



June 20, 2014

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

Via Email

Re: Proposed Rule on Standards of Conduct

Dear Mr. Mardock:

Lone Star, ACA (“Lone Star”) appreciates the opportunity to comment on the Farm Credit Administration’s (“FCA”) Proposed Rule regarding Standards of Conduct and Referral of Known or Suspected Criminal Violations that was published in the February 20, 2014 *Federal Register*.

In preparing this comment, Lone Star reviewed and discussed the proposed rule with its management, its Board of Directors, certain of its employees, certain of its present and former agents, and its funding bank. Lone Star also participated in meetings and discussions with other groups, associations, district banks, and directors, agents, and employees of other associations and/or district banks and reviewed the background of the current proposed rule, FCA-published materials relating to standards of conduct, and authorities relating to the interpretation and application of laws and regulations.

This comment reflects Lone Star’s general comments on the proposed rule, as well as Lone Star’s specific comments on particular provisions of the proposed rule. As part, and in further support, of its comment, Lone Star incorporates herein by reference the comments on the proposed rule made by the Farm Credit Bank of Texas and the Farm Credit Council.

General Comments

As noted in the FCA’s Examination Manual on Standards of Conduct (the “SOC Manual”), the primary focus of standards of conduct regulations “is on prohibited activities designed to limit conflict-of-interest situations,” and the current regulations appear to set forth the behavior in which employees and directors cannot engage with this focus in mind. Notably, however, the examination manual recognizes that some differentiation between employees and directors may be necessary to avoid deterring qualified directors from serving on the Boards of System institutions. Specifically, in discussing prohibited employee conduct, the FCA notes in its SOC Manual that “enforcing similar provisions for directors could make it difficult to attract directors with the appropriate expertise.” Importantly, the FCA has recognized in its SOC Manual that the common law imposes certain requirements and duties on directors, including the duties of loyalty, obedience, and care, in fulfilling their fiduciary role in the System, while the FCA regulations “require policies and procedures to contain requirements and prohibitions

sufficient to promote public confidence,” “preserve the integrity and independence of the supervisory process,” and “prevent improper use of official property, position, or information.” The FCA has also recognized the role of the Standards of Conduct official as being a person designated by the association, *e.g.*, to advise directors and employees concerning the regulatory requirements, receive regulatory-mandated reports, investigate cases, maintain a record of actions taken regarding certain cases, and report to the Board and Chief Examiner as required by 12 CFR, Part 617. It is clear that, in reviewing the current FCA regulations and the SOC Manual, a distinction has been appropriately drawn between directors, who owe legal duties under the regulations and common law to the institutions on whose boards they sit and to their respective stockholders and who are responsible for their actions and their disclosures, and the Standards of Conduct official, who is an agent or employee of the association and who is assigned certain duties to advise, receive, investigate, maintain, and report consistent with other FCA regulations (*e.g.*, 12 CFR, Part 617). The distinctions drawn by the FCA in its manual are supported by the current regulations and are consistent with the roles of directors, agents, and management under traditional notions, common law, and FCA regulations.

The proposed Standards of Conduct rule, however, appears to draw significantly different distinctions in the roles between directors and the Standards of Conduct official, as well as proposes to expand the authority of the Standards of Conduct official, impose additional burdens on the Standards of Conduct official, conflict with other FCA regulations (such as referrals), and limit the Standards of Conduct official’s ability to carefully investigate, review, and report on actual or perceived conflicts of interest that fall within the meaning of that defined term. Additionally, the proposed rule attempts to expand the FCA’s reach over (or effect on) agents and consultants who give advice or provide services to institutions. In its examination manual, the FCA recognized that “it is not feasible to carry out extensive procedures specifically to disclose conflicts of interest.” The proposed rule, however, would run contrary to this thought.

Further, the FCA has historically seemed to appreciate the role of management when it comes to selecting agents and the Standards of Conduct official for the association based on the needs and resources of the association. In its Examination Manual on Overall Assessment, the FCA said that:

Management is probably the most important element in an institution’s operations. All areas of operations...are affected by management actions. As such, management must have a thorough and complete understanding of the interrelationships between these areas and how their decisions will affect the soundness of the institution. Management must also be cognizant of the institution’s external environment and how factors outside the institution will affect operations. Even without adequate knowledge of the institution’s operating environment, management must still exercise considerable judgment and carefully weigh the costs, benefits, risks, and rewards of decisions.

The proposed Standards of Conduct rule, however, attempts to insert itself into the management of institutions by limiting who can be appointed as the Standards of Conduct official and giving itself the power to overturn Board decisions, *e.g.*, even when such decisions are in line with the policies and procedures of the association. As a result, the proposed rule would greatly impact management’s ability to make the appropriate choices for the association without the benefit of furthering standards of conduct compliance.

Lone Star agrees that standards of conduct are important and are of vital importance to the safety and soundness of the Farm Credit System and to each of its institutions. The regulations, as currently written, appropriately distinguish between the role of the employee (and what he or she must disclose and what he or she must refrain from doing), the role of the director (and what he or she must disclose and what he or she must refrain from doing), the role of the Standards of Conduct official (a role designed to advise, receive, report, maintain, and investigate standards of conduct issues consistent with other regulations), the role of management (in selecting the appropriate person, whether he or she is an employee or outside agent, to dutifully carry out the important role of being the Standards of Conduct official), and the role of agents and contractors (and what he or she must disclose or refrain from doing). The regulations as currently written also appropriately assign responsibility to each person in the standards of conduct process. For example, employees and directors are responsible for the disclosures that they make, which is consistent with their roles in or with the association, common law, and the regulations, and the Standards of Conduct official is charged with reviewing, investigating, reporting, and maintaining the standards of conduct information it receives but without ensuring or guaranteeing that information (which the Standards of Conduct official cannot do and is not required to do by law). The proposed rule, however, reassigns the roles and responsibilities of those involved in the standards of conduct process in a manner that is inconsistent with the traditional roles assigned to each person, the common law, the current regulations, and FCA examination materials and in a manner that would unfairly burden the association and the Standards of Conduct official without achieving the goals of the standards of conduct process.

Lone Star strongly supports standards of conduct and believes that some changes to the current rule could further the goals of safety and soundness of the System and add clarity to the rule as long as such changes: (1) further the primary purposes to be addressed by Standards of Conduct regulations (*i.e.*, avoiding the use of insider information for personal benefit, the participation in deliberations on any question affecting the interest of insiders or any related parties, and obtaining special advantages or favoritism from others based on roles in, or relationships with, System institutions) without interfering with the relationships between associations and third parties, without deterring “farmer- and rancher-borrower participation in the management, control, and ownership”¹ of Farm Credit System institutions, and, importantly, without altering the traditional, and legally supportable, roles of directors, management, and non-management employees; and (2) increase the enforceability, consistency, predictability, and sustainability of appropriate standards of conduct, without which there would not be any best practices to follow. However, as set forth more fully below, the proposed Standards of Conduct rule does not further the goals or increase the clarity of the governing standards of conduct but, rather, increases the burden on associations, including their directors, employees, Standards of Conduct officials, and agents/contractors of associations without any appreciable benefit, adds uncertainty in the rule’s application, creates a lack of predictability in its enforcement, and appears to represent an expansion of the scope of standards of conduct beyond that which is found in any other Federal banking regulation or common law corporate governance. For these and other reasons, Lone Star makes the following specific comments and suggestions regarding the proposed rule, which Lone Star hopes will assist the FCA in furthering its objectives of clarifying and strengthening the current standards of conduct.

¹ See, *e.g.*, 12 U.S.C. § 2001(b) (Policy and Objectives of the Farm Credit Act).

Specific Comments

12 CFR § 612.2130 (Definitions)

The proposed definitions of “controlled entity,” “family,” and “employee” are overbroad, vague, and ambiguous and, as such, may be difficult to apply in practice. For example, in the definition of “controlled entity,” the current and proposed threshold of 5% of the equity or voting stock in an entity is not reflective of what a reasonable person would consider a controlling interest. Further, such a low threshold results in a needless increase in the time a Standards of Conduct official must spend reviewing insignificant matters. Therefore, Lone Star believes that this definition should be revised to raise the 5% threshold appearing in subparts (1) and (2) of the “controlled entity” definition to a level that would include only those entities that an ordinary, reasonable person would consider to be controlled by the applicable director or employee (*e.g.*, 25% or 33%).

Likewise, the proposed definition of “family” is overbroad, vague, and ambiguous. In particular, including “anyone whose association or relationship with the director or employee is the equivalent of the foregoing” in the definition of “family” may lead to inconsistency, unpredictability, and difficulty in the interpretation, application, and enforcement of the definition. Attempting to add non-traditional relationships that are non-formal or not legally recognized puts a burden on the Standards of Conduct official and the association to determine the degree to which romantic or co-habitation arrangements should be disclosed and to investigate the nature of such arrangements. This could have unintended and embarrassing consequences for employees and may create a perception of discrimination or disparate treatment. Further, the current rule already captures most “non-traditional” relationships (*e.g.*, same-sex spouses and adopted children). Therefore, for at least these reasons, Lone Star believes that “anyone whose association or relationship with the director or employee is the equivalent of the foregoing” should be stricken from the definition of “family.” Lone Star further suggests that the definition of “family” be limited to those persons living in the same household as the director or employee, which is consistent with other sections of the proposed rule, in order to eliminate distant and non-material relationships from the definition.

The proposed definition of “employee” is equally vague and ambiguous. In particular, rather than clarifying that the definition includes non-salaried employees such as hourly wage earners, the proposed definition causes confusion regarding whether contract employees, *e.g.*, fall under the definition of “employee” or “agent” or neither. Lone Star suggests that the definition of “employee” be revised to include only officers or part-time, full-time, contract, or temporary employees, without the distinction between salaried and non-salaried employees. Lone Star further suggests that the inclusion of temporary employees be limited to those temporary employees whose tenure is expected to be longer than 6 months in order to lessen the expense and burden caused by including all temporary employees in the definition of “employee” (*e.g.*, interns).

12 CFR § 612.2165 (Code of Ethics, Policies, and Procedures)

Proposed section 612.2165(c) allows a Board to adopt policies and procedures that allow for case-by-case exceptions to: (1) conflicts of interest requirements under section 612.2136; (2) reporting requirements under sections 612.2140 and 612.2150; (3) the employee prohibition on serving as an officer or director of a non-System entity under section 612.2155(a)(4); (4)

restrictions on an employee serving jointly at a bank and an association as set forth in section 612.2157; (5) prohibitions on sharing information under sections 612.2145(a)(2) and 612.2155(a)(2); and (6) the 5% threshold for defining a “controlled entity” under section 612.2130. While the ability to propose exceptions may be beneficial to institutions (*e.g.*, institutions can define what is “material”), the exceptions adopted by the Board are subject to FCA examination without the opportunity for guidance or input beforehand, which mitigates against any benefit to institutions. *See* proposed 12 CFR § 612.2165(e) (providing that the FCA may take “appropriate action against any institution, director or employee who or that has entered into any transaction for the purpose of evading the requirements of this part”); proposed 12 CFR § 612.2165(f) (providing that, notwithstanding any exceptions that may be authorized or approved under section 612.2165, the FCA may find that a particular financial interest, transaction, relationship, or activity constitutes a conflict of interest or the appearance of such a conflict). Additionally, creating a method for institutions to adopt exceptions to certain of the rules, and allowing for the retroactive review (and reversal) of such exceptions by the FCA, unnecessarily complicates the Standards of Conduct rule and all but eliminates consistency among institutions and predictability of enforcement. Simplicity, clarity, consistency, and predictability are necessary components to the FCA’s goal of increasing “best practices” among institutions and achieving transparency (which is achievable under the current regulations), and Lone Star believes that allowing institutions to adopt case-by-case exceptions that the FCA can retroactively reverse will hinder the FCA in reaching this goal. It is also likely that this rule, as proposed, may make it almost impossible for institutions to train its employees and directors on “best practices” (and, likewise, for the FCA to enforce “best practices” as it proposes to do).

Notwithstanding the above, if the FCA is going to permit case-by-case exceptions that it can review after the transaction at issue is complete, then the FCA’s ability to take “appropriate action” should be limited only to future transactions. Additionally, institutions should have the ability to appeal (without fear of reprisal) an FCA determination that a particular financial interest, transaction, relationship, or activity constitutes a conflict of interest or the appearance of such a conflict notwithstanding an exception approved by the Board.

Last, proposed section 612.2165(b)(2)(i) requires that the Board establish policies and procedures that include the authority and responsibility of the Standards of Conduct official to review all loans before the supervisory bank approves the loans as required by 12 CFR §§ 614.4460 and 614.4470. The current regulations, however, already provide for a mechanism for the referenced loans to be reviewed. It is unnecessary (and inefficient) to have the Standards of Conduct official review such loans in advance of the supervisory bank as proposed and only serves to increase the work to be performed by the Standards of Conduct official, who is proposed to be an officer of an association. Further, the Standards of Conduct official may not necessarily be a credit officer, *e.g.*, and, as such, may not have the requisite qualifications or expertise to review loans as this rule proposes. Therefore, Lone Star believes that the requirement set forth in proposed section 612.2165(b)(2)(i) should be stricken in its entirety.

12 CFR § 612.2135 (Responsibilities and Conduct)

Proposed section 612.2135(b) requires that directors and employees observe “all applicable local, state, and Federal laws and regulations and policy statements, instructions, procedures, and guidance of the Farm Credit Administration.” While the current rule already includes policy statements, instructions, and procedures, adding “guidance” expands the scope of the rule (which was already overbroad) and increases the risk that non-binding positions will be elevated to the equivalent of a statute, regulation, or other law, *e.g.*, without going through the

proper process of becoming law. *See* Administrative Procedures Act (“APA”), 5 U.S.C. § 553 (notice, time for comment, and publication in *Federal Register* required before regulation can be implemented); *Safe Air for Everyone v. U.S. Envtl. Prot. Agency*, 488 F.3d 1088, 1098 (9th Cir. 2007) (“[T]he APA mandates that agencies provide interested parties notice and an opportunity for comment before promulgating rules of general applicability. [I]f permitted to adopt unforeseen interpretations, agencies could constructively amend their regulations while evading their duty to engage in notice and comment procedures.”) (emphasis added). Not only does elevating informal guidance (in addition to policy statements, instructions, and procedures) to the equivalent of a binding legal requirement subvert the purpose of the APA, it is also inconsistent with the Office of Management and Budget’s *Final Bulletin for Agency Good Guidance Practices*, 72 Fed. Reg. 3432 (Jan. 25, 2007) (the “Bulletin”).

Specifically, the Bulletin notes that agency guidance should not be “improperly treated as legally binding requirements” and that “[t]he courts, Congress, and other authorities have emphasized that rules ... which establish new policy positions that the agency treats as binding must comply with the APA’s notice-and-comment requirements.” *Id.* (emphasis added). Additionally, requiring institutions to observe “policy statements, instructions, procedures, and guidance” with regard to standards of conduct introduces ambiguity into the rule and is likely to result in inconsistency among institutions (*e.g.*, as a result of non-public or verbal “guidance” of which only some institutions may be aware) and regulation by examination (*i.e.*, informal opinions by examiners that might carry the effect of regulation), making compliance almost impossible. Last, adding “guidance” to section 612.2135(b) may also have the unintended consequence of discouraging institutions from seeking the FCA’s guidance for fear that it could subject them to additional requirements for which penalties could be assessed. Therefore, for at least these reasons, “policy statements, instructions, procedures, and guidance” should be removed from proposed section 612.2135(b).²

12 CFR § 612.2136 (Conflicts of Interest)

Proposed section 612.2136 includes “agents” and “consultants” among the group of persons who must avoid conflicts of interest. In particular, the new, proposed rule provides, among other things, that agents and consultants, as well as directors and employees, must avoid conflicts of interest and disclose any conflicts of interest to the Standards of Conduct official. Additionally, the proposed rule provides that, in certain circumstances, agents and consultants must disclose to the “official or the board” all material non-privileged information relevant to the matter in which the agent or consultant has a conflict of interest, refrain from participating in the official action or Board discussion regarding the matter, and refrain from voting on the matter, as applicable. *See* proposed 12 CFR § 612.2136. “Agents” and “consultants” should be removed from the auspice of section 612.2136 because requiring agents and consultants to disclose matters that “may present a conflict of interest or the appearance thereof” and “material non-privileged information relevant to the consideration of the matter” is impractical to implement and may cause certain agents and consultants (including vendors) to cease doing business with or performing services for System institutions.

First, institutions simply do not have the ability to control, enforce, or manage agents and consultants as the proposed rule seeks to require. Rather, agents and consultants are often subject to state law and/or other rules of professional responsibility, which address conflicts

² Lone Star’s proposed change would still require directors and employees to observe “all applicable local, state, and Federal laws and regulations,” which is enforceable and consistent with the APA and applicable authorities.

while allowing the agent/consultant to preserve confidences as required by law. Lawyers, for example, are subject to professional rules of responsibility, which govern conflicts of interest and allow for certain engagements to proceed, despite an actual or potential conflict, as set forth in those rules. Not only will proposed section 612.2136 be difficult to enforce by the institutions with respect to agents and consultants, but proposed section 612.2136 may unjustifiably expand the professional or ethical standards under which some agents/consultants operate and/or may impair an agent's or consultant's ability to represent or work with a System institution, thus, making an institution's ability to engage qualified and competent legal counsel, *e.g.*, more difficult if not impossible.

Likewise, expanding coverage of this rule to agents and consultants will be overly burdensome and nearly impossible for institutions to achieve compliance. Many individuals and entities provide advice to and perform services for various System institutions as well as to companies that do business with or borrow from such institutions. Requiring a disclosure or conflict check for these (non-attorney) individuals and entities may result in institutions not having access to some of such critical resources (*e.g.*, because the individuals or entities will not release the required information to the institution), create a supervisory burden for the Standards of Conduct official that will unnecessarily divert his or her time and attention away from other important matters, and/or delay an institution's ability to get timely assistance, which may be critical in order to avoid a loss to the institution. For example, if an institution learned that its collateral was being converted and injunctive relief was needed on an immediate, *ex parte* basis, then the institution may have to obtain Board approval before retaining counsel under the proposed rule depending on that counsel's relationship with the institution and/or other System institutions. Such a process would put the association in the untenable position of choosing between either violating a Standards of Conduct rule or suffering a loss as a result of delaying (if not precluding) the association's ability to obtain the immediate relief it needs under exigent circumstances.

Last, proposed section 612.2136 also requires that any person who has a conflict of interest automatically "refrain from participating in the official action or board discussion of the matter, activity[,] or transaction." Proposed 12 CFR § 612.2136(b)(2). Lone Star believes, however, that recusal should continue to be determined by the Standards of Conduct official on a case-by-case basis and, therefore, suggests that the proposed section 612.2136 be withdrawn.

12 CFR §§ 612.2145 & 612.2155 (Prohibited Conduct for Directors and Employees)

Lone Star generally agrees with the prohibitions set forth in sections 612.2145(a) and 612.2155(a); however, the exceptions set forth in sections 612.2145(b)(3) and (4) and 612.2155(b)(4) and (5) are too restrictive. In particular, the requirements in sections 612.2145(b)(3)(ii) and (3)(iii) and 612.2155(b)(4)(ii) and (4)(iii) as they relate to personal property are difficult, if not impossible, to implement in practice. Most (if not all) directors and employees of institutions do not have the information or resources readily available that would be necessary to determine whether the personal property they seek to purchase was owned by the institution within the last 12 months. This problem is exacerbated in large institutions whose territory spans several counties, several hundred miles, or several states. Further, it is unlikely that there could be sufficient time or information available to the Standards of Conduct official to determine, *prior to the sale*, whether a particular auction is open to the public and has competitive bidding or that the director or employee does not have an advantage over other bidders. In reality, directors and employees often do not know what auctions they will be attending days in advance, and Standards of Conduct officials will not always be available at a

moment's notice. Further, without written information to investigate and serve as documentation, the Standards of Conduct official cannot make a fully informed and documented determination as required by the proposed rule.

Additionally, with respect to the restrictions set forth in sections 612.2145(b)(4)(iii) and 612.2155(b)(5)(iii), it is often impractical (or impossible) for a director or employee to obtain approval from the Standards of Conduct official prior to entering into a transaction that would otherwise be prohibited under section 612.2145(a)(7) or section 612.2155(a)(8), as applicable, but that is in the ordinary course of business, *e.g.*

Placing these types of restraints on directors, employees, and Standards of Conduct officials will hinder directors and employees from being able to make timely, prudent, and critical purchases of personal property, which may serve as a disincentive for qualified persons to serve as directors or remain employed with the institution and which may harm the institutions. Additionally, the requirement for pre-approval (and not allowing for ratification after the fact) under sections 612.2145(b)(3)(iii) and (4)(iii) and 612.2155(b)(4)(iii) and (5)(iii) could impair commerce and interfere with the ordinary course of business, not all of which could be anticipated in advance and not all of which may be covered by a policy or procedure. *See* 12 CFR § 612.2165 (allowing for the Board to adopt exceptions to certain Standards of Conduct rules in policies and procedures). The current rule successfully achieves the standards of conduct objectives with regard to the transactions at issue. To the extent any modifications are made, proposed sections 612.2145(b)(3) and (4) and 612.2155(b)(4) and (5) should be revised to allow the Standards of Conduct official to retroactively ratify or approve a transaction, which would greatly reduce the burden on directors and employees with respect to transactions made in the ordinary course of business and would provide a remedy for situations where a director or employee learned of a fact after the transaction was completed that made a transaction subject to reporting requirements, *e.g.*

12 CFR § 612.2160 (Institution Responsibilities)

Proposed section 612.2160 requires, among other things, that each institution ensure compliance with the Standards of Conduct rule by its “directors, employees, and agents...” Proposed 12 CFR § 612.2160(a). Lone Star agrees that institutions should expect compliance with applicable regulations and other laws by its directors, employees, and agents; however, requiring that System institutions (presumably through its Standards of Conduct official) *ensure* compliance is burdensome and impossible to achieve. While the Standards of Conduct official can conduct training and provide information to institution directors, employees, and agents, *e.g.*, it is simply not possible for the Standards of Conduct official or System institution to *ensure* full and complete compliance with the rule, especially with respect to an institution’s agents. The role of the Standards of Conduct official should not be that of enforcement; rather, the Standards of Conduct official’s role should be to educate, inform, investigate, and take appropriate action with regard to the Standards of Conduct rule and any violations thereof. Perhaps most importantly, neither the institution nor its Standards of Conduct official should be held responsible for violations of directors, employees, or agents. This shift of responsibility from individual directors, employees, and agents to System institutions and Standards of Conduct officials, and the possibility that the institution and/or its Standards of Conduct official could be held liable for violations of directors, employees, or agents, will likely lead to difficulties in finding individuals willing to serve as the Standards of Conduct official.

Second, proposed section 612.2160(a)(3) requires that institutions notify the FCA immediately of any known or suspected material Standards of Conduct violations. *But see* proposed 12 CFR § 612.2170(b)(7)(iii) (requiring the “prompt” reporting of known or suspected standards of conduct violations). This proposed provision is troublesome for at least four reasons. First, *suspected* violations simply should not be required to be reported to the FCA as proposed; institutions need sufficient time to conduct due diligence and should only be required to report violations after the institution has determined an actual violation has occurred. Second, no definition of “material” is provided. Third, proposed section 612.2160(a)(3) appears to conflict with proposed section 612.2170(b)(7)(iii) (*i.e.*, immediately vs. promptly). In this regard, Lone Star suggests that this proposed section be revised to only require that institutions notify the FCA *promptly* of any known material standards of conduct violations and to provide a definition of “material” that is consistent with common law norms or other definitions of materiality, which would minimize the level of regulatory burden on institutions while maintaining the intent of the disclosure process. Last, the proposed rule, as written, would have negative implications on the attorney-client privilege and any other communications or relationships protected by law, *e.g.* In particular, the disclosure of privileged information to the FCA (*i.e.*, a third party) could be construed as a waiver of privileges or confidences that are otherwise protected under applicable law. Therefore, Lone Star suggests that the rule be revised to clarify that System institutions are only required to report non-privileged information to the FCA.

As for section 612.2160(d), which would require that each institution remain informed of all “applicable industry approved best practices for standards of conduct,” the proposed rule should be withdrawn because “best practices” are goals to be achieved and not rules to be enforced and because best practices can change over time. The proposed rule is simply not practical and cannot be readily applied by any System institution let alone consistently enforced or examined by the FCA across the System, especially given the various differences among institutions (*e.g.*, it is unclear in the proposed rule which practices are at issue, who determines the best practices, and when and how are institutions made aware of what the best practices are). Accordingly, this subsection should be removed from the proposed rule in its entirety for at least these reasons.

Last, the requirement in proposed section 612.2160(f) that institutions (1) have documentation that agents are subject to applicable industry or professional ethics standards or (2) obtain certifications from agents that they will adhere to the institution’s Code of Ethics creates a compliance burden with no appreciable benefit to the System or its institutions. System institutions should be able to reasonably rely on an agent’s good standing with his or her licensing board, *e.g.*, without having to retain documentation or obtain certifications to that end.

12 CFR § 612.2180 (Standards of Conduct for Agents)

Proposed section 612.2180(b) requires agents who represent a System institution in contacts with third parties or who provide professional or consultant services to review and acknowledge receipt of the employing institution’s Code of Ethics. Additionally, agents must certify that they will follow their professional or industry ethics standards or that they will follow the institution’s Code of Ethics provisions applicable to agents. The proposed rule further provides that institutions are responsible for their agents and “must take appropriate investigative and corrective action in the case of a breach of fiduciary duties...” Proposed 12 CFR § 612.2180(b). These requirements, while well-intentioned, impose burdens on agents by requiring them to review and acknowledge a Code of Ethics, which may exceed the rules of

professional responsibility or other applicable standards, *e.g.*, or put agents in a position of breach where no such breach opportunity would otherwise exist. Further, the requirement that a System institution be responsible for its agents and/or take certain action with regard to its agents imposes burdens on the institution that may not otherwise exist at law and/or interferes with the relationship between the agent and the institution. Notably, it does not appear that any other financial regulatory agency has a similar requirement for its agents or reaches this far into the relationships between regulated institutions and third parties, especially those relationships that are privileged or otherwise protected by law.

Additionally, proposed section 612.2180(d) prohibits an agent from “knowingly acquir[ing], directly or indirectly, ... any interest in real or personal property, including a mineral interest, that was owned by the System institution ... as a result of a foreclosure or similar action during the agent’s employment” for one year after the institution transfers the property or one year after the agent’s termination, whichever occurs first. Not only would this rule be difficult (if not impossible) for an institution to enforce (especially after the institution sells the property at issue and/or the agent is no longer engaged by the institution), but, much like proposed section 612.2136, the breadth of this proposed rule could be a deterrent for those individuals or companies that would otherwise want to perform services for System institutions. Notably, this provision is inexplicably *more* restrictive than the similar provisions applicable to directors and employees as it applies to *all* agents regardless whether the agent was involved in the acquisition of the property by the association or whether the agent had access to any inside information regarding the property and it may apply after the agent’s engagement has ended. *Compare* 12 CFR §§ 612.2145(b)(3) & 612.2155(b)(4) (providing an exception for directors and employees who do not participate in a decision to foreclose on or dispose of the property or set the terms of the sale). Moreover, there does not appear to be a benefit gained by the System or its institutions by prohibiting an agent of an institution from acquiring property from a third party where that property was owned by the institution within the past year or restricting an agent’s purchase of property after his or her engagement has terminated. Once the property is sold or transferred by the institution to a third party as permitted by applicable law, the property (and to whom it is subsequently transferred or sold) is no longer under the institution’s control and, therefore, its disposition or acquisition should not be subject to FCA regulation. Likewise, FCA regulations should not restrict purchases of property by third parties for the sole reason that such third parties were previously engaged by a System institution. Therefore, for at least these reasons, Lone Star suggests that the proposed rule be revised so that it only prohibits an agent from acquiring any interest in real or personal property *directly* from the System institution where the institution acquired the property as a result of a foreclosure or similar action during the agent’s engagement. Further, this limitation should only apply for so long as the agent is engaged by the institution who acquired the property at issue. Alternatively, and at a minimum, the proposed rule should be revised to except agents who had no involvement in the institution’s acquisition or disposition of the property (*e.g.*, partners or associates at a law firm who had no involvement with the transfer even though one of the lawyers may qualify as an agent under the proposed rule).

12 CFR § 612.2170 (Standards of Conduct Official)

Proposed section 612.2170(a) requires that the Standards of Conduct official be an *officer* of the System institution. However, in light of the increased burden that would be placed on the Standards of Conduct official under the proposed regulations, and/or based on the size or needs of the institution, an institution should be able to select its Standards of Conduct official from among the institution’s officers, employees, *and* outside agents as long as he or she is qualified

to perform the role competently. There is no reason why the Standards of Conduct official must be an officer (as opposed to an employee or outside agent) of the institution in order to perform his or her job effectively, nor is there any appreciable benefit resulting from such a requirement. Therefore, Lone Star believes that this requirement should be removed from the proposed rule.

Next, proposed section 612.2170(b)(8)(iii) requires the Standards of Conduct official to investigate all “complaints” received against directors, employees, and agents of the institution. The term “complaints” is overbroad and, as such, could be construed to include customer service complaints, *e.g.*, regarding a particular employee or other complaints directed at performance rather than ethical behavior, which should be addressed by the employee’s supervisor or management and not the Standards of Conduct official. Therefore, Lone Star believes that section 612.2170(b)(8)(iii) should be revised to limit “complaints” to those related to an actual or purported violation of the standards of conduct rule.

Last, proposed section 612.2170(b)(7) appears to require the Standards of Conduct official to file all criminal referrals and reduces the time period within which referrals should be made (*i.e.*, promptly). Compare 12 CFR § 612.2301(a) (providing that the *institution* shall make a referral within *30 calendar days*). While certain matters may need to be reported as soon as possible, mandating a timeframe that is inconsistent with the referral regulations and that does not contemplate investigation time is problematic. Further, the Standards of Conduct official should not be required to make criminal referrals; rather, the institution is in the best position to determine who should make criminal referrals on its behalf. See also proposed 12 CFR 612.2170(b)(8)(i) (requiring the Standards of Conduct official, rather than the institution, to investigate possible violations of criminal statutes).

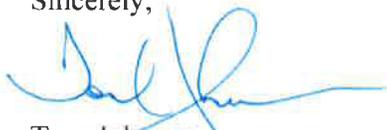
Conclusion

Lone Star believes that, by and large, those involved in the Farm Credit System exhibit high moral and ethical standards, which is shown by the reputation of the Farm Credit System and which reflects the soundness and effectiveness of the current Standards of Conduct regulations; thus, Lone Star does not believe it is necessary to re-write the current rule or alter the relationships between the association and third-parties or the traditional roles of directors, management, and non-management employees, which relationships and roles are consistent with current common law and other industry norms and guidelines. The violations of the current regulations can be addressed through proper enforcement of the regulations by the FCA rather than an expansion of the rules, which proposed rules re-assign roles of directors, management, non-management employees, and agents in ways that are inconsistent with the common law, industry norms, and guidelines and are not found in any other Federal banking regulation or notion of corporate governance – all without the benefit of furthering the historical purpose and goals of standards of conduct. The current regulations, by comparison, appropriately balance the goals of safety and soundness without discouraging the necessary involvement of qualified, competent directors, employees, and agents in the System. The proposed rule, on the other hand, threatens to discourage involvement of such persons in the System due to the increased burdens and uncertainties created by the proposed rules, which proposed rules conflict with other authorities and, in many cases, are overreaching, vague, and ambiguous and will likely only lead to confusion and inconsistency in implementation and enforcement. In short, the proposed rules will ultimately hinder the FCA’s goal of increasing “best practices” among institutions.

For at least the reasons included in this comment, and for the reasons set forth in the comments made by the Farm Credit Bank of Texas and the Farm Credit Council, Lone Star respectfully requests that the FCA withdraw the proposed Standards of Conduct rule or substantially minimize and revise any proposed changes to the current regulations consistent with this comment.

Thank you for your consideration and review of Lone Star's comment. If the FCA has any questions regarding this comment, or if Lone Star can be of any further assistance to this process, then please let us know.

Sincerely,



Tom Johnson
Chairman of the Board of Directors
Lone Star, ACA

Sincerely,



Troy Bussmeir
Chief Executive Officer
Lone Star, ACA

Sincerely,



Stephanie E. Kaiser
Exec. VP / General Counsel
Lone Star, ACA