October 12, 2018

VIA EMAIL

Alfred M. Pollard, Esq.
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, S.W.
Washington, D.C. 20219
RegComments@fhfa.gov

**Re: Proposed Rule on Golden Parachute and Indemnification Payments, Comments/RIN 2590-AA72**

Dear Mr. Pollard:

The undersigned Federal Home Loan Banks and the Office of Finance (together, the "Banks") appreciate the opportunity to comment on the Federal Housing Finance Agency's ("FHFA") proposed amendments to the rule on Golden Parachute and Indemnification Payments (the "Proposal"), which was published on August 28, 2018.[1] Overall, the Banks are content with the Proposal; however, there are several areas that the Banks feel could be improved. Our comments are set forth below.

1. The Proposed Amendments Relating to Exempt Agreements and Payments Should be Modified in Certain Respects to Facilitate Attracting and Retaining Talent

The Banks previously argued in their comment letter dated July 15, 2013 that the "double approval" required by the current rule acts to detract from the Banks' ability to recruit talented executives. The current rule requires that the FHFA Director must review and consent to a payment made pursuant to a golden parachute agreement, even if the Director already consented to the agreement. The "double approval" process creates uncertainty for executives that the compensation agreements they negotiated at the start of employment may not be honored. Essentially, the purported assurances provided by those agreements are potentially illusory as the executive has no control over subsequent government approval (which is by no means assured).

The proposed amendments allow the Director to approve both the agreement and the payment at the same time, and, thus, potentially eliminate the "double approval" process for executive officers. The Banks support this proposed change; however, other proposed exemptions create confusion and should be clarified or, in some respects, modified, to facilitate the Banks' ability to attract and retain talent.

- The exemption for *de minimis* payments, and agreements that contemplate *de minimis* payments, to non-executive officers, should be raised from $2,500 to

[1] 83 Fed. Reg. 43801 (Aug. 28, 2018) (the "Preamble").

$5,000. This would be consistent with guidance issued by the FDIC with respect to golden parachute payments to lower level employees of FDIC-insured banks.[2] The FDIC determined that $5,000 was the appropriate *de minimis* amount to avoid unnecessary and costly review of relatively small payments to lower level employees who are very unlikely to have been substantially responsible for an institution's troubled condition while, at the same time, preserving the FDIC's ability to review the types of golden parachute payments intended to be covered by the prohibition. The same rationale applies in the case of the Banks and provides ample support for the FHFA to adopt a $5,000 *de minimis* threshold for non-executive officers. Indeed, one of the FHFA's purposes in amending the rule in 2014 was to more closely align its golden parachute regulation with the FDIC rule.[3]

- FHFA should confirm that agreements or severance plans entered into prior to the time an entity becomes a troubled institution will not be deemed impermissible retroactively if the entity later becomes a troubled institution. The proposal includes language in the Preamble following the discussion of change in control agreements that might suggest otherwise ("FHFA anticipates that it would review such agreements or plans either at the time a regulated entity becomes a troubled institution or at the time a payment is proposed to be made . . . and could then determine that the agreement or plan to make a golden parachute payment is not permissible . . . ")[4]. There is no basis in the statute to apply the rule retroactively to any agreements or plans entered into prior to the time an entity becomes a troubled institution. Accordingly, we suggest that the definition of "permitted" be amended to clarify that agreements entered into prior to the time a regulated entity becomes a troubled institution do not require FHFA consent.

## 2. The Regulation Should Retain the Exemption for Nondiscriminatory Severance Pay Plans

The proposed elimination of the exemption for non-discriminatory severance pay plans creates an obstacle for regulated entities to attract and retain employees. As FHFA notes in the Preamble, severance pay is an important incentive for retaining employees, particularly in times of distress.[5] Note also that impediments to the adoption of broad-based severance plans could operate to the detriment of rank-and-file employees, who may be deprived of coverage that might otherwise have been put in place.

The proposed amendments subject all severance pay plans (including attendant benefit plans) of troubled institutions to Director review by eliminating the exemption for "nondiscriminatory

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[2] FDIC Guidance on Golden Parachute Applications, FIL Letter 66-2010, Oct. 14, 2010.
[3] 79 Fed. Reg. 4394, 4395 (Jan. 28, 2014).
[4] Preamble at 43813.
[5] *Id*. at 43808.

severance pay plans."[6] Subjecting all of these plans to review once a regulated entity becomes a troubled institution results in a burdensome process for the FHFA and creates more uncertainty for the regulated entity at a time when employee retention is critical to turn around its condition. At a minimum, (i) an exception should be made for the coverage of rank-and-file employees, and (ii) the determination of whether an institution is troubled should be made only at the time of the adoption (or material amendment) of the plan.

The Preamble cites as a reason for eliminating the exemption that FHFA review of the Banks' severance pay plans was required in any event because such plans did not meet the current rule's 'nondiscriminatory' definition and thus were not exempt. However, instead of eliminating the exemption entirely, we suggest that the exemption be modified to be more useful to how "nondiscriminatory" severance pay plans are actually structured. For instance, it is common for Banks to offer all employees a certain number of weeks' salary as a severance payment, along with the employer share of benefit payments, if their jobs are terminated for reasons outside the employees' control. FHFA should retain the exemption for these types of nondiscriminatory severance pay plans.

3. The Requirement for the Banks to Provide Notice to the FHFA under Certain Circumstances if it is not Reasonably Assured that an Affiliated Party Satisfies the "No Bad Actor" Requirements should be Eliminated

Under the proposal, a troubled institution may enter into an individually negotiated settlement agreement with, or make a golden parachute payment in accordance with a permitted agreement to, an affiliated party, without FHFA consent, as long as it is reasonably assured, following due diligence, that the affiliated party satisfies the "no bad actor" requirements. However, if the troubled institution determines not to enter into such agreement or make such payment because it cannot make the "no bad actor" finding with respect to its affiliated party, and thereafter does not seek FHFA approval for such agreement or payment, then it nevertheless must provide notice to the FHFA identifying the affiliated party and the reasons why it could not make the "no bad actor" finding. We believe such a reporting requirement is unnecessary and, in many instances, could result in a waiver of a Bank's attorney-client privilege. Such a requirement could also have a chilling effect on the willingness of a Bank and its employees to enter into individually negotiated settlement agreements and other types of severance arrangements.

In many instances, particularly in connection with individually negotiated settlement agreements, the Bank's inside or outside counsel will be involved in negotiating the applicable agreements as well as conducting an internal investigation and/or the due diligence of the affiliated party required under the rule. Legal advice provided to the Bank in this context, including information about the conduct of the affiliated party, will likely be subject to the attorney-client privilege.

Requiring disclosure of documents and information that are privileged would hinder the due diligence process by discouraging candor and openness by employees knowing that the information they are providing could potentially be disclosed to the regulator. Indeed, forced

[6] *Id.*

disclosure of privileged information by FDIC-insured banks to their regulator has been the subject of significant debate and litigation over the years.[7] In the early 2000's, the DOJ and the SEC implemented policies whereby they encouraged cooperation by promising leniency to supervised institutions that turned over requested documents. However, some courts have held that such disclosure meant the supervised institutions were waiving the attorney-client privilege, thereby opening the door for third party litigants to use the same documents against the institutions. Congress recognized this dilemma when it passed 12 USC 1828(x) as part of the Financial Services Regulatory Relief Act of 2006, which states that institutions turning over documents to a bank regulatory agency in the course of a supervisory process are not deemed to be waiving their right to assert the privilege in other contexts. Although this would seem to solve the issue of waiving privilege for FDIC-insured institutions sharing privileged information with the Federal Reserve Board, the Comptroller of the Currency, the FDIC or the Consumer Financial Protection Bureau, the Banks are not afforded the same protections with respect to privileged information shared with the FHFA.

The prospect of waiving the attorney-client privilege could discourage Banks from entering into individually negotiated settlement agreements and other types of severance arrangements in order to avoid the due diligence documentation that they may be required to report under the rule. Employees might also be discouraged from entering into such agreements by the prospect of being reported to the regulator for certain actions without necessarily having had an opportunity to tell their side of the story. In either event, discouraging severance arrangements would not be in the interests of the Banks or their employees. Among the many reasons that an employer might use severance as a legitimate and important part of the compensation package are: (i) appropriately compensating employees; (ii) cushioning the exit for departing employees, which could have the effect of being more humane, and could also be useful in retaining and attracting other desirable employees; (iii) reducing the potential distraction that a departing employee might experience under stressful circumstances, thus improving the likelihood of the employer's getting better service at potentially important junctures; and (iv) increasing the likelihood of goodwill with the employee after the employee's departure. We are concerned that the "bad actor" reporting requirement of the proposed rule could have an undesirable chilling effect on the willingness of a Bank and its employees to use this legitimate and useful compensatory tool.

We would also note that the FHFA has access through the examination process to suspicious activity reports ("SARs") the Federal Home Loan Banks are required to file with the Treasury's

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[7] See Federal Reserve Board Supervisory Letter, SR 97-17 (June 6, 1997), which recognized that financial institutions may assert the attorney-client privilege for documents requested during an examination. See also *Clarke v. American Commerce National Bank*, 974 F.2d 127 (9th Cir. 1992) (recognizing the attorney-client privilege when the OCC requested attorney billing statements from the bank under an administrative subpoena); and *U.S. v. Lockheed Martin Corp.*, 995 F. Supp. 1460, M.D. Fla. Feb 27, 1998) (recognizing the ability to assert the attorney-client privilege for documents requested by the Department of Defense's Inspector General when it was examining Lockheed Martin for overbilling).

Financial Crimes Enforcement Network.[8] These SAR filing obligations cover illegal or questionable activities that overlap with many of the "bad actor" provisions in the golden parachute rule. As such, "bad actor" employees that would be reported to the FHFA under the proposed rule would, in many instances, already be reported by the Banks pursuant to the SAR process.

For the foregoing reasons, we believe the proposed "bad actor" reporting requirements are unnecessary, could adversely affect the Banks and their employees and should be eliminated.

4. The "Golden Parachute Payment" Definition Should Continue to Incorporate the Phrase "Pursuant to an Obligation of the Regulated Entity".

The proposed amendments would remove the phrase "pursuant to an obligation of the regulated entity" from the golden parachute payment definition. However, this phrase is included in the statutory language and indicates Congress' intention to regulate payments that an institution is contractually obligated to make. As safety and soundness supervisor of the Banks, the FHFA has ample authority to prohibit or limit payments that are not pursuant to an obligation -- such as improper voluntary gifts to an affiliated party -- to the extent the FHFA viewed those payments as excessive or an unsafe or unsound practice.[9] However, that does not mean those payments should be regulated as golden parachute payments. Such an interpretation would be inconsistent with the statutory text in the Federal Housing Enterprises Financial Safety and Soundness Act as well as the analogous golden parachute payment definition in the Federal Deposit Insurance Act.[10]

5. Clarification of When a Payment is "Abusive" or "Excessive"

The proposed amendments add new factors for the Director to consider when determining whether a golden parachute payment is permissible under 12 CFR § 1231.3(f). One new factor requires the Director to consider whether the golden parachute payment or agreement is excessive or abusive or threatens the financial condition of the troubled institution.[11] The Banks suggest that the FHFA define or clarify the terms "excessive" and "abusive" so that the parameters of what is and is not permissible are clearer.

[8] See 31 C.F.R. § 1030.320.

[9] As the FHFA pointed out in the Preamble, it could always prohibit or limit improper gifts or contributions to an affiliated party under its existing statutory authority. See generally, 12 USC 4511(b)(2), 4513(a)(1), 4513b and 4526.

[10] We are not aware that the FDIC has ever interpreted its golden parachute rules as prohibiting voluntary payments to institution-affiliated parties, nor are we are aware that such payments have caused supervisory issues in the banking industry.

[11] *Id*. at 43824

6. Clarification of Language in Regulatory Text Pertaining to Golden Parachute Payments for which FHFA Consent is not Required

For purposes of clarification, we suggest the regulatory text in 12 CFR 1231.3(d)(3) be modified so that the introductory clause in (d)(3) reads as follows:

> "(3) To an affiliated party who is not an executive officer, where:"

This is not a substantive change, but by removing unnecessary text, the change would improve the readability of the rule.

*  *  *

We appreciate your consideration of these comments.

Sincerely,

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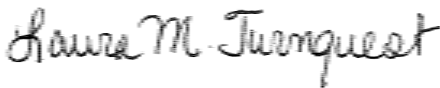

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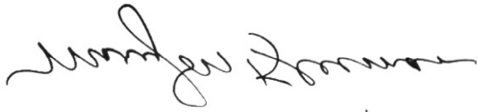

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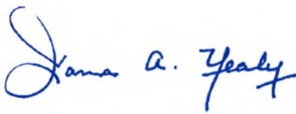

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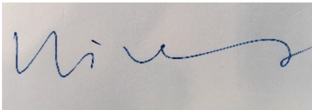

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