



June 20, 2014

Via Electronic Mail

Mr. Barry F. Mardock
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

RE: Standards of Conduct – 79 Fed. Reg. 9649-61 (February 20, 2014)

Dear Mr. Mardock:

I am writing on behalf of Farm Credit Illinois (“FCI”) to comment on the Farm Credit Administration’s (“FCA”) proposed rule published in the February 20, 2014 Federal Register regarding standards of conduct for directors, employees, and agents of Farm Credit System (System) institutions and requiring each institution to adopt a code of ethics. We appreciate the opportunity to comment on the proposed rule.

**FCI Agrees with Comments of Farm Credit
Council**

FCI agrees with the comments submitted by Charles Dana and the Farm Credit Council. FCI submits the following comments to emphasize those areas of particular concern to FCI.

**Standards of Conduct Official Should Not
Have to Determine Each Matter of General
Applicability**

Sections 612.2145(a)(1) and 612.2155(a)(1) provide a director or an employee must not “[p]articipate, directly or indirectly, in deliberations on, or the determination of, any matter affecting, directly or indirectly, the financial interest of the [director or employee], any relative of the [director or employee],” Sections 612.2145(b)(1) and 612.2155(b)(1) then provide that a director or an employee may participate in a matter prohibited under

(a)(1) "only if the matter is one of general applicability affecting all shareholders/borrowers in a nondiscriminatory way, *as determined by the Standards of Conduct Official.*" (emphasis supplied).

Almost every issue a director or senior officer/employee addresses arguably may affect, directly or indirectly, the financial interest of a borrower/shareholder. System institutions are cooperatives and are owned by their member borrowers. Many System institutions issue patronage refunds or dividends to their members based on the institution's profit. In addition, the interest rates an institution charges on its loans typically are based, in part, on the level of the institution's operating expenses. Therefore, almost every matter affecting an institution's income or expense could "directly or indirectly" affect the financial interest of every borrower or stockholder. Because all elected directors are borrowers, every elected director would have a conflict of interest with respect to any issue that may affect the institution's income or expense.

Because almost every matter affecting an institution's income or expense could "directly or indirectly" affect the financial interest of every elected director, under the regulation as proposed, the Standards of Conduct Official would have to sit in on every board meeting where deliberations or decisions occur and make a finding that virtually every matter addressed by the board is one of general applicability affecting all shareholders/borrowers in a nondiscriminatory way.

The requirement also would be problematic with respect to an employee who is a senior officer. A senior officer who has a relative¹ that is a borrower could not participate in any matter that could affect the institution's income or expense unless the Standards of Conduct Official determined that the matter is one of general applicability affecting all shareholders/borrowers in a nondiscriminatory way. Because officers continually deliberate and make decisions that could "indirectly" affect the financial interest of a borrower, the Standards of Conduct Official constantly would have to be available to such a

¹ It would not be unusual for a senior officer to have a relative that is a borrower because "relative" is very broadly defined in § 612.2130. For example, if a senior officer has a niece whose husband is a borrower, the proposed rules would prohibit the officer from deliberating or voting on any matter that "indirectly" could affect the financial interest of a borrower, unless an exception is satisfied.

senior officer to make the required findings necessary to allow the officer to function.

FCI believes sections 612.2145 and 612.2155 should be revised to: (a) make clear that matters affecting the institution's income or expenses, without more, are not included in those that "indirectly affect" a shareholder/borrower; (b) provide that the prohibitions in 612.2145(a)(1) and 612.2155(a)(1) only apply to matters that *materially* affect the financial interest of the individual or entity at issue; and (c) remove the requirement that an exception applies only if there is a specific finding by the Standards of Conduct Official.

Exceptions for Matters of General Applicability Should be Expanded

The exceptions provided in sections 612.2145(b)(1) and 612.2155(b)(1) only apply if, among other things, the matter is "one of general applicability affecting all shareholders/borrowers in a nondiscriminatory way." FCI believes this standard is too narrow.

For example, board members and employees regularly engage in deliberations regarding loan programs, interest rate programs, disaster assistance programs, YBS programs, etc. that affect various classes of borrowers, but not "all" borrowers. Directors and officers need to be able to discuss all aspects of such programs, including the parameters that will define the class of members eligible for such programs. Under the proposed rule, if a board was deliberating on the desired scope of a program that may or may not apply to all borrowers, every elected director (and every officer who has a relative who is a borrower) would have an incurable conflict of interest. Because the available exceptions (provided in sections 612.2145(b)(1) and 612.2155(b)(1)) only apply if the matter is one of general applicability affecting *all* shareholders/borrowers in a nondiscriminatory way, under the rule as proposed, an elected director (and an officer who has a relative who is a borrower) could never participate in any matter that could "indirectly" affect the financial interest of a borrower that did not affect all shareholders/borrowers in a nondiscriminatory way.

It also is unclear how the phrase "in a nondiscriminatory way" qualifies the exception. Any program that does not apply to all shareholders/borrowers necessarily discriminates against those shareholders/borrowers who are not eligible. For example, a program limited to young farmers may be viewed as "discriminatory" against old farmers, and a program designed to attract new

borrowers may be viewed as "discriminatory" against current borrowers. Because a benefit conferred on one group could "indirectly" affect the financial interest of every borrower, either positively or negatively, the literal language of the exception would not appear to allow any elected director to discuss or vote on a young farmer program or a program designed to attract new borrowers.

FCI suggests the language of the proposed rule be revised to provide an exception "if the matter is one of general applicability."

The Proposed Rules Will Place Unnecessary Burdens on Directors and May Deter Desirable Candidates From Serving

The proposed rules prohibit a director from entering into a lending transaction with an employee, agent, borrower or loan applicant of the institution unless, among other things, the transaction is approved in advance by the Standards of Conduct Official. Similarly, sections 612.2140(b)(1) and (b)(3)(ii) require directors to disclose material financial interests with the institution's borrowers or agents. These provisions will be very burdensome for many directors, and they will be the most burdensome for those directors who have the most extensive contacts within the agricultural community.

FCI believes each System institution should seek to attract directors who have broad knowledge and experience in agriculture, agribusiness, business operations, financial management and other areas that will allow the director to effectively guide the institution's business affairs. Directors with those desired qualifications typically will have many contacts and dealings with those in their community, including other borrowers, loan applicants and agents.

Requiring those directors to attempt to identify borrowers, loan applicants and agents and to seek prior approval of ordinary course transactions will impose a significant burden on them. FCI has approximately 8,000 borrowers, so its directors cannot reasonably be expected to know or remember the names of all of FCI's borrowers, loan applicants and agents. To comply with the proposed rules, directors would appear to have little choice but to obtain a list of FCI's borrowers, loan applicants and agents (which will need to be updated regularly) and refer to the voluminous list when they are conducting their everyday business. In the alternative, directors could call FCI to determine whether a person is an borrower, loan

applicant or agent before engaging in any transaction with the person. Complying with the proposed rules will be very disruptive to a director's business.

Each of FCI's elected directors operates a farming business as his or her primary occupation. The directors need to be able to operate their businesses without undue interference or burdens. The System should exercise extreme caution when imposing burdens on directors' business operations and should only do so as a last resort and when absolutely necessary. Requiring directors to attempt to identify borrowers, loan applicants and agents and to seek prior approval of ordinary course transactions will impose a significant burden on them, with very little corresponding benefit to the institution.

The burdens imposed by the proposed provisions likely will discourage individuals with substantial business contacts from serving as a director, and those most likely to be discouraged will be those individuals with the most extensive contacts. FCI believes the System should seek to encourage individuals with extensive and diverse agricultural and business contacts to serve as directors. Accordingly, FCI believes the rule should be revised as suggested below.

Directors Should Not Need Prior Approval for Transactions in the Ordinary Course of Business

Section 612.2145(b)(4) provides that a director may enter into an otherwise prohibited lending transaction if, among other things, the transaction is approved in advance by the Standards of Conduct Official. As explained above, this provision will impose a heavy burden on a director's day-to-day business operations. FCI believes the rule should be revised so directors do not have to obtain prior approval before entering into a lending transaction with a borrower as long as the transaction is in the ordinary course of business. By definition, a transaction in the ordinary course of business may not be preferential, so any transaction with preferential terms still would have to be approved in advance. At the very least, prior approval should not be required for lending transactions in the ordinary course of business made at a generally available price.²

² For the same reasons, the disclosure provisions of sections 612.2140(b)(1) and (b)(3)(ii) also should not apply to transactions in the ordinary course of business.

The Rule Should Provide Some Procedure for Retroactive Approval

The Supplementary Information emphasizes that the "Standards of Conduct Official cannot ratify prohibited conduct after the fact." FCI acknowledges that when approval is necessary, prior approval is desirable. However, diligent and honest directors nevertheless may inadvertently overlook a matter. Despite a director's best efforts, it may be difficult for a director when conducting everyday business to keep in the forefront of his or her mind the many different individuals and entities that are institution borrowers or agents. In addition, a director may enter into a routine transaction in the ordinary course of business without much thought or consideration. Honest mistakes certainly will occur, and there should be some mechanism for a director to receive approval for a transaction that would have been approved in advance if a timely request had not been inadvertently overlooked.

Disclosures and Prohibitions Should Only Apply With Respect to Those a Director Knows to be a Borrower or Agent

As stated, Section 612.2145(a)(7) prohibits a director from entering into certain transactions with an employee, agent, borrower or loan applicant of the institution. Similarly, sections 612.2140(b)(1) and (b)(3)(ii) require directors to disclose material financial interests with the institution's borrowers or agents. However, directors typically do not know the identities of the institution's borrowers or agents. FCI's directors do not sit on loan committees, are not given lists of FCI's borrowers, and address matters relating to specific loans in only extremely rare situations. FCI's directors likewise generally are not advised of the identities of all those who provide the association with professional services. As a result, FCI's directors do not know the identities of the vast majority of FCI's borrowers or agents. Sections 612.2145(a)(7), 612.2140(b)(1) and (b)(3)(ii) on their face apply even if the director does not know the other person is a borrower or agent. FCI suggests these provisions be modified to provide that a director need only disclose business transactions with those people or entities the director knows to be borrowers or agents.

Unless modified, the proposed rules likely will force all directors to learn or at least have readily available the identities of all of the institution's borrowers. FCI believes the System would be at greater risk if directors know the identities of all borrowers, than it is under the current state of affairs in which directors typically do not know borrowers' identities.

Less Formal Matters Should Not Be Given the Weight of Binding Regulations

Section 612.2135(b) provides that “directors and employees must observe, to the best of their abilities, the letter and intent of all applicable local, state, and Federal laws and regulations and policy statements, instructions, procedures, and guidance of the Farm Credit Administration. . . .” FCI believes the inclusion in this section of the new word “guidance” is inappropriate. The word “guidance” is ambiguous and could be construed to include very informal communications, such as correspondence and verbal discussions. Informal matters are not subject to the notice and comment procedures required to establish formal rulemaking. The attempt to confer the authority of a regulation on such informal matters is inappropriate and violates the spirit of the administrative procedure act. The proposed language requiring directors and employees to observe “policy statements, instructions and procedures” is problematic for the same reasons. FCI believes the language “policy statements, instructions, procedures, and guidance” should be deleted from the regulation. At the very least the word “guidance” should be deleted and the regulation should only refer to “published policy statements, instructions, and procedures.”

Regulations Should Not Apply To Undefined Consultants, Professionals or Experts

In addition to the defined term “agent,” several of the proposed rules also refer to “consultants, professionals or experts.” These other terms are not defined and are ambiguous and confusing. The supplementary information states, “[t]he requirements of disclosure and recusal in this section apply not only to directors, employees, and agents, but also those consultants, professionals or experts who are hired to give advice on a matter, transaction or activity but may not necessarily meet our definition of ‘agent’.” The term “agent” is broadly defined to include all those who provide “professional services” to the institution, and it is unclear what consultants, professionals or experts would be doing for the institution if they are not providing “professional services.” FCI believes all references to “consultants,” “professionals” or “experts” should be deleted.

Proposed Changes to Definition of Family are Not Workable

FCI believes the proposed addition of the words “and anyone whose association or relationship with the director or employee is the equivalent of

the foregoing” to the definition of “family” in section 612.2130 is ambiguous and problematic. Attempting to add non-traditional relationships, which generally are neither formal nor legally recognized, puts a burden on the Standards of Conduct Official and the institution to determine the degree to which informal relationships should be disclosed and to further delve into the nature of such relationships. In addition, it is difficult to understand what sort of relationship would be “equivalent” to most of the specifically identified family relationships, such as a niece, aunt or half-brother. If it is determined the rule should include some very close non-traditional relationships that are not specifically listed in the current definition of “family”, FCI suggests a more objective standard be adopted, such as “any person residing in the individual’s household.”

Standards of Conduct Official Should Not Have to Immediately Report Violations

Section 2160(a)(3) requires the Standards of Conduct Official to immediately notify FCA of “known or suspected material standards of conduct violations as described in § 612.2170(b)(7).” The obligation to “immediately” report “suspected” violations is problematic. The proposed language would result in many unnecessary notifications to FCA because the rule allows no time for the Standards of Conduct Official to conduct any sort of investigation. Under the literal language of the rule, a Standards of Conduct Official would be required to notify FCA immediately following an informal discussion when the Standards of Conduct Official first learns of a suspected violation.

Complaints

Section 612.2170(b)(8) requires the Standards of Conduct Official to investigate all cases involving “[c]omplaints received against the directors, employees, and agents” of the institution. The regulation does not define the word “complaint,” nor does it limit the types of complaints the Standards of Conduct Official must investigate. FCI believes the proposed regulation is far too broad because people often informally “complain” about the employees, co-workers, supervisors, agents, etc. with whom they interact for all sorts of reasons. FCI believes the proposed rule should be revised to require the Standards of Conduct Official to investigate only complaints that involve a potential standards of conduct violation.

Thank you for the opportunity to comment on this proposed rule. Please contact me if you have any questions regarding FCI's comments.

Sincerely,

A handwritten signature in cursive script that reads "Robert H. Rhode". The signature is written in black ink and is positioned below the word "Sincerely,".

Robert H. Rhode
General Counsel