June 24, 2015

<u>Via Email (reg-comm@fca.gov)</u>
Ms. Laurie A. Rea, Director
Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

<u>Re: Proposed Rule—Federal Agricultural Mortgage Corporation General Provisions; Federal Agricultural Mortgage Corporation Governance; Federal Agricultural Mortgage Corporation Risk Management; Federal Agricultural Mortgage Corporation Disclosure and Reporting; Farmer Mac Corporate Governance and Standards of Conduct (12 CFR Parts 650, 651, 653, and 655, RIN 3052-AC89, March 26, 2015)</u>

Dear Ms. Rea:

This letter is submitted by CoBank, ACB; CoBank, FCB (together with CoBank, ACB, "<u>CoBank</u>"); and the Farm Credit Bank of Texas ("<u>FCBT</u>") in response to the above-captioned proposed rule published by the Farm Credit Administration ("<u>FCA</u>"). As you know, we are Class B shareholders of the Federal Agricultural Mortgage Corporation ("<u>Farmer Mac</u>" or the "<u>Corporation</u>") and, as such, have a particular interest in the subject matter of the proposed rule.

General Comments

We commend FCA for seeking comment on its proposed rule addressing Farmer Mac's corporate governance, risk management, disclosure and reporting, and standards of conduct. We are grateful that in its proposed rule, FCA has recognized the importance of the representational nature of the Farmer Mac board that is reflected in the unique composition of the Farmer Mac board of directors. In designing Farmer Mac's corporate structure, Congress struck a delicate balance to ensure that Farmer Mac's board of directors would be representative of three separate and distinct constituencies: (1) five directors elected by holders of Farmer Mac's Class A voting common stock that are "insurance companies, banks, or other financial institutions or entities," (2) five directors elected by holders of Farmer Mac's Class B voting common stock that are "Farm Credit System institutions," and (3) five directors appointed by the President of the United States, with the advice and consent of the United States Senate, and subject to certain additional criteria.[1] When describing the legislation creating Farmer Mac (and specifically the role of the three types of directors on the Farmer Mac board), Representative Bereuter noted that "to protect the interests of both the Farm Credit System and commercial lenders, the permanent Farmer Mac board provides for equal representation on the board by the Farm Credit System, commercial lenders and the public sector."[2] The "equal

[1] 12 U.S.C. § 2279aa-2(b)(2).

[2] 133 Cong. Rec. 36,458 (Dec. 18, 1987).

representation" on the Farmer Mac board provided to Class A and Class B shareholders was provided with a particular Congressional purpose in mind—namely, to protect the interests of the Farm Credit System ("FCS") and other financial institutions by bringing their independent perspective and judgment to the Farmer Mac board. Subsequent legislation has not altered this clearly articulated, and fundamental, Congressional intent that Class A and Class B directors have the ability to represent the interest of their respective class of shareholders. Given the intention of Congress, we believe that the final rule should not only provide assurance that Class A and Class B directors will be able to act in a such way that they can reflect the interests and positions of those shareholders that they represent, it should acknowledge that the Class A and Class B directors are duty bound to represent the interests of their respective class of shareholders.

We applaud FCA's efforts in the proposed rule to modernize Farmer Mac's standards of conduct and corporate governance practices. We would, however, like to see FCA further modernize the regulations governing Farmer Mac to reflect those regulations imposed on the FCS, such as the Basel III framework for capital standards and diversity and inclusion. Consistent with Section 650.3 of the proposed rule, FCA has the enforcement authority under the Farm Credit Act of 1971 to "protect the financial safety and soundness of the Corporation", including the authority to require capital restoration plans, to restrict dividend distributions, and to require the acquisition of new capital, among other things.[3] Thus, FCA can, if it so chooses, subject Farmer Mac to the Basel III framework.

We further applaud FCA for acknowledging and recognizing in the proposed rule the fundamental difference between a publicly traded company incorporated under State statutes and a Government Sponsored Enterprise ("GSE") such as Farmer Mac. Section III.B.3.c of the preamble to the proposed rule states, "Unlike corporations incorporated under State statues of incorporation, statutorily chartered GSEs are not free to alter their purposes or powers, even when such alteration may be in the best interest of the investing stockholders. For GSEs, such changes can only be made by law. Thus, it is the responsibility of Farmer Mac directors to lead the Corporation in the matter that best effectuates the public policy it was designed to serve." We completely agree with this statement by FCA and think that it is vital that Farmer Mac keep its public policy mission in mind first. Thus, where an inconsistency could be raised between modern corporate governance principles and the representational nature of the Farmer Mac board, we believe that FCA has the obligation to defer to the statute and follow Congressional intent. In this respect, we find Farmer Mac's compensation structure for its directors that include the award of Class C stock options to be fundamentally at odds with Farmer Mac's public policy mission. In the final rule, it is imperative that FCA ensure that the compensation policy for directors incentivizes Farmer Mac directors to be focused first on the Corporation's statutory public policy mission and not on short-term performance at the expense of its public policy mission. In structuring the board of Farmer Mac as representative of the Corporation's two primary types of users along with representatives of the public interest while denying to the Class C shareholders any voice in its governance, Congress provided a clear answer to any conflict that arises between the interests of Farmer Mac as a publicly traded company and its public policy mission as a GSE: Congress made it clear that Farmer Mac's public policy mission is paramount. During Farmer Mac earnings calls, however, Farmer Mac's Class C shareholders

[3] 80 Fed. Reg. 15942 (March 26, 2015).

consistently have asked for increased leverage, dividend payouts, and stock buybacks, all with the aim of boosting their returns. More recently, Farmer Mac appears to be heeding these requests, particularly as it relates to increased dividend payouts. This drive to generate returns and assume risk for investors in Farmer Mac's publicly traded stock is potentially at odds with the Corporation's public policy mission and with considerations of the Corporation's safety and soundness. To serve its mission effectively, Farmer Mac directors must often ensure that the company retain earnings and build capital to reduce leverage to ensure financial strength and constrain growth, particularly during good economic times. Many of these decisions, all made in the interest of protecting the long-term mission and safety and soundness of Farmer Mac to ensure credit availability to particular segments of the rural economy, are contrary to the short-term interests of investors looking to maximize return on their investment in Farmer Mac stock. We applaud FCA for recognizing the inherent tension and inconsistency between Farmer Mac's duty to fulfill its public policy mission and the general corporate responsibility to the interests of Class C shareholders as public investors in the Corporation.

By contrast, the FCS's structure as a cooperative ensures a long-term focus on mission fulfillment and financial strength in order to be a consistent provider of credit through the economic, financial, and agricultural business cycles of the industries that the FCS serves. Farmer Mac does not share this inherent alignment between its corporate structure and its public policy mission. While FCA is correct in its analysis regarding Farmer Mac and the importance of its public policy mission, it does not go far enough to curtail the interests of Farmer Mac as a publicly traded corporation seeking to maximize shareholder gains. We continue to believe that Farmer Mac's reliance on publicly traded stock is an inherent flaw in its business model that increases overall riskiness and requires FCA to implement strong regulatory requirements and limitations to guard against this inherent conflict.

We believe Farmer Mac's practice of compensating its directors with Class C stock options undermines the Congressional structure of Farmer Mac's board. Awarding Class C stock to Farmer Mac's Class A and Class B directors erodes the representational separation of interests intended by Congress, and may provide unintended incentives for directors as they weigh the gains that they may receive from their Class C stock options against the fiduciary duties they owe to the Corporation in fulfilling its Congressionally mandated public policy purpose.[4] The foregoing is not intended to impugn the actions of any current director of Farmer Mac, but rather it is simply to call attention to the misaligned incentives that arise from awarding directors Class C stock options. Fortunately, FCA can easily resolve this issue by prohibiting the awarding of stock options and, ultimately, requiring the elimination of Class C stock altogether over time.[5] We believe that such a result would enhance Farmer Mac's financial discipline, transparency, and director accountability, while also being consistent with its fundamental approach to meeting capital needs through earnings retention, Class A and Class B capital

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[4] The issue is not limited solely to Class A and Class B directors. The five Presidentially appointed directors are similarly incentivized to balance the gains they might receive from their Class C stock options and their obligation to represent the interests of the general public on the Farmer Mac board.

[5] Conceptually, Farmer Mac could replace Class C stock with Class A, Class B, and/or perpetual preferred stock to meet its capitalization needs. In the case of perpetual preferred stock, such stock should be priced and traded based on Farmer Mac's true financial capacity to perform and its risk profile.

contribution, and, as seen over recent years, through the issuance of preferred stock. Finally, such a result would align Farmer Mac with evolving best practices to prevent excessive exposure to loss by the U.S. taxpayer which was an unfortunate consequence of this hybrid form of GSE ownership in the housing market.

With these general principles concerning Farmer Mac's corporate governance, risk management, disclosure and reporting, and standards of conduct in mind, we now turn to more specific comments we wish to provide FCA with respect to the various sections of the FCA's proposed rule.

Section 651.1 Definitions

In Section 651.1 of the proposed rule, FCA defines "material" to mean "conflicting interests of sufficient magnitude or significance that a reasonable person with knowledge of the relevant facts would question the ability of the person having such interest to discharge official duties in an objective and impartial manner in furtherance of the interests and statutory purposes of the Corporation."[6] While we agree with FCA's definition applying an objective "reasonable person" standard, we find the proposal, in this respect, inconsistent with the standard that the FCA proposed to impose on the FCS in the recent Standards of Conduct proposed rulemaking.[7] There is no reason for the FCA to apply different standards of materiality with respect to the institutions that it regulates. We urge FCA to be consistent in the materiality standards imposed on Farmer Mac and on FCS institutions and adopt an objective "reasonable person" standard for both.

Separately, we urge the FCA to provide a definition of a "conflict-of-interest" in the final rule. Currently, the proposal offers no definition of a "conflict-of-interest," only a proposed definition of a "potential conflict-of-interest" in Section 651.1 of the proposed rule. We submit that the definition of a "conflict-of-interest" – something akin to the currently proposed definition of a "potential conflict-of-interest" – is fundamental to the proposal and should be provided in the final rule.

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[6] 80 Fed. Reg. 15943 (March 26, 2015).

[7] "The proposed rule would not change the definition of 'material.' However, each System institution must set specific parameters on what constitutes a material financial interest or transaction. The value of a material financial interest or transaction may change depending on the circumstances and, to some extent, the geographic location of the institution involved. The institution's determination of materiality would be subject to FCA examination.

The institution's policies and procedures may include de minimis values below which a financial interest is determined by the board not to be material. The de minimis amount is necessarily System institution-specific, and must be appropriate to the institution's size, location and risk tolerance. A de minimis amount is an amount or value representing an interest that is so insignificant that no reasonable person could conclude that it would influence a director or employee's ability to act impartially and in the best interests of the System institution. The institution would need to adequately support the values established in its determination of de minimis or not material, and this determination would be subject to FCA examination." 79 Fed. Reg. 9649 (February 20, 2014).

Section 651.2 Indemnification

In requiring Farmer Mac to establish policies and procedures for offering indemnification insurance, we would like assurance that a director's affiliated entity is not obligated to provide indemnification insurance that Farmer Mac should otherwise provide. As currently drafted in the proposed rule, FCA seems to be shifting the burden of indemnification from Farmer Mac to each director's affiliated entity. Consistent with industry standards, however, Farmer Mac should offer its directors a reasonable indemnification policy for their role as directors. Farmer Mac should offer such an indemnification policy equally to all directors regardless of class. If a director feels that additional indemnification is necessary beyond this policy, it should be up to the affiliated entity of such director to decide whether or not to supplement Farmer Mac's indemnification policy on its own accord. We find it both problematic and inappropriate for FCA to shift this fundamental first line of support for director indemnification from Farmer Mac to other entities. We are not aware of other circumstances where the type of approach set forth in the proposed rules is taken with regard to indemnification and believe that taking this approach will have a chilling effect on directors' willingness to serve on the Farmer Mac board.

In the case that another FCA regulated institution provides supplemental indemnification to a director in order to encourage participation on the Farmer Mac board, FCA should also consider the safety and soundness impact of such a supplemental indemnification on the other FCA regulated institution and, as a result, FCA should require that Farmer Mac indemnify any such director, in the first instance, before separate indemnification to be provided by the other FCA regulated institution is considered.

Finally, Section 651.2(b) of the proposed rule requires Farmer Mac to notify OSMO before making an indemnification payment. We find this notification requirement to be inappropriate. Additional notification to OSMO is unnecessary and threatens to chill director candidates' willingness to serve on the board if they fear FCA may second-guess an indemnification payment made in compliance with Farmer Mac's corporate policy. Moreover, indemnification payments are a corporate and legal matter, not a regulatory issue. FCA notice is simply regulatory burden. FCA already expects Farmer Mac to let FCA know about financially material matters that would threaten safety and soundness. So adding a notification requirement for any indemnification payment is simply unnecessary, particularly given it creates the appearance of a regulatory approval process.

Section 651.22 Conflict-of-Interest Policy

We appreciate that Section 651.22 of the proposed rule requires that Farmer Mac's conflict-of-interest policy acknowledge and respect the representational affiliations of elected directors and that the proposed rule carves out such representational affiliations from imputing a conflict-of-interest.

We, however, find the treatment of agents under the conflict-of-interest policy to be overly prescriptive. For purposes of the conflict-of-interest policy, an agent should not be treated the same as a director, employee, or officer of the corporation. Agents are often subject to their own professional standards, which address conflicts-of-interest issues. Requiring agents to adhere to a one-size-fits-all conflict-of-interest policy simply adds cost and burden without any benefit. Further, such agents may not wish to do business with Farmer Mac if they are subject to such conflict-of-interest requirements in addition to their own professional standards. Recognizing the potential differences among agents, we instead believe that conflicts-of-interest for agents should be addressed through diligence and monitoring by Farmer Mac and contractual obligations rather than trying to impose conflict-of-interest policies of the Corporation on the agent via regulation.[8]

Finally, in defining the conflict-of-interest policy, except in one case in Section 651.22(b)(1), FCA does not specify whether it is referring to material conflicts-of-interest or to potential conflicts-of-interest. Instead, FCA simply refers to "conflict-of-interest" and provides no further guidance. Further adding to the confusion, as discussed above, in Section 650.1 of the proposed rule, although FCA includes definitions for "material" and for "potential conflicts-of-interest", it does not define "conflict-of-interest." As a general matter, FCA should clarify to which type of conflict-of-interest the proposed rule is referring in the policy, and provide a definition for a "conflict-of-interest." More specifically, we believe that, in its final rule, FCA should clarify that, in subsections 651.22(b)(4) and 651.22(b)(5), it is referring to "material" conflicts-of-interest, *i.e.*, to only those conflicts-of-interest that would "question the ability of the person having such interest to discharge official during in an objective and impartial manner in furtherance of the interests and statutory purposes of the Corporation."

Section 651.23 Conflict-of-Interest Disclosure and Reporting

Section 651.23(a) of the proposed rule requires directors, officers, and employees of the Corporation to submit annual conflict-of-interest reports to Farmer Mac. As currently written in the proposed rule, the required conflict-of-interest reports are overly broad and should be modified. Rather than mandate that such reports include all financial interests, transactions, relationships, and activities, such reports should be limited to such information that has the potential to adversely affect or appear to adversely affect the ability of the reporting individual to perform his or her official duties at the Corporation.

In the event that potential or real conflicts arise between reporting periods as set forth in Section 651.23(a)(2) of the proposed rule, conflict-of-interest reports should not simply be updated but rather the director, officer or employee should be required to resubmit the report in its entirety listing, at that later point in time, all relevant information about interests that have the potential to adversely affect or appear to adversely affect the ability of the reporting individual to perform his or her official duties at the Corporation.

Section 651.23(d) of the proposed rule adds a requirement that the Corporation must disclose any unresolved material conflict-of-interest through various securities filings. This requirement is at best redundant with the federal securities laws and at worst in tension with them. We submit this provision should be eliminated. As long as Farmer Mac is a publicly traded corporation, it must comply with the federal securities laws. This proposed provision adds nothing to that pre-existing obligation except potential confusion.

[8] See Letter from the Farm Credit Council, dated June 20, 2014, regarding Standards of Conduct - RIN 3052-AC44 / Federal Register 79 (February 20, 2014) 9649-9661.

Section 651.24 Director, Officer, Employee, and Agent Responsibilities

Similar to our comments regarding Section 651.22, we find that the treatment of agents under Section 651.24 to be overly prescriptive. An agent does not have the same responsibilities as a director, officer, or employee of the Corporation and thus should not be treated the same as a director, employee, or officer of the Corporation. We instead believe that conflicts-of-interest for agents should be addressed through diligence and monitoring by Farmer Mac and contractual obligations rather than trying to impose conflict-of-interest policies of the Corporation on the agent via regulation.[9]

Generally, we question the need for Section 651.24. Farmer Mac is a publicly traded corporation and is already subject to the federal securities laws with respect to the disclosure and use of material nonpublic information. We do not see the benefit of this additional layer of obligations on what the securities laws already impose.

More specifically, with respect to Section 651.24(a) of the proposed rule, the provision prohibits a director, officer, employee, or agent from making "any untrue or misleading statement of a material fact intended or having the effect of reducing public confidence in the Corporation."[10] But the proposed rule does not provide any guidance with respect to what is meant by any of these terms including the amorphous phrase "reducing public confidence." If FCA decides to keep Section 651.24, we urge FCA to clearly define, or drop, these amorphous terms.

Similarly, Section 651.24(b) of the proposed rule prohibits a director, officer, employee, or agent from making improper use of official Corporation property or information. We would assume "improper" implies using Corporation property or information for personal gain. The proposed rule, however, does not define "improper use," so the intended meaning is unclear. Not only is the statement vague, it is overly broad. Again, if the whole provision is not deleted, FCA should clearly define the operative terms. Regulatory protections for Class A and Class B representational rights and obligations are critical given we believe Farmer Mac has a history of expending effort to undermine and limit such rights and obligations.

Finally, and in all events, the proposed rule should make clear that sharing information with a director's own Class A or Class B affiliated entity will not be deemed to be an improper use of such official Corporation property or information for purposes of Section 651.24 or any provision of the Corporation's bylaws or corporate governance provisions.

Section 651.30 Director Elections

We appreciate that Section 651.30(a) of the proposed rule requires that the director election procedures, to be promulgated by the Company, must allow for any shareholder to submit a director-candidate for consideration to the board. We also appreciate that Section 651.30(b)(3) of the proposed rule requires that director-candidates receive affirmative votes for nomination from a majority of those representing the same class of shareholders as the director-candidate. We feel this requirement is appropriate and will greatly help to ensure that the Class A and

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[9] See supra n.8.

[10] 80 Fed. Reg. 15944 (March 26, 2015).

Class B elected directors are representative of the respective class of shareholders electing each of them.

We would, however, like to see the process by which Class A and Class B shareholders have the ability to notify Farmer Mac of director-candidates moved closer to the date of, including on the floor at, Farmer Mac's annual meeting. As currently adopted, the Farmer Mac Code of Business Conduct and Ethics and bylaws deny Class A and Class B shareholders the ability to nominate and elect director-candidates from the floor of the Farmer Mac annual meeting, requiring instead stringent and extremely advance notice of such nominations. Not only is the existing process time-consuming and expensive for shareholders, it also provides minimal flexibility and the restrictive nature of the process is contrary to clearly articulated Congressional intent. Indeed, the current process is so restrictive and the timeline is so much in advance of the actual election, it essentially denies Class A and Class B shareholders their full franchise rights to elect board members.

In all events, allowing for a petition process would help to ensure that Class A and Class B shareholders are able to vote for director-nominees of their choice, unencumbered by the types of restrictions Farmer Mac has now put in place. Increased flexibility in the nomination process is consistent with Congressional intent to allow Class A and Class B shareholders broad participation in the management of the American agricultural financial system.[11]

We agree with Section 651.30(c) of the proposed rule which requires that Class A and Class B directors on the Farmer Mac board must have a "recognized affiliation or relationship" with their respective class of voting shareholders at the time of nomination and election to the Corporation's board of directors and that documentation of such relationship must be maintained until three years after the director's service ends. We suggest that FCA reiterate this discussion in the final rule with respect to the need for Class A and B directors to maintain an "official affiliation" with a Class A or B institution during their tenure as directors of Farmer Mac. This affiliation requirement is necessary to give effect to the statutory language ensuring the representational nature of the Farmer Mac board. FCA authoritatively addressed the question of "official affiliation" in the final rule for the current standards of conduct provisions. At that time, FCA wrote:

> "The FCA believes that the statutory term 'representative' means that elected directors must have an ***official affiliation with a class A or class B*** institution in order to serve as a Corporation director. The FCA views an ***official affiliation as a substantial and visible connection such as serving as director, officer, or employee of a class A or class B institution***. This interpretation of 'representative' stems in part from the vacancy and continuation of membership provisions of Sections 8.2(a)(4) and 8.2(b)(5)of the 1971 Act. Vacancy of an elected Board seat is filled by the permanent Board 'from among persons eligible for election to the position for which the vacancy exists,' suggesting that some objective eligibility criterion exists other than being elected by the shareholder class. The continuation provision has the effect of terminating the term of a director when he or she ceases to be 'a representative.' ***By contrast, were 'representative' interpreted broadly to mean anyone who is selected by the***

[11] See 12 U.S.C. § 2279aa-2(b)(2).

> ***institutions to act as a delegate, everybody would be eligible for election when a vacancy occurred and the automatic termination provisions would not work***. Taken together, these provisions suggest that elected directors must have an official affiliation that is visible and substantial so that the presence and termination of this affiliation can be readily ascertained."[12] (***Emphasis added)***

Nothing has changed from a statutory perspective that would cause reconsideration of FCA's previous analysis of what representation means with respect to a Class A and Class B director. We would not want the FCA's failure to reiterate the official affiliation requirement to result, in the future, in arguments by Farmer Mac that the term "representative" must be interpreted broadly to mean anyone selected by the Corporation.

Section 651.35 Director Removal

We commend the FCA for proposing Section 651.35 of the proposed rule providing certain guidelines regarding director removal, including (1) prohibiting director removals by Farmer Mac that may "adversely affect the rights of voting shareholder"; (2) requiring director removal procedures to be specified in the Corporation's bylaws; and (3) requiring that Farmer Mac notify OSMO at least 14 days prior to initiating any director removal.[13]

We would, however, like the final rule to prohibit Farmer Mac from adopting a bylaw that automatically removes an elected director for violations of a conflict-of-interest policy. We believe that a bylaw for the automatic removal of a director has the potential to upset the board's carefully constructed balance and goes against Congressional intention of "equal representation" among the three classes of shareholders. The automatic removal of an elected director and replacement of such person by the board would take away power from Class A and Class B shareholders and shift it into the hands of the Farmer Mac board. Given that, under the proposed rule, Farmer Mac has been delegated to draft and enforce its own conflict-of-interest policy, adding to this a provision allowing for the automatic removal of a director for violations of policy only exacerbates this shift in power to the Farmer Mac board. Further complicating this matter is that determining whether there is a conflict-of-interest in a given circumstance is subject to interpretation and thus to automatically remove an elected director is an excessive remedy. In light of the foregoing, we urge FCA to explicitly prohibit bylaws that would automatically remove an elected director for violations of a conflict-of-interest policy in the final rule.

In addition to allowing for director removal procedures to be contained in the Corporation's bylaws, Section 651.35(a) of the proposed rule also allows for mandatory resignations of directors based on contractual agreements with the Corporation. This is inappropriate because it places undue power in the hands of the Corporation and enables the Corporation to make unreasonable demands on its directors. FCA should not permit the Corporation to require by contract such mandatory resignations.[14]

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[12] See 59 Fed. Reg. 9622 (March 1, 1994)

[13] See 80 Fed. Reg. 15944 (March 26, 2015).

[14] It should be noted that both situations – allowing the Corporation to adopt a bylaw for automatic removal or a mandatory resignation as part of a contractual arrangement – present a conflict-of-interest (continued…)

Given the importance of the public policy mission to the governance of Farmer Mac, in the case of the removal of a Class A or Class B director, we maintain that FCA should require the affirmative vote of a majority of the remaining directors of the same class as the director subject to removal in order to effectuate the director's removal.

We also propose that FCA give the Class A and Class B shareholders the right to a notice and comment process for the proposed removal of any of their respective directors from the Farmer Mac board of directors before FCA permits such a removal to become effective.

Section 651.40 Director Fiduciary Duties and Independence

While we understand FCA's intent in proposing a rule that identifies the fiduciary responsibilities associated with serving as a director on the Farmer Mac board, we find the requirements in Section 651.40 of the proposed rule to be overly stringent and believe that they fail to recognize the full extent and scope of Farmer Mac's statutory charter, its public purpose, its special status as a GSE, and the representational nature of Farmer Mac's board. As we noted in the introduction, in designing Farmer Mac's corporate structure, Congress intended that Farmer Mac's directors would be representative of the three separate and distinct constituencies. We find there to be a conflict between Congress's intent that directors elected by their specific class of shareholders represent that class and the language in Section 651.40(c)(2) stating that each director of the Corporation must "administer the affairs of the Corporation fairly and impartially and without discrimination in favor of or against any investor, stockholder, or class of stockholders" In light of this inconsistency, the FCA has the obligation to defer to the statute and follow Congressional intent.

We note that Farmer Mac has applied the independence standards of the New York Stock Exchange (NYSE) in such a manner as to weaken this representative form of governance established by Congress when it devised the structure of the Farmer Mac board. The NYSE requires that the majority of directors be independent, meaning that they have no material relationship with the listed company.[15] This requirement, designed to reduce the possibility of conflicts-of-interest, is not appropriate for Farmer Mac because it undermines the representative form of governance intended by Congress. This requirement (promulgated by the NYSE, a self-regulatory organization) cannot and should not override Farmer Mac's statutory charter and the clear intent of Congress in establishing Farmer Mac's board of directors embodied therein.

Even if the NYSE standard for independence is adopted, the FCA should require that Farmer Mac adopt it consistent with the NYSE rules,[16] and not in a way that advantages an entrenched

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by Corporation's board's remaining members who are given the statutory power to pick the removed director's replacement, rather than the class of shareholders who originally elected the removed director.

[15] NYSE Listed Company Manual §§303A.01 and 303A.02 (<u>available at</u> http://nysemanual.nyse.com).

[16] "In order to tighten the definition of 'independent director' for purposes of these standards:

(a)(i) No director qualifies as 'independent' unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company).

(continued…)

board. In this respect, Farmer Mac currently has determined that an employee of an FCS institution is not independent, but that a director is considered independent. As an employee is given guidance by a director, they are inherently connected, and treated the same under NYSE rules. So it should be irrelevant as to whether an individual is an employee or a director for independence purposes under the Farmer Mac rules for what constitutes an independent director.

In all events, we think that it is appropriate and necessary for FCA to establish through regulation that Class A and Class B directors have a fiduciary duty to represent the interests of their respective Class and clarify that such duty is not a conflict-of-interest and does not jeopardize a director's "independence". This approach would ensure Farmer Mac's governance structure functions as intended under the Agricultural Credit Act of 1987.

Although we appreciate the flexibility afforded by Section 651.40(d) of the proposed rule for Farmer Mac's directors to comment on non-private and non-privileged corporate business, provided that doing so will not violate laws or regulations, particularly securities laws, we think that Section 651.40(d), is unnecessary and that compliance with applicable securities laws should be sufficient to allow Farmer Mac to protect its proprietary business information. We recognize, however, that FCA is trying to strike an appropriate balance in Section 651.40(d) on a director's use of corporate information and we appreciate FCA's efforts to create such a balance. However, as drafted, the proposed "independence" provision may have the opposite effect in practice.

We think that by failing to prohibit or at least to limit in some way the Corporation from protecting proprietary, privileged, and non-public information, FCA is effectively giving the Corporation blanket authority to define what is "proprietary, privileged and non-public." We do not agree that such authority should be given, as this would allow the Corporation potentially to deem that any corporate information is "proprietary, privileged and non-public." Indeed, the Corporation has taken just this position in deeming that any information – no matter how public – is confidential and proprietary information if it does not appear on the Corporation's website or in a federal securities filing. We request that FCA define "proprietary, privileged, and non-public" in the context of Section 651.40(d) in order to limit the Corporation's authority on this matter.

(ii) In addition, in affirmatively determining the independence of any director who will serve on the compensation committee of the listed company's board of directors, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:

(A) the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the listed company to such director; and

(B) whether such director is affiliated with the listed company, a subsidiary of the listed company or an affiliate of a subsidiary of the listed company."

NYSE Listed Company Manual §303A.02 (available at http://nysemanual.nyse.com).

Section 653.2 General

In Section 653.2 of the proposed rule, it states that "[t]he Corporation's board of directors must approve the overall risk-appetite and risk tolerance of the Corporation." We believe that these requirements put the cart before the horse. At the outset, the Corporation's board of directors should be required to approve the risk-bearing capacity of the Corporation. We think that a reasonable standard to follow would be the Basel III standards for capital adequacy applicable to commercial banks, including the appropriate treatment of equity securities and risk weighting of assets. Under Section 650.3 of the proposed rule, FCA has the enforcement authority "to protect the financial safety and soundness of the Corporation and to ensure the Corporation's powers, functions and duties are exercised in a safe and sound manner."[17] This authority enables FCA, as the supervisor of Farmer Mac, if necessary, to enforce Basel III standards.

The capital standards applicable to regulated financial institutions are appropriate for Farmer Mac to avoid excessive leverage and risk taking as well as to provide financial strength to service its public policy mission during downturns in the agricultural and financial markets. The Farmer Mac board should be required to establish a risk bearing capacity that is consistent with capital adequacy standards for common equity Tier I, Tier I, and Tier II, including applicable conservation buffers and applicable leverage ratios. In applying these standards, FCA should strongly consider prohibiting Farmer Mac from using excessively creative interpretations around the treatment of capital securities as appears to have occurred with the Farmer Mac's FALConS preferred stock issuance and risk profiles of securitized assets or off-balance sheet guarantees. The application of the Basel III standards, as implemented by U.S. banking regulators, should be implemented for the Corporation unadulterated by Farmer Mac, particularly given Farmer Mac is not a cooperative institution but a joint stock company.

Section 653.3 Risk Management

We commend FCA for proposing a risk management program for Farmer Mac in Section 653.3 of the proposed rule, which would address, at a minimum, "exposure to credit, market, liquidity, business and operational risks." We believe that the creation of such a program is a step in the right direction and critical to the long-term performance of Farmer Mac's public policy mission. It is also consistent with good corporate governance principles. Similar to Section 653.2 of the proposed rule, however, we think that Section 653.3 of the proposed rule should also address the risk-bearing capacity of the Corporation. In particular, we believe that FCA should require the Farmer Mac board to manage Farmer Mac's capital position in a manner consistent with other regulated financial institutions (i.e., in accordance with the Basel III framework). Given that Farmer Mac is already publicly communicating that it is complying with Basel III capital standards, albeit incorrectly, as demonstrated by its statement that its recent perpetual preferred stock issuance qualifies as Tier 1 capital,[18] adoption of Basel III would be a logical measurement for directors to use in establishing risk bearing capacity for Farmer Mac.

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[17] 80 Fed. Reg. 15942 (March 26, 2015).

[18] See Farmer Mac News Release, dated June 17, 2014, and titled "Farmer Mac to Enhance Capital Position Through the Issuance of $75 Million of Series C Preferred Stock." In this press release, Farmer Mac announced that "it has agreed to issue $75 million of Tier 1 capital through the public offering ...."

As the risk management program develops, we encourage FCA to closely monitor the program to assure that it is being implemented effectively. Similar to its relationship with FCS institutions, FCA should use its authority (as defined in Section 650.3 of the proposed rule) to offer guidance to Farmer Mac regarding specific risk tolerance measures.

That being said, we find it inappropriate for FCA to regulate compensation practices as part of the risk management program in Section 653.3(a)(5). The risk management program is not a compensation program, and thus it is an inappropriate place to address compensation structures. Proposed Section 653.3(a)(5) should be deleted.

We further commend the introduction of risk committees in Section 653.3(b) of the proposed rule. Risk committees are considered a component of a strong corporate governance model within the financial services industry. We find the creation of a risk committee within Farmer Mac's board of directors to be appropriate and we think that FCA should ensure that the risk committee is consistent with standards applicable to the FCS institutions.

Finally, while we agree that it is appropriate for Farmer Mac to have a risk officer, we do not believe that it is FCA's place to regulate or require that position. The Corporation's board of directors should instead be given the freedom to implement the structure that they find most appropriate. We see this as an overreach for a safety and soundness regulator to require certain positions within the management of the Corporation. While the requirement for the board to establish a policy is logical and appropriate from a regulatory perspective, the FCA should avoid overreaching into the board's area and management's areas of responsibility on how best to staff the Corporation to meet regulatory requirements. We believe FCA is overreaching and crossing over well-understood boundaries relating to regulatory requirements and ongoing institution management. In fact, FCA is essentially now placing itself in the position of being board and management for Farmer Mac, which is entirely inappropriate and problematic. There is no assurance that requiring a risk officer is the best way from a safety and soundness or regulatory compliance perspective for accomplishing the spirt and intent of the proposed regulatory risk management provisions. FCA offers no logical business, regulatory, or policy basis that justifies imposing such a burdensome and inappropriate requirement. As long practiced by safety and soundness regulators, FCA should use its examination authorities to determine if an RO or other structure is needed to manage risk rather than using regulatory fiat to accomplish that outcome. Accordingly, proposed Section 653.3(c) should be deleted.

Section 653.4 Internal Controls

Section 653.4 of the proposed rule requires the Corporation to report to OSMO annually on the effectiveness of the internal control system. We find this to be an overreach of authority, burdensome, and problematic given it implies a report is sufficient from a regulatory oversight perspective. Rather than relying on a reporting requirement, it would be logical for FCA use its examination function and supervisory authority, which is made explicit in Sections 650.2 and 650.3 of the proposed rule, to determine the effectiveness of the Corporation's internal control program through rigorous annual examinations. We fear that such a reporting requirement, were it to exist, would have the potential to allow FCA to excuse itself from conducting rigorous examination and supervision of the Corporation as part of the agency's safety and soundness responsibilities with respect to the Corporation.

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Thank you for your consideration of our comments on these important matters. We would be pleased to discuss any of our comments with you further, at your request.

Respectfully submitted,

CoBank, ACB and CoBank, FCB

Robert B. Engel
Chief Executive Officer

Farm Credit Bank of Texas

Larry R. Doyle
Chief Executive Officer