AgCREDIT

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October 22, 2018

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

RE: Proposed Rule – Organization; Definitions; Eligibility Criteria for Outside Directors (12 CFR Parts 611 and 619)
RIN 3052-AC97

Dear Mr. Mardock:

Ag Credit ACA submits the following comments to the Farm Credit Administration (FCA) in response to the notice published in the Federal Register on August 24, 2018, requesting comments on the Organization, Definitions, and Eligibility Criteria for Outside Directors (the "Proposed Rule").

Ag Credit recognizes and appreciates the efforts expended in drafting the Proposed Rule and supports certain of the proposed changes. However, there are several provisions contained within the Proposed Rule that we believe are unnecessary, overly burdensome and would result in making it more difficult for our association to find and recruit qualified outside directors.

Ag Credit is generally supportive of the positions taken by Ag First Farm Credit Bank and the Farm Credit Council with regard to their comments on the Proposed Rule.

Ag Credit believes that consideration should be given to suspending action on the Proposed Rule until such time as the rule on Standards of Conflict is final. Clearly, there is overlap between the Standards of Conduct draft rule and the Proposed Rule and the form of the final rule on Standards of Conduct will affect the Proposed Rule.

Current Impact to our Outside Directors

Ag Credit will discuss below its section-by-section concerns with the Proposed Rule. However, if FCA were to adopt the Proposed Rule, as presented, we believe it is appropriate to describe the immediate impact to our association.

Ag Credit currently has two outside directors, one of whom is our financial expert. One of our outside directors has been with our association since 2012 and is an individual that worked in private industry, not related to agriculture, for over thirty years. This outside director has provided valuable input from his years of experience in private industry to our association and members for the past almost seven years. However, under the Proposed Rule this director would be disqualified and no longer able to serve our association as his sister, after his initial appointment, became a small borrower on a rural home loan and home equity line of credit.

We have found in our experience with this director, that the existence of a sister who has two small loans does not create and has not created a conflict of interest or affected his ability to fulfill his

obligations as a director. We would note that if a conflict of interest did arise, the current Standards of Conduct provisions would allow us to manage any such issue and to that extent believe that many of the provisions in the Proposed Rule are unnecessary to manage or prevent conflicts of interest.

We believe that the foregoing is representative of the potential impact of the overly broad scope of the Proposed Rule. There is little risk of an actual or perceived conflict of interest arising from the fact that this outside director's sister has two loans with our association. However, despite the absence of any conflict or potential conflict of interest, the director would no longer be able to serve our association and our association would be worse off without this director. The Proposed Rule does not, for the most part, assist us in carrying out our obligations, it simply makes finding qualified directors unnecessarily difficult.

Ag Credit would note as well that we are currently considering additional individuals for appointment as a third outside director.[1] As we embark on that search we are finding that the pool of potential candidates willing to serve as an outside director is fairly small. We believe that if the Proposed Rule were adopted as written, that the potential pool of candidates would be significantly, and unnecessarily, reduced.

Section-by-Section Comments

Definitions (Proposed §611.220(a))

Affiliated Organization (Proposed §611.220(a) (1))

The Proposed Rule adds "affiliated organization" to the definitions in 611.220. Language in the definition provides "organized for the benefit of, and in support of, an institution, and conducts activities that advance the mission of an institution" which would be overly broad in application. This language would appear to impact institutions like Farm Credit Council, Farm Credit Council Services, Future Farmers of America, Farm Bureau Insurance, and any number of other entities that "conduct activities that advance the mission of" a Farm Credit institution. This provision should either be deleted or revised to better reflect the intent of the definition. For example, adding the word "solely" before "organized and operated" and replacing "that advance the mission of" with "on behalf of" would restrict the definition more appropriately.

Borrower (Proposed §611.220(a)(2))

Ag Credit strongly objects to the proposed definition of "borrower" as the language is overly broad with regard to the potential list of individuals that would be excluded from consideration as an outside director. For example, the inclusion of "or purchased a loan or participation interest in a loan" is overly expansive. The sentence should specify application to the individuals receiving the loan in a participation. In addition, the inclusion of leases is problematic and overly limiting. While the provision is likely intended to apply to farm equipment leases, the language as currently drafted would apply to all leases, including commercial real estate leases.

We also note the use of the word "has" in the following context: "to which an institution *has* made a loan or a commitment to make a loan [emphasis added]" and "to whom an institution *has*

[1] Ag Credit previously had three outside directors. However, approximately two years ago one of our outside directors retired. Interestingly, under the Proposed Rule that director also would now be disqualified from serving.

made a lease or a commitment to make a lease [emphasis added]." This word choice would appear to include all individuals and entities who have ever had a loan, a pending loan, a lease, or a pending lease, regardless of whether the loan or lease has expired or been satisfied or was ever even consummated. Based on the current language of the proposed definition, if a candidate, or the immediate family member of a candidate, had a loan twenty or thirty years prior, that person would be permanently excluded from the list of outside director candidates.

The application of such a broad exclusion would serve to unnecessarily diminish the pool of potential candidates for outside director positions. Further, the use of the word "has" would appear to be in conflict with certain language in proposed §611.220(b)(1)(i) (discussed in greater detail below) which seems to suggest application only to existing relationships. Ag Credit requests amending the language to limit application to current or pending lending or lease relationships.

The new definition for "borrower" is problematic with its inclusion of guarantors. Guarantors are not able to run for stockholder-elected seats to the board as they are not considered "voting stockholders," and System associations are only permitted to appoint voting stockholders to serve as directors.[2] As such, by also exempting guarantors from serving as an outside director, this entire class of individuals, many of whom may have compelling qualifications, would be disqualified from association board service of any type. We believe that guarantors should not be included in the definition of "borrower."

Controlling Interest (Proposed §611.220(a)(3))

The Supplementary Information to the Proposed Rule states "The new term *controlling interest* is consistent with the definition of controlled entity found in §612.2130(c)." We note, however, that the definition of "controlled entity" and "entity controlled by" would be removed by the pending Proposed Rule on Standards of Conduct (12 CFR Part 612) published in the Federal Register on June 15, 2018 (the "SOC Proposed Rule"). This definition would be replaced with "reportable business entity" and would no longer reference a percentage for the determination of control. Supplementary Information to the SOC proposed rule states:

> The proposed rule would provide that a reportable business entity is an entity in which the reporting individual, directly or indirectly or acting through or in concert with one or more persons, owns a material percentage of the equity; owns, controls, or has the power to vote a material percentage of any class of voting securities; or has the power to exercise a material influence over management of policies of such entity. We would make this change to avoid confusion with the term ''control'' in the corporate context, and to allow the System institution discretion to determine how much interest represents a conflict. This determination may vary depending on whether the entity is private, public, profit, or not for profit. The intent of this provision is to require directors and employees to identify and report any business interest that is significant enough to create a conflict of interest or the appearance of a conflict of interest when considered from the perspective of an ordinarily prudent and reasonable person.

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[2] The FCA has specifically stated "FCA believes it is permissible under the Act for Farm Credit bank and association boards of directors to appoint stockholders to serve as directors (other appointed directors), serving as an outside director, except that associations may only appoint voting stockholders under sections 2.1 and 2.11 of the Act [emphasis added]." BL-009 (Revised December 15, 2006).

Given the Proposed Rule's stated purpose of consistency with §612.2130(c), we find this comparison troubling and confusing considering the planned change to the section. We note that the reporting requirement related to a "reportable business entity" under the SOC Proposed Rule is overly broad and that reporting should be limited to entities conducting business with the System institution or any institution supervised by the System institution. Accordingly, we ask that the discussion related to the definition of "controlling interest" retain the format in the current proposed §612.220(a)(3) (with the exception noted below). In addition, the discussion in the Supplementary Information referencing the definition in §612.2130(c) should be amended to be consistent with the outcome of the SOC Proposed Rule.

In addition, the Supplementary Information to the Proposed Rule related to a "controlling interest" states "[t]he proposed rule would not limit employees of entity borrowers or affiliated organizations from consideration as an outside director." Proposed §611.220(a)(3), however, provides that a "controlling interest" includes "an individual that, directly or indirectly, or acting through or in concert with one or more persons: ...(iii) Has the power to exercise a controlling influence over the management of policies of such entity." Given the potential for issues related to whether an employee of an entity potentially has the "power" provided for in proposed §611.220(a)(3)(iii), we request that §611.220(a)(3)(iii) be amended to read as follows: "(iii) Has the power to exercise a controlling influence over the management of policies of such entity; provided, however, such limitation shall not apply to an individual acting in the capacity of officer or employee of an entity." Without this specific delineation in the regulation, the regulation would be overly burdensome and broad and would make it increasingly and unnecessarily difficult to identify and qualify appropriate outside director candidates.

Immediate Family Member (Proposed §611.220(a)(5))

The application of the proposed broadly defined term "immediate family member" would also be unduly burdensome and would create an undue hardship on our ability to identify and qualify appropriate outside director candidates. The proposed regulation would prevent an individual from serving as an outside director if a member of their "immediate family" were a director, officer, employee, agent, stockholder, or borrower of any system institution. As noted above one of our two existing outside directors would be disqualified with the expanded definition.

We are particularly concerned with the inclusion of "in-laws" in the proposed definition. While we recognize the implementation by the FCA of rules similar to those applicable to public corporations, we believe such restrictions are not necessary or appropriate given the nature of System institution ownership and board construction. Our Association and many associations in the System do not have a board comprised primarily of executive managers or others traditionally deemed "insiders" by public corporations. The concerns with regard to outside directors of public corporations are not the same as those for System institutions. The definitions and restrictions applicable to public corporations are not appropriate for System institutions.

Our concern with the inclusion of "in-laws" in the proposed definition is magnified when applying this definition in conjunction with the term "agent." For example, potential outside director candidates would be eliminated from consideration if an "in-law" acts as an agent for any Farm Credit institution, regardless of proximity. This application is too restrictive and overly broad in that it potentially covers individuals who are remote to the potential candidate and the involved

institution. "Agents" could include large companies with offices nationwide, and it is unreasonable to disqualify a potential candidate because a distant or unfamiliar in-law might work for such an agent in a role unrelated to Farm Credit. The references to "in-laws" should be removed from the definition of "immediate family member."

The definition of "immediate family member" should be limited to individuals or "family members" who reside in the same household, conduct business jointly or in partnership, and/or are otherwise involved in coordinated or combined financial obligations. Said another way, the definition should be limited to those individuals that might actually have a conflict of interest. The proposed definition, as drafted, is too far-reaching and results in eliminating too many potential candidates.

Eligibility, Number and Term (Proposed §611.220(b))

We have serious concerns regarding the interpretation and application of proposed §611.220(b). Proposed §611.220(b)(1) provides in pertinent part:

> Eligibility to serve, and continue serving as an outside director requires independence from affiliations with the Farm Credit System. Farm Credit banks and associations must make a reasonable effort to select outside directors possessing some or all of the desired director qualifications identified pursuant to §611.210(a).

The Supplementary Information for proposed §611.220(b) suggests that this proposal is applicable only to candidates/nominees as specified in the following statement: "We propose modifying the existing outside director eligibility criteria in §611.220(a) by expanding the list of persons who would be excluded from nomination for an outside director's seat." Further, existing §611.220(a)(1) applies the eligibility requirements to "candidates for an outside director position." However, the language in proposed §611.220(b)(1) would govern eligibility "to serve, *and continue serving* [emphasis added]." Additional confusion is created by proposed §611.220(b)(1)(i) which specifically refers to a "candidate."

We believe the "continue serving" language in the proposed regulation creates confusion, and would potentially require the removal of a sitting outside director in the event a relationship is no longer allowed. The impact of this provision would be disruptive to the appropriate and timely conduct of business by a board of directors. Given the statutory and regulatory requirements that all System institution boards must have outside directors,[3] in the event sitting outside directors are deemed ineligible to serve, it is unclear as to whether or not our board would have the ability to vote and take action during the period required to identify and qualify a new outside director.

Furthermore, should it be determined that this new rule applies to sitting outside directors, questions arise with regard to the necessity of a new reporting process for such outside directors. We request clarification regarding the application of the Proposed Rule to sitting outside directors and, if the rule is deemed applicable to sitting outside directors, the appropriate process for boards to take action during the interim period required to identify and qualify a new outside director. In addition, FCA should clarify whether the outside director would be granted the opportunity to

[3] See Sections 1.4, 2.1, 2.11, 3.2, 3.21(b)(1)(C) and 7.12(c)(3)(A) of the Farm Credit Act of 1971, Pub. L. 92-181, 85 Stat. 583; FCA Reg. §611.220(a)(2); FCA Prop. Reg. §611.220(b)(2).

resolve the conflict to avoid disqualification.

Proposed §611.220(b)(1)(i)

Proposed §611.220(b)(1)(i) also creates cause for concern with regard to its application and the potential for confusion. The language in the Proposed Rule provides:

> No candidate for an outside director position may be a director, officer, employee, agent, stockholder, or borrower of an institution in the Farm Credit System or be an immediate family member of any of the above. An outside director candidate or an immediate family member of such candidate must not have a controlling interest in: (A) An entity that borrows from a System institution; or (B) An affiliated organization of a System institution.

As an initial matter, the Proposed Rule's use of the terms "be," "must not have" and "borrows" suggest application only to existing relationships. As previously discussed with regard to the proposed definition of "borrower," we note the apparent inconsistency of application within the Proposed Rule. We request that this section and the definition of "borrower" be amended to make clear that only existing relationships are considered for purposes of the Proposed Rule. In the alternative, we request that application to past relationships should be restricted to a specific, reasonable timeframe (such as within the prior five years). Absent such a clarification or qualification, the application of the Proposed Rule would be unduly burdensome in its elimination of a broad pool of potential candidates.

We note that there appears to be a conflict between the Supplementary Information to the Proposed Rule and the actual wording in the Proposed Rule. The Supplementary Information states "The proposed rule would add the following to the list of persons excluded from consideration for an outside director position: (1) Borrowers of *the* institution [emphasis added]." However, proposed §611.220(b)(1)(i) specifically references "of *an* institution in the Farm Credit System [emphasis added]." This discrepancy creates a significant conflict between the Supplementary Information and the proposed regulation with vastly different potential application and resulting impact on potential outside director candidates. We request that proposed §611.220(b)(1)(i) be corrected to reflect "the institution."

We understand and appreciate the intent related to the inclusion of "agent" in the Proposed Rule, but we note the lack of an accompanying new defined term for "agent." Rather, "agent" is defined in §612.2130(a), and the Supplementary Information to the Proposed Rule consistently refers to the definitions in §612.2130. Based on this understanding, we are left to assume that §612.2130(a) would provide the governing definition of the term "agent." If this is the case, then construction of the term "agent" may be problematic due to the pending SOC Proposed Rule. As currently proposed, the SOC Proposed Rule would greatly increase the scope of agents, potentially including cyber/technology service providers, and many other institution vendors.

Our concern over the meaning of "agent" is magnified when coupled with the new definition of "immediate family member," as the combined impact of these definitions would be substantial. We have serious concern regarding the impact of this potential broad "agent" rule, particularly as in much of our territory we have few options with regard to service providers and vendors. Use of

this broad construction of the term "agent" for purposes of outside directors would be too far-reaching and would create an undue hardship on our attempt to identify and qualify outside directors.

Should the prohibition related to immediate family members of agents, stockholders, and borrowers of the institution remain in the Proposed Rule, language clarifying a "to the best of the outside director's knowledge" or a "knows or has reason to know" standard should be added. Without some form of qualification, the proposal as currently drafted would create an impossible hardship on institutions and candidates in trying to find and disclose all of the enumerated relationships. For example, an outside director candidate cannot reasonably be expected to know the intricacies of every relationship of his or her "immediate family members," and especially in their role as a potential "agent." Also, without this qualifying language, Farm Credit institutions will be required to provide lists of all agents, stockholders, and borrowers to outside director candidates which could involve thousands of names. This requirement would be overly burdensome and administratively costly to produce and keep current, and nearly impossible for the candidates to vet.

In addition, the nature of these requirements would appear to be beyond the FCA's scope and intended purpose as the impact would involve requiring loan and employment reporting for individuals not otherwise connected with the System (i.e., "family members" of potential candidates). The resulting public perception might be that the System is overly restrictive, which could further diminish the pool of interested candidates.

We have concerns related to other substantial requirements in proposed §611.220(b)(1)(i). The Proposed Rule states "An outside director candidate or an immediate family member of such candidate must not have a controlling interest in: (A) An entity that borrows from a System institution; or (B) An affiliated organization of a System institution." This proposal exemplifies the culmination of the various overly broad definitions and the compounding effect on institutions and the potential candidates themselves. Specifically, we begin to see the impact and ripple effects caused by the prior discussions of "immediate family member," "controlling interest," and "affiliated organization." As these overly broad terms are layered upon one another, the reach of the definitions becomes magnified to an impossible level.

First, with regard to the prohibition related to "affiliated organizations" in proposed §611.220(b)(1)(i)(B), we will be forced to develop processes for identifying and maintaining a list of any and all such organizations. This information then will need to be shared with outside director candidates for consideration during the nominations process, and sitting outside directors also would be required to periodically review this information for continued eligibility. Without clarification with regard to the intent and extent of "affiliated organizations" (as previously discussed), this requirement will serve as an additional extreme limitation on the pool of potential outside director candidates.

The application of the standards in the Proposed Rule creates absurd results which do not further the stated goals. By example, if a potential candidate for our association has a brother-in-law serving on a local 4-H board in Washington State, or for that matter anywhere in the United States, under the Proposed Rule the candidate would not be eligible to serve as an outside director. The issue facing institutions and candidates is made even more impossible where the potential candidate has no knowledge of the brother-in-law's involvement with 4-H. We ask that the FCA consider the cumulative impact of these requirements, not only on the pool of available candidates,

but on the institutions as well given the costs of administration related to gathering and monitoring this level of information. Limiting the definitions, as previously discussed, will lessen the impact on both.

In addition, with regard to the administrative burdens and costs associated with the application of the Proposed Rule, it is impractical for our association to be expected to know or learn whether an whether an "immediate family member" of an outside director candidate "exercises controlling influence over the management of policies" (proposed §611.220(a)(3)(iii)) of an "affiliated organization."

Finally, it would be all but impossible for our association to verify any of this information, particularly given situations where the other involved entity will not share employment information with a System institution. These points further illustrate that our association will face unnecessary hardships and administrative costs associated with instituting and maintaining necessary and appropriate reporting and verification processes to satisfy the requirements of the Proposed Rule, particularly with regard to implications associated with the interplay of "family members," "control," and "affiliated organizations."

We request that further consideration be given to the overall impact of proposed §611.220(b)(1)(i)(B) given the impact of the overly broad defined terms and the difficulty with complying with the potential requirements. We further request confirmation that we will not be required to verify such information, and instead will be able to rely on self- disclosure as part of an annual certification process similar to that provided for by the standard of conduct rules.

Compliance Date

As the Proposed Rule comingles applicability of candidate eligibility with current director eligibility, we would appreciate clarification on the expectation for handling sitting directors following implementation of the final rule. In light of potential expanded prohibitions, we request that the FCA consider a "grandfather clause" applicable to current sitting outside directors until their current term expires. In addition, we again note the overlap and interplay of the Proposed Rule with the SOC Proposed Rule, to include references in the Proposed Rule's Supplementary Information to definitions in §612.2130(c) that are currently proposed to be amended. Given the direct ties between the two proposals, we would request that comment period of the Proposed Rule be delayed until the SOC Proposed Rule has been finalized.

Conclusion

Identifying and qualifying outside director candidates of the highest quality and ability is a priority for our association. The Proposed Rule imposes significant administrative burdens as well as challenging identification and qualification issues for our association. We believe that without question the Proposed Rule will not only result in increased administrative costs, but also severely limit the pool of individuals who may be willing to bring their expertise to our board, all with little or no benefit to our association or the System.

We respectfully ask that the FCA consider the comments of AgFirst, the Farm Credit Council and other System comments to revise the Proposed Rule to reduce unnecessary administrative burdens and clarify responsibilities and requirements so that we are not hindered in the advancement of the mission of the Farm Credit System to provide financing to our rural and agricultural communities.

Thank you for the opportunity to comment.

Respectfully submitted,

Ag Credit ACA

Brian J. Ricker
President and Chief Executive Officer