



June 17, 2014

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

RE: Proposed Rule on Standards of Conduct – RIN 3052–AC44
Federal Register 79 (February 20, 2014) 9649-9661

Dear Mr. Mardock:

Northwest Farm Credit Services (Northwest FCS) appreciates the opportunity to provide comments on the Farm Credit Administration's (FCA) proposed rule regarding standards of conduct. Standards of conduct and ethical business practices are very important to the Farm Credit System. We hope that our comments provide perspective to the FCA that will result in a final rule that is practical and workable. Our comments have been developed in coordination with other System institutions. We also support and endorse the comments being submitted by the Farm Credit Council on behalf of the entire System.

Overall Comments

Northwest FCS finds portions of the proposed rule to be burdensome and problematic. While we appreciate the FCA's intent to clarify and strengthen the regulations in this area, we feel this goal can be better achieved through a more workable and pragmatic approach. The proposed approach provides serious disincentive for qualified individuals who wish to serve as directors and inappropriately shifts the responsibility and accountability for ethical behavior from individuals to their institutions via the standards of conduct official.

The level of scrutiny placed upon directors through requiring pre-approval of ordinary course of business transactions in the proposed rule has the potential to greatly decrease interest in serving as a director for a System institution. The most qualified potential directors might be put off by prescriptive and burdensome requirements. This disincentive could have serious implications on individual institutions and the System, as a whole.

We are concerned that the proposed rule, in its current form, necessitates the standards of conduct official's role to be that of an all-knowing enforcement official. In this new role, the standard of conduct official must investigate the backgrounds of all individuals continuously, in order to attempt to ensure compliance with the proposed requirements by individuals (see proposed §612.2160(a)). This proposed regulatory standard seems nearly impossible to meet. It is also challenging, considering the standards applied to other regulated financial institutions and the government itself.

The standards of conduct officials and their institutions should only be responsible for administering the standards of conduct program and addressing ethical violations in an effective manner. They should not be held accountable for regulatory ethical and conduct violations of the individuals they employ, absent some clear deficits in their standards of conduct programs. The proposed rule sets up institutions and their standards of conduct officials for failure. We see this result as contrary to what is working well, under existing regulations. Today, the standards of conduct officials are resources who work in tandem with employees, directors, and agents to better the institution and the System through the effective management of conflicts of interest and assistance in compliance with regulatory requirements.

The shift in the proposed rule from individuals being accountable for their conduct to institutions being accountable is troubling. The approach is problematic and it is out of step with well-established industry best practices. Currently, employees and directors are responsible for making disclosures and standards of conduct officials help manage identified potential conflicts of interest. If an employee or director fails to make appropriate disclosures or engages in a conflict matter, the standards of conduct official completes an investigation and takes appropriate action. The proposed rule moves away from this highly effective business practice and places standards of conduct officials in an untenable position of being responsible and accountable for the quality and accuracy of individual disclosures.

We find certain provisions of the proposed rule to be unworkable from a practical standpoint and unique in the financial services industry. Some of the provisions concerning the treatment of "agents" make full compliance with the proposed rule extremely difficult in today's marketplace. We believe that the FCA can accomplish its objective in this area, while allowing for a workable approach that is more consistent with market standards. We ask the FCA to revise the proposed rule to make it effective and manageable for institutions. This can be accomplished through minor changes in the proposed rule's language and still strengthen requirements in an appropriate manner. More detailed section-by-section comments follow.

Section-by-Section Comments

§612.2130 Definitions

The proposed rule provides a definition for the term "**agent**." This definition is vague, both as it relates to individuals and entities that represent a System institution in contacts with third parties and to providers of other professional services similar to legal, accounting and appraisal services. "Agent," under this definition, could include individuals and entities such as underwriters of preferred stock, ratings agencies, administrative agents in syndicated loan transactions, providers of information technology services, contract employees provided by temporary employment agencies and consultants, among others. It is unclear, from the definition, who the FCA intends to capture by the requirements concerning agents. We recommend the definition be clarified and include examples of the types of individuals and entities that constitute "agents."

The proposed rule's definition of "**controlled entity**" or "**entity controlled by**" sets a five (5) percent ownership or voting control threshold that is not appropriate for the term "control." We suggest the term be changed to "disclosable interest," while the definition remains the same, due to the importance of this concept for standards of conduct. This change is needed to avoid confusion with terms "controlled entity" or "entity controlled by" used elsewhere in the regulation or commonly for other purposes, such as attribution or financial reporting.

It is unclear from the definition of "**employee**" whether contract employees are considered employees, or if they require a separate definition. Further, the definition could be clarified by striking "salaried" and "any non-salaried employee who receives a wage" so that it reads "any part-time or full-time employee."

The newly inserted language in the definition of "**family**" ("anyone whose association or relationship with the director or employee is the equivalent to the foregoing") is open-ended and should be removed. If this added language is attempting to be inclusive of domestic partnerships, common-law spouses, adopted children or other relationships, those should be explicitly included in the definition. Alternatively, other sections of the proposed rule refer to "any relative or person residing in the director's (or employee's) household." We find that "anyone whose association or relationship...is the equivalent of the foregoing" would have already been captured by this requirement and therefore makes the newly inserted language unnecessary.

The proposed rule's definition of "**material**" is vague and is open to various interpretations by different System institutions. Given the tremendous disparity in size among System institutions, it is appropriate to have different definitions for "material." The new rule should make it clear that each System institution should be given broad latitude in identifying what is material for it.

§612.2135 Responsibilities and Conduct

We have grave concerns regarding the phrase "policy statements, instructions, procedures, and guidance" in paragraph (b) of this section. Policy statements, instructions, procedures, and other guidance should never be given the same weight and authority as regulations. This language circumvents the notice and comment process and runs contrary to the intent of the Administrative Procedures Act. The use of "guidance" in this section is ambiguous and makes full compliance with this section virtually impossible. Institutions should not be expected to speculate whether something is considered guidance by the FCA's definition and the FCA should not establish requirements that circumvent clear administrative standards relating to regulatory and supervisory practice. Northwest FCS strongly maintains that the phrase "policy statements, instructions, procedures, and guidance" is inappropriate, problematic and should be stricken, in its entirety, from the final rule.

§612.2136 Conflicts of Interest

Northwest FCS has serious concerns with the requirements that directors, employees, agents, consultants, etc. must report "conflicts of interest" to the standards of conduct official, as stated in this section of the proposed rule. The preamble provides the example of a director purchasing a combine harvester from a known borrower and states that such a transaction should be immediately reported to and reviewed by the standards of conduct official. We disagree that such a transaction, which occurs in the ordinary course of business, should be considered a "conflict of interest."

We find the requirement that such "conflicts of interest" be reported to the standards of conduct official and that the standards of conduct official then somehow review and rule on the proposed transaction to be overly burdensome requirements and, more importantly, to have the potential to provide a disincentive for qualified individuals to serve as Farm Credit directors. Directors of Farm Credit institutions need the flexibility to manage their operations without having the standards of conduct official inserted into day-to-day transactions. It contravenes the structure and purpose of cooperatives, where by definition financial transactions among members is the norm and appropriate. There is also no logical support for the proposed prior approval process.

Inclusion of these transactions in the employees' and directors' existing reporting on a post-transaction basis meets the FCA's goal of having employees and directors take ownership for their own ethical responsibilities. Directors at most System institutions, no longer participate in the loan approval process, unlike the past, which significantly reduces the potential for a conflict of interest and the need for approval prior to each individual transaction.

The extension of this section to "consultants who provide expert or professional services to the System institution" is problematic. Adding "consultants" compounds the already existing confusion around the definition of "agent" discussed in the definition section of

the proposed rule. It is unclear to us who, besides agents, is the focus of including "consultants." We ask this language be stricken from the proposed rule in order to provide clarity.

§612.2140 Director Reporting & §612.2150 Employee Reporting

The proposed rule requires directors and employees to report to the standards of conduct official "the name of any relative or any person residing in the director's (or employee's) household, any business partner, or any entity controlled by the director (or employee) or such persons (alone or in concert) if the director (or employee) knows or has reason to know that such individual or entity transacts business with the institution or any institution supervised by the director's (or employee's) institution." We have concerns that a Northwest FCS director or employee may not necessarily know about each and every transaction that the listed individuals and entities might have with Northwest FCS.

Further, whether a director or employee would "have reason to know" about such transactions creates additional confusion and ambiguity. Either a director or employee knows about a given transaction between any of the listed individuals or entities and a Farm Credit institution or they do not. Those transactions that are known by the employee or director should be sufficient for the reporting standards. For these reasons, we ask that the FCA strike the phrase "or has reason to know" from the director and employee reporting sections prior to issuing the final rule.

§612.2145 Directors – Prohibited Conduct & §612.2155 Employees – Prohibited Conduct

The proposed rule requires the standards of conduct official to make written determinations on a case-by-case basis for a director or employee to enter into any financial transaction with another director, employee, agent, borrower, or loan applicant of their institution. We find it unnecessary for a director (or an employee who might have a part-time farming operation) to be required to request documentation from the standards of conduct official prior to making a routine purchase from a local feed store or selling a commodity to their co-op. It is the reality of the small farming communities, in which our directors and employees live and work, that commerce goes on between employees, directors, and member-borrowers. This requirement has the potential to place the standards of conduct official in the middle of dozens of ordinary course of business transactions daily and shifts the standards of conduct official's role to that of an enforcement official. Directors or employees, many of whom run successful operations, would find it difficult to comply with such a burdensome requirement. We ask that the FCA consider including a provision in this section exempting transactions which occur "in the ordinary course of business" from this pre-approval requirement.

The proposed rule requires that these determinations made by the standards of conduct official be renewed annually. This requirement is especially burdensome. Once a determination is made by the standards of conduct official, it should only be required to

be renewed or updated as the circumstances around the determination change, as disclosed by the director. If nothing has changed, then the annual review has no substantive value.

The preamble of the proposed rule prohibits the standards of conduct official from ratifying prohibited conduct after the fact. The director or employee would be considered to have violated the regulation should they enter into a transaction without prior written approval. This does not provide a director or employee incentive to disclose a transaction that occurred in the past and may have been inadvertently overlooked. It creates an untenable situation where disciplinary action would be immediately required, despite the circumstances and intent. This would create a negative "caught you" ethics environment. To strengthen the rule and encourage transparency, the standards of conduct official must have the authority to ratify transactions that have occurred in the past, as they deem appropriate.

§612.2160 Institution Responsibilities

Paragraph (a) of this section requires that each institution must "ensure compliance" with this part. It is challenging to assume that an institution can truly and accurately "ensure" that individuals will comply with any regulation, from a practical standpoint. It is appropriate for an institution to take all necessary steps to ensure compliance including, but not limited to, requiring education on policies to their constituencies and mandating signatures acknowledging such policies. Because an institution cannot fully guarantee compliance by individuals, we find it inappropriate for the regulation to require an institution to "ensure" compliance, therefore holding the institution responsible for the actions of individuals. We ask that the FCA consider revising this paragraph to require System institutions take all necessary steps to effectively ensure they maintain effective standards of conduct programs that support compliance by individuals. This approach ensures that accountability for regulatory compliance is appropriately maintained between the institutions and the individuals, with the institutions accountable for maintaining the programs and the individuals accountable for their own conduct regarding the programs and regulatory requirements.

In paragraph (a)(3), the proposed regulation states that Farm Credit institutions are required to notify the FCA immediately of known or suspected material standards of conduct violations. We find the term "suspected" to be ambiguous and having the potential of being interpreted differently by various parties. Many misunderstandings or misinterpretations could easily be considered a "suspected" violation, but the reporting of such suspected activities, without proper research and proof appears dangerous on several levels. We ask that the FCA remove the phrase "or suspected" prior to issuing a final rule. We also ask that the requirement to notify the FCA "immediately" be changed to "promptly" to be consistent with the language found in Section 612.2170(b)(7) of the current regulations. The FCA should allow System institutions to set some de minimus

standard for reporting to avoid reporting on inconsequential issues, such as delayed updating of a disclosure form.

Further, we have concerns this provision, as currently drafted, would have implications regarding the attorney-client privilege. For example, under the law of many states, the disclosure of privileged information to a third party, such as the FCA in this case, could be deemed as a waiver of the attorney-client privilege between the institution and its legal counsel. It is inappropriate to require an institution to waive such a privilege. We believe that the regulation should be adjusted to clarify that only non-privileged information is required to be reported to the FCA in these circumstances.

Northwest FCS has concerns regarding the requirement that third party agents not subject to industry or professional ethics standards must certify adherence to the Northwest FCS' Code of Ethics. We do not find this requirement to be market standard for either publicly-traded companies regulated by the Securities and Exchange Commission (SEC) or other financial services institutions regulated by federal banking regulators. As a mission-based lender, Northwest FCS makes it a priority to contract the most qualified agents available. We are concerned that this requirement could have the unintended consequence of limiting the number of agents willing to work with Farm Credit institutions. As the agent realizes no benefit in agreeing to such certification, not to mention that any legal implications would be unprecedented, we fear that many agents would be unwilling to offer their services to Farm Credit institutions, thereby decreasing the pool of qualified service providers and quality of available services, which increases risk and potential cost for the Farm Credit System. This provision is overreaching and burdensome. We request the FCA to revise the provision to permit customary business practices with agents that address conflict, conduct, and confidentiality within contractual agreements.

If the mandate of imposing individual System institutions' cultural codes into their agents is deemed necessary, the FCA should also provide a grandfather provision for existing contracts and not impose unique or non-uniform requirements that are not consistent with well-established legal standards. The time and resources required to get all existing contracts updated with the added requirement around a Code of Ethics certification could be extremely extensive. For this reason, we ask that the FCA consider a grandfather provision for all contracts entered into prior to the effective date of the final rule.

Given the numerous implications in the standards of conduct regulations for agents, we ask that the FCA consider revising the final rule so the provisions pertaining to agents are consolidated in a single section. We find it would be unduly burdensome for agents to be expected to review the standards of conduct regulations in their entirety in order to identify the applicable provisions.

§612.2165 Code of Ethics, Policies, and Procedures

The proposed rule requires the board to "establish criteria for business relationships and transactions not specifically prohibited by this part." This language is vague and potentially applicable to any type of business transaction or relationship that could conceivably take place. It is difficult to expect a Farm Credit institution to come up with criteria for every business relationship or transaction that could potentially transpire. We ask that the FCA remove this requirement prior to issuance of a final rule or, alternatively, clarify its intent.

Paragraph (b)(2)(i) of this section assigns the standards of conduct official the responsibility to review all loans under Sections 614.4460 and 614.4470 for compliance. Often, the standards of conduct official may not be the most appropriate person in an institution for such an undertaking. There could conceivably be many instances where the standards of conduct official is not someone with the technical expertise or knowledge of terms, interest rates, or other relevant information necessary for such a role. It would be appropriate for the standards of conduct official to have the authority to delegate this responsibility to a designated loan committee or another individual whose role is more aptly suited for such a responsibility. We ask that the FCA make this delegation authority clear, prior to issuing a final rule.

We appreciate that individual institution's boards of directors are granted the authority to consider case-by-case exceptions to conflicts of interest requirements. This authority is appropriate and reflective of good governance principles. We note, however, that paragraph (f) of this section grants the FCA the right to find that "a particular financial interest or transaction, relationship or activity constitutes a conflict of interest or an appearance of a conflict of interest" therefore making the exception process essentially useless. We ask that the FCA consider, at a minimum, codifying what would constitute the overruling of such an exception by the FCA. This would assist boards of directors as they develop their policies.

Finally, we find the entire section overly prescriptive. It is unnecessary to enumerate in such specificity all of the various policy issues that must be addressed. The result is a rule that will be inflexible and quickly become obsolete. We ask the FCA reduce the prescriptive and excessive detailed requirements from this provision.

§612.2180 Standards of Conduct for Agents

This section states that an agent "may not knowingly acquire, directly or indirectly, except through inheritance, any interest in real or personal property, including a mineral interest, that was owned by the employing institution or any supervised or supervising institution as a result of foreclosure or similar action during the agent's employment" for one year after the transfer of the property or after termination of the agency relationship. The restriction should specify that it only applies to transactions in which the agent directly participated in the deliberations or decision to foreclose or take similar action.

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As written, this restriction is too broad and it would be very difficult for an agent to know whether Northwest FCS had any prior ownership interest in a particular property and nearly impossible to know if the supervising institution had any prior ownership interest.

Thank you again for allowing Northwest FCS the opportunity to comment on this important proposed rule. We hope that these comments have provided the FCA with some perspective on how the proposed rule would affect the System from a practical standpoint. As previously noted, we find this topic to be very important and look forward to working with the FCA to ensure a workable final rule. Please contact me if you wish to discuss our comments or require additional information in support of our comments.

Sincerely,

A handwritten signature in black ink, appearing to read 'P. DiPofi', written in a cursive style.

Phil DiPofi

President & CEO

Northwest Farm Credit Services