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1700 G Street, N.W.  
Washington, D.C. 20552  
Attention: Comments/RIN 2590-AA12

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

Dear Mr. Pollard:

On behalf of the Federal Home Loan Bank of Des Moines (“Bank”), we are writing to comment on the Federal Housing Finance Agency’s (“FHFA”) proposed rule on Executive Compensation (the “Proposal”), which was published on June 5, 2009.<sup>1</sup> The Proposal contains proposed executive compensation regulations that would implement sections 1113 and 1117 of the Housing and Economic Recovery Act of 2008 (“HERA”) with respect to the Office of Finance and the Federal Home Loan Banks (collectively, the “FHLBanks”, and individually, a “FHLBank”). We welcome this opportunity to comment on the Proposal.

The Bank has collaborated with the other FHLBanks in the development of these comments. Therefore, many of the comments contained herein may be similar to those expressed by other FHLBanks.

As detailed more fully below, our principal concerns with the Proposal are that it 1) does not take into consideration the effective role the cooperative structure of the FHLBanks plays in ensuring FHLBank compensation is reasonable and comparable, 2) is in apparent violation of the HERA prohibition on the FHFA setting FHLBank executive compensation, and 3) usurps unnecessarily the authority and responsibility of the FHLBanks’ board of directors to set executive compensation. To address these concerns, we recommend that the final rule neither specify comparator institutions nor establish presumptive limits on compensation for determining if compensation is reasonable and comparable. Finally, our comments contain a number of recommendations on how the Proposal could be improved to provide more clarity with regard to the review process, to better comport with the Bank’s operational practices, and to better conform with HERA and other legal requirements.

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<sup>1</sup> 74 Fed. Reg. 26989 (2009) (to be codified at 12 C.F.R. pt. 1230).



I. The Proposal Does Not Take Into Consideration the Cooperative Structure of the FHLBanks and the Transparent Nature of the FHLBanks' Compensation Process

A. Implications of a Member-Controlled Cooperative Structure for FHLBank Executive Compensation

While we appreciate the FHFA's efforts to implement the HERA provision that requires the FHFA to prohibit executive compensation that is not reasonable and comparable, we believe the Proposal fails to recognize how the unique cooperative structure of the FHLBanks advances the goal of this statutory provision. The cooperative structure ensures that the member-controlled boards of directors of the FHLBanks set executive compensation that balances the need to attract and retain talented individuals with the need to minimize FHLBank expenses.

Compensation decisions have been and will continue to be a critical aspect of the function of the FHLBanks' boards of directors. The ability to provide compensation arrangements that allow the FHLBanks to attract and retain highly qualified executives, especially during a period of extraordinary financial turmoil, is a tool that is essential to the board's ability to ensure the effective operation of an FHLBank. At the same time, board members are acutely aware of the need to operate an FHLBank in the most efficient manner possible and the need to be effective at fulfilling the FHLBank's missions for its members and the public, since all costs come out of the pockets of the members, and a majority of directors must be either an officer or director of a member.

Moreover, from a public perspective, efficient operation of an FHLBank enhances the ability of an FHLBank to support its Affordable Housing Program and Community Investment Program initiatives. Since compensation is a major element of FHLBank non-interest expenses, ensuring that executive compensation levels do not exceed the amounts necessary to meet an FHLBank's requirements is a key focus of board attention. The balancing of these competing considerations is a quintessential example of the business judgment that is best exercised by the boards of directors of the FHLBanks.

B. Transparency of the FHLBanks' Executive Compensation Process

In addition to the structural advantages associated with the FHLBanks' cooperative nature in promoting strong oversight of the executive compensation process, each FHLBank is registered with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 ("Exchange Act"), which ensures transparency in the process as well. As Exchange Act registrants, the FHLBanks are required to provide, among other information, a detailed annual description of their compensation practices. This typically includes a discussion of an FHLBank's compensation philosophy, the roles played by its board and board compensation committee, their use of independent consultants or outside compensation survey information, the peer or comparator institutions that they look to, and the results of the operation of these processes with respect to certain key executives. This discussion, which is referred to as the Compensation Discussion and Analysis ("CD&A"), is included in each FHLBank's annual Form 10-K. As may be required, additional compensation information is also provided periodically in Forms 8-K filed by the



individual FHLBanks. As a result of these requirements, members of the FHLBanks and the public in general are fully informed as to the FHLBanks' executive compensation process as well as to the amounts and elements of compensation.

C. Consideration of the Impact of the FHLBanks' Cooperative Structure Under 12 U.S.C. § 4513(f)

Under 12 U.S.C. § 4513(f), prior to promulgating any regulation that applies to the FHLBanks, the FHFA Director is required to consider the differences between the FHLBanks and Freddie Mac and Fannie Mae ("Enterprises") with respect to, among other things, the FHLBanks' cooperative structure. The Proposal requested comments on the application of section 4513(f). As discussed above, because the member-controlled cooperative structure of the FHLBanks (which is not present at the Enterprises) directly and dramatically mitigates against the possibility that an FHLBank's board of directors will compensate the FHLBank's executive officers in excess of compensation comparable with other similar businesses (including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities, it is particularly inappropriate to impose a regulatory structure on the FHLBanks that effectively shifts the principal responsibility for establishing FHLBank executive compensation from each FHLBank's compensation committee or board of directors to the FHFA.

II. The Proposal is in Apparent Violation of the Statutory Prohibition on the FHFA Setting FHLBank Executive Compensation and Unwarrantedly Usurps the Authority and Responsibility of the FHLBanks Boards of Directors

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

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

in order to take into account the Banks' size and structure, FHFA may consider the Federal Reserve Bank and the Farm Credit Banks as examples of appropriate comparators to assess the reasonableness and comparability of executive compensation provided by the Banks.<sup>2</sup> (emphasis added).
- Second, proposed section 1230.2, which, among other things, establishes a definition of "comparable", provides that:
 

FHFA generally considers comparable to be at or below the median compensation for a given position at similar institutions.

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<sup>2</sup> 74 Fed. Reg. at 26990.



In particular circumstances, consideration as described in paragraph (1) of this definition, may indicate the appropriateness of higher or lower benefit amounts to which FHFA would not object. (emphasis added).

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

**(d) Prohibition of setting compensation**

In carrying out subsection (a) of this section, the Director may not prescribe or set a specific level or range of compensation.<sup>3</sup>

However, under the FHFA’s intended approach, as reflected in the preamble and the text of the proposed rule, the FHFA would effectively take control of the compensation process, thereby displacing the business judgment of the twelve individual FHLBank’s boards of directors and compensation committees. This result is neither legally permissible under 12 U.S.C. § 4518(d), as enacted by section 1113 of HERA,<sup>4</sup> nor warranted as a matter of appropriate corporate governance or regulation of the FHLBanks.

We do not believe that Congress intended for section 1113 of HERA to be applied in a manner that so dramatically strips the boards of directors of the FHLBanks of their authority and proper incentives in making sound executive compensation decisions. Section 12 of the Federal Home Loan Bank Act authorizes the FHLBanks to hire and set the compensation of FHLBank executives. While HERA authorizes the FHFA to review FHLBank compensation, it did not alter the fundamental authority of the board of directors of each FHLBank to set executive compensation.

The Federal Housing Finance Board (“FHFB”), the predecessor to the FHFA with respect to the FHLBanks, made it clear that a key responsibility of an FHLBank board of directors was to “hire and retain competent management.”<sup>5</sup> In that regard, the FHFB indicated that an FHLBank’s

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<sup>3</sup> The same provision initially was enacted as part of the Federal Housing Enterprises Financial Safety and Soundness Act (“1992 Act”) and provided that: “In carrying out subsection (a) of this section, the Director may not prescribe or set a specific level or range of compensation.” Subsection (a) of 12 U.S.C. § 4518 requires the Director to prohibit the FHLBanks from paying executive compensation that is not reasonable and comparable with compensation for employment in other similar businesses (including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities.

<sup>4</sup> 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).

<sup>5</sup> FHFB Office of Supervision Examination Manual April 2007 at 6.2.



board of directors would be evaluated based on, among other things, its oversight of management's performance and compensation, including "the establishment and period review of compensation which is reasonable in view of an officer's performance and the condition, operating performance and risk profile of the FHLBank."<sup>6</sup>

The FHFA's approach would impose uniform FHFA-mandated compensation outcomes on a widely divergent set of FHLBanks – though they share the same mission – that operate in different circumstances and under different strategies. Instead of **reviewing** the reasonableness of the outcome of an individual FHLBank's compensation process against the statutory standard of reasonableness and comparability with "other similar businesses (including other publicly held financial institutions or major financial services companies) involving similar duties and responsibilities,"<sup>7</sup> the FHFA effectively would be dictating an outcome to the FHLBanks' boards of directors, thereby assigning to the FHFA the role that is properly assigned to the FHLBanks' boards of directors.

The FHFA's intention is made clear in proposed section 1230.3(a), which 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. (emphasis added.)

This provision does not appear in 12 U.S.C. § 4518(a). When read in the context of the FHFA's suggested comparable entities and the use of a median compensation level, the Proposal appears to be an effort by the FHFA to compel the individual FHLBank boards of directors to acquiesce to the FHFA's usurpation of their authority and responsibility to determine executive compensation. Instead of undertaking an independent evaluation and determination process, the compensation committee and board of directors could be presented with a *fait accompli* by the FHFA.

As a practical matter, under the Proposal, the FHFA would be able to impose on FHLBank boards of directors the determination of which entities are relevant comparator institutions and the FHFA would also be able to impose a median comparator compensation level as a *de facto* compensation cap. Thus, it appears that the legal framework and limitations specified by Congress are being ignored by the FHFA in the Proposal.

Section 1113 of HERA has assigned to the FHFA an important oversight role in ensuring that executive compensation decisions made by the FHLBanks are reasonable and comparable, but has prohibited the regulator from setting caps, limits or ranges on such executive compensation decisions. We believe that this careful balance reflects a recognition by Congress that each

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<sup>6</sup> Id. at 6.29.

<sup>7</sup> 12 U.S.C. § 4518(a).



participant in the executive compensation process, both directors and the regulator, benefit from the proper involvement of the other. Directors are best positioned to engage in the highly-individualized process of determining comparator institutions and specific percentile ranges for executive compensation, while the regulator is intended to review these decisions carefully and objectively to ensure that they are reasonable and comparable.

There is no indication in the Proposal that the FHFA considered, in any respect, the extensive independent compensation setting process that each FHLBank's compensation committee or board of directors followed as set forth in great detail in the CD&A section of each FHLBank's Form 10-K for 2006, 2007 and 2008. We believe that a fair evaluation of the description in the Form 10-Ks of the FHLBanks' independent board controlled compensation processes, which typically have made use of outside compensation experts, would confirm that those processes establish a firm foundation for the FHFA's review of an individual FHLBank's determination of reasonable compensation for its executive officers that is intended by 12 U.S.C. § 4518(a).<sup>8</sup>

A central element of the compensation processes is the identification, on an individual FHLBank basis, of the appropriate peer or comparator institutions for that particular FHLBank. The FHFA's decision to specifically refer to a plan to potentially use Federal Reserve Banks or Farm Credit Banks as comparator institutions for the FHLBanks, without (i) any apparent consideration of the different roles and functions that these institutions play, (ii) any reference to any relevant competitive relationship between executive officer employment at Federal Reserve Banks or Farm Credit Banks and the FHLBanks, or (iii) any discussion of actual comparability of current compensation among these entities appears to reflect an arbitrary and capricious process.

The current executive compensation regulations governing the Enterprises<sup>9</sup> promulgated by the Office of Federal Housing Enterprise Oversight in 2001 ("OFHEO Compensation Rule") under substantively similar statutory requirements do not include a specific presumptive percentage cap relative to comparator institution compensation that would apply to the Enterprises executive compensation determinations. Nor does the OFHEO Compensation Rule or its preamble specify particular comparator institutions for the Enterprises. We believe that the approach taken in the OFHEO Compensation Rule in these respects is correct and that the FHFA should use this approach in any final rule applying to the FHLBanks.

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<sup>8</sup> The FHLBanks' general compensation practices are described in detail in Section III below.

<sup>9</sup> 12 C.F.R. pt. 1770.



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

A. Current FHLBank Compensation Practices

The FHLBanks take executive compensation very seriously. Compensation decisions at the FHLBanks are made by the FHLBanks' boards of directors, and particularly their compensation committees. Under the terms of the Federal Home Loan Bank Act ("Bank Act"), FHLBank boards may not include any representatives of FHLBank management, but rather are composed of representatives of the FHLBank's member institutions and independent board members. Under the Bank Act, the majority of each of the FHLBank's boards is comprised of representatives of member institutions who would have no incentive to provide excessive compensation to FHLBank executive officers, since such payments would drive down earnings available for distribution to their member institutions. In addition, each FHLBank uses (and discloses the use of) independent, third party compensation consultants and/or independent market data sources in reviewing and establishing compensation.

The CD&A sections from the FHLBanks' Form 10-Ks for each of the last three years demonstrate the executive compensation process undertaken by the FHLBanks. We believe that a review of each of these FHLBanks' compensation practices will enable the FHFA to make the judgment that executive compensation at the FHLBanks is reasonable and comparable as required under HERA.

There is no single formula for setting compensation among the FHLBanks. A review of the FHLBanks' descriptions of their compensation processes demonstrates that the peer groups and benchmarking percentages differ for each FHLBank. This reflects the differences in the competitive employment environment confronting each individual FHLBank and the individualized strategic approaches and analysis that each FHLBank's compensation committee and board of directors undertake in determining the FHLBank's compensation levels. For the FHFA to select one peer group for the entire FHLBank System and to establish a presumptive benchmarking percentage for all the FHLBanks would violate 12 U.S.C. § 4518(d), and indeed the proposed rule itself, by effectively setting *de facto* compensation levels.

The FHFA should not seek to substitute its judgment for that of compensation committees or boards of directors in determining comparables. The compensation committees and boards of directors, should, with the outside advice and assistance that they deem appropriate, determine the appropriate comparables and adjust them, as they deem appropriate. 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 approach the FHFA is suggesting is significantly at odds with the FHLBanks' current disclosures required under Item 402(b) of the SEC's Regulation S-K. Each FHLBank is required to include in its CD&A a discussion of its compensation philosophy and how



compensation actually paid to executive officers fits into that philosophy. Specially, each FHLBank must discuss whether it has engaged in any benchmarking and if so, identify and explain the rationale for the relevant comparables as well as specific benchmarking targets. Therefore, if the proposed rule were adopted in its present form, the CD&As for the FHLBanks would likely have to include a statement that the peer groups and benchmarking percentages are set by the FHFA rather than at the discretion of the FHLBanks boards of directors.

#### B. Similar Institutions and Peer Groups

In selecting peer groups, a task that is performed typically with the assistance of compensation consultants, the FHLBanks focus on competitors from both business and labor market perspectives. Factors considered include company size by assets, revenues, and employee population, and complexity and similarity of business functions. FHLBanks also consider firms from which the FHLBank historically has hired employees, firms to which the FHLBank has lost employees, and firms that regularly are identified as having qualified candidates by internal and external recruiters. The FHLBanks focus on the realistic employment opportunities for their executives in assessing comparability, since their key compensation objectives include attracting and retaining executives.

The FHFA should not dictate which entities are similar institutions for compensation purposes. Rather, it should review the reasonableness of the determinations of comparable institutions made by the FHLBanks. The problem with having the FHFA take on the unwarranted authority to make compensation comparator determinations is illustrated by the suggestion in the Proposal that the Federal Reserve Banks and Farm Credit Banks are appropriate comparators. Section 1113 of HERA directs the FHFA to look to compensation levels at similar businesses, including other publicly traded financial institutions or major financial services companies. Using this approach, we believe the FHFA would, in assessing appropriate comparators, have identified the types of institutions that generally have been used by FHLBanks in their compensation setting processes – namely, generally publicly traded regional and national bank holding companies and other large publicly traded financial services firms and other FHLBanks.

In contrast, the FHFA cited in the preamble to the proposed rule the Federal Reserve Banks and the Farm Credit Banks as examples of possible comparators. However, the FHFA gives no indication that it analyzed actual comparative compensation among the executive officers of the Federal Reserve Banks, the Farm Credit Banks, and the FHLBanks.<sup>10</sup> Nor does it give any indication as to whether it has evidence that the FHLBanks are in actual or potential competition for

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<sup>10</sup> In that regard, we are not aware that the Federal Reserve Banks publicly disclose the individual compensation of their executive officers. The Board of Governors of the Federal Reserve System in its annual report discloses information regarding the salary (and not any other forms of compensation) of the President of each Federal Reserve Bank and does not provide any compensation information regarding other executive officers of the Federal Reserve Banks. The five Farm Credit Banks disclose individual level compensation information only for their chief executive officers.



current or prospective employees with the Federal Reserve Banks or the Farm Credit Banks, a fact that would appear to be critical to any assertion that these are appropriate comparators for purposes of assessing the reasonableness and comparability of FHLBank executive compensation. We also note that these institutions are neither publicly traded nor registered with the SEC under the Exchange Act.

### C. Benchmarking Percentages

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. Again, a review of the Form 10-Ks filed by the FHLBanks indicates that, although many of the FHLBanks' boards of directors have chosen to utilize the median level, others look to the 65<sup>th</sup> percentile or the 75<sup>th</sup> percentile. The critical point is that this choice, consistent with 12 U.S.C. § 4518 and corporate governance principles under the 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. 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 FHFA ignores 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. For example, many CD&As disclose that the benchmarking percentage is different when looking at (i) other FHLBanks and (ii) other comparators. 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 at some FHLBanks 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.

A general description of the Bank's benchmarking process is described in its CD&A filed as part of its Form 10-K. As with the selection of comparator institutions, the Bank undertakes this process in its own unique manner that allows it to address its particular allocation of functions and personnel strength and weaknesses. The Proposal sweeps past this highly nuanced individualized process and seeks to apply a 'one size fits all' presumptive compensation cap to the Bank. We therefore 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.<sup>11</sup>

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

Proposed section 1230.3 appears to give the FHFA the authority to direct an FHLBank to permanently withhold payment, transfer or disbursement of any compensation of an FHLBank executive officer based on any factors the FHFA 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.

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 FHLBank executive officer to make restitution or reimbursement of “excessive compensation.” Under this provision, the FHFA appears to suggest that it cannot only prohibit earned compensation from being paid to an FHLBank executive officer, but that it can require an FHLBank 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.

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<sup>11</sup> We further request that the FHFA delete the reference in clauses (1) and (2) of the definition of “reasonable and comparable” compensation to compensation taken “in whole or in part” and replace it with “taken as a whole.” We believe that if an executive’s compensation package taken as a whole is reasonable and comparable to compensation at similar institutions for similar duties, the FHFA should not be permitted to reject a discrete element of an executive’s compensation as excessive.

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



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 FHLBank executive officers. Such executive officers should not have to be concerned that an exercise of unfettered agency discretion could eliminate the financial results of years of hard work over an amorphous dispute as to what constitutes "excessive compensation."

We urge the FHFA to consider this negative consequence to the operations of the FHLBanks in developing the final rule and to modify the rule to provide reasonable and appropriate limitations on the FHFA's exercise of any authority under proposed sections 1230.3 and 1230.7.

V. The FHFA Should Limit the Scope of the Definition of 'Executive Officer' for the FHLBanks

Proposed section 1230.2 provides a list of persons by title or area of responsibility which are considered executive officers for the FHLBanks. The proposed section also includes those executive officers deemed "named executive officers" under the SEC's disclosure requirements, as well as additional persons based on role and reporting responsibility. It further provides that the FHFA "Director may add or remove persons, or functions to or from the list set forth... by communication to the [FHL]Banks or a [FHL]Bank at any time."

We request that the definition of executive officer of an FHLBank be modified to incorporate a 'bright line' test which encompasses solely the ten most highly compensated employees at each FHLBank. While the number of employees who appropriately could be viewed as executive officers because they are responsible for both management and strategy varies between each FHLBank, we believe that there are no more than ten individuals in such positions at each FHLBank. Indeed, in the case of many FHLBanks, there may be as few as five or six individuals who can be identified as having such a role. We believe that, across the FHLBanks, the individuals who have combined management and strategic responsibilities would all be included in the top ten most highly compensated group, thus providing coverage to the key employees who are presumably of interest to the FHFA. As such, having the Proposal apply to the ten highest compensated officers should ensure that the FHFA has comprehensive coverage of the top compensation structure at each FHLBank in order to perform its obligations under 12 U.S.C. § 4518.

VI. The Proposal Should be Modified to Clearly Explain How It Will Apply to the FHLBanks

The intended application of the Proposal to the FHLBanks 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), an FHLBank is required to submit certain compensation related information to the FHFA for its review within one week after a specified event has occurred. The compensation related information could include actions that could result in an immediately effective increase in an executive officer's compensation. However, nothing in the proposed sections suggests that



there is any restriction on an FHLBank's ability to immediately implement such increases in executive officer compensation.<sup>12</sup>

- Proposed section 1230.3(c) provides that:

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

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

- 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 an FHLBank, proposed section 1230.3(e)(1) does not expressly contain such a notice requirement. It provides that:

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

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

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<sup>12</sup> In an October 1, 2008 memorandum, FHFA Acting Deputy Director Ronald Rosenfeld informed the FHLBanks that pending FHFA action on section 1113 of HERA they should submit to the FHFA all compensation actions relating to the five most highly compensated officers, including compensation plans of general applicability to those officers at least four weeks in advance of any planned board of directors action with respect to such actions, including studies of comparable compensation.



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 an FHLBank would be prevented from providing **any compensation** to an executive officer without prior approval of the FHFA Director, if the FHFA Director has provided written notice to the FHLBank that a particular executive officer's compensation is being reviewed by the FHFA Director.

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 FHFA Director under proposed section 1230.3, the provisions and their operation lack clarity and raise numerous issues, some of which are noted below:

- o How does an FHLBank know that a review is underway in regard to the circumstances described in proposed sections 1230.3(e)(2)(i) and (ii)? (The provisions do not specifically provide for a written notice to the FHLBank.)
- o Is it the FHFA's intent for an FHLBank to assume that a circumstance covered by proposed section 1230.3(e)(2)(i) or (ii) is automatically a matter being reviewed by the FHFA Director under proposed section 1230.3? What is expected of the FHLBank if this were the case?
- o 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?
- o Under what circumstances does a review of annual compensation, bonuses, and other incentive pay provided by an FHLBank to its President (as described in proposed section 1230.3(e)(2)(ii)) require the FHLBank to obtain prior approval from the FHFA to transfer, disburse or pay compensation to the President, or to enter into an agreement with the President?
- o Which circumstances require the FHLBank 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))?<sup>13</sup>

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

We further recommend that the new section make it clear that, except to the extent that the FHFA has given written notice to an FHLBank that it is conducting a review under proposed section 1230.3 with respect to a particular executive officer, the FHLBank will be under no restrictions on transferring, disbursing or paying compensation to any executive officer, or entering into an agreement with any executive officer.<sup>14</sup>

The revised section also should provide for specific written notice to be given to an FHLBank in the event that the FHFA determines to conduct a review of a particular executive officer's compensation. The notice should specify what forms and amounts of compensation, if any, that the FHLBank is directed not to transfer, disburse or pay to the executive officer pending the outcome of the FHFA's review. In this regard, we believe that the regulation should provide direction that such withheld amounts not include:<sup>15</sup>

- 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;

<sup>13</sup> 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 FHFA 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).

<sup>14</sup> The FHLBank would remain subject to any applicable information submission requirements with respect to executive officer compensation that might apply under proposed section 1230.5(b).

<sup>15</sup> The definition of compensation in proposed section 1230.2 should be modified to expressly exclude payments to an executive officer under his indemnification and advancement rights to the extent not prohibited by applicable law.



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

The FHFA should not withhold compensation such that it is treated as deferred compensation under Section 409A of the Internal Revenue Code of 1986, as amended, nor act in a manner that exposes an executive officer 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.

VII. The Proposal Should be Modified To Address the Due Process Rights of FHLBank Executive Officers

Proposed section 1230.3(b) of the Proposal provides that in determining whether compensation provided by an FHLBank to an executive officer is not reasonable and comparable, the FHFA Director may take into consideration any factors that the FHFA Director considers relevant. Proposed section 1230.3(b) currently specifies only one factor that the FHFA Director might consider relevant to such a determination: “any wrongdoing on the part of the executive officer, such as 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 believe that the rule should be modified to provide more specificity as to the types of factors that would be deemed relevant in supporting a determination by the FHFA Director that an executive officer’s compensation is not reasonable and comparable.

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

- Pension benefits under qualified and excess benefit plans;
- Health, life and disability insurance benefits under nondiscriminatory plans;
- Any wages that are protected under state statute; and
- Compensation previously deferred.

In addition, proposed section 1230.3(b) does not provide any opportunity for an executive officer to present his or her views or defenses with respect to either the factors that the FHFA Director is considering, including any alleged wrongdoing or the amount and form of any compensation that may be potentially withheld. Proposed section 1230.3(b) also provides no



standard as to the degree of proof of a claim of wrongdoing or other conduct that would be required to support a decision by the FHFA Director to order an FHLBank to permanently withhold compensation that had been earned by an executive officer.

As such, Section 1230.3(b) in its current form raises significant due process concerns. An adverse compensation determination by the FHFA 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 FHLBank 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. This is particularly the case given the possibility that a Form 8-K might be required to be filed in connection with an arrangement or order to withhold any compensation due to the executive officer. Thus, an executive officer has a compelling interest in the outcome of the FHFA Director’s compensation review. The applicable FHLBank 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 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.<sup>16</sup> 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.<sup>17</sup>

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<sup>16</sup> 65 Fed. Reg. 78994 (2000) (to be codified at 12 C.F.R. § 908.7).

<sup>17</sup> 67 Fed. Reg. 9897, 9901 (2002).



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”).<sup>18</sup> 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 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 therefore believe that the FHFA should incorporate similar protections into any final rule.

#### VIII. The Proposed Rule’s Information Submission Requirements Should be Modified in Certain Respects

The one-week timeframe for submissions set forth in proposed section 1230.5(b) is inadequate. As a matter of corporate practice, board minutes and resolutions are often not officially approved until the next board or committee meeting which typically does not occur until well after one week following a board or committee meeting. The proposed rule should be revised to recognize this factor.

In addition, 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. Does “general benefit plans applicable to executive officers” include 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 an FHLBank with respect to compensation of executive officers, when delivered. This could lead to a result where a FHLBank must submit such studies to the FHFA

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<sup>18</sup> FHFb Order Number 2005-12, (June 16, 2005).



before the board of directors has had an opportunity to review or approve the study. We believe that the board of directors should have the opportunity to review and comment on such a study prior to submission to the FHFA.

#### IX. Existing Executive Compensation Arrangements Should be Grandfathered

We believe that compensation arrangements with FHLBank executive officers that are in effect prior to the effective date of the final rule should not be subject to action by the FHFA under 12 U.S.C. § 4518 or under the final rule. 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.<sup>19</sup>

Further support for this approach is provided by the FHFA's recent proposed rule on golden parachute and indemnification payments ("Golden Parachute Proposal").<sup>20</sup> 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.<sup>21</sup>

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

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<sup>19</sup> 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.").

<sup>20</sup> 74 Fed. Reg. 30975 (2009) (to be codified at 12 U.S.C. Part 1231).

<sup>21</sup> Id. at 30976.



X. The Proposed Section Regarding the FHFA Director's Temporary Executive Compensation Power Should be Revised to Reflect the Limitations on the Applicability of that Power

Section 1117 of HERA authorizes the Secretary of the Treasury (the "Secretary") to purchase FHLBank obligations under certain circumstances until December 31, 2009. Section 1117 also contains a provision stating that the FHFA Director shall have the power to approve, disapprove, or modify the executive compensation of the FHLBank as defined under Regulation S-K, 17 CFR 229. We believe that the FHFA Director's authority under Section 1117 is triggered only with respect to a particular FHLBank if the Secretary makes a covered purchase of such FHLBank's obligation under Section 1117. Proposed section 1230.6 should be modified to reflect this limitation on the FHFA Director's authority in this respect. Moreover, we note that legal issues including potential takings or other legal claims could arise depending upon the method in which any such authority was exercised.

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We appreciate your consideration of these comments.

Sincerely,

A handwritten signature in black ink, appearing to read "D. A. Lind".

Dennis A. Lind, Chair  
Human Resources and Compensation Committee  
Board of Directors, Federal Home Loan Bank of Des Moines

A handwritten signature in black ink, appearing to read "Nancy L. Betz".

Nancy L. Betz, Director  
Human Resources  
Federal Home Loan Bank of Des Moines