Comment # 6

FHLBank
San Francisco

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OFFICE OF GENERAL COUNSEL

**Dean Schultz**
President and
Chief Executive Officer

December 29, 2008

Alfred M. Pollard, General Counsel, and
Christopher Curtis, General Counsel
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, DC 20552
Attention: Comments/RIN 2590–AA08,

VIA E-MAIL (RegComments@FHFA.gov)

RE: Proposed Amendment to Interim Final Regulations on Golden Parachutes and Indemnification Agreements

Gentlemen:

The Federal Home Loan Bank of San Francisco ("Bank") appreciates the opportunity to comment on the Federal Housing Finance Agency ("Finance Agency") proposed amendment ("Proposed Amendment") to the interim final regulation on golden parachute and indemnification payments. 73 Fed. Reg. 67424 (Nov. 14, 2008). As proposed, the amendment would establish certain prohibited and permissible indemnification payments that a Federal Home Loan Bank ("FHLBank") may make to its directors and officers in connection with administrative proceeding or civil actions instituted by the Finance Agency, following substantially the regulatory indemnification standards established by the Federal Deposit Insurance Corporation ("FDIC") for insured depository institutions.

We offer the following comments for your consideration:

**Section 1231.6 Applicability in a Receivership**

Section 1231.6 of the propose rule, which largely follows the FDIC's provision at 12 CFR 359.7, generally says that actions by the Finance Agency approving agreements under the rule would not in any way bind a receiver or otherwise obligate a receiver of a FHLBank to pay any claim or obligation pursuant to any indemnification or other agreement. Section 1231.6 also says that vested employee benefits that are contingent on termination of employment at the time a receiver is appointed would not be provable claims against the receiver.

The proposal goes far beyond what is necessary to prevent any unjust enrichment of executives of a FHLBank and could have the very serious consequence of causing long-term senior employees to resign at the first sign of significant trouble to protect their vested retirement benefits.

The FDIC model is not appropriate in this instance. The FDIC faces much different challenges in administering its regulation that justify much tougher treatment in its regulation. First, compensation of senior executives of insured depository institutions can be in the tens of millions of dollars, and sometimes hundreds of millions of dollars, per annum for senior executives at large institutions. These amounts are several orders of magnitude greater than the compensation of FHLBank officers. Second, the FDIC is responsible for insuring over 8,500 institutions, meaning it is not reasonable to expect the

FDIC to do a detailed review of the compensation plans of each institution; the Finance Agency is responsible for 14 institutions. Finally, the FDIC is not the primary regulator for most of the institutions that it insures.

The key language of proposed Section 1231.6 is as follows:

> Any consent or approval granted under the provisions of this part by the FHFA shall not in any way obligate the FHFA or receiver to pay any claim or obligation pursuant to any golden parachute, severance, indemnification, or other agreement. Claims for employee welfare benefits or other benefits which are contingent, even if otherwise vested, when a receiver is appointed for any regulated entity, including any contingency for termination of employment, are not provable claims or actual, direct compensatory damage claims against such receiver. 73 Fed. Reg. 67427 (Nov. 14, 2008).

By providing that even vested benefits are not provable claims, the Finance Agency is proposing a punitive sanction of completely eliminating the value of vested benefits for all FHLBank employees, even if there has been no wrongdoing on the part of the employees. Vested benefits should not be subjected to this rule. Even if a vested benefit is a provable claim, FHLBank employees could still face a partial loss in a receivership if an unfunded vested benefit is deemed a general unsecured claim (the employee could suffer a loss to the same percentage that any other general creditor suffered a loss).

Furthermore, disallowing vested benefit claims as not provable against a receiver where those vested benefits are contingent on nothing more than termination of employment is inconsistent with court decisions in several jurisdictions, including the Ninth Circuit (See, *Modzelewski v. RTC*, 14 F.3d 1374 (9th Cir. 1994)).

The Bank believes that the proposal is seriously misguided, and that a fairer way to ensure that benefit plans were reasonable, that would not risk driving away long-term employees when their skills were most needed, would be to eliminate that proposed section of the regulation, and instead have the Finance Agency engage in a case-by-case review of the benefit plans of each FHLBank.

**<u>Section 1231.4 -- Indemnification Payments</u>**

Under the proposed rule, a FHLBank's board of directors must specifically authorize indemnification payments made to an indemnitee. Standard corporate law in some jurisdictions, such as California, recognizes another way in which a person may obtain permissive indemnification, specifically by obtaining a ruling from the judge before whom the underlying case was heard.[1] We believe that the regulation should be amended to allow this alternative route to indemnification as well.

[1] "[A]ny indemnification under this section shall be made by the corporation only if authorized in the specific case, upon a determination that indemnification of the agent is proper in the circumstances because the agent has met the applicable standard of conduct set forth in subdivision (b) or (c), by any of the following . . . . (4) The court in which the proceeding is or was pending upon application made by the corporation or the agent or the attorney or other person rendering services in connection with the defense, whether or not the application by the agent, attorney or other person is opposed by the corporation." Cal. Corp. Code § 317(e).

**Section 1231.2 – Definitions**

The proposed definition of "Prohibited indemnification payment" would expressly permit regulated entities in conservatorship to indemnify their officers and directors against certain types of civil money penalties authorized by the statute. (12 U.S.C.4636(b)(1) and (2)). The effect is to allow indemnification for conduct giving rise to Tier 1 or 2 civil money penalties if a FHLBank is in conservatorship. The final rule should clarify whether the conduct giving rise to indemnification under this provision is conduct that occurs prior to or only during the conservatorship. In addition, the final rule should establish a mechanism for allowing similar indemnification for officers and directors of regulated entities prior to and after a conservatorship, subject to the indemnification standards of the rule being met. At the very least, the FHLBanks should be allowed to apply to the Finance Agency to have it approve indemnification agreements of a similar scope.

Thank you for consideration of our comments.

Sincerely,

Dean Schultz
President and Chief Executive Officer