



FARM CREDIT COUNCIL

October 23, 2018

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

RE: Outside Directors Eligibility Criteria – RIN 3052-AC97/ Federal Register 83, No. 165
(August 24, 2018)

Dear Mr. Mardock,

The Farm Credit Council (Council), on behalf of its membership, appreciates the opportunity to comment on the Farm Credit Administration's (FCA) proposed rule published in the August 24, 2018 Federal Register (Proposed Rule) addressing eligibility requirements for the outside directors on the boards of directors of banks and associations of the Farm Credit System (System).

The comments that follow were developed after soliciting input from all System institutions. Following receipt of comments, a series of conference calls was held with a group of System representatives to discuss specific concerns. A draft comment letter was then circulated for further review and comment. Due to the significance of this proposed rulemaking to each bank and association, we anticipate that many System institutions will submit their own comments on various aspects of the Proposed Rule.

GENERAL COMMENTS

We are greatly concerned about the disruption that could occur if the Proposed Rule is adopted. In the process of developing this letter, we have had several institutions advise us that they believe their currently serving outside director(s) may be disqualified as a result of family members having borrowing or other prohibited relationships with the System. In such a situation, an institution could find itself without a qualified outside director until the position is filled, and thus not in compliance with either the statute or the regulation. Of equal concern is the impact the Proposed Rule will have on the recruitment of prospective outside directors. A candidate should not be required to ask a relative if they have a loan, or other prohibited relationship, with the System. Moreover, outside directors certainly should not be required to tell relatives that they cannot establish relationships with the System because of their position as outside directors. Adoption of the Proposed Rule will make it significantly more difficult to

recruit well-qualified, statutorily eligible candidates bringing diversity, a unique perspective and relevant experience to serve as outside directors.

We believe the Farm Credit Act (Act) provides a clear and unambiguous rule for the eligibility requirements for outside directors. The proposed regulations go well beyond the statutory requirements. The requirements in the 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, or agent of a System institution” were established in the 1987 Amendments to the Act. As FCA is well aware, all System directors are independent of management, and no System employees, management or otherwise, serve on bank or association boards. It is also important to note that the purpose for the inclusion of these board-elected directors was to provide expertise and perspective to the boards. (*Excerpts from the testimony from the FCA Board are attached for reference.*)

The Act specifically requires that the boards (including both stockholder-elected and board member-elected directors) be determined “in such manner, and with such qualifications as may be required by its bylaws...” (Emphasis added). The 1987 Amendments also specifically provide that FCA “shall not have authority, either direct or indirect, to approve bylaws, or any amendments or modifications or changes to bylaws, of System institutions.” FCA did not adopt any other eligibility requirements for outside directors until it promulgated 611.220 and 619.9235 in 2006, and those new regulations continue to mirror the exclusions from eligibility contained in the Act. In adopting the new regulations, the FCA described the limitation on their authority in 5.17(b) of the Act as “technical” in nature and not applicable to their action. We disagree and believe that the statutory language is clear and unambiguous. Indeed, for the period following passage of the 1987 Amendments to the Act until 2006, no additional regulatory restrictions existed.

Since the adoption of the 1987 Amendments, and following the adoption of FCA’s regulations in 2006, System bank and association boards have focused their outside director selection efforts on identifying candidates who not only meet the statutory, and now regulatory, requirements for independence, but also provide valuable background, knowledge, diversity and expertise that exceeds those requirements. Moreover, the banks and associations have taken affirmative efforts to fully engage those directors as fully participating members in their boards. As noted herein, we are concerned that the Proposed Rule will have the effect of limiting the role of outside directors in service to the board and the System. Excluding outside directors from service on “affiliated organizations” is contrary to the guidance FCA provided in Bookletter 009 (Revised), *Farm Credit Bank and Association Appointed Directors*. The Bookletter states that:

“All directors have the same fiduciary responsibilities to each institution’s stockholders, regardless of how they are selected. All directors must also have the same voting rights, and related responsibilities and duties, and be subject to the same rules and requirements, including requirements on pledges of confidentiality, disclosures, and conflicts of interest. Therefore, outside directors and other appointed directors have full voting rights on all matters that come before the board of directors.”

We do not see how limiting the role of outside directors is consistent with this guidance. We also do not see how it improves institution safety and soundness and, in fact, it may limit the effectiveness of outside directors. We strongly believe that once selected, outside directors should have the same roles, responsibilities and authorities as any other director.

We note that the FCA is currently considering changing the definitions of some of the terms used in this Proposed Rule as well as in their proposed rule regarding Standards of Conduct. Until the definitions in the Standards of Conduct rule are finalized, it is difficult to fully analyze their impact on this rule. Also, the FCA recently issued guidance on the nomination and election of stockholder-elected directors. That guidance will impact the determination of who is considered a “stockholder” and eligible to be elected as such, and thereby excluded from consideration as an outside director. Finally, as discussed below, some issues concerning the issue of the definition of “borrower” or as to the impact of an immediate family member’s activities could be better addressed by the Standards of Conduct review process.

The statutes regarding outside directors are clear and unambiguous. The additional restrictions in the Proposed Rule exceed FCA’s regulatory authority. For these reasons, as well as for the specific comments below, we are recommending that the FCA withdraw the Proposed Rule at this time. Once withdrawn, System representatives would like to meet with FCA officials to discuss issues and concerns and identify any significant deficiencies and how best they could be addressed. In the alternative, we are providing our specific comments to the Proposed Rule below.

SECTION-BY-SECTION COMMENTS

Section 611.220 (a) Definitions.

The new defined term “affiliated organization” is unclear and ambiguous and should be clarified. We are concerned that as currently written, the Proposed Rule could limit participation in organizations such as 4-H and FFA since these organizations support Young, Beginning and Small Farmers and therefore the System’s mission. In addition, association board members serve on any number of advisory organizations that provide input to their respective funding banks. The definition specifically refers to service on the board of 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. The definition also does not address board service for an organization that advances the mission of the System as a whole.

This affiliated organization concept is particularly troublesome in the context of the Proposed Rule’s prohibition of service on more than one System institution or affiliated organization board. This prohibition has the effect of limiting the role of outside directors. Once an outside director has been duly elected as a board member, he or she should be fully engaged and not limited in their service to Section 4.25 organizations or affiliated organizations. This can deny the System, and FCA, of outside directors’ perspective in all the affairs of the System. We see

no reason to limit their participation, and it is certainly contrary to all the guidance FCA has provided in the past concerning service by all directors.

The term “borrower” has been added 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 need clarification. In those situations, we believe the Standards of Conduct process can be utilized to determine if the prospective candidate or immediate family member, or a controlled entity of the candidate or family member, has a borrowing relationship that should exclude the prospective candidate from consideration.

Section 611.220 (b)

We strongly object to the exclusion of a prospective candidate for an outside director position who may have an immediate family member who is, or has a controlling interest in, a “borrower” of a System institution, or is a director, officer, employee, agent, stockholder of an institution. As proposed, this rule would presumably prohibit an association affiliated with one Farm Credit bank from selecting a well-qualified candidate if she had a sister residing across the country who worked for the accounting firm who audited an association affiliated with another Farm Credit bank. Similarly, it would presumably preclude that same person from consideration if her sister (again residing across the country and dealing with an association in a separate district) had signed as a co-obligor or otherwise cosigned on the rural resident loan of another family member. Such an exclusion goes well beyond any reasonable interpretation of the statutory exclusions, which do not include immediate family members. As a practical matter, it would be difficult for prospective candidate to even know that such a relationship existed. As noted at the outset, we believe a Standards of Conduct approach to this issue should be applied. Moreover, we believe that candidates should NOT be disqualified from consideration simply because they have a family member who has a relationship with an institution in the System. While not directly applicable, we note that Congress chose to address the issue with respect to disclosure of loan information for immediate family members of directors. Disclosures are only permitted in those cases where an immediate family member resides in the same household or the director has a material financial or legal interest in the loan or business operation of the family member. (Sec. 5.17 (a) (8) (B) of the Act).

As noted above, we object to the exclusion related to service on “affiliated organization” boards, particularly as it relates to service on such organizations following the selection to serve as outside director. We see no valid policy reason behind such a prohibition and it is contrary to the guidance provided by the FCA in Bookletter 009 (Revised). Also, as regards service on other System institution boards, when FCA adopted the existing rule, it noted that service on such a board would disqualify such a director from consideration for reelection to the board. We believe that service by outside directors on the boards of other System institutions, particularly Section 4.25 service organizations, may be desirable. As a practical matter, the

current rule discourages that service, as the individual would be precluded from seeking another term on their current board.

CONCLUSION

The System supports a strong, proactive program by the boards of directors of banks and associations to identify and select well-qualified, independent candidates for outside director positions. We are unaware of situations in which outside directors lack the “independence” required by Congress in the Act. The intent of Congress and, until now of the FCA, has been to fully engage outside directors in the affairs of the institution they serve. Of course, each bank and association is an integral part of the System as a whole. Restricting the selection of, and participation by, outside directors beyond the statutory requirements should be avoided. As we have noted, a Standards of Conduct approach can be utilized to determine if borrowing relationships or other activities by immediate family members compromise independence. We believe that the restrictions included in the Proposed Rule will have a very serious, negative impact on the System’s ability to attract otherwise eligible, well-qualified candidates for outside director seats. As mentioned previously, a number of current outside directors could possibly be disqualified if the Proposed Rule were adopted.

Accordingly, we urge the FCA to withdraw the Proposed Rule at this time so that System representatives could meet with FCA officials to discuss issues and concerns and identify any significant deficiencies and how best they could be addressed. We appreciate the opportunity to comment and trust that our comments, as well as those submitted by System institutions, will assist the Agency. If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script, appearing to read "Charles Dana".

Charles Dana
Senior Vice President, General Counsel
Farm Credit Council

Attachment

ATTACHMENT

1987 AMENDMENTS TO THE FARM CREDIT ACT FCA TESTIMONY ON THE ROLE OF OUTSIDE DIRECTORS HOUSE COMMITTEE ON AGRICULTURE

“Restructuring is a common thread running throughout the proposals. It is generally recognized by all interested parties that some form of restructuring must take place if the System is to continue to offer credit to agricultural producers. Variance in discussion appears to center on offering lending services by System institutions outside of traditional regional boundaries and using of outside directors on institution boards to bring a different perspective to operations. Outside directors can be a positive influence in improving business operations. When outside directors are discussed the communication often breaks down over how they should be chosen. The more important question than how is who. The involvement of outside directors with strong business credentials may offer a significant change in perspective and operations.”
Agricultural Credit Conditions, Problems, and Legislative Proposals, Relating to the Farmers Home Administration, the Farm Credit System, and Commercial Farm Lenders: Hearings Before the Subcommittee on Conservation, Credit, and Rural Development of the House Committee on Agriculture, 100th Cong. 1634-1635 (1987) (Statement of Frank W. Naylor, Jr., Chairman, Farm Credit Administration Board).

“I believe the expertise that outside directors could bring to system institutions would be considerable. Outside directors should be mandatory on the district level and encouraged among associations. They should be selected from among persons experienced in the financial market place and in financial management. They would, of course, have to be adequately compensated as an incentive to serve.”
Agricultural Credit Conditions, Problems, and Legislative Proposals, Relating to the Farmers Home Administration, the Farm Credit System, and Commercial Farm Lenders: Hearings Before the Subcommittee on Conservation, Credit, and Rural Development of the House Committee on Agriculture, 100th Cong. 1648 (1987) (Statement of Marvin R. Duncan, Member, Farm Credit Administration Board).