7] (emphasis added).

The practical effect of the FHFA's (i) identifying particular comparator institutions to determine compliance with the regulation and (ii) imposing a presumptive cap of "at or below the median" on compensation by reference to those particular institutions, effectively sets a specific level or range of compensation. This is precisely what Congress prohibited the FHFA Director from doing in 12 U.S.C. § 4518(d), which provides as follows:

> "In carrying out subsection (a) of this section, the Director may not prescribe or set a specific level or range of compensation."[8]

Moreover, the "at or below the median" provision ignores the concept of a median as the middle point around which there would be some levels of compensation both above and below. This narrow definition of comparability could also eliminate a board of directors' ability in establishing executive compensation that considers longer than average and/or more valuable experience at the FHLBank or within the FHLBank System, above average knowledge of the

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[5] 12 U.S.C. § 4518(a).

[6] 74 Fed. Reg. at 26990.

[7] *Id* at 26993.

[8] The same provision was initially enacted as part of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("1992 Act") and provided that: "In carrying out subsection (a) of this section, the Director may not prescribe or set a specific level or range of compensation." Subsection (a) of 12 U.S.C. § 4518 requires the Director to prohibit the FHLBanks from paying executive compensation that is not reasonable and comparable with compensation for employment in other similar businesses (including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities.

FHLBank and/or the FHLBank System, and above average prior performance of a given executive officer.

In summary, we believe the FHFA should *review* the comparator institutions chosen by and the levels or ranges of compensation established by FHLBanks for their reasonableness, rather than prescribing or setting comparator institutions or specific levels or ranges of compensation.

C. The FHFA Should Not Require Prior Approval of an FHLBank President's Compensation by the Director

As written, proposed section 1230.3(e)(2)(ii) appears to require the FHFA Director's prior approval with respect to the annual compensation, bonuses and other incentive pay provided by an FHLBank to its president. For the reasons discussed above in this Section I, we believe that proposed section 1230.3(2)(ii) inappropriately inserts the FHFA into the decision making process of an FHLBank's board of directors with respect to the compensation of that FHLBank's president. We believe that the proper role of the FHFA is only to review the compensation of an FHLBank's president to decide whether the determination of that president's compensation and the processes that led to that determination are reasonable.

D. The FHFA Should Rescind Its Guidance on Executive Compensation Issued on October 1, 2008

We expect that upon promulgation of a final rule the FHFA would rescind its current guidance requiring four weeks' prior notice to the FHFA before an FHLBank may increase the compensation of a "named executive officer" (within the meaning of the Securities Exchange Act of 1934 ("Exchange Act").[9]

II. The FHFA Should Not Select Comparator Institutions or Establish Presumptive Compensation Caps Either Formally or Informally in Connection with the Executive Compensation Rule

As discussed below, we believe that the Proposal, as currently drafted, inappropriately allows the FHFA to select comparator institutions and thereby establish presumptive compensation levels and caps for the FHLBanks. It is the responsibility of each FHLBank's board of directors to establish and implement a responsible compensation philosophy and policy, including the determination of comparator institutions. The method by which the FHLBanks' boards of directors carry out this responsibility is transparently set forth in each FHLBank's Compensation Analysis and Discussion ("CD&A") that is required to be included in the Form 10-K that each FHLBank files annually under the Exchange Act. For the FHFA to select a peer group for the entire FHLBank System and to establish a presumptive benchmarking percentage for the FHLBanks would violate 12 U.S.C. § 4518(d), and indeed the Proposal itself, by effectively setting *de facto* compensation levels. The FHFA should intervene in the FHLBanks' processes for determining executive compensation only if the determinations of an FHLBank's

[9] In an October 1, 2008 memorandum, FHFA Acting Deputy Director Ronald Rosenfeld informed the FHLBanks that, pending FHFA action on section 1113 of HERA, they should submit to the FHFA all compensation actions relating to the five most highly compensated officers, including compensation plans of general applicability to those officers, at least four weeks in advance of any planned board of directors action with respect to such compensation actions, including studies of comparable compensation. We would expect that this requirement would no longer apply to the FHLBanks once the executive compensation regulation is promulgated and request the FHFA's guidance on this issue.

compensation committee or board of directors are manifestly unreasonable or proper procedures are not followed.

A. Current FHLBank Compensation Practices are Appropriate and Sufficient

Under the Federal Home Loan Bank Act (the "Bank Act"), each FHLBank's board is comprised of (i) representatives of member institutions and (ii) directors (who cannot be directors or officers of FHLBank members themselves) who are either public interest directors with experience in representing consumer or community interests in financial services or housing, or who have knowledge of certain specified areas. Both groups of directors are elected by the FHLBank's shareholders. As stated above, all directors of the FHLBanks are independent in the sense that none is a member of the FHLBank's management and, therefore, have no personal pecuniary interest in the FHLBank's executive compensation. Directors who are representatives of member institutions in particular would have no incentive to provide excessive compensation to FHLBank executive officers, since such payments would drive down earnings available for distribution to their member institutions.

The FHLBank executive compensation process is conducted in a very transparent manner. Each FHLBank is registered with the Securities and Exchange Commission ("SEC") under the Exchange Act. As an Exchange Act registrant, each FHLBank is required to file annually with the SEC a CD&A, which is a detailed annual description of its compensation practices. The CD&A typically includes a discussion of an FHLBank's compensation philosophy, the roles played by its board and board compensation committee, its use of independent consultants or outside compensation survey information, the peer or comparator institutions that it looks to, and the results of the operation of these processes with respect to certain key executives. As may be required, additional compensation information is also provided periodically in Current Reports on Form 8-K filed by the individual FHLBanks. As a result of these requirements, members of the FHLBanks and the public in general are fully informed as to the FHLBanks' executive compensation processes as well as to the amounts and elements of compensation.

A central element of the compensation processes described in the FHLBanks' CD&As is the identification, on an individual FHLBank basis, of the appropriate peer or comparator institutions for that particular FHLBank. These differences in approach and appropriate peer or comparator institutions among the FHLBanks reflect the differences in the competitive employment environment confronting each individual FHLBank and the individualized strategic approaches and analysis that each FHLBank's compensation committee and board of directors undertakes in determining the FHLBank's compensation philosophy.

The Proposal does not address or consider this extensive SEC executive compensation regime. Also, the approach the FHFA is suggesting is significantly at odds with the FHLBanks' current disclosures required under Item 402(b) of the SEC's Regulation S-K. Each FHLBank is required to include in its CD&A a discussion of *its* compensation philosophy and how compensation actually paid to executive officers fits into *that* philosophy. If the Proposal were adopted in its present form, FHLBanks would likely have to include a statement in their CD&As that the peer groups and benchmarking percentages are set by the FHFA rather than at the discretion of the FHLBanks' boards of directors. We believe that a fair evaluation of the description in the Form 10-Ks of the FHLBanks' independent board-controlled compensation processes, which typically have made use of outside compensation experts, would confirm that those processes establish a

firm foundation for the FHFA's review of an individual FHLBank's determination of reasonable compensation for its executive officers that is actually intended by 12 U.S.C. § 4518(a).

B. Similar Institutions and Peer Groups

In selecting peer groups, a task that is performed typically with the assistance of compensation consultants, the FHLBanks focus on (i) operations in similar geographic markets, (ii) company size by assets, revenues, and employee population, and (iii) complexity and similarity of business functions. The FHFA cited in the preamble to the Proposal the Federal Reserve Banks and the Farm Credit Banks as examples of possible comparator institutions for the FHLBanks. The FHFA's apparent decision to use Federal Reserve Banks or Farm Credit Banks as comparators appears to have been made without (i) any apparent consideration of the different roles and functions that these institutions play, the differences in their lines of business, and the corresponding differences in the duties performed by the executive officers of those institutions as compared to the FHLBanks, (ii) any reference to any relevant competitive relationship between executive officer employment at Federal Reserve Banks or Farm Credit Banks and the FHLBanks, (iii) any discussion of actual comparability of current compensation among these entities, or (iv) any discussion of the reasons the FHFA did not take into account the actual comparable institutions as set forth in the FHLBanks' CD&As.[10]

The FHLBanks in their CD&As have not identified as peers either the Federal Reserve Banks or the Farm Credit Banks. We are of the view that the Federal Reserve Banks and Farm Credit Banks are not appropriate comparators. We note as one factor in a comparative analysis that these institutions are not registered with the SEC under the Exchange Act. Moreover, the Federal Reserve Banks are clearly more vested with a governmental mission than are the FHLBanks.

The FHFA should not dictate which entities are similar institutions for purposes of a comparison of the appropriate compensation for FHLBank executive officers. As such, the final rule should make it clear that the FHLBanks' boards of directors are expected and charged with the responsibility to make their own individual determinations regarding comparator institutions and that the FHFA will not purport to engage in this function. Rather, the FHFA should review the reasonableness of the determinations of comparable institutions made by the FHLBanks. Section 1113 of HERA directs the FHFA to look to compensation levels at similar businesses, including other publicly traded financial institutions or major financial services companies. Using this approach, we believe the FHFA would, in assessing appropriate comparators, have identified the types of institutions that have generally been cited by FHLBanks in their CD&As – namely, generally publicly traded regional and national bank holding companies, other large publicly traded financial services firms and other FHLBanks.

C. Benchmarking Percentages

Under the statutory framework established by HERA, the FHFA may not mandate a specified benchmarking level for compensation by establishing a presumption that "comparable

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[10] The Board of Governors of the Federal Reserve System in its annual report discloses information regarding the salary (and not any other forms of compensation) of the President of each Federal Reserve Bank and does not provide any compensation information regarding other executive officers of the Federal Reserve Banks. The five Farm Credit Banks disclose individual level compensation information only for their chief executive officers.

[compensation] . . . be at or below the median compensation for a given position at similar institutions."[11] Such prescription violates the language in the 1992 Act, which was effectively unchanged in HERA; further, section 1230.3(d) of the Proposal states that the FHFA Director may not prescribe or set a specific level or range of compensation. By purporting to delineate the appropriate comparator group and providing that each FHLBank must presumptively pay compensation at or below the median compensation of the comparator institutions, the FHFA effectively mandates compensation at a certain level in violation of the prohibition in 12 U.S.C. § 4518(d) and proposed section 1230.3(d).

A general description of the benchmarking processes used at the FHLBanks is described in the CD&As of the respective FHLBanks filed as part of their Form 10-Ks. As with the selection of comparator institutions, each FHLBank undertakes this process in its own unique manner that allows it to address its particular allocation of functions and personnel strengths and weaknesses. The Proposal sweeps past this nuanced individualized process and seeks to apply a "one size fits all" presumptive compensation cap to executive officers of the FHLBanks. Among other things, this would preclude a board of directors' prerogative to consider factors such as an executive's tenure with the FHLBank or the FHLBank System, the executive's knowledge of the FHLBank and the FHLBank System, and the executive's prior performance in determining the appropriate relationship between the executive's compensation and the benchmark compensation levels. We, therefore, urge the FHFA to delete the provision in proposed section 1230.2 that establishes a presumptive compensation cap and instead avoid any specific regulatory statement regarding appropriate comparative compensation levels.[12]

III. The FHFA Should Limit the Scope of the Definition of "Executive Officer" for the FHLBanks

Proposed section 1230.2 provides a list of persons by title or area of responsibility who are considered executive officers for the FHLBanks. The proposed section includes those executive officers deemed "named executive officers" under the SEC's disclosure requirements, as well as additional persons based on role and reporting responsibility. It further provides that the FHFA

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[11] Proposed section 1230.2.

[12] We further request that the FHFA delete the reference in clauses (1) and (2) of the definition of "reasonable and comparable" compensation to compensation taken "in whole or in part" and replace it with "taken as a whole." We believe that if an executive's compensation package taken as a whole is reasonable and comparable to compensation at similar institutions for similar duties, the FHFA should not be permitted to reject a discrete element of an executive's compensation as excessive.

We also request that clause (1)(iv) of the definition of "reasonable and comparable" compensation clarify that the reference to "goals" could be a reference to goals of a division, department, or unit of a regulated entity, rather than just personal goals for the individual or enterprise-wide goals. We further request that clause (1)(iv) should be revised to eliminate the reference to "guidance." While compliance with FHFA regulations and orders, and written agreements with the FHFA is mandatory and subject to enforcement action by the FHFA, "guidelines" issued by the FHFA under its 12 U.S.C. § 4526 authority do not constitute the basis for an FHFA enforcement action. Given the apparent advisory status of "guidance" or "guidelines" they should not form the basis for an evaluation of executive compensation.

"Director may add or remove persons, or functions to or from the list set forth . . . by communication to the [FHL]Banks or a [FHL]Bank from time to time."

We request that the definition of executive officer of an FHLBank be modified to encompass solely those executive officers deemed "named executive officers" under the SEC's disclosure requirements, i.e., the President, the Chief Financial Officer, and the three most highly compensated officers other than the President and the Chief Financial Officer. It is unlikely that the compensation of employees below these officers would be excessive if the compensation of these officers is determined to be reasonable and comparable with positions at similar institutions.

If the FHFA believes this is too few executive officers for the regulation to cover, then we request, for similar reasons, that the definition of executive officer encompass solely the ten most highly compensated executive officers at each FHLBank determined in the same manner as named executive officers are determined under the SEC's rules. While the number of employees who appropriately could be viewed as executive officers because they are responsible for both management and strategy varies among FHLBanks, we believe that the ten most highly compensated executive officers in such positions at each FHLBank provide a sufficient sample to determine whether the FHLBank's compensation practices are reasonable. We believe that defining executive officers as either (i) the named executive officers under the SEC's disclosure requirements or (ii) the ten most highly compensated executive officers, would provide the FHFA with sufficient information in order to perform its obligations under 12 U.S.C. § 4518.

We also request that Section 3(iii)(B) of the definition of executive officer ("[anyone] Who reports directly to the [FHL]Bank's chairman of the board of directors, vice chairman, president or chief operating officer") be removed. This provision could capture a non-executive assistant or secretary who reports to one of the named officeholders.

IV. The Proposal Should Be Modified to Clearly Explain the Mechanics of How It Will Apply to the FHLBanks

We believe the intended application of the Proposal to the FHLBanks and some of its procedural requirements are not clear. Our questions and suggested revisions are set forth below by the applicable section of the proposed regulation.

A. Withholding of Compensation and Prohibition of Payment or Agreement by a Regulated Entity (Sections 1230.3(c) and (e))

Proposed section 1230.3(c) provides that:

> "During a review under paragraph (a) of this section, the Director *may* require a regulated entity or the Office of Finance to withhold *any* payment, transfer or disbursement of compensation to an executive officer, or to place such compensation in an escrow account." (emphasis added).

This provision appears to suggest that if an FHLBank is expected by the FHFA to take any action with regard to an executive officer's compensation, it will be directly and expressly informed of such a directive by the FHFA. However, proposed section 1230.3(c) does not contain any provision for such notification.

Also, neither the preamble to the Proposal nor the text of the proposed regulation explains how proposed section 1230.3(c) relates to proposed section 1230.3(e). In contrast with proposed section 1230.3(c), which is apparently triggered only when a notice is given by the FHFA to an FHLBank, proposed section 1230.3(e)(1) does not expressly contain such a notice requirement. It provides that:

> "Subject to paragraph (e)(2) of this section, a regulated entity or the Office of Finance *shall not* transfer, disburse, or pay compensation to any executive officer, or enter into an agreement with such executive officer, without the approval of the Director, for matters being reviewed by the Director under § 1230.3." (emphasis added).

Since both proposed section 1230.3(c) and proposed section 1230.3(e)(1) refer generically to executive compensation matters under review by the FHFA Director under proposed section 1230.3, we do not understand in what circumstances proposed section 1230.3(c)'s discretionary provision would apply, and in what circumstances proposed section 1230.3(e)(1)'s apparent mandatory provision would apply.

The intended relationship between proposed sections 1230.3(c) and 1230.3(e)(1) and the meaning of proposed section 1230.3(e)(1) is further complicated by proposed section 1230.3(e)(2). Proposed section 1230.3(e)(2) appears to operate in a manner such that the otherwise mandatory provisions of proposed section 1230.3(e)(1) would *not* operate in a wide range of situations. Presumably any compensation action and/or payment that is not covered by proposed section 1230.3(e)(2) would not be subject to the prohibition and prior approval requirements of proposed section 1230.3(e)(1).

Under proposed section 1230.3(e)(2)(iii), it would appear that proposed section 1230.3(e)(1) would operate such that an FHLBank would be prevented from providing *any compensation* to an executive officer without prior approval of the FHFA Director, if the FHFA Director has provided written notice to the FHLBank that a particular executive officer's compensation is being reviewed by the FHFA Director.

Given all of the foregoing, we believe that it is essential that the Proposal be revised to provide a clear and precise process for the operation of the FHFA's review function. In that regard, we recommend that proposed sections 1230.3(c) and (e) be combined into a single section to eliminate any potential conflict or ambiguity between their current provisions.

We further recommend that the new section make it clear that, except to the extent that the FHFA has given written notice to an FHLBank that it is conducting a review under proposed section 1230.3 with respect to a particular executive officer, the FHLBank will be under no restrictions on transferring, disbursing or paying compensation to any executive officer, or entering into an agreement with any executive officer.[13]

The revised section should also provide for specific written notice to be given to an FHLBank in the event that the FHFA determines to conduct a review of a particular executive officer's compensation. The notice should specify what forms and amounts of compensation, if any, that the FHLBank is directed not to transfer, disburse or pay to the executive officer pending the

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[13] The FHLBank would remain subject to any applicable information submission requirements with respect to executive officer compensation that might apply under proposed section 1230.5(b).

outcome of the FHFA's review. In this regard, we believe that the regulation should provide direction that such withheld amounts not include:[14]

- Base salary at levels generally consistent with amounts provided in the prior year;
- Pension benefits under qualified and excess benefit plans and employer and employee contributions with respect to such plans;
- Compensation previously deferred;
- Health, life, and disability insurance benefits under nondiscriminatory plans or consistent with amounts set aside in prior years;
- Benefits in the form of use of regulated entity equipment and resources; and
- Vacation, sick, bereavement, community service and other leave benefits.

The FHFA should not withhold compensation such that it is treated as deferred compensation under Section 409A of the Internal Revenue Code of 1986, as amended, nor act in a manner that exposes an executive officer (and other participants in the deferred compensation plan) to unwarranted tax liability. FHFA and Treasury should coordinate so that the payments are considered in the nature of legal settlements excepted from Section 409A.

B. Prior Approval of the Director (Section 1230.3(e)(2))

In the case of the Dallas Bank, its short-term incentive compensation plan provides for cash payments to all employees, including the president and other executive officers, based on the achievement of objectively measurable individual and corporate goals. Under this plan, however, the Dallas Bank's Board of Directors maintains the discretion not to authorize any payments even though objectively measurable goals have been achieved, and the Board of Directors is required to affirmatively approve payments in accordance with the terms of the plan after the completion of the year to which the bonus payment relates. We believe the Proposal should clarify that, where prior approval by the FHFA of a payment under the plan to an executive officer is required (either under section 1230.3(e)(2) or as may be in effect required under section 1230.5, which is discussed below), approval by the FHFA of the terms of the plan with respect to executive officers would be sufficient if the major portion (e.g., 75%) of the payment to an executive officer is determined on the basis of objectively measurable criteria under the plan and that no further approval by the FHFA would be required at the time a payment is disbursed, even if the board of directors of the FHLBank reserved the right not to make any payment (or portion thereof) that would otherwise be due under the terms of the plan.

[14] The definition of compensation in proposed section 1230.2 should be modified to expressly exclude payments to an executive officer under indemnification and advancement rights to the extent not prohibited by applicable law.

C. Submission Requirements (Section 1230.5)

Under proposed sections 1230.5(b)(1)-(5) and (7), an FHLBank is required to submit certain compensation-related information to the FHFA for its review within one week *after* a specified event has occurred. The compensation-related information could include actions that could result in an immediately effective increase in an executive officer's compensation. Nothing in the proposed sections, however, suggests that there is any restriction on an FHLBank's ability to immediately implement such increases in executive officer compensation. The one-week timeframe for submissions set forth in proposed section 1230.5(b) is unworkable. As a matter of corporate practice, board minutes and resolutions are often not officially approved until the next board or committee meeting, which typically does not occur until well after one week following a board or committee meeting. The Proposal should be revised to recognize this factor.

We also note that proposed section 1230.5(b)(4) requires the submission of general benefit plans applicable to executive officers to the FHFA. Does "general benefit plans applicable to executive officers" include all benefit plans applicable to *all* employees (including executive officers) or only those benefit plans meant to apply primarily to executive officers?

Finally, proposed section 1230.5(b)(5) requires submission to the FHFA of any study conducted by or on behalf of an FHLBank with respect to compensation of executive officers, when delivered. This could lead to a result where an FHLBank must submit such studies to the FHFA before the FHLBank's board of directors has had an opportunity to review or to approve or reject the study. Is this the FHFA's intent? We believe that the board of directors should have the opportunity to review and comment on such a study prior to submitting it to the FHFA.

V. The Proposal Should Be Modified To Address the Due Process Rights of FHLBank Executive Officers

Proposed section 1230.3(b) of the Proposal provides that in determining whether compensation provided by an FHLBank to an executive officer is not reasonable and comparable, the FHFA Director may take into consideration any factors that the FHFA Director considers relevant. Proposed section 1230.3(b) currently specifies only one factor that the FHFA Director might consider relevant to such a determination: "any wrongdoing on the part of the executive officer, such as any fraudulent act or omission, breach of trust or fiduciary duty, violation of law, rule, regulation, order, or written agreement, and insider abuse with respect to the regulated entity or the Office of Finance." We believe that the rule should be modified to provide more specificity as to the types of factors that would be deemed relevant in supporting a determination by the FHFA Director that an executive officer's compensation is not reasonable and comparable.

Separately, proposed section 1230.3(b) does not offer an executive officer who is the subject of a compensation review based on, among other things, a potential claim of wrongdoing as set forth in that section, any notice of (i) the FHFA's decision to consider directing the executive officer's FHLBank to permanently withhold certain of the executive officer's compensation or (ii) the potential amount and form of the compensation that may be withheld. The Proposal should be modified to make it clear that certain types of compensation are *not* subject to being permanently withheld under proposed section 1230.3. These types of compensation should include:

- Pension benefits under qualified and excess benefit plans;
- Health, life and disability insurance benefits under nondiscriminatory plans; and

- Compensation previously deferred.

In addition, proposed section 1230.3(b) does not provide any opportunity for an executive officer to present his or her views or defenses with respect to either the factors that the FHFA Director is considering, including any alleged wrongdoing, or the amount and form of any compensation that may be potentially withheld. Proposed section 1230.3(b) also provides no standard as to the degree of proof of a claim of wrongdoing or other conduct that would be required to support a decision by the FHFA Director to order an FHLBank to permanently withhold compensation that had been earned by an executive officer. As such, Section 1230.3(b) in its current form raises significant due process concerns. We note here that the importance of protecting employees' due process rights was recognized by the FHFB with respect to its actions relating to the suspension or removal of directors, officers or employees of an FHLBank. The FHFB provided the following explanation:

> "Numerous comments on the removal provision argue that the agency lacks authority to adopt the rule and challenge whether the rule met the constitutional requirements of due process. The Finance Board has deleted the removal provision from the final rule . . . . [B]ecause section 2B(a)(2) of the Act . . . does not require that a hearing on the record be held to remove or suspend an officer, director, employee or agent of a Bank, it raises additional and disparate administrative law issues."[15]

On June 16, 2005, the board of directors of the FHFB issued an order that established a process for the removal or suspension of an FHLBank director or officer (the "Order").[16] That Order included a resolution by the board of directors that referred to "ensur[ing] that the process for removal or suspension of a [FHL]Bank director or officer is fair, impartial, and meets constitutional due process requirements". We believe that the notice, hearing and decision principles that the FHFB ultimately included in the Order properly recognize the importance of providing appropriate due process protections to an FHLBank officer who may be subject to adverse action by a government regulatory agency. We, therefore, believe that the FHFA should incorporate similar protections into any final rule.

VI. Existing Executive Compensation Arrangements Should be Grandfathered

We believe that compensation arrangements with FHLBank executive officers that are in effect prior to the effective date of the final rule should not be subject to action by the FHFA under 12 U.S.C. § 4518 or under the final rule. Support for this approach is provided by the FHFA's recent proposed rule on golden parachute and indemnification payments ("Golden Parachute Proposal").[17] The preamble to the Golden Parachute Proposal excludes pre-existing arrangements from coverage under the proposed rule:

> "In proposing the amendment, FHFA recognizes that prior to the enactment of HERA, the regulated entities or the Office of Finance may have entered into agreements that provide for golden parachute payments beyond that which is proposed to be permissible under section 1318(e) of

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[15] 67 Fed. Reg. 9897, 9901 (2002).

[16] FHFB Order Number 2005-12 (June 16, 2005).

[17] 74 Fed. Reg. 30975 (2009) (to be codified at 12 C.F.R. pt. 1231).

> the Safety and Soundness Act (12 U.S.C. 4518(e)) and the proposed amendment. FHFA intends that the proposed amendment would apply to agreements entered into by a regulated entity or the Office of Finance with an entity-affiliated party on or after the date the regulation is effective."[18]

We believe that the same principle that the FHFA has indicated that it intends to follow in the Golden Parachute Proposal should be applied in the final rule, so that the rule does not apply to compensation arrangements with FHLBank executive officers entered into prior to the date that the final rule becomes effective. Such an approach would help avoid possible legal issues or challenges that might arise if the regulation were applied to pre-existing compensation arrangements.

In certain contracts governing executive officers' compensation, the contract provides that its termination date will annually be automatically extended by one year unless either party to the contract gives to the other prior notice within a specified time before the anniversary of the contract that the first party does not wish to extend the term of the contract. To the extent that executive compensation arrangements existing prior to the effective date of the Proposal are grandfathered, such grandfathering should continue to apply to extensions of such arrangements, provided that there is no material change to the terms of the arrangement (a reasonable periodic increase in base salary would be deemed not to be a material change to the terms of the arrangement).

We appreciate your consideration of these comments.

Sincerely,

Lee R. Gibson
Chairman of the
Board of Directors

Bobby L. Chain
Chairman of the Compensation and
Human Resources Committee

[18] *Id.* at 30976.