



July 15, 2013

VIA EMAIL

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RegComments@fhfa.gov

**Re: Interim Final Rule on Executive Compensation, Request for  
Comments, RIN 2590-AA12**

Dear Mr. Pollard:

The 12 Federal Home Loan Banks (“FHLBanks”) and the FHLBanks Office of Finance appreciate the opportunity to comment on the Federal Housing Finance Agency’s (“FHFA”) interim final rule on Executive Compensation (“Rule”), which was published on May 14, 2013.<sup>1</sup> We recognize the FHFA’s consideration of the FHLBanks’ and Office of Finance’s comments on the FHFA’s proposed rule on executive compensation (“Proposal”)<sup>2</sup> and very much appreciate the changes that the FHFA made in the Rule in response to those comments. We are writing in response to the FHFA’s invitation to provide additional public input to the Rule.<sup>3</sup>

1. The Rule in Effect Prescribes a Level or Range of Executive Compensation

Congress provided in 12 U.S.C. § 4518(d) that the FHFA is not to prescribe or set specific levels or ranges of compensation.

In response to the Proposal, the FHLBanks expressed concern that two elements of the Proposal could have the practical effect of prescribing or setting a specific level or range of compensation: (i) naming the Federal Reserve Banks and the Farm Credit Banks as examples of

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<sup>1</sup> 78 Fed. Reg. 28442 (May 14, 2013).

<sup>2</sup> Executive Compensation, 74 Fed. Reg. 26989 (June 5, 2009).

<sup>3</sup> The Office of Finance joins this letter but reaffirms its views to the effect that the Rule should not apply to the Office of Finance as expressed in its July 31, 2009 comment letter on the Proposal. Without waiving any rights to challenge such action, the Office of Finance supports the comments in this letter as they pertain, expressly or implicitly, to the Office of Finance.

appropriate comparative institutions, and (ii) providing that comparable compensation must be at or below the median compensation for a given position at similar institutions.

We appreciate that the FHFA modified the Rule in some ways, but believe it still puts the FHFA in a role that is inconsistent with the statute.

The preamble to the Rule states:

FHFA concludes that the Farm Credit Banks and Federal Reserve Banks should be included as points of reference in assessing the reasonableness and comparability of compensation at the Federal Home Loan Banks, and that doing so does not result in dictating any particular level or range of compensation.<sup>4</sup>

Section 1230.2 of the Rule, in turn, defines “comparable” compensation as follows:

(2) *Comparable* – compensation that, taken in whole or in part, does not materially exceed compensation paid at institutions of similar size and function for similar duties and responsibilities.

Finally, section 1230.3(a) of the Rule provides that:

No regulated entity or the Office of Finance shall pay compensation to an executive officer that is not reasonable and comparable with compensation paid by such similar businesses involving similar duties and responsibilities.

Taken together, these provisions encroach on the primary role of the boards of directors of the FHLBanks in regard to compensation decisions. These provisions impose a mandatory template on FHLBank executive compensation decisions that does in effect (i) designate particular comparator institutions that will determine compliance with the Rule, (ii) impose a presumptive cap of “not materially exceed[ing]” compensation at similar institutions, and (iii) prohibit FHLBanks from paying compensation that is not “reasonable” and “comparable” in a manner that prescribes or sets a specific level or range of compensation. We believe this is what Congress sought to prevent when it provided that the FHFA is not permitted to set a specific level or range or compensation in the Rule.

In our comment letters to the Proposal, we described how the unique member-controlled cooperative structure of the FHLBank System ensures that compensation decisions are a market-driven result of a board of directors-controlled process. The directors of each FHLBank must

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<sup>4</sup> 78 Fed. Reg. 28442, 28444-5.

balance numerous factors to ensure the efficient operation of an FHLBank for the benefit of its member institutions, including offering compensation sufficient to attract and retain highly qualified executives. We believe that this element of the cooperative ownership structure of the FHLBank System is exactly the type of special attribute of the FHLBank System that Congress intended the FHFA take into account in promulgating the Rule.<sup>5</sup>

The preamble to the Rule states that the Director did consider the differences between the Banks and the Enterprises in adopting the Rule, as required by statute.<sup>6</sup> However, it provides no explanation of the result of the Director's consideration in regard to the role of the FHLBanks' boards of directors in establishing executive compensation. Moreover, the Rule does not reflect any difference in treatment between the FHLBanks and the Enterprises in this regard, notwithstanding the unique and highly relevant member-sensitive executive compensation process at each FHLBank. In that way, the record does not provide a full and fair basis on which to comment.

We request that the FHFA reconsider the Rule and revise it so that the FHFA's role is properly limited, among other things, to reviewing the reasonableness of the process and outcome of individual FHLBank compensation. We recommend that such reconsideration define the Director's role consistent with the statute to determine the reasonableness and comparability of executive compensation to other similar businesses (including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities.

We note that the FHFA does indicate that it intends to address differences in aspects of executive compensation between the FHLBanks and the Enterprises by establishing policies for appropriate compensation packages and termination benefits.<sup>7</sup> At a minimum, we urge that such future guidance to the FHLBanks fully recognize the unique role played by the member-controlled boards of the FHLBanks and the prohibition on the FHFA taking actions to set a specific level or range of compensation.

## 2. Consideration of Compensation In Whole or In Part

The FHLBanks commented in response to the Proposal that the FHFA's review of executive compensation should be based on compensation that is "taken as a whole" rather than "in whole or in part." The FHFA decided not to accept that FHLBanks' comment and retained the reference to compensation "in whole or in part." In this regard, we note that the FHLBanks do not have publicly traded stock and thus are not in a position to provide stock-related executive compensation. As a result, the FHLBanks are more restricted than other large financial

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<sup>5</sup> 12 U.S.C. § 4513(f)

<sup>6</sup> *Id.* at 28444.

<sup>7</sup> *Id.* at 28445.

institutions in the methods that they can use to compensate their executives. We urge the FHFA to take these important distinguishing factors into consideration in any FHLBank compensation reviews.

3. Status as an FHLBank Executive Officer

We appreciate the FHFA's attention to the FHLBanks' comments regarding the definition of "executive officer" with respect to the FHLBanks and its revision to the Rule in this regard. We note that the preamble indicates that the FHFA intends that the revised definition of "executive officer" track the Securities and Exchange Commission's ("SEC") rule regarding "Named Executive Officers."<sup>8</sup> Accordingly, we understand the reference in the definition of "executive officer" of an FHLBank in section 1230.2 to the "three other most highly compensated officers" to mean an FHLBank's three most highly compensated executive officers other than the principal executive officer and principal financial officer who served as executive officers in accordance with the use of the term "executive officer" in the SEC's Regulation S-K.<sup>9</sup>

The preamble indicates that the FHFA intends for the concept of "executive officer" to apply at the same time to persons who qualified as an executive officer as of the FHLBank's last filing, those who qualify as of the date of a current filing, and those who are expected to be executive officers in the future. The structure of the rule triggers notice to the FHFA in regard to specified proposed compensation actions related to an executive officer. Under these circumstances, we request that the FHFA make it clear that the term "executive officer" be limited to a person that qualifies as an "executive officer" as of the time of a required notice under section 1230.3(d)(1)-(4), rather than to cover persons who no longer qualify as an executive officer at that time or to call for speculation as to who may at some point in the future become an executive officer.

4. Compensation Actions Requiring Advance Notice

Section 1230.3(d) sets forth prior notification requirements for certain executive compensation actions. In that regard, section 1230.3(d)(3) provides:

A regulated entity or the Office of Finance shall not, without providing the Director at least 30 days' advance written notice, pay, disburse, or transfer to any executive officer, annual compensation (where the annual amount has changed), pay for performance or incentive pay, or any other element of compensation.

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<sup>8</sup> *Id.* at 28447.

<sup>9</sup> 17 C.F.R. § 229.402(a)(3)(iii).

It is unclear how the Rule is intended to operate with respect to “any other element of compensation.” In the absence of an explanation of this term in the Rule or the preamble, it is not clear whether it is intended, for example, to cover amounts received under an FHLBank’s employee benefits plans or policies for covering employee expenses such as travel costs.

We suggest that the FHFA either eliminate the reference to “any other element of compensation” or clarify what it is intended to cover, and how it is intended to operate, particularly in light of the broad definition of “compensation” set forth in the Rule. In that regard, we request that the FHFA confirm that general FHLBank plans, such as health insurance plans, which executive officers participate in together with other FHLBank employees who are not executive officers, are not covered by any of the provisions of section 1230.3(d)(1)-(4).

## 5. FHFA Review of Executive Compensation

The FHLBanks expressed a series of concerns in our comment letters regarding the FHFA compensation review process. We continue to have concerns regarding the executive compensation review process from the perspectives of the FHLBanks and their boards of directors, as well as that of the FHLBanks’ executive officers themselves.

Section 1230.3(e) of the Rule appears to provide that once the specified review period for a particular executive compensation action set forth in section 1230.3(d)(1)-(4), and any extension of the review period pursuant to section 1230.3(d)(5), has ended, an FHLBank is free to enter into or take the compensation action that was under review, unless the FHFA provided otherwise.

In contrast, sections 1230.3(a) and (e) of the Rule do not provide any similar direction with respect to an FHFA review of compensation that is not occurring pursuant to section 1230.3(d) (“Section 1230.3(a) Review”). These sections give no indication of how an FHLBank would be formally informed that such a compensation review was being undertaken.

### 5.1. The Need to Clarify FHLBank Input In the Process

With respect to a Section 1230.3(a) Review, the absence of any provisions regarding an FHLBank’s right to be informed of the nature of the potential basis on which the FHFA might seek to prohibit the payment of executive compensation, or the FHLBank’s right to respond to such potential action by the FHFA, should be addressed. Under section 1230.3(b), the specified reasons for such an action by the FHFA with respect to an executive officer involve serious misconduct, including fraudulent acts, breaches of fiduciary duty, violations of law or regulations, and insider abuse. Such potential misconduct by an executive would, of course, be of great importance to an FHLBank and would require FHLBank input. Such concerns by the FHFA could trigger an independent FHLBank inquiry under an FHLBank’s corporate governance and internal review processes. Moreover, a FHFA executive compensation directive could lead to adverse positions between an FHLBank and an executive officer, including potential litigation. Under these circumstances, the Rule should provide a clear and express process for the FHLBank

to provide its input in regard to whatever basis the FHFA is considering for exercising its executive compensation authority.

The preamble to the Rule indicates that the FHFA does contemplate developing a process for FHLBank input, but that it is yet to be determined. On one hand, the preamble states that the “FHFA *anticipates* that . . . *decisions that compensation is excessive* will be communicated in writing, with an opportunity for the entity to respond by letter or to request a meeting.”<sup>10</sup> This appears to suggest that the FHFA will communicate the determination that it has reached to the FHLBank, and that the FHLBank will then be given an opportunity to express its views.

On the other hand, the preamble also states that “a notice and hearing is unnecessary in light of the extent of communication that will occur *before making a decision that executive compensation is excessive*.”<sup>11</sup> This suggests that the FHLBank will have input **before** rather than **after** the FHFA has made a determination. The lack of certainty and apparent contradiction on this important point illustrates why the FHFA, at minimum, should amend the Rule to provide a clear set of procedures for notice to an FHLBank, an explanation of the action the FHFA is considering, and an opportunity for the FHLBank to provide input.

In our comment letters, the FHLBanks requested that the FHFA modify the final rule to clarify that amounts that are subject to being withheld, escrowed or prohibited not include certain items and that certain items not be included within the term “compensation.”<sup>12</sup> The FHFA did not address these comments. We continue to believe that these are important clarifications to the Rule and request that the FHFA amend the Rule to address them.

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<sup>10</sup> 78 Fed. Reg. at 28447 (emphasis added).

<sup>11</sup> *Id.* (emphasis added).

<sup>12</sup> The items identified were: (i) base salary at levels generally consistent with amounts provided in the prior year; (ii) pension benefits under qualified and excess benefit plans and employer and employee contributions with respect to such plans; (iii) compensation previously deferred; (iv) health, life, and disability insurance benefits under nondiscriminatory plans or consistent with amounts set aside in prior years; (v) benefits in the form of use of regulated entity equipment and resources; and (vi) any wages that are protected under state statute; and vacation, sick, bereavement, community service and other leave benefits.

The comment letters also stated that the FHFA should not withhold compensation so 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. The comment letters also requested that the definition of compensation in proposed section 1230.2 be modified to expressly exclude payments to an executive officer under his indemnification and advancement rights to the extent not prohibited by applicable law.

5.2. The Rule Does Not Address the Due Process Rights of FHLBank Executive Officers

In our comment letters regarding the Proposal, the FHLBanks requested that the FHFA modify the Proposal to address the due process rights of FHLBank executive officers citing, among other things, the Federal Housing Finance Board's ("FHFB") recognition of those rights in an FHFB Order governing an FHFB action to suspend or remove an FHLBank officer or director. The FHLBanks requested that the FHFA incorporate the notice, hearing and decision principles included in the FHFB Order into any final rule.

The FHFA did not amend the Rule to address the due process concerns raised by the FHLBanks. The FHFA concluded that it believes that "implementing a process incorporating notice and a hearing is unnecessary in light of the extent of communication that will occur before making a decision that executive compensation is excessive and would unduly delay corrective action."<sup>13</sup>

We request that the FHFA reconsider this position. We believe that the actions taken under section 1230.3 of the Rule do implicate due process rights of an FHLBank executive, and that the Rule should be amended to provide appropriate protection of such rights.<sup>14</sup>

An action by the FHFA to adversely impact the compensation of an FHLBank executive plainly implicates the interests that are protected by the Due Process Clause. As the FHFA acknowledges, such an action by the FHFA would involve the financial, and thus property interests, of an FHLBank executive.<sup>15</sup> Furthermore, an action by the FHFA predicated on any of the grounds specified by the FHFA in section 1230.3(b) may involve an injury to the executive's

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<sup>13</sup> *Id.* The FHFA appeared to base its decision on the following three grounds: (i) due process rights of the executives are not triggered because the executive compensation process is solely between the FHFA and a particular FHLBank; (ii) although a directive to an FHLBank to withhold compensation impacts an executive financially, any such decision is made only after a thorough review and full understanding of the facts and the application of the facts to the FHFA's authority; and (iii) a compensation decision does not result in either the suspension or removal of the executive and, therefore, does not implicate the due process considerations that the FHFB addressed in the FHFB Order.

<sup>14</sup> Due process requirements impose constraints on governmental decisions which deprive individuals of liberty or property interests within the meaning of the Due Process Clause of the Fifth or Fourteenth Amendments. *Matthews v. Eldridge*, 424 U.S. 319, 332 (1976). The Supreme Court has found that "[f]or more than a century, the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard." *Hamdi v. Rumsfeld*, 542 U.S. 507, 533 (2004).

<sup>15</sup> *See Sniadach v. Family Finance Corp.*, 395 U.S. 337, 339 (1969) (procedure in which "wage earner is deprived of his enjoyment of earned wages without any opportunity to be heard and to tender any defense he may have" violates due process).

reputation that could likewise trigger an interest protected by the Due Process Clause.<sup>16</sup> The fact that a compensation action by the FHFA does not directly involve a suspension or removal of an executive officer does not necessarily insulate the action from an individual executive officer's due process rights. The Supreme Court has recognized that while as a general matter, an individual who is only collaterally or incidentally harmed by government action does not have a due process right, if the government acts against one person "for the purpose of punishing or restraining another" the punished or restrained person may have a right to due process.<sup>17</sup>

In the case of an executive compensation action under section 1230.3 based on one or more of the executive misconduct factors set forth in section 1230.3(b), there is no doubt that it is the conduct and reputation of the executive that is at issue. Similarly, in such an action, it is the compensation that would be denied to the executive that is at issue. Thus, in such an action, while the Rule is structured to provide for an order from the FHFA to an FHLBank, it is clear that the party whose conduct is under review and the party who will be subject to punishment is the FHLBank executive from the perspective of both the amount of any financial penalty and the reputational repercussions that may flow from it. We note that an executive officer's due process rights as against a financial institution regulator was recognized by court, in such a scenario, in 2004.<sup>18</sup>

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<sup>16</sup> *Paul v. Davis*, 424 U.S. 693, 708-709 (1976) (due process is violated when government action stigmatizes individual and deprives him of a tangible interest because, "[w]here a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him, notice and an opportunity to be heard are essential.") (emphasis in original); *Huntley v. Community Sch. Bd.*, 543 F.2d 979 (2d Cir. 1976) (due process violated when government's actions stigmatized individual such that his property interest in employment opportunities was impaired).

Compensation action by the FHFA purportedly based on the types of misconduct specified in section 1230.3(b) would clearly have an adverse impact on the reputation and future employment prospects of an FHLBank executive officer. In that regard, the Interagency Biographical and Financial Report that the federal banking agencies require be submitted by certain persons seeking to hold positions at depository institutions includes a question as to whether the individual has been involved in any administrative proceeding by a U.S. government agency that resulted in any penalty including "loss of right or benefit" or "forfeiture of property interest." See Board of Governors of the Federal Reserve System, FR 2081c, Item 5.e.

<sup>17</sup> *O'Bannon v. Town Court Nursing Home*, 447 U.S. 773, 789 (1980).

<sup>18</sup> *Brendsel v. Office of Federal Housing Enterprise Oversight*, 339 F. Supp. 2d 52 (D.D.C. 2004). The former chief executive officer of Freddie Mac sought to enjoin the Office of Federal Housing Enterprise Oversight ("OFHEO") from ordering Freddie Mac to freeze employment benefits and assets payable to the officer pending the outcome of certain administrative hearings. As part of the action, the officer brought a Fifth Amendment due process claim against OFHEO. The court denied OFHEO's motion to dismiss the officer's due process claim finding that the officer had sufficiently pled the claim. It granted the officer's request for a preliminary injunction against OFHEO, finding that the public had a "profound interest" in ensuring "that those whose assets might be frozen by OFHEO are accorded a fair modicum of due process."



For the reasons described above, we request that the FHFA amend the Rule to provide for a Constitutionally appropriate set of notice and hearing procedures that provide an executive officer an opportunity to present his or her views with respect to the factors that the FHFA is considering, including any alleged wrongdoing, and/or the amount or form of any compensation that may potentially be withheld, in order to address the due process rights of an FHLBank executive officer that is subject to an executive compensation review under section 1230.3.

As discussed in our prior comments, we continue to request that section 1230.3(b) of the Rule be amended to provide more specificity as to the 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. We also continue to request that section 1230.3(b) be modified to specify the degree of proof of 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.

#### 6. Grandfathering of Existing Executive Compensation Arrangements

The FHLBanks requested 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. We noted, among other things, that our request was consistent with the approach taken by the FHFA in its proposed rule on golden parachutes which stated that the FHFA intends that the rule would apply to agreements entered into by a regulated entity on or after the date the regulation is effective.

The FHFA declined to include any express grandfathering in the Rule. It did state that it recognizes that compensation agreements in place prior to HERA's enactment deserve consideration and that the FHFA intends to consider all the facts and circumstances in reviewing existing agreements.<sup>19</sup>

We note that the FHFA in its re-proposed golden parachute rule, published on the same day as the Rule, provides grandfathered status to certain employment related agreements entered into after HERA. The FHFA in the re-proposal stated that all retirement plans established for the benefit of executives in place as of the re-proposal's publication date are grandfathered from the application of the golden parachute rule.<sup>20</sup>

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<sup>19</sup> 78 Fed. Reg. at 28449. In an analogous situation, the FDIC took a broader approach to the grandfathering of compensation arrangements. In the second proposal in its golden parachute rulemaking it stated that it would look unfavorably on agreements entered into after the date of the second proposal but before the effective date of the final rule. 60 Fed. Reg. 16069, 16074 (March 29, 1995). That suggests that agreements entered into before effective date of the statute under which the FDIC issued the regulation or the date that the second proposal was issued, would be grandfathered. We request that the FHFA consider the approach taken by the FDIC in regard to its treatment of grandfathering in relation to the Rule.

<sup>20</sup> 78 Fed. Reg. 28542, 28543 (May 14, 2013).

We request that the FHFA reconsider the issue of grandfathering of executive compensation arrangements. Express grandfathering would be consistent with the FHFA's approach in an analogous situation and would help avoid possible legal issues or challenges that might arise if the regulation were applied to pre-existing compensation arrangements.

We appreciate your consideration of these comments.

Sincerely,

**Federal Home Loan Bank of Atlanta**



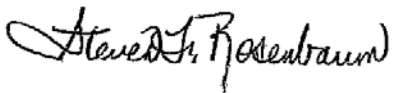
Gary F. Garczynski  
Chairman, Governance and Compensation  
Committee of the Board of Directors

**Federal Home Loan Bank of Boston**



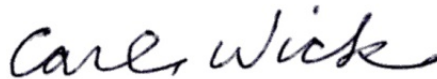
Mark E. Macomber  
Chairman, Personnel Committee of the Board  
of Directors

**Federal Home Loan Bank of Chicago**



Steven F. Rosenbaum  
Chairman, Human Resources and  
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**Federal Home Loan Bank of Cincinnati**



Carl F. Wick  
Chairman of the Board of Directors  
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Committee of the Board of Directors

**Federal Home Loan Bank of Dallas**



Patricia P. Brister  
Chair, Compensation and Human Resources  
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**Federal Home Loan Bank of Des Moines**

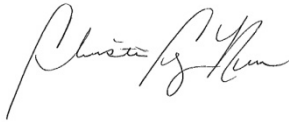


John H. Robinson  
Chairman, Human Resources and  
Compensation Committee of the Board of  
Directors

**Federal Home Loan Bank of Indianapolis**



Paul Clabuesch  
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