



June 18, 2014

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

Re: Proposed Amendments to Standards of Conduct Regulations (RIN 3052-AC44)

Dear Mr. Mardock:

AgStar Financial Services, ACA (“AgStar”) appreciates the opportunity to comment on the Farm Credit Administration’s (“FCA”) proposed amendments to the Standards of Conduct regulations found at 12 C.F.R. Part 612. I am submitting these comments on behalf of the Board of Directors and management of AgStar. We appreciate FCA’s efforts to update the Standards of Conduct and support many of the proposed amendments, but we have concerns about some of the proposed changes.

AgStar, like other System institutions, recognizes the need to operate in an ethical manner and is proud of the culture we have created around our Standards of Conduct program. Our board of directors holds itself to very high standards as do our employees. We work hard to make sure that conflicts of interest are understood and real or perceived conflicts are appropriately dealt with whenever they might arise. Our board and team work collaboratively with our Standards of Conduct Official to make sure AgStar continues to be viewed by our stockholders and others as a strong and ethical company.

We have structured our comments to the various amendments by addressing each section of the proposed regulations separately.

A. Definitions §612.2130

### **Controlled Entity**

AgStar urges FCA to reconsider its refusal to update the definition of ‘controlled entity’ to something greater than having a 5% interest in an entity. Put simply, a 5% equity interest in an entity or the ownership of 5% of a class of voting securities in an entity is

not a controlling interest. AgStar encourages FCA to move the threshold to a level more reflective of an ability to exert actual control over the entity. In fact, the best way to address this issue may be to limit the definition to those entities where one had “the power to exercise a controlling influence over management policies.” This language is an inherently a vague standard, but it reflects an ability to direct the operations or decisions made by an entity, which is more indicative of ‘control’ than a particular level of equity ownership in an entity. The controlling interest over management decision may occur as a result of a majority or substantial ownership interest, but there can situations where someone with even a 30% or 40% ownership interest may not have the ability to in fact ‘control’ the operations of the entity. Similarly, given the totality of the circumstances, someone with a very small equity position may have the ability to exert a significant amount of control over an entity.

## **Family**

AgStar is very concerned about the proposal to broaden the definition of ‘Family.’ AgStar contends that the definition is already too broad for the purposes of dealing with real or perceived conflicts of interest and the addition of the clause related to “equivalent” relationship will likely prove unworkable. FCA’s proposed amendment would require System institutions to inquire about and directors and employees to report about cohabitation or other relationships, which many individuals may prefer to not disclose for any number of legitimate reasons. Expanding the already over broad definition will not enhance the reputation of the System or help identify actual conflicts interest. Indeed, the proposed definition is broad enough to likely require an employee to report a relational with a mentor who that treats the employee ‘like a son’ or ‘like a daughter.’ If the mentor provides personal and professional advice, shows care and concern, provides companionship, etc., then reporting may be required. For the purposes of the Standards of Conduct regulations, there is simply no need for this excessively broad definition, and AgStar encourages FCA to abandon the proposed change.

### **B. Director and Employee Conduct, Generally – §612.2135**

FCA’s proposed addition of the phrase ‘and guidance’ §612.2135(b) should not be included in the final rule. The proposed language suggests that System institutions are required to follow the ‘guidance’ of FCA, which likely violates the Administrative Procedures Act.

AgStar certainly appreciates and respects the need to follow the language of the Farm Credit Act and the regulations promulgated by FCA, and we always seek to work collaboratively with FCA’s office of examination. But the reality is System institutions are not required to follow recommendations and other ‘guidance’ from examiners or others in the agency like they are the requirements of the Act and regulations. Even so, AgStar has often agreed to make changes to its practices based on FCA’s recommendations. However, to suggest that System institutions must observe ‘guidance’ provided by the agency puts far too much emphasis on what could be the beliefs of

individual FCA examiners or other employees. FCA should not include the proposed additional language in this section of the regulations.

### C. Conflicts of Interest – §612.2136

#### **Director and Employee Reporting**

AgStar is supportive of the concept of requiring directors and employees to report actual conflicts of interest. That said, the provisions requiring a director, team member, or agent in all cases disclose information regarding conflicts of interest is impractical. It is appropriate for a director or employee to be expected to recuse him or herself from consideration of a matter if they are aware of an actual conflict of interest. However, there may be any number of situations where it would be impractical or inappropriate for the director or employee to disclose information about the situation as the proposed rule suggests. While AgStar directors and employees should not compromise their loyalty to our organization, they also should not be put in the situation of being forced to convey information that may violate a duty or obligation owed to a third party.

FCA seems to recognize this concept by including the limitation that the required disclosure should be of “material, non-privileged information,” but this limitation is too narrow to prove workable. Disclosure of all material non-privileged information should be required if a Director or employee is seeking a waiver from the presumptive recusal requirement. However, if a Director or employee chooses to not participate in any of the discussion or consideration related to a situation where an actual conflict exists and indicates the recusal is based on a conflict no additional disclosure should generally be necessary. If there are concerns in individual situations that even through recusal the conflict may be something that must be addressed or considered further, the Standards of Conduct Official can follow up with the director or employee.

#### **Agent Reporting**

Additionally, AgStar is very concerned about the practicality of System institutions being required to obtain reporting from agents and consultants. This new requirement is not only burdensome, it may also be impractical and lead to highly skilled, qualified and ethical third-parties choosing to not do business with System institutions. In fact, AgStar is not aware of similar requirements being made of other lending institutions and is concerned that this type of requirement may put the System at a competitive disadvantage when it comes to partnering with top-quality agents and consultants.

Many third-parties may be unwilling or unable to, for example, share the identity of their other customers, which is one of the things that could potentially be required by the proposed regulation. They may perceive doing so as disclosing proprietary information or they may be precluded from doing so by non-disclosure agreements or other contractual, legal or regulatory limitations. For example, as the proposed regulation reads, an IT services provider who provides services to a System institution, and similar services to a commercial bank, would be required to report to the System institution “all material non-

privileged information relevant to the consideration of the matter, activity or transaction.” It is simply unreasonable to expect System institutions to seek this kind of information from third-parties and unlikely that it would be provided if requested. FCA should eliminate the references to agents and consultants in §612.2136.

#### D. Director Reporting – §612.2140

AgStar is concerned about the practicality of requiring directors to report ‘all material financial interests with directors, employees, agents or borrowers of the employing, supervised and supervising institution.’ AgStar recognizes that the commentary to the proposed amendments suggests that institutions adopt policies and procedures to determine whether something rises to the level of being ‘material financial interest.’ However, this seems to ignore obvious practical challenges associated with any such policy or procedure.

First, as a cooperative, all of AgStar’s stockholder-elected directors are farmers who routinely enter into normal course of business transactions with a multitude of third parties as part of their farming operation. They may buy seed, fertilizer, feed, equipment, services or other items as part of their operation. They will also routinely sell products they produce or may sell services to other farmers. Given the nature and location of their business, there is a high probability that many of these normal course of business transactions will take place with others who borrow from or are otherwise somehow affiliated with the System.

The proposed regulation seems to suggest that normal course of business transactions might create a conflict of interest. However, given the manner in which AgStar and many other System institutions conduct their business there is no opportunity for this type of situation to create a conflict of interest. AgStar’s directors rarely, if ever, are asked to weigh in on or consider an individual transaction with an individual borrower. While the board sets various policies for the organization, management is charged with transacting business with individual borrowers. A better approach would be to simply require that directors recuse themselves from any action related to an individual borrower, director or team member with whom the director has a material financial interest.

Second, AgStar is concerned that the proposed regulations provide no guidance as to what FCA may deem to be material. Is \$5,000 material? Is \$50,000? Is \$100,000? The challenge for AgStar and presumably other System institutions is that what may be ‘material’ for one director and his or her operation may not be anything close to ‘material’ for another. For example, what is material to a director who runs a 400 acre cash grain operation and owns the majority of the land he or she farms, may be very different than what is material to a director who runs a large commercial size dairy operation. System directors should be able to engage in those transactions with third-parties that are necessary to conduct the normal operations of their farming or other business interests without a requirement to report and obtain prior approval for those transactions. The requirement to disclose actual conflicts of interest will suffice to make

sure that Directors act appropriately in matters involving those with whom they have non-System business dealings.

#### E. Director Prohibited Activities – §612.2140

AgStar is concerned about the reference in the commentary to the proposed rule that there is no opportunity for the Standards of Conduct Official or board to ratify otherwise prohibited conduct after the fact. Simply put, prior approval may not always be practical. Day-to-day business dealings may require a director to make quick decision related to his or her farming or other business operation, and requiring prior approval in all instances is unnecessary to protect the System from conflicts of interest. Additionally, it is possible that a director may not learn that the other party with whom the director is conducting non-System business is a System borrower until after the transaction occurs. The proposed amendments suggest that in no circumstance can the Standards of Conduct Official or board of directors ratify a transaction that should have been subject to prior approval after the transaction has occurred. Failure to permit any type of ratification process could also lead to a situation where a director chooses to not disclose something they otherwise should for fear that FCA may find the director violated the regulation. The regulations should encourage, not discourage, disclosure, and the inability to ‘correct’ a reporting error runs counter to this.

#### F. Employee Reporting and Prohibited Conduct – §612.2150 and §612.2155

AgStar’s concerns related to Director reporting and prohibited conduct apply to the sections of the rule related to Employee reporting and prohibited conduct.

#### G. Joint-Employees – §612.2157

AgStar offers no comments on this section of the proposed rules.

#### H. Institution Responsibilities – §612.2160

### **Agents**

The new language suggests that System institutions should “ensure compliance” with the regulations by not only directors and employees but also agents. This is an impractical and unduly burdensome proposal. AgStar appreciates the fact that when it retains a third-party to act on its behalf that it will in many cases be responsible for the outcome of the conduct of that third-party. That said, to suggest that any System institution will have the ability to “ensure compliance” by an entity that is not subject to regulation by the FCA is unrealistic.

Also, FCA’s vague definition of “agent” will make compliance with the proposed regulations extremely burdensome. AgStar has thousands of third-parties that it deals with and although the full list of third-parties is undoubtedly broader than the list of “agents,” this will be an enormous administrative burden. Tracking which agents

received and acknowledged our Standards of Conduct policy and Code of Ethics and determining which agents are subject to another set of industry ethics guidelines is unlikely to enhance in anyway ethical behavior. AgStar is also concerned that some “agents” will choose not to do business with the System if in order to do so they need to agree to compliance with a set of regulations they are not otherwise subject to. AgStar has excellent relationship with hundreds of third-parties who provide AgStar and its clients with valuable services. It’s simply unrealistic to expect System institutions to seek to obtain “certifications” from each “agent.”

Finally, AgStar is not aware of any significant or validated concern related to the ethical conduct of agents who provide services to the Farm Credit System. The existing regulations require that System institutions exercise due care in the selection and management of agents. The FCA has not identified any compelling reason to make the changes that it has suggested in the proposed rules.

### **‘Immediate’ reporting to FCA**

The FCA is also seeking to increase institution responsibility around notifying FCA of known or suspected material standards of conduct violations. The proposed regulations suggest that notification should occur “immediately.” It also fails to define in any way what is and what is not a “material” standard of conduct violation. The existing regulation requires “prompt” notification if an investigation leads to removal or discharge of a director or employee or if a violation may have an adverse impact on the public’s confidence in the System.

FCA has failed to identify any rationale for this proposed change, and AgStar is concerned that the proposal does not allow the Standards of Conduct Official any opportunity to conduct an investigation. System institutions and their Standards of Conduct Officials should have a reasonable amount of time to conduct an investigation to determine whether there is credible evidence to support a conclusion that a violation has occurred. AgStar urges FCA to maintain the current requirements and not move forward with the proposed change.

#### **I. Code of Ethics, Policies and Procedures – §612.2165**

### **Code of Ethics**

AgStar supports the concept of the creation of a Code of Ethics for its directors and employees. For the reasons stated above, however, any requirement that “agents” certify they will adhere to the Code of Ethics should be eliminated from the proposed rule.

### **Review of Employee and Director Loans**

This section also contemplates adding a new responsibility for the Standards of Conduct Official of reviewing employee and director loans. It is important to note that the Standards of Conduct Official will often not be an individual who has regular

involvement with credit analysis or loan approval. Therefore, in order for any such review to be effective, FCA will need to allow the Standards of Conduct Official to rely on certifications from other individuals that terms and rates are similar to those offered to borrowers of similar creditworthiness.

## **Training**

AgStar supports the concept of requiring annual training on the Standards of Conduct but notes that training can take place in many forms and format. AgStar encourages FCA to approach the training requirement with flexibility so that individual institutions can tailor both the substance and delivery method of the training to meet the evolving needs of the institution.

## **Exceptions**

The exceptions provision of this section of the proposed rule should be amended to require documentation of any exceptions but to eliminate the reporting requirement. Reporting to FCA exceptions made under the rules is unnecessary and burdensome. If FCA believes it needs to review exceptions that have been granted, it can use its examination process to accomplish its objectives.

Finally, AgStar objects to the provision of this section that suggests FCA may overrule an exception granted by the board of directors. As currently drafted, there is no criteria identified against which FCA will make its determination. In essence, this provision would allow FCA to overrule a decision made by the board for any reason FCA chooses. AgStar urges FCA to remove this provision from the proposed rule or, at a minimum, provide System institutions with the standard by which FCA will evaluate decisions. Absent such information from FCA, the ability of FCA to second-guess a reasoned decision by the board will likely make the exception provisions meaningless from a practical perspective.

### **J. Standards of Conduct Official – §612.2170**

AgStar is generally supportive of the changes to this section of the regulations. The new provision regarding reporting “promptly” known or suspected standards of conduct issues that may have an impact on public confidence in the System to FCA is a more appropriate standard for reporting than what is suggested in §612.2160 of the proposed regulations and discussed above.

### **K. Standards of Conduct for Agents – §612.2180**

For the reasons expressed above, AgStar urges FCA to abandon the proposed changes to the regulations related to agents. The current regulations provide appropriate guidance to the System to ensure that System institutions are engaged in safe and sound practices related to the hiring and management of agents.

L. Purchase of System Obligations – §612.2190

AgStar offers no comments on this section.

M. Conclusion

As noted above, AgStar appreciates FCA's attempts to improve the Standards of Conduct regulations. Clearly, ethical business practices are critical to the success of individual institutions and the System as a whole. The comments and concerns identified above are intended to allow System institutions like AgStar to maintain the solid foundation of high standards and ethics that already exist and augment those with sensible and practical enhancements that do not add unnecessary administrative burdens.

Please feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Spencer Enninga".

Spencer Enninga  
Chairman of the Board