FHLBANKS
OFFICE OF FINANCE

July 31, 2009

VIA EMAIL TO REGCOMMENTS@FHFA.GOV AND BY HAND

Alfred M. Pollard, Esq.
General Counsel
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

Dear Mr. Pollard:

The Office of Finance of the Federal Home Loan Bank System ("OF") is writing to comment on the Federal Housing Finance Agency's ("FHFA") proposed rule on Executive Compensation published on June 5, 2009 (the "Proposal").[1] The Proposal contains proposed executive compensation regulations that the FHFA indicates are intended to implement section 1113 of the Housing and Economic Recovery Act of 2008 ("HERA") with respect to the OF. The OF welcomes this opportunity to comment on the Proposal.

I. We Respectfully Submit That The Final Rule Should Not Apply to the OF; Congress Clearly Intended For Sections 1318(a)-(d) of Federal Housing Enterprises Financial Safety and Soundness Act of 1992 to Apply Only to "Regulated Entities" and Not to the "Office of Finance"

HERA amended a series of provisions of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (as amended by HERA, the "1992 Act")[2] to effectuate the combined responsibilities of the FHFA over Freddie Mac and Fannie Mae, as well as the Federal Home Loan Banks ("FHLBanks"). In particular, section 1113 of HERA amended section 1318(a) of the 1992 Act (12 U.S.C. § 4518(a)), which as amended provides that:

> The Director shall prohibit the regulated entities from providing compensation to any executive officer of the regulated entity that is

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

2 12 U.S.C §§ 4501-4642.

> 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 (emphasis added).

HERA also amended the 1992 Act to include a specific definition of the term "regulated entity." The term "regulated entity" for purposes of the 1992 Act (including section 1318 of the 1992 Act) is defined to mean the "(A) Federal National Mortgage Association and any affiliate thereof; (B) the Federal Home Loan Mortgage Corporation and any affiliate thereof; and (C) any Federal Home Loan Bank."[3] The term "regulated entity" as defined in the 1992 Act (including for purposes of section 1318 of the 1992 Act) does not include the OF.[4]

We respectfully submit that had Congress intended the executive compensation provisions in sections 1318(a)-(d) of the 1992 Act to apply not only to the "regulated entities" (*i.e.*, Fannie Mae and Freddie Mac (and their respective affiliates) and the FHLBanks) but also to the OF, Congress could have easily effectuated such an intent by amending those statutory provisions to specifically refer to the OF. Congress, however, chose not to do so. Instead, in enacting section 1113 of HERA, Congress amended section 1318(a) of the 1992 Act by striking the words "enterprise" and "enterprises" in that section to describe the type of entities covered by that section and by replacing those references with the defined terms "regulated entity" and "regulated entities". Moreover, Congress in enacting section 1318(c) of the 1992 Act in section 1113 of HERA limited the authority of the FHFA Director ("Director") to order a temporary withholding of compensation to an order to the "regulated entities" and not to the OF.

In making its determination only to refer to "regulated entity" or "regulated entities" in sections 1318(a) and (c), and not to refer to the OF, we respectfully submit that Congress evinced a clear and unambiguous intention that the executive compensation provisions in sections 1318(a)-(d) were to be applied only to Fannie Mae and Freddie Mac (and their affiliates) and the FHLBanks, and not to the OF. We believe this position is strongly supported by the fact that Congress also amended the 1992 Act to expressly refer to <u>both</u> the regulated entities and the OF when it intended to do so.[5]

---

3 12 U.S.C. § 4502(20). Similarly, in proposed section 1230.2 of the Proposal, the FHFA defines the term "regulated entity" to mean "the Federal National Mortgage Association and any affiliate thereof; the Federal Home Loan Mortgage Corporation and any affiliate thereof; or any Federal Home Loan Bank; the term "regulated entities" means, collectively, the Federal National Mortgage Association and any affiliate thereof; the Federal Home Loan Mortgage Corporation and any affiliate thereof; and any Federal Home Loan Bank."

4 12 U.S.C. § 4502(19) defines the term "Office of Finance" as the "Office of Finance of the Federal Home Loan Bank System (or any successor thereto)."

5 For example, section 1101 of HERA amended 12 U.S.C. § 4511 to specifically refer to the Director as having general regulatory authority over each "regulated entity *and the Office of Finance*" (emphasis added). 12 U.S.C. § 4511(b)(2). Similarly, section 1153 of HERA amended 12 U.S.C. § 4631(a)(1) to

While acknowledging "the Office of Finance is not directly covered by section 1113 of HERA,"[6] the FHFA seeks to apply such provisions to the OF on the basis that the OF "is subject to the Director's "general regulatory authority" under section 1311(b)(2) of the [1992 Act], as amended by HERA."[7] We respectfully submit that the FHFA's position in this regard is contrary to the plain language of sections 1318(a) and (c) of the 1992 Act, the will of Congress, and established law.[8] By purposely omitting the OF from the ambit of sections 1318(a)-(d) of the 1992 Act, we believe that Congress has clearly and unambiguously expressed its intent to exclude the OF from the reach of these provisions.[9] Furthermore, under well established principles of administrative law, the FHFA may not rely on its general rulemaking authority to expand the reach of the executive compensation provisions and effectively rewrite the statute.[10]

---

provide that any person subject to a removal or prohibition order under that section shall not participate in any manner in the conduct of the affairs of any "regulated entity *or the Office of Finance*" (emphasis added), and also amended 12 U.S.C. § 4631(d)(4) to provide that any such person shall not vote for a director, or serve or act as an entity-affiliated party of "a regulated entity or as an officer or director of the *Office of Finance*" (emphasis added). *See also* 12 U.S.C. § 4636(e), which, as amended by section 1377 of HERA, contains several references to a "regulated entity *or the Office of Finance* (emphasis added)".

6 74 Fed. Reg. at 26990.

7 Section 1311(b)(2) of the 1992 Act (as amended by section 1101 of HERA) provides as follows: "The Director shall have general regulatory authority over each regulated entity and the Office of Finance, and shall exercise such general regulatory authority, including such duties and authorities set forth under section 1313, to ensure that the purposes of this Act, the authorizing statutes, and any other applicable law are carried out." 12 U.S.C. § 4511(b)(2).

8 It is well settled that when the intent of Congress is clear, an agency must give effect to the expressed intent of Congress. *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 842-43 (1984).

9 We respectfully submit that to conclude otherwise would violate the canon of statutory construction, *expressio unius est exclusio alterius*, which states that "the mention of some implies the exclusion of others not mentioned." *United Dominion Indus. v. United States*, 532 U.S. 822, 836 (2001); *see also*, e.g., *Barnhart v. Peabody Coal Co.*, 537 U.S. 149, 168 (2003) (stating that "when the items [listed in a statute] are members of an associated group or series," courts will infer "that items not mentioned were excluded by deliberate choice, not inadvertence."); *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993) (applying the canon of *expressio unius est exclusio alterius*); *Pac. Nw. Generating Coop. v. DOE*, 550 F.3d 846 (9th Cir. 2008) (holding that mandatory language in a statute did not apply to a certain class of utility customers, because that class was not included on the list of customers to whom the mandatory language applied).

10 An agency's rulemaking power "is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute." *Bd. of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (1986); *see also*, e.g., *Fin. Planning Ass'n v. SEC*, 482 F.3d 481, 493 (D.C. Cir. 2007) (holding that the Securities and Exchange Commission ("SEC") could not invoke its general rulemaking authority to broaden the class of broker-dealers exempt under the Investment Advisers Act where Congress unambiguously defined which broker-dealers were exempt under the Act); *American Bankers Ass'n v. SEC*, 804 F.2d 739, 755 (D.C. Cir. 1986) (holding that the SEC could not use its rulemaking powers to

Accordingly, no basis exists in law for the FHFA to apply its final rule on executive compensation to the OF. We request therefore that the FHFA modify the final rule to delete all operative references to the application of the final rule to the OF or its executive officers.[11] In the event that the FHFA nevertheless seeks to apply its final rule to the OF, and without waiving any rights to challenge such an action, we offer the following comments for the FHFA's consideration on the Proposal.

II. The Final Rule Should Not Designate Particular Comparator Institutions for the OF; and the Final Rule Should Not Impose A Presumptive Cap on Executive Compensation at the OF

We note that the preamble to the Proposal provides that the 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 Banks***."[12] The term "Banks," as defined in proposed section 1230.2 of the Proposal, means, "collectively, all the Federal Home Loan Banks".[13] Thus, as the FHFA has defined it, the term "Banks" does not include the OF.[14] Consequently, we understand that the FHFA is not proposing that the Federal Reserve Banks or the Farm Credit Banks may be considered by it to be examples of appropriate comparators to assess the reasonableness and comparability of executive compensation provided by the OF.

Furthermore, we note that in defining the term "comparable" in proposed section 1231.2 of the Proposal, the FHFA has suggested that it "generally considers comparable to be at or below the median compensation for a given position at similar institutions." Proposed section 1231.1 defines the term "similar institutions" only with respect to "the Banks and Enterprises." Neither the defined term "Banks" nor "Enterprises" includes the OF.[15] As we understand the

---

expand the definition of "bank" and increase its regulatory jurisdiction when Congress included a clear and unambiguous definition of "bank" in the statute).

11 We note that proposed section 1230.6, which is intended to address the executive compensation limitations set forth in section 1117 of HERA, by its express terms applies only to the regulated entities and not to the OF.

12 74 Fed. Reg. at 26990 (emphasis added).

13 Similarly, the FHFA has defined the term "Banks" in the preamble to the Proposal to mean the FHLBanks. *Id.* at 26989.

14 Proposed section 1230.2 separately defines the term "Office of Finance" to mean the "Office of Finance of the Federal Home Loan Bank System (or any successor thereto)."

15 The term "Enterprises" is defined in proposed section 1230.2 to mean "the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (collectively, Enterprises) and, except as provided by the Director, any affiliate thereof."

Proposal, therefore, the FHFA is not proposing that, with respect to the OF, comparable means "at or below the median compensation" for a given position at similar institutions.

If, contrary to our understanding of how the Proposal applies to the OF, the final rule seeks (i) to designate, either formally or informally, particular comparator institutions to determine compliance of the OF with the final regulation, or (ii) to impose a presumptive cap on executive compensation at the OF by providing comparable means "at or below the median compensation" for a given position at similar institutions, we respectfully submit that such an approach would not be supported by adequate notice in the Proposal. We further believe that such an approach would violate the express statutory prohibition in 12 U.S.C. § 4518(d), which provides that the Director "may not prescribe or set a specific level or range of compensation."[16] Furthermore, we believe the FHFA would effectively take control of the compensation process at the OF, thereby displacing the business judgment of the board of directors of the OF ("OF Board"). Such an approach would be neither legally permissible under 12 U.S.C. § 4518(d), as enacted by section 1113 of HERA,[17] nor warranted as a matter of appropriate corporate governance or regulation of the OF. In such a circumstance, instead of undertaking an independent evaluation and determination process in such circumstances, the OF Board could be presented with a *fait accompli* by the FHFA.

We do not believe that Congress intended for section 1113 of HERA to be applied in a manner that so dramatically strips the OF Board of its authority and proper incentives in setting policy and making sound executive compensation decisions. While HERA authorizes the FHFA to review compensation for the regulated entities, we submit that it did not alter the fundamental authority of the OF Board to set executive compensation.

A. Current Compensation Practices at the OF

The OF takes executive compensation very seriously. The OF Board is responsible for determining the philosophy and objectives of the OF's compensation program. The philosophy of the OF's compensation program is to provide a flexible and market-based approach to compensation that attracts, retains and motivates high performing, accomplished financial services executives who, by their individual and collective performance, achieve the OF's strategic business initiatives. Because employees of the OF are not permitted to own FHLBank capital stock, all compensation is paid in cash and the OF has no equity compensation plans or arrangements.

By law, the OF Board consists of three members appointed by the FHFA, including two FHLBank Presidents and one person not employed by an FHLBank or the OF who has a

---

16 The same provision initially was enacted as part of the 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."

17 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).

demonstrated expertise in financial markets.[18] The expenses of the OF are generally allocated among the FHLBanks based on each FHLBank's percentage of total capital stock, percentage of consolidated obligations issued, and percentage of consolidated obligations outstanding. The FHLBank Presidents who serve on the OF Board clearly have no incentive to pay excessive compensation to OF executive officers, since the operations of the OF are funded by the FHLBanks, and excessive compensation payments to OF executive officers would drive down earnings at the FHLBanks.

The OF has a compensation policy that is reviewed and approved annually by the OF Board. The compensation program focuses on establishing competitive compensation levels for different jobs with additional considerations with regard to responsibility, knowledge, and experience levels, the position's impact on the financial performance of the FHLBanks or the success of the OF in meeting its goals, different labor markets, staff turnover, and the relatively small number of OF staff relative to the volume of aggregate debt securities issuances. In addition, the OF Board and OF management use an independent third party compensation consultant and independent market data sources in reviewing and establishing compensation for OF's CEO, Director of Internal Audit, as well as for other executive officers and staff.

The OF Board utilized a compensation study by McLagan Partners, a nationally recognized compensation consulting and benchmarking firm for the financial services industry, in determining market competitive compensation for the CEO for 2008, as described more fully below. (In April of 2009, a similar study was conducted in connection with the promotion of a new COO). The OF Board strives to create a program that generally delivers compensation for the CEO of the OF which is between the 50th and 75th percentile as compared to the FHLBanks, and generally, at the 50th percentile as compared to the other entities in the study, with additional considerations as noted immediately above.

McLagan Partners also assists the OF Board and OF management in determining market competitive compensation for executives generally other than the CEO of the OF.[19] Each year, the OF Board approves salary ranges appropriate for all employment levels and sets a total approved budget, as well as the aggregate of the incentive pool. Specific salary decisions for executive officers are delegated to the CEO of the OF, and then reviewed with the OF Board. The CEO of the OF also works closely with the OF Board to set incentive targets and the OF Board reviews all incentive payments before they are paid. Detailed compensation information for the executive officers, including written evaluations, is provided to the OF Board. In addition, the OF Board and OF management commissioned a compensation study to cover all employees (including the CEO) in 2009. (A prior study was commissioned in 2005). For personnel generally, total compensation is typically benchmarked against the 50th percentile of outside market data as approved by the OF Board.

---

18 12 C.F.R. § 985.7. The non-employee OF Board position is currently vacant.

19 The OF Board also makes all compensation decisions for the Director of Internal Audit and historically, has made compensation decisions for the Deputy Managing Director.

B. Similar Institutions and Peer Groups

A central element of the compensation processes employed by the OF Board and the CEO of the OF is a thorough determination of the appropriate peer or comparator institutions. In selecting peer groups, a task that is performed typically with the assistance of a compensation consultant as described above, the OF Board and OF management focus on competitors from both business and labor market perspectives. Factors considered include (i) operations in similar geographic markets, (ii) company size by assets, revenues, and employee population, and (iii) complexity and similarity of business functions. The OF Board and OF management also consider firms from which the OF historically has hired employees, firms to which the OF has lost employees, and firms that regularly are identified as having qualified candidates by internal and external recruiters. The OF Board and OF management focus on the realistic employment opportunities for the OF's executives in assessing comparability, since their key compensation objectives include attracting and retaining executives.

As noted above, in determining market competitive compensation in 2009, the OF Board and OF management are engaging McLagan Partners to provide a compensation study. The McLagan 2008 OF CEO study covered three groups: corporate banking, fixed income originators (debt capital markets), and treasury & asset-liability management. The study was comprised from data provided by over 60 companies. In addition, the McLagan 2008 OF CEO study included the compensation of the 12 FHLBank Presidents. We expect that the list for the 2009 study will be substantially similar. These comparator institutions do not include the Federal Reserve Banks or the Farm Credit Banks.[20]

C. Federal Reserve Banks and Farm Credit Banks

As discussed above, the Proposal does not appear to take the position that the Federal Reserve Banks and the Farm Credit Banks are appropriate comparators for determining executive compensation with respect to the OF. We agree with the Proposal in that respect.

The OF does not compete for talent with the Federal Reserve Banks. Historically, employees of the Federal Reserve Banks generally do not move to the OF or vice versa. The reality of employment competitors to the OF and the lack of relevance of the Federal Reserve Banks and Farm Credit Banks is described in a paper by McLagan Partners, an executive compensation consulting firm which provides consulting services to the OF, which is attached hereto in Appendix ("McLagan Paper"). Furthermore, the Federal Reserve Banks are also not

---

20 We note that the OF compensation policy specifies that "for positions at the managerial level and those requiring the highest level of specialized skills and expertise, the OF must compete against national market compensation standards of a select group of comparable financial services organizations, including other government-sponsored enterprises, federal agencies that supervise financial institutions or have a housing-related mission, and certain specialized segments of the financial services industry (e.g. dealers, investment banking firms and national and regional financial institutions)." As a matter of practice, the OF includes Fannie Mae, Freddie Mac, and the FHLBanks among its comparators – but not the Federal Reserve Banks or the Farm Credit Banks.

appropriate comparators from a business perspective. The Federal Reserve Banks fundamentally are engaged in very different lines of activity than the OF. The Federal Reserve Banks are the front-line component of the regulatory, supervisory and enforcement operations of the Board of Governors of the Federal Reserve System. Included among their regulatory responsibilities are the examination and supervision of state member banks and bank holding companies and their affiliates. The Federal Reserve Banks also play a major role in the payments system and currency system. Historically, Federal Reserve Banks have been engaged in lending activities to depository institutions only on a short-term basis. Furthermore, financing of Federal Reserve Bank operations is fundamentally intertwined with the issuance of U.S. currency.

In contrast to the Federal Reserve Banks, the OF does not have any regulatory responsibilities and is not engaged in the payment and currency system activities of the Federal Reserve Banks. Instead, the OF acts as centralized debt issuance facility for the entire FHLBank System. In addition to issuing and servicing all of the debt of the FHLBank System, the OF also prepares the combined financial statements, selects and evaluates underwriters, and develops and maintains the infrastructure needed to meet goals of the FHLBank System. In short, the Federal Reserve Banks are not appropriate comparator institutions for the OF.

Likewise, the Farm Credit Banks are not appropriate comparators for the OF. The OF does not compete for talent with the Farm Credit Banks. Historically, employees of the Farm Credit Banks do not generally move to the OF, nor do employees of the OF move to the Farm Credit Banks. As discussed in the McLagan Paper, the OF does not view the Farm Credit Banks as comparator institutions. The nature of the business of the OF is also very different from that of the Farm Credit Banks. As contrasted to the primary function of the OF, which is to act as a clearinghouse for the issuance of debt securities for the FHLBank System, none of the Farm Credit Banks act as a centralized debt issuance facility. In fact, the Farm Credit Banks utilize a fiscal agent, the Federal Farm Credit Banks Funding Corporation, to issue, market, and handle their debt securities. Moreover, in contrast to the OF which has no lending function, the primary function of the Farm Credit Banks is to make long-term mortgage loans to farmers and other businesses in the agricultural sector. Furthermore, unlike the OF which is a joint office of the FHLBanks located a single location in Reston, Virginia, the Farm Credit Banks are cooperatively-owned by member institutions and are located in different regions of the United States. The FHFA should not therefore impose a determination that the Farm Credit Banks are appropriate comparator institutions for the OF.

D. Benchmarking Percentages

As discussed above, the Proposal does not appear to apply a presumptive compensation cap to the OF. Nevertheless, and without waiving our position in this regard in any respect, we respectfully offer the following comments regarding the benchmarking approach set forth in the Proposal which expressly applies to the FHLBanks.

We respectfully submit that the FHFA may not mandate that "comparable [compensation] ... be at or below the median compensation for a given position at a similar institution." We believe that such a 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 Director may not prescribe or set a specific level or range of compensation. The Office of Federal Housing Enterprise Oversight ("OFHEO") did not make any effort to mandate a particular benchmark percentage in its executive compensation regulations governing the Enterprises promulgated in 2001 ("OFHEO Compensation Rule"). By purporting to delineate the appropriate comparator group and providing that compensation must be at or below the median compensation of the comparator institutions, the Proposal 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).

Under 12 U.S.C. § 4518, the FHFA may not mandate a specified benchmarking level for compensation by establishing a presumption that FHLBanks must pay compensation at or below the median compensation. The critical point is that this choice of individual executive compensation level, consistent with 12 U.S.C. § 4518 and corporate governance principles under the Federal Home Loan Bank Act, should be made by the individual FHLBank's compensation committee or board of directors utilizing their own business judgment and not dictated by the FHFA. We respectfully submit that the FHFA should only intervene in this process if the determinations of an FHLBank compensation committee or board of directors are manifestly unreasonable or proper procedures are not followed.

In addition, the Proposal appears to ignore the reality that benchmarking is not done in isolation but is related to (i) the entity chosen as comparable, (ii) the position chosen at the "comparable" entity, (iii) individual performance or other factors, and (iv) a review of the total employment proposition. Benchmarking positioning will vary depending on the peer group. Second, benchmarked jobs typically are selected based on division, role, and level of responsibilities, considering only "realistic employment opportunities" for each executive. Third, the benchmarking target may increase or decrease depending on individual performance or other factors. Finally, benchmarking takes into account all aspects of compensation to ensure that total compensation is appropriate. The Proposal appears to sweep past the highly nuanced individualized process and seeks to apply a 'one size fits all' presumptive compensation cap. We urge the FHFA to delete the provision in proposed section 1230.2 that establishes a presumptive compensation cap, and instead follow the approach in the OFHEO Compensation Rule which avoids any specific regulatory statement regarding appropriate comparative compensation levels.

E. Summary

To the extent that the FHFA seeks to apply the final rule to the OF, we respectfully submit that the final rule should make it clear that the OF Board and OF management are expected to make their own determination regarding comparator institutions, and that the FHFA will not purport to engage in this function. We also submit that the final rule should also make it clear that the FHFA's function in this regard will be limited to reviewing the comparator decisions made by the OF Board and OF management. Such a review would appropriately consider the process that the OF undertook in reaching a comparator decision; however, the FHFA should not substitute its views for the business judgment of the OF Board on compensation issues.

In this respect, we note that the OFHEO Compensation Rule promulgated under substantively similar statutory requirements does not specify particular comparator institutions for the Enterprises. Nor were such institutions specified in the preamble to the OFHEO Compensation Rule. Moreover, the OFHEO Compensation Rule does not include a specific presumptive percentage cap relative to comparator institution compensation that would apply to the Enterprises executive compensation determinations. We believe that the approach taken in the OFHEO Compensation Rule in this respect is correct and that the FHFA should use this approach in any final rule in this rulemaking proceeding. To the extent that the FHFA purports to apply the final rule to the OF, we urge the FHFA to delete the provision in proposed section 1230.2 which establishes a presumptive compensation cap, and instead follow the approach in the OFHEO Compensation Rule which avoids any specific regulatory statement regarding appropriate comparative compensation levels.[21]

III. The Proposal Appears to Put an OF Executive Officer At Risk With Respect to all Compensation the Officer May Have Received Or Earned, and is Likely to Make it Difficult For the OF to Attract or Retain Highly Qualified Executive Officers.

If applied to the OF, proposed section 1230.3 would appear to give the FHFA the authority to direct the OF to permanently withhold payment, transfer or disbursement of any compensation of the executive officers of the OF, based on *any factors* the Director considers relevant. Moreover, the proposed rule does not place any limitations on:

- The types of compensation that are subject to being permanently withheld;
- The time period in which the alleged factor justifying the withholding occurred;
- When the compensation to be withheld was earned; and
- The time period in which an action by the FHFA must be commenced and/or concluded.

---

21 We further request that the FHFA delete the reference in paragraphs (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 paragraph (1)(iv) of the definition of reasonable and comparable compensation be revised to clarify that the goals reference could also be those of a division, department, or unit of a regulated entity or the OF, rather than just personal goals for the individual or enterprise-wide goals. We further request that paragraph (1)(iv) 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.

Furthermore, proposed section 1230.7 refers to the possibility that the FHFA could take corrective or remedial action, including an enforcement action to require an OF executive officer to make restitution or reimbursement of "excessive compensation." Under this provision, the FHFA appears to suggest that it can not only prohibit earned compensation from being paid to an OF executive officer, but that it can require an OF executive officer to repay compensation the officer has already received under the claim that such compensation was "excessive compensation." Proposed section 1230.7 provides no limitations on the FHFA's purported enforcement or other corrective or remedial authority in this regard.

We submit that the combination of proposed sections 1230.3 and 1230.7 and the absence of any apparent limitations on the FHFA's exercise of this authority with respect to time or scope can only have a detrimental effect on the recruitment and retention of executive officers to the OF. Further, executive officers at the OF should not have to be concerned that an exercise of unfettered agency discretion could eliminate the financial results of years of hard work over a dispute as to what constitutes "excessive compensation." The FHFA should consider this negative consequence to the operations of the OF in developing the final rule and, to the extent made applicable to the OF, should modify the final rule to provide reasonable and appropriate limitations on the FHFA's exercise of any authority under proposed sections 1230.3 and 1230.7.

IV. The FHFA Should Modify the Definition of "Executive Officer" in the Final Rule With Respect to the OF

Proposed section 1230.2 defines the term "executive officer" with respect to the OF as (i) any individual who occupies a position in any of the top five pay bands and (ii) any individual, without regard to title, who is in charge of a principal business, unit, division or function. The OF has a relatively small workforce currently comprised of less than 90 employees. The OF currently has only 4 employees that it considers to be executive officers. These individuals occupy the position of "Senior Director" or above at the OF. Given the relatively small workforce at the OF and the relatively small number of executive officers, we request that the definition of "executive officer" with respect to the OF in the final rule incorporate a 'bright line' test that encompasses solely the five most highly compensated employees at the OF. We believe that having the final rule apply to the five highest compensated officers at the OF should ensure that the FHFA has comprehensive coverage of the top compensation structure at the OF in order to perform any of its obligations under 12 U.S.C. § 4518.

V. The Proposal Should be Modified to Clearly Explain How It Will Apply

We submit that the intended application of the Proposal is not clear. We will first discuss the sources of the lack of clarity, and then suggest potential revisions to address these issues.

- Under proposed sections 1230.5(b)(1)-(5) and (7), the OF 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. However, nothing in the proposed sections suggest that there is any restriction on the OF's ability to immediately implement such increases in executive officer compensation.

- 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 the OF 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.

- Neither the preamble to the Proposal nor the text of the proposed rule explains how proposed section 1230.3(c) relates to proposed section 1230.3(e). In contrast with proposed section 1230.3(c), which apparently is triggered only when a notice is given by the FHFA to the OF, 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 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 complicated further 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 the OF would be prevented from providing any compensation to an executive officer without prior approval of the Director, if the Director has provided written notice to the OF that a particular executive officer's compensation is being reviewed by the Director.

While proposed section 1230.3(e)(2)(iii), providing for written notice, would be a circumstance in which proposed section 1230.3(e)(1) becomes operative for matters being reviewed by the Director under proposed section 1230.3, the provisions and their operation lack clarity and raise numerous issues, some of which are noted below:

- How does the OF know that a review is underway in regard to the circumstances described in proposed section 1230.3(e)(2)(i)? (The provisions do not specifically provide for a written notice to the OF.)

- Is it the FHFA's intent for the OF to assume that a circumstance covered by proposed section 1230.3(e)(2)(i) is automatically a matter being reviewed by the Director under proposed section 1230.3? What is expected of the OF if this were the case?

- How does the notice referred to in proposed section 1230.3(e)(2)(iii) relate to a notice that might be contemplated by proposed section 1230.3(c) or do such notices potentially have different impacts?

- Which circumstances require the OF to obtain prior approval from the FHFA to transfer, disburse or pay compensation to an executive officer in connection with the review of a written agreement that provides the executive officer with a term of employment of six months or more or that provides for compensation in connection with termination of an executive officer's employment (as described in proposed section 1230.3(e)(2)(i))?[22]

We believe that a procedure that requires the OF to obtain the Director's approval to continue to pay any compensation to an executive officer presumably was not the intent of Congress.

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

---

22 We note that the preamble to the Proposal provides that termination benefits provided under a corporate-wide or top hat policy previously approved by the Director do not require an additional approval but that point is not addressed in the text of proposed section 1230.3(e)(2)(i)(B).

We further recommend that the new section make it clear that, except to the extent that the FHFA has given written notice to the OF that it is conducting a review under proposed section 1230.3 with respect to a particular executive officer, the OF will be under no restrictions on transferring, disbursing or paying compensation to any executive officer, or entering into an agreement with any executive officer.[23] We also believe that the revised section should provide for specific written notice to be given to the OF in the event that the FHFA determines to conduct a review of a particular executive officer's compensation. We submit that the notice should specify what forms and amounts of compensation, if any, that the OF is directed not to transfer, disburse or pay to the executive officer pending the outcome of the FHFA's review. In this regard, we believe that the regulation should provide direction that such withheld amounts not include:[24]

- 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;
- Any wages that are protected under state statute; and
- Vacation, sick, bereavement, and other leave benefits.

We submit that 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 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.

---

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

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

VI. The Final Rule Should be Modified To Address the Due Process Rights of the OF Executive Officers

Proposed section 1230.3(b) of the Proposal provides that in determining whether compensation provided by the OF to an executive officer is not reasonable and comparable, the Director may take into consideration any factors that the Director considers relevant. Proposed section 1230.3(b) currently specifies only one factor that the Director might consider relevant to such a determination: "any wrongdoing on the part of the executive officer, such as an 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 respectfully submit that the final rule should provide more specificity as to the types of factors that would be deemed relevant in supporting a determination by the 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 OF 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 final rule should 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;
- Any wages that are protected under state law; 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 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 Director to order the OF to permanently withhold compensation that had been earned by an executive officer.

As such, we submit that proposed section 1230.3(b) in its current form raises significant due process concerns. An adverse compensation determination by the Director based on "wrongdoing" or other factors could have a materially adverse financial impact on an executive officer. Moreover, any adverse compensation action against an executive officer, particularly one premised on some type of finding by a government agency of "wrongdoing" could have severe adverse reputational and employment impacts on the executive officer. As a practical matter, such a determination by the FHFA, based in whole or in part on purported wrongdoing

by an OF executive officer, could have adverse consequences for the officer's current position and could make it very difficult for the officer to secure a similar type of employment in the future. Thus, an executive officer has a compelling interest in the outcome of the Director's compensation review. The OF likewise has an interest in understanding the circumstances that might result in an adverse compensation determination against one of its executive officers. At the same time, the FHFA also has a strong interest in ensuring that any determination that it makes is well founded and based on a full understanding of the applicable facts and circumstances.

We note here that the importance of protecting employees' due process rights was recognized by the Federal Housing Finance Board ("FHFB") with respect to its actions relating to the suspension or removal of directors, officers or employees of an FHLBank. In December 2000, the FHFB proposed a rule regarding agency rules of practice and procedure that would have authorized the agency to suspend or remove such an individual without any prior notice or opportunity to be heard.[25] However, in the final rule published in March 2002, the FHFB withdrew the proposed suspension and removal portion of the rule. The FHFB provided the following explanation for its action:

> 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.[26]

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 ("Order").[27] That Order included a resolution by the board of directors that referred to "ensur[ing] that the process for removal or suspension of a Bank director or officer is fair, impartial, and meets constitutional due process requirements". The Order required that at least 20 calendar days before taking any action FHFB staff will communicate in writing to the director or officer ("Respondent"), the Respondent's counsel, and the relevant FHLBank of the factual and legal circumstances the staff believes may warrant removal or suspension. The Order provides that the Respondent will (i) have the opportunity to respond in writing to the factual and legal bases cited by FHFB staff and (ii) have the opportunity to make an oral presentation at a meeting of the board of directors of the FHFB. The board of directors is required to issue a written decision to the Respondent and the

---

25 65 Fed. Reg. 78994 (2000) (codified at 12 C.F.R. § 908.7).

26 67 Fed. Reg. 9897, 9901 (2002).

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

FHLBank. If the Respondent is removed or suspended the board of directors' decision must describe the factual and legal bases for the findings of cause for removal or suspension.

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 respectfully request that the FHFA should incorporate similar protections into any final rule.

VII. The Proposal's Information Submission Requirements Should be Modified in Certain Respects

We submit that the one-week timeframe for submissions set forth in proposed section 1230.5(b) is not adequate. 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. We request that the final rule be revised to recognize this factor.

In addition, we request that the requirement that there be no redactions in materials that are submitted should be deleted as there are *bona fide* reasons for redactions. For example, redactions may relate to information that is subject to the attorney-client privilege.

We also note that proposed section 1230.5(b)(4) requires the submission of general benefit plans applicable to executive officers to the FHFA. We ask for clarification as to whether the reference to "general benefit plans applicable to executive officers" includes all benefits 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 the OF with respect to compensation of executive officers, when delivered. We believe this could lead to a result where the OF must submit such studies to the FHFA before the OF Board has had an opportunity to review or approve the study. We respectfully submit that the OF Board should have the opportunity to review and comment on such a study prior to submission to the FHFA.

VIII. Existing Executive Compensation Arrangements Should be Grandfathered

To the extent that FHFA seeks to apply the final rule to the OF, we submit that compensation arrangements with OF 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. In this regard, we note that Congress, in amending the charter acts of the Enterprises to include certain restrictions on the payment of termination benefits by the

Enterprises to their executive officers, provided that such restrictions should be applied prospectively only to agreements entered into after the date of the enactment of the 1992 Act.[28]

Further support for this approach is provided by the FHFA's recent proposed rule on golden parachute and indemnification payments ("Golden Parachute Proposal").[29] 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 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.[30]

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 its final rule on executive compensation, so that the final rule does not apply to compensation arrangements, agreements, or plans with or that apply to OF executive officers which were 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.

* * * * *

---

28 12 U.S.C. § 1723a(d)(3)(B) and 12 U.S.C. § 1452(h)(2). This principle is included in the OFHEO Compensation Rule 12 C.F.R. § 1770.1(b)(2) ("Agreements or contracts that provide for termination payments to executives that were entered into before October 28, 1992 are not retroactively subject to approval or disapproval by the Director. However, a renegotiation, amendment or change to such an agreement or contract entered into on or before October 28, 1992 shall be considered as entering into an agreement or contract that is subject to approval by the Director.").

29 74 Fed. Reg. 30975 (2009) (to be codified at 12 C.F.R. Part 1231).

30 *Id.* at 30976.

If you have questions or need clarification with respect to these comments, please feel free to contact (703)467-3640 or fisk@fhlb-of.com.

On behalf of the OF, we appreciate your consideration of these comments.

Sincerely,

Terry Smith
Acting Chairman
OF Board of Directors

MCLAGAN
FACT-BASED ADVICE

1600 Summer Street
Suite 601
Stamford, CT 06905

T 203.359.2878
F 203.323.9851
www.mclagan.com

Appendix

July 29, 2009

McLagan is submitting this letter in support of The Office of Finance of the Federal Home Loan Bank System ("OF") comment letter regarding the Federal Housing Finance Agency's ("FHFA") proposed rule on Executive Compensation (the "Proposal"), which was published on June 5, 2009 (74 Fed. Reg. 26989 (2009) - to be codified at 12 C.F.R. pt. 1230).

Background on McLagan's Relationship with the Federal Home Loan Bank System

In the spirit of full disclosure, the FHFA should know that McLagan has provided compensation benchmarking and advisory services to the 12 Federal Home Loan Banks ("FHLBanks") and the OF independently, beginning in 1998 with the OF. McLagan has been conducting a compensation survey for the FHLBanks since 2005 and while the OF does not participate in this survey; it does receive aggregated results for specific positions. The survey covers a broad range of financial service firms including regional, national and international banks engaged in various lending and capital markets activities. The OF independently participates in various other compensation survey programs.
From time to time, McLagan also provides compensation and related advisory services to the board of directors and the executive management of OF including assessment of market compensation trends, its relative pay positioning versus the market for executives and staff, recommendations on pay ranges, evaluation of salary administration and design of annual and longer-term incentive plans. We are well acquainted with the challenges of determining fair and reasonable pay levels for executives.

McLagan's Position of Support for the OF's Comment Letter

As discussed in the OF's comment letter, the final rule should not apply to the OF; Congress clearly intended for sections 1318(a)-(d) of Federal Housing Enterprises Financial Safety and Soundness Act of 1992 to apply only to "Regulated Entities" and not to the "Office of Finance." In the event that the FHFA nevertheless seeks to apply its final rule to the OF we would caution against substituting FHFA's judgment regarding OF executive compensation for the judgment of OF's Board of Directors for the following reasons:

1. Determining reasonable executive compensation requires many diverse inputs in addition to market data. Most importantly there is a need for real insight into the relative complexity of the role versus the benchmark and an assessment of the capability of the individual filling that role. These assessments cannot be made remotely.

2. The OF's Board of Directors is most familiar with the OF's performance, needs and constraints and therefore best positioned to determine the process for establishing competitive market pay.
3. In our experience, the OF already has a robust market-based approach to compensation that focuses on attracting, retaining and motivating high performing, accomplished financial services executives who, by their individual and collective performance, achieve the OF's strategic business initiatives. This market-based approach relies on constructing customized peer groups of competitors, including federal housing GSEs, private sector financial institutions including both mortgage and commercial banks and FHLBanks against which to benchmark relative pay and performance.
4. The OF compensation policy is reviewed and approved annually by the OF Board. The compensation program focuses on establishing competitive compensation levels for different jobs according to variances with regard to responsibility, knowledge, experience levels, turnover, the position's impact on the financial performance of the FHLBanks, the success of the OF in meeting its goals, different labor markets, and the relatively small number of staff relative to the OF's enormous debt issuance. The OF also seeks to take into account the total compensation and benefits package, the lack of equity awards, volatility/risk of employment, quality of work environment and geographic location in establishing a broad employment proposition versus the external market and to select the comparable market benchmark statistic (i.e., market 25th, 50th or 75th percentile).
5. The OF's compensation process and program is transparent and clearly described in the FHLBanks 2008 Combined Financial Report.
6. The FHLBank Presidents who serve on the OF Board clearly have no incentive to pay excessive compensation to OF executive officers, since the operations of the OF are funded by the FHLBanks, and excessive compensation payments to OF executive officers would drive down earnings at the FHLBanks.

We recognize that the FHFA has a critical role in ensuring the stability and effectiveness of the Federal Home Loan Bank System, but we strongly believe that the FHFA should only intervene in the compensation process if the OF's Board of Directors are not effectively exercising their responsibilities and proper procedures are not followed.

The Use of Market Data Sources in Establishing Reasonable and Comparable Compensation

Market data sources such as surveys are just one set of tools for the OF's Board of Directors to make informed compensation decisions within the context of performance, needs and constraints. Surveys provide a useful starting point in establishing competitive pay, but should in no way replace the judgment of the Board of Directors who are most familiar with their needs and constraints.

The Compensation Benchmarking Process

The compensation benchmarking process is composed of establishing a philosophy, articulating goals and objectives, determining a comparative peer group of firms,

establishing benchmark jobs and defining a desired position versus market. In order to make the best use of external market data, the OF's Board of Directors has established a market-based compensation and benefits philosophy. The philosophy of the compensation program is to provide a flexible and market-based approach to compensation that attracts, retains and motivates high performing, accomplished financial services executives who, by their individual and collective performance, achieve the OF's strategic business initiatives.
To achieve this, the OF compensates the CEO using a total compensation program approach that combines base salary, short and long-term variable (incentive-based) compensation, retirement benefits and modest fringe benefits. The objectives of the program are to communicate short and long-term goals and standards of performance for the successful achievement of OF's mission and to recognize, motivate and reward the CEO and other executives commensurate with their contribution.
The emphasis on attracting versus retaining and motivating employees must be balanced and continues to evolve as the OF adjusts to its internal needs, the requirements of the markets and their own resource constraints.

Peer groups of firms are established based on labor market competitors, business competitors and practical limitations such as the availability of data. OF's customized peer groups of competitors, includes federal housing GSEs, private sector financial institutions including both mortgage and commercial banks and FHLBanks. The private sector banks included in the peer group are selected based on their engagement in wholesale funding and/or capital markets activities. **Small retail banks, Federal Reserve Banks and Farm Credit Banks have not been included in the OF's peer groups since they engage in significantly different financial activities.** This is consistent with advice McLagan has given the OF on the appropriateness of excluding small retail banks, Federal Reserve Banks and Farm Credit Banks.

- Retail banks not included - The OF does not engage in retail lending and typically does not recruit from or lose employees to small retail banks.
- Federal Reserve Banks not included – The OF does not engage in the development or implementation of monetary policy, control the Federal Funds Rate, conduct open market operations, set reserve requirements, operate the discount window, conduct foreign currency operations, conduct supervisory functions, regulatory functions or provide consumer protection – the primary functions of the Federal Reserve Banks. Our experience is that the OF neither recruits executives from nor lose executives to the Federal Reserve Banks.
- Farm Credit Banks not included – The OF is not involved in wholesale lending or funding to the agricultural sector. The OF neither recruits executives from nor loses executives to the Farm Credit Banks.

Benchmark jobs are identified based on positions that have similar scope of responsibility and represent reasonable employment opportunities. For example, when using a large commercial/regional bank peer group the OF compares its overall head of the function (e.g., Chief Financial Officer) to the peer group divisional head of the function or "Senior

Function Manager" (e.g., Divisional Chief Financial Officer representing a 2nd level direct report to the overall Chief Financial Officer for the firm).

Relative position versus the market (e.g., market 25th, 50th or 75th percentile) for a selected executive is based on the peer group and benchmark job selected according to variances with regard to responsibility, knowledge, experience levels, turnover, the position's impact on the financial performance of the FHLBanks, the success of the OF in meeting its goals, different labor markets, and the relatively small number of staff relative to the OF's enormous debt issuance. The OF Board also seeks to take into account the total compensation and benefits package, the lack of equity awards, volatility/risk of employment, quality of work environment and geographic location in establishing a broad employment proposition versus the external market.
The market statistics may be used in both setting targets and final determination of pay. For example, the market 50th percentile may establish the incentive pay target when the OF "meets" its performance goals while the market 75th percentile may be the target when it "exceeds" its performance goals. **Prescribing the 50th percentile as a maximum pay level does not account for the peer group being used or the unique construct of the role and discourages performance above "target".**

McLagan's experience working with the OF Board has been that the compensation benchmarking process that establishes philosophy, peer group, benchmark jobs and relative position versus the market is spiritedly challenged. The Board is responsible for determining the CEO incentive plan targets and actual payouts (and likewise for the Director of Internal Audit). In closed Board executive session, which excludes the CEO, McLagan provides to the Board the recommended competitive compensation range based on peer group, benchmark jobs and desired market position established as part of the OF's compensation philosophy. The CEO of the OF also works closely with the OF Board to set incentive targets for other executives and staff and the OF Board approves all incentive payments before they are paid. Detailed compensation information for the executive officers, including written evaluations, is provided to the OF Board by the CEO and Director of Human Resources. McLagan provides competitive compensation ranges position established as part of the OF's compensation philosophy. The Board intimately understands the unique challenges and opportunities of the OF including the skills and qualities they require of OF executives in providing funding and other services to the FHLBanks. The OF Board has accepted, rejected and modified our recommendations on different occasions through the exercise of their judgment and what they believe is in the best interest of their Bank. The process they employ in making these decisions is thoughtful and detailed and is in what they believe to be in the best interest of the FHLBank System.

Other General Considerations

Availability of non-public data needs to be determined when establishing peer groups based on specific firm's level of participation in survey programs and certain restrictions on the use of confidential data.

Market data sources may define total compensation slightly differently or refer to it in different terms. The definition of total compensation should be scrutinized when comparing various market sources as well as the timing of the release of such information to ensure comparability.

The definition of "executive management" differs considerably. McLagan typically defines executive management as those individuals who lead a major function, provide strategic direction and set policy. For the OF, this would include the CEO and three "Senior Directors". Therefore, a "bright line" test of including the five highest paid executives, inclusive of the CEO would ensure that the FHFA has comprehensive coverage of the top compensation structure at the OF in order to perform any of its obligations under 12 U.S.C. § 4518.

Sincerely yours,

Patrick J. Connell

Head of Corporate and Consumer Banking Consulting
McLagan