

November 25, 2008

BY EMAIL

Federal Housing Finance Agency
1625 Eye Street, NW
Washington, DC 20006
Attention: Public Comments/RIN 2590-AA03

RE: Federal Housing Finance Agency Interim Final Regulation with Request for Comments: Federal Home Loan Bank Boards of Directors – Eligibility and Elections

Ladies and Gentlemen:

The Federal Housing Finance Agency (FHFA) has issued an interim final rule (the Interim Final Rule) with respect to the eligibility and election of Federal Home Loan Bank directors. This letter sets forth the comments of the Federal Home Loan Bank of Topeka (the Bank) with respect to the Interim Final Rule and is based on analysis and discussion among the Federal Home Loan Banks (FHLBanks). We appreciate the FHFA's effort to expedite its rulemaking on this topic in response to the Housing and Economic Recovery Act of 2008 (HERA), and we thank you for the opportunity to comment on this important matter.

The Bank shares the FHFA's goal of promoting safety and soundness and believes that the election of qualified directors is a critical element in achieving that goal. With that shared goal in mind, we offer the following comments for your consideration:

- Permit the FHLBank Boards to Establish the Number of Public Interest Directorships. The FHFA requests comment on whether the FHFA Director or the FHLBank boards should establish the number of public interest directorships for each FHLBank. We believe that FHLBank directors should designate the number of public interest directorships because the directors are in the best position to identify the skills and experience needed by the board as a whole. Depending on the particular skills of incumbent directors and other considerations, such as the FHLBank's strategic goals or risk profile, a board may determine that oversight is enhanced by having a greater number of individuals with the qualifications of public interest directors. At other times, depending on such considerations, a board may determine that its shareholders are better served by having no more than the number of public interest directors required by statute and a greater number of independent directors with skills and experience in other areas that address the FHLBank's needs at that time. Of course, a board could reduce the number of public interest directors

only as terms of incumbent public interest directors expire, but the flexibility to make this determination enhances the board's ability to ensure that the board as a whole possesses the optimum combination of skills and experience.

- Clarify the Interim Final Rule's Application of the Statutory Term Limitation. The FHFA seeks comment on the Interim Final Rule's application of the consecutive full-term limitation in section 7(d) of the Federal Home Loan Bank Act (Bank Act). The Bank Act, as amended by HERA, limits the service of directors chosen by election to three consecutive full terms; directors are then eligible for re-election two years after the end of the last full term.
 - Based on the preamble to the regulation, we understand that the intent of the rule is to deem existing three-year terms of both member and independent directors expiring after December 31, 2008 and four-year terms beginning after the effective date of the Bank Act (July 30, 2008) to be full terms. Terms beginning after July 30, 2008 that are shortened to implement staggering are not intended to be full terms; nor are they intended to be gaps in service. For example, we understand that the intent of the rule is as follows:

Term	Full or Shortened?	Counts for Consecutive Term Limitation?	Term Limitation Reached?
First Term: 1-1-03 to 12-31-05	Full	Yes	No
Second Term: 1-1-06 to 12-31-08	Full	Yes	No
Third Term: 1-1-09 to 12-31-11	Shortened to Implement Staggering	No	No
Fourth Term: 1-1-12 to 12-31-15	Full	Yes	Yes

However, the Interim Final Rule does not correspond to that intent. Section 1261.4(c)(2)(ii) states, “ Any three year term of office ending immediately before a term of office that is adjusted after July 30, 2008 to a period of fewer than four years and *any term of office commencing immediately following such adjusted term of office* shall constitute consecutive full terms of office” [emphasis added]. Pursuant to the italicized phrase, a term of office immediately following a shortened term is a full term even though it may be less than a four-year term.

For example, we understand the application of the Interim Final Rule to be as follows:

Term	Full or Shortened?	Counts for Consecutive Term Limitation?	Term Limitation Reached?
First Term: 1-1-03 to 12-31-05	Full	Yes	No
Second Term: 1-1-06 to 12-31-08	Full	Yes	No
Third Term: 1-1-09 to 12-31-11	Shortened to Implement Staggering	No	No
Fourth Term: 1-1-12 to 12-31-14	Shortened to Implement Staggering	Yes	Yes

Under section 1261.4(c)(2)(ii), the last three-year term is deemed to be a full term contrary to the intent stated in the preamble to the Interim Final Rule. In addition, section 1261.4(c)(2)(ii) conflicts with section 1261.4(c)(2)(i) which provides that a term of office that is adjusted after July 30, 2008 to a period of less than four years is not deemed to be a full term. Rather than retain 1261.4(C)(2)(ii), the FHFA might revise it to state simply that terms shortened after July 30, 2008 to achieve staggering do not constitute breaks or gaps in service.

- Also for consistency in applying the statutory term limitation provision to all classes of directors (including directors previously appointed by the Federal Housing Finance Board) to correspond to the intent stated in the preamble, section 1261.4(c)(2)(iii) should be revised to read, “A three year term of office existing on or before July 30, 2008 shall be deemed to be a full term.” Without such clarification, the rule does not address the application of the term limitation provision to directors previously appointed by the Federal Housing Finance Board.
- Finally, in order to enhance understanding of the rules, we suggest that the FHFA consider placing the various rules on term limitations in the form of tables or charts. We believe that a graphical presentation of the rules will make this complex section of the regulations easier to follow and will assist in compliance.
- Retain the Consultative Role of the Advisory Council. The FHFA seeks comment on whether it should require the Advisory Council to play any specific role in

consulting with the board regarding independent director nominees and whether the FHFA should prescribe procedures on how the consultation should take place. We believe that the nomination of independent directors implicates the board's fiduciary duties and that boards should have flexibility to specify the role of the Advisory Council and design a process that, in the board's judgment, best assists it in fulfilling those duties. The form, content, and timing of advice that each FHLBank needs from its Advisory Council will differ depending on the background and experience of the FHLBank's board and the FHLBank's process for identifying nominees. A regulatorily-prescribed process may not meet the unique requirements of each FHLBank. The Interim Final Rule provides flexibility for each FHLBank to establish a process that will meaningfully assist the board in fulfilling its statutory mandate to nominate independent directors.

- Deem Existing Public Interest Directors to be Public Interest Directors Under HERA. The FHFA has asked whether it should apply HERA's requirement of an additional two years of relevant experience to current public interest directors. The Bank's public interest directors meet HERA's experience requirement, so application of the rule will not affect the Bank. However, from the perspective of the FHLBank system as a whole, we believe that the immediate benefit of continuity of service is greater than the benefit derived from two additional years of experience in the required areas, given the current economic environment.
- Retain the Rule Permitting the Board to Nominate a Minimum of One Nominee for Each Independent Directorship. The FHFA has asked whether FHLBank boards should be required to nominate more candidates for independent directorships than there are positions to be filled, if the board determines that there are sufficient applicants who are both eligible and qualified. As stated previously, the nomination of independent directors implicates the board's fiduciary duties. Boards should be free to nominate the candidates who are most qualified and who will contribute experience and skills that enhance board oversight. A rule requiring more nominees than directorships to be filled may force boards to nominate candidates who meet the minimum requirements for eligibility and qualifications, but who are not the most qualified considering the board's particular needs at the time. Such a rule potentially limits the board's role to that of a conduit, merely placing eligible, qualified candidates' names on the ballot. Given that independent directors are elected at large, shareholders may not be familiar with candidates who are not from their states, and they should be able to rely on the board's judgment in identifying the most highly qualified candidates. The Bank further agrees with the FHFA that requiring more than one nominee will likely discourage qualified individuals from submitting their applications. Highly qualified applicants would be much more willing to serve as independent directors if they are not subject to the potential of publicly losing the election.
- Clarify that the Board May Immediately Elect a Member Director if the Number of Nominees Is Insufficient. The preamble to the Interim Final Rule states that the board must wait until January 1 of the year following an election to elect a member director to fill a vacancy resulting from insufficient nominees. However, sections

1261.7(c) and 1261.14(a) together require the board to fill such a vacancy “as soon as practicable after any vacancy occurs.” We believe that these sections of the Interim Final Rule correctly permit the board to fill such a vacancy immediately, so that the member director can begin service on January 1. To delay such action until January 1 may cause a board to violate the statutory board composition requirements and may prolong the length of a vacancy.

- Do Not Require 20 Percent of Eligible Votes Cast to Elect Independent Directors. The Bank requests that this requirement be deleted, or, in the alternative, that the minimum percentage be lowered to 10 percent. The Bank understands the concern the requirement is designed to address – that director-nominated candidates may not be the choice of shareholders. However, such a concern is minimized in the context of a cooperative. If, despite these factors, the FHFA determines to retain such a requirement, the requirement should be reduced to a lesser percentage, such as 10 percent, to avert the possibility of failed elections.
 - This is Not an Issue Given the Bank’s Cooperative Structure. The FHFA’s reason for adopting this requirement is not persuasive in the context of cooperatives such as the FHLBanks. The FHFA believes that receiving at least a minimum percentage of votes affirms that the candidate is the choice of the members. The FHFA’s concern is appropriate for a typical corporation where the board essentially is self-perpetuating in that the entire board comprises individuals nominated by each other without any shareholder input and many of whom are “insiders” (i.e., members of management). In contrast, FHLBank shareholders directly nominate 60 percent of the board. If shareholders believe the board is nominating inappropriate candidates for independent directorships, they – unlike shareholders in a typical corporation – can easily replace the majority of the board. In addition, no member of management can serve on the board of an FHLBank. This independence from management, together with a majority of directors nominated directly by shareholders, is sufficient to mitigate the concerns about director accountability to shareholders that seem to underpin the Finance Agency’s motivation in adopting this requirement.

The Bank respectfully requests that the FHFA reconsider this requirement, particularly in light of the fact that the rule may cause elections to fail, with the result that an FHLBank may violate the statutory board composition requirements.

- Clarify the Election Process following Failed Independent Director Elections. If the FHFA retains some percentage requirement for the election of independent directors, it should more explicitly define the process for holding elections subsequent to an election in which a nominee fails to obtain the required percentage of votes. For example, the rule should specify shortened time frames for delivery of independent director applications, review by the FHFA, and voting, so that the vacancy can be filled prior to the January 1 commencement of the directorship’s term. Furthermore, the rule states that “the board of directors of the Bank shall identify additional nominee (*sic*) and shall conduct additional election (*sic*) for the

directorship.” The Bank requests clarification on what constitutes “additional nominees” and would request that the FHFA permit a board to nominate the same candidate for a subsequent election, which an FHLBank might do if it believed that low voter participation, rather than shareholder disfavor of the candidate, was the real cause of the candidate’s failure to receive 20 percent of the eligible votes. The rule also should address the content of the report of election required by 1261.7(g) as it relates to failed elections.

- Conflicts of Interest Rules. The rule creates ambiguity about a director’s ability to accept reasonable and customary entertainment and ordinary-course business gifts by deleting the prior rule’s safe harbor for non-substantial gifts. Under the prior rule, prohibited “substantial gifts” are gifts of more than token value, entertainment the cost of which is unreasonable, non-customary and not accepted business practice, and any item or service for which the director pays less than market value. Any gift may have the appearance of influencing a director’s actions, but only substantial gifts (as defined in the prior rule) are likely to do so. It seems more prudent to adopt a rule with a workable standard, rather than to create a rule that will be violated automatically by the acceptance of any gift or entertainment. The rule also should be revised to permit explicitly member directors’ receipt of gifts that are customarily given to other members as such gifts by their nature are not intended to influence a director’s actions as a member of the board.
- Support for Election of Member Directors. The Bank requests that the FHFA allow the board of directors, officers, attorneys, employees and agents to support the nomination and election of individuals for a member directorship in their official capacity. Section 1261.9 allows the above individuals to support the nomination or election of any individual for a member directorship in their individual capacity and allows them to support individuals nominated for an independent directorship in their official capacity.

The Bank believes that the corporate governance of the FHLBanks would be further enhanced if the Interim Final Rule allowed the FHLBanks to follow the best corporate practices utilized by companies registered with the Securities and Exchange Commission (SEC) to the maximum extent permissible under the Federal Home Loan Bank Act (the Act). The boards of many SEC registered companies nominate a slate of candidates who it believes would best provide the skills and experience for the board, and in the proxy statement mailed to stockholders, identifies the slate of candidates endorsed by management and the board, and also lists any other nominees. However, unlike most SEC-registered companies in which company senior officers serve on the board and the CEO typically is the chairman of the board, management is prohibited from serving on the board of an FHLBank, and thus all of the directors on the board are independent of management.

Allowing a Bank director, officer, attorney, employee or agent to support a nominee in his or her official capacity would increase the likelihood that directors with the most appropriate skills and experience would be elected. All such practices are permissible under the Act except that candidates for member director positions are

nominated by members and not by the Bank's board, and the Act prescribes unique voting procedures for the FHLBanks. The different nomination procedures are not an issue because any director candidate recruited by an FHLBank could be nominated by his or her institution. The only impediment to such practices is in Section 1261.9 which prohibits directors, officers, attorneys, employees and agents from supporting member director nominees in their official capacity. Accordingly, we support the removal of the language in 1261.9(b)(1) which states "provided that no such director may purport to represent the views of the Bank or its board of directors in doing so," as well as removing the language which states "acting in his or her personal capacity."

In the alternative, if the FHFA determines it necessary to maintain the prohibition on Bank directors, officers, attorneys, employees or agents from supporting member director nominees in their official capacity, the Bank requests clarification of Section 1261.9(b) and (c). The language in (b)(1) states that a "Bank director, officer, attorney, employee, or agent, acting in his or her personal capacity, may support the nomination or election of any individual for a member directorship." However, that section continues, but refers only to directors, by stating "provided that no such **director** may purport to represent the views of the Bank or its board of directors in doing so" [emphasis added]. The language allows individuals to support nominees in their individual capacity, but only specifically prohibits directors from purporting to represent the views of the Bank. Furthermore, Section 1261.9(c) seems unnecessary in the event (b) is clarified. Subsection (b) provides both the approved and prohibited actions that may be taken with respect to supporting directors for nomination or election, and subsection (c) adds unnecessary confusion to the regulation.

- Technical Changes. The Bank notes the following technical changes for the FHFA's consideration:
 - The Bank requests that section 1261.9(b) of the Interim Final Rule be clarified to permit individual Advisory Council members to support the candidacy of the Bank's nominees for independent directorships; as currently written, the rule implies that only the Advisory Council as a whole may do so.
 - Section 1261.14(a), like section 7(f)(2) of the Bank Act, produces an odd result with respect to the application of the provision requiring that any person elected to fill a vacancy must meet the eligibility and qualification requirements applicable to his predecessor in office. For example, candidates filling vacancies for public interest directorships in existence prior to HERA must have only two years of relevant experience. Also, candidates for member directorships must be officers or directors of institutions that were members as of the record date of the election in which the predecessor in office was elected (see 1261.4(a)(2)). So, for example, if a member directorship filled by election in 2008 (with a record date of December 31, 2007) becomes vacant in 2010, any candidate to fill the vacancy must have been a member as of December 21, 2007. The Bank requests that the FHFA clarify the rule to permit the Bank to fill such vacancies with an officer or director of an

institution that is a member at the time of the board's election to fill the vacancy and to apply the four-years' experience requirement to public interest directors elected in this manner by the board.

Thank you for your consideration of our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Ronald K. Wentz". The signature is written in a cursive style with a large initial "R".

Ronald K. Wentz
Chairman of the Board
Federal Home Loan Bank of Topeka