



October 22, 2018

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

RE: Proposed Rule on Standards of Conduct – RIN 3052-AC97 / *Federal Register*  
83, No. 165 (August 21, 2018) 2018-42807

Dear Mr. Mardock:

Farm Credit of New Mexico (FCNM) appreciates the opportunity to comment on the Farm Credit Administration's (FCA) proposed rule amendments regarding outside director eligibility criteria. We understand and agree with the importance of outside directors and objectives for the amended rules outlined in the background of the proposed rule including the following:

"Outside directors are appointed by stockholder-elected directors to provide independent perspective and expertise in appropriate areas. Outside directors achieve this by broadening the board's collective knowledge, enhancing the board's independence, and improving the board's ability to carry out its fiduciary duties to the System institution, stockholders and investors."

### **Overall Comments**

While we understand and agree with the importance of Outside directors and the stated objectives for the amendment, we are concerned that the amendments extend the independence requirements farther than is necessary to provide independent perspective and expertise. Our primary concern is the proposed rule will impair our ability to identify and attract a sufficient number of quality candidates for our outside director positions under the more stringent requirements proposed.

The requirements in the Farm Credit Act ("Act") regarding the election of at least one member of the board by the other board members who "shall not be a director, officer, employee, stockholder, (and with respect to associations), or agent of a System institution" were established in the 1987 Amendments to the Act. The Act does not use the term "Outside" to describe those

directors. While use of the Outside director term in the regulations may have some benefit in terms of distinguishing the types or classes of directors serving on System institution boards, it is also seriously misleading in that it creates the appearance that our stockholder-elected directors are “inside”. The term “inside” as it applies to directors, is consistently used in corporate governance to refer to those directors who are members of management or are otherwise selected by management. All other directors are consistently referred to in corporate governance as outside directors. Based upon the consistent prevailing use of the term outside director, all System directors are independent of management, and under our regulations no System employees, management or otherwise, are permitted to serve on bank or association boards. It is also important to note that the purpose for the inclusion of appointed directors was to gain financial expertise and a broader perspective for System entity boards.

## **Comments on the revised Section**

### **Section 611.220 (a) Definitions.**

The term “affiliated organization” is unclear and ambiguous. The statute already clearly prohibits Farm Credit entity directors from serving on boards of any other System institution. The term “affiliated organization” is vague and may suggest a wide array of agricultural organizations including: those that support farmers and ranchers generally, special interest groups such as Young, Beginning and Small Farmers or other organizations that may align with System institutions on various issues. It is common for existing Board members of associations to serve on the boards of any number of advisory organizations that provide input to their respective funding banks. The definition specifically refers to service on an affiliated organization that supports the mission of “an” institution. Presumably, the institution in question is the one for which the candidate is being considered, but that is not clear. It also does not appear to address service on an organization which advances the mission of the System as a whole or any System institution.

This definition is particularly troublesome in the context of the proposed rule which prohibits outside directors from service on more than one board. Outside directors who have been duly elected as board members should be fully engaged and not limited in their service, except as to other System institutions. Expanding the breadth to affiliated organizations will deny the System institutions of Outside directors with broader perspective in all the affairs of the System. We see no reason to limit their participation.

The term “borrower” has been added so to expand the exclusion from eligibility for consideration to individuals other than stockholders who are otherwise indebted to the institution. As noted above, we believe the statutory language is clear. Nevertheless, we agree that distinction between a “stockholder” and a “borrower” may be arbitrary in some cases. In those situations, we believe the Standards of Conduct Process can be utilized to determine if the individual has a borrowing relationship which should exclude them from consideration. The impact of this exclusion becomes even more concerning when it is extended to prohibit service if an “immediate family member” is a borrower of any system institution and to prohibit service if any entities a director controls are borrowers utilizing a very low standard for control proposed.

### **§612.220 Outside Directors**

The proposed amended rule would substantially extend the current limitations on Outside directors. We are very concerned with the revised regulation which would exclude anyone as a candidate for an outside director position who may have a family member who is a “borrower” of

a System institution, or is a director, officer, employee, agent, stockholder of a System institution. The biggest concern is that extending the requirements for Outside directors to include prohibited relationships of immediate family members, will disqualify candidates who have immediate family members who have loans with any system institution.

Many of the people who have the financial and accounting skill sets together with reasonable knowledge of agricultural finance, all of which are desired for an Outside director, have “immediate family members” who are involved in agriculture. As a result these candidates often have one or more “immediate family members” who have loans from some system institution if not the same association. These same concerns apply to disqualifying outside director candidates who have any immediate family members who are a director, officer, employee, agent of any system institution. We believe that many potential candidates for Outside director positions may have one or more “immediate family members” who are either a director, officer, employee or agent of any system institution.

Candidates would not be eligible to serve as an Outside director if they or an immediate family member meets the defined control test for an entity that is borrower of an institution in the Farm Credit System. Applying this test to entities controlled by immediate family members with loans from any system institutions seems to go far beyond the level needed to materially enhance independence. Furthermore, the threshold for control is very low to be used even for immediate family members involved in entities that borrow directly from the same association.

### **Potential Impact on our Association**

Based on the proposed FCA changes to the Outside director eligibility guidelines, FCNM would incur a major setback on the current Board of Directors make-up. We have two current appointed directors who would be at risk.

We have a current director serving as Board Vice Chairman and Audit Chairman who would not meet the enhanced requirement. Because the rule describes eligibility to serve, and continue serving, as an outside director, it appears that he would have to resign his position immediately if the proposed regulation is finalized. The Audit Chairman would not meet the independence criteria, as his daughter-in-law works at another Farm Credit System Association in the Texas Farm Credit District. Farm Credit of New Mexico is associated with the CoBank District. The Audit Chairman has been an appointed Outside director since 2002 and is one of the leaders on the board. In addition to his 16 years of experience on our Board, he has four years of commercial banking and 30 years of appraisal experience. The Audit Chairman was appointed to fulfill the ‘outside financial expert’ requirement on the Farm Credit of New Mexico’s Board. He has served in this capacity admirably and FCNM would benefit greatly if he continues to serve in this important role.

FCNM has another appointed director who is also possibly at risk. The Vice-Chair of our Audit Committee is a stockholder who was appointed to the Board in 2013 to fulfill a vacancy on the Audit Committee due to the resignation of another financial expert the board had appointed. The Audit Vice-Chair’s appointment came about due to the new Diversity and Inclusion guidelines set forth by FCA during 2010-2011 timeframe. The memorandum sent out by FCA allowed a board to appoint a stockholder to fill a void within the existing board. The Audit Vice-Chair has over 36 years of commercial banking experience and FCNM’s board wanted to strengthen the Audit Committee by having numerous financial experts on said committee.

This director owns more than 5% interest in a family owned entity that borrows from FCNM and would be excluded for Board service if the regulation is construed to apply to all appointed directors as opposed to “Outside’ directors as defined in the draft.

Each of these directors sign an ethics agreement annually and disclosures of all relevant relationships annually that are reviewed by our Standards of Conduct Officer to determine any conflicts of interest and to consider whether recusal will address any potential conflicts. The confusing point of the revised Outside director eligibility requirements is that these same regulations do not apply to our elected directors, unless the immediate family member is employed at FCNM. An elected director would be able to have an immediate family member employed at another Farm Credit System Institution.

Farm Credit of New Mexico's Board is made up of 7 elected directors and three appointed directors to fulfil our financial expertise needs. FCA regulations only require two appointed directors, but with high demands of financial knowledge within the system today, our board has chosen to continue with three appointed directors – all with very strong financial backgrounds.

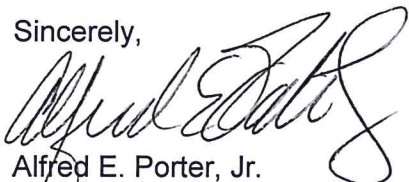
We are hopeful that FCA reconsiders these proposed eligibility guidelines so FCNM does not lose 66% of its Audit Committee Members and 20% of our existing board. We request that FCA recognize that independence may be maintained when directors have either immediate family members or controlled entities who are borrowers, employees, etc. with other System institutions. Another important factor is that it takes many years for directors to become familiar with FCA regulations and GAAP Accounting guidelines. This type of expertise is hard to come by and we are fortunate to have found in directors Drake and Shafer.

## **Conclusion**

Extending the disqualifications as far as the amendments propose will substantially limit our Association's ability to locate qualified outside directors. If the disqualifications were limited to "immediate family members" having the listed relationships with the Association (and perhaps adding its funding bank), the impact would be much more manageable for Associations. Limiting the additional prohibitions to "immediate family members" having the listed relationships with the Association and or its funding bank would still materially enhance increased independence which is the stated objective of the amendment.

Thank you again for allowing FCNM the opportunity to comment on this important regulation regarding outside directors. We hope that these comments will provide FCA with some perspective on how the proposed rule will affect the System from a practical standpoint. We consider this a very important topic and look forward to working with FCA to ensure a workable final rule. Please contact the undersigned or Alan Pedersen, General Counsel at (505) 875-6040 or email him at [alan.pedersen@farmcreditnm.com](mailto:alan.pedersen@farmcreditnm.com) if you wish to discuss our comments or require additional information in support of our comments.

Sincerely,



Alfred E. Porter, Jr.  
President and Chief Executive Officer