FARM CREDIT
OF FLORIDA

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:

Farm Credit of Florida (the "Association") appreciates the opportunity to submit comments to the Farm Credit Administration ("FCA") in response to the notice published in the Federal Register on August 24, 2018, requesting comments on proposed amendments to the regulations on the Organization, Definitions, and Eligibility Criteria for Outside Directors (the "Proposed Rule"). The Association has a vested interest on behalf of its stockholders to maintain high standards of impartiality and independence in the operation and function of their respective boards of directors and to pursue necessary and appropriate steps to ensure the safety and soundness of the Farm Credit System (the "System"). However, we are concerned that the Proposed Regulations, as currently drafted, are overly broad in potential application, create significant administrative costs, and pose serious threats to the identification and qualification of appropriate candidates to fill the important positions created and intended by the FCA regulations. In addition to this letter, the Association would like to indicate its general support of the AgFirst Farm Credit Bank's comments, and the Farm Credit Council's comments on the Proposed Rule.

Definitions (Proposed § 611.220(a))

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

The Proposed Rule adds "affiliated organization" to the definitions in Section 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 Funding Corporation, 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 be revised to better reflect the

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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))

The Association notes a number of issues with the proposed definition of “borrower” as the language is overly broad. 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. The Association requests that this language be revised to accommodate these concerns.

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* 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 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. The Association requests amending the language to limit application to current or pending lending or lease relationships.

The new definition for “borrower” is especially troubling in its inclusion of guarantors. Because guarantors are not obligors on the loan and do not sign a promissory note, this language will potentially cause confusion with regard to an institution’s understanding and treatment of guarantors as “borrowers” for other purposes, such as borrower rights. Furthermore, the inclusion of guarantors in the definition of “borrower” can have consequences under state law. For example, the ability of Farm Credit institutions to seek repayment from guarantors under state law could be detrimentally affected by this definition. As guarantors are not borrowers for these purposes, this new definition may cause unintended consequences by allowing guarantors to challenge the legal basis of the guarantee or to move them into a protected status not afforded by their state law. While the challenge should not be successful, there will be additional expense and time to the process of collection under the guarantee.

In addition, we express particular concern over the impact of the Proposed Rule on our Association. 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.[1] As such, by also exempting guarantors from serving

[1] 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),

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. Based on the foregoing, the Association requests that additional consideration is given to the above concerns related to the inclusion of guarantors 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.

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

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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).

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 impact of the regulation would be overly burdensome and broad and would create undue hardship on an institution in its attempt 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 an institution in its attempt to identify and qualify appropriate outside director candidates. Specifically, the proposed regulation would prevent an individual from serving as an outside director if a member of their "immediate family" is a director, officer, employee, agent, stockholder, or borrower of any system institution. The Association is 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, the Association believes such restrictions are not necessary or appropriate given the nature of System institution ownership and board construction. Generally, System institutions 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, and as a result the definitions and restrictions applicable to public corporations are not automatically appropriate for System institutions.

The Association's 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 Association requests that references to "in-laws" be removed from the definition of "immediate family member." Other concerns related to "agents" are discussed below related to proposed § 611.220(b)(1).

In the alternative, the Association suggests that 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. The proposed definition, as drafted, is too far-reaching and results in eliminating too many potential candidates. The definition should be restricted to cover familial relationships that could genuinely create a potential for a conflict of interest, as contemplated by discussion in the Supplementary Information to the Proposed Rule,

focusing on whether "the outside director [can] adequately fulfill the intended independent role of an outside director."

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

The Association has 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).

As an initial matter, the Association notes that 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."

Based on the foregoing, the Association believes 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,[2] in the event sitting outside directors are deemed ineligible to serve, the Association questions the board's 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. The Association requests 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, the Association requests clarification with regard to whether the outside director would be granted the opportunity to resolve the conflict to avoid disqualification. Furthermore, current FCA Regulation § 611.220(b) (proposed § 611.220(c)) and System institution bylaws and policies provide that a majority vote of all voting stockholders or a two-thirds majority vote of the full board of directors is required to remove an outside director before the expiration of the outside director's term. We request clarification on the treatment of a

[2] 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).

situation in which the shareholders or the board do not receive the necessary vote to remove an outside director and/or whether the Proposed Rule will require such bylaws and policies be amended to implement a new standard.

Proposed § 611.220(b)(1)(i)

Proposed § 611.220(b)(1)(i) also creates cause for concern with regard to application and potential confusion. The proposed regulation 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, and the Association requests clarification that past relationships are not contemplated. Specifically, we request that this section and the definition of "borrower" be amended to stipulate 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.

The Association notes that there appears to be a conflict between the Supplementary Information to the Proposed Rule and the actual wording in the proposed regulation. 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. The Association requests that proposed § 611.220(b)(1)(i) be corrected to reflect "the institution."

The Association understands and appreciates 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. This 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. The Association has expressed serious concern regarding the impact of this potential broad "agent" rule, particularly on rural territories that have fewer 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 institutions in their 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, the Association requests language clarifying a "to the best of the outside director's knowledge" or a "knows or has reason to know" standard. Without some form of qualification, the proposal as currently drafted would create an impossible hardship on institutions and the candidates themselves. For example, an outside director candidate cannot 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 tens of 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.

The Association has numerous 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), the Association notes that System institutions 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 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. For example, an individual serving on the board of the local Farm Bureau in Tulsa, Oklahoma (as an entity that

theoretically "conducts activities that advance the mission of an institution" as provided for in the proposed definition of an "affiliated organization") would not be eligible to serve as an outside director based on the current perceived application of the Proposed Rule. Similarly, if a potential candidate (living in Atlanta, Georgia) has a brother-in-law serving for the local Farm Bureau in Tulsa, Oklahoma, 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 Farm Bureau. The Association requests 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, the Association asserts that it is impractical for a System institution to be expected to know or learn whether an outside director candidate "exercises controlling influence over the management of policies" (proposed § 611.220(a)(3)(iii)) of an "affiliated organization." Even more burdensome, the Association cannot be expected to determine whether an "immediate family member" exercises this level of influence. Finally, the Association asserts that it would be impossible for a System institution 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 System institutions will face undue 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." As a result, the Association requests 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 inability for System institutions to satisfy the potential requirements. We further request confirmation that the Association 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.

Proposed § 611.220(b)(1)(ii)

Proposed § 611.220(b)(1)(ii) provides "At any given time, an outside director is eligible to serve on the board of directors of only one Farm Credit System institution or affiliated organization." The Association again notes that the feasibility of this requirement cannot be accurately determined without clarification on the intent and extent of organizations included as "affiliated organizations."

The Association appreciates the clarification in Footnote 4 of the Supplementary Information to the Proposed Rule that ACAs, PCAs, and FLCAs are not considered separate entities for purposes of this rule.

Compliance Date

As the Proposed Rule comingles applicability of candidate eligibility with current director eligibility, the Association would appreciate clarification on the expectation for handling sitting directors following implementation of the final rule. In light of potential expanded prohibitions, the Association would 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 the effective date of the Proposed Rule be delayed until the SOC Proposed Rule has been finalized.

General Considerations

The Association notes that the issues raised above would require an additional and much more in-depth reporting process for outside directors than a stockholder-elected director. These requirements seem to conflict with the ongoing emphasis in other FCA regulations and guidance that outside directors should not be treated differently than stockholder-elected directors. We also note that the Proposed Rule is silent with regard to reporting frequency and request more guidance and clarification in this regard.

Furthermore, the Association again notes that the FCA appears to be applying outside director requirements generally accepted in the public sector to System institutions that are significantly, and importantly, different from public corporations. As previously discussed, System stockholders do not have the same material financial investments in Association stock that a stockholder of a public corporation might, and the board of directors of System institutions are not comprised primarily of executive managers or others traditionally deemed "insiders" by public corporations. As a result, the concerns with regard to outside directors of public corporations are not the same as those for System institutions. Furthermore, in many cases System territories have smaller pools of outside director candidates who are both able and willing to make a meaningful difference in helping elected directors with oversight of critical areas like legal, financial, technology, and/or human resources. The impact of the Proposed Rule serves to shrink this available pool to an unmanageable and unsustainable degree. The Association believes that expertise, character, understanding of the System, and acceptance of fiduciary duty should trump some of the concerns focused on in the Proposed Rule.

Conclusion

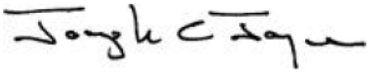
Identifying and qualifying outside director candidates of the highest quality and ability is a priority for the Association. While we agree with the intent and objectives of the Proposed Rule to strengthen the safety and soundness of System institutions and to strengthen the independence of System institution boards, the Proposed Rule imposes significant administrative burdens as well as challenging identification and qualification issues for System institutions. Institutions will ultimately be responsible for vetting the independence of potential candidates and sitting outside directors using the criteria set forth in the final rule. The more reasonable the

criteria, the more effective and efficient that vetting process will be. Furthermore, the Proposed Rule will not only result in increased administrative costs, but also severely limit the pool of directors who may be willing to bring their expertise to the boards of the Association.

We respectfully ask that the FCA consider the Association's, AgFirst's and other District 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. Again, we sincerely thank you for the opportunity to constructively comment on the Proposed Rule.

Respectfully submitted,

Farm Credit of Florida



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