

May 21, 2014

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

Re: Proposed Rule on Standards of Conduct
RIN 3052-AC44

Dear Mr. Mardock:

I am writing to provide the following comments to the proposed rule on behalf of the Board and management of AgSouth Farm Credit, ACA (“AgSouth”). I wish to begin by taking the opportunity to thank the Farm Credit Administration (“FCA” or “Agency”) for engaging with System institutions to receive input on how to improve upon the oversight of standards of conduct. Our general feeling is that the proposed rule is a good first step at attempting to identify and address issues that the final regulation will need to take up.

Purpose for Standards of Conduct

One initial concern I would raise is that the proposed rule seems to be unnecessarily broad, perhaps to address specific fact patterns that have arisen. I would argue that in evaluating the need for additional rulemaking, FCA should remain focused on the underlying purposes for a standards of conduct regulation. As noted in the original comments to the 1994 regulation, the primary issues that should be addressed are (1) the use of insider information for personal benefit; (2) participating in deliberations on any question affecting the interest of insider or any related parties; and (3) obtaining special advantage or favoritism from others. Additional prohibitions discussed in the original rule looked at accepting or soliciting gifts by insiders or related parties, acquiring foreclosed property from the institution, and borrower from or lending to other insiders.

In evaluating the new proposed rules, the Agency should remain true to these original purposes and avoid expanding the regulations into areas that will be unduly burdensome to comply with or that will add little in the way of bolstering confidence in the integrity of the System. By creating additional administrative and technical requirements, focus is shifted from the primary goals noted above. That said, this rulemaking presents an opportunity to improve and modernize the existing processes and hopefully can add new value to the System and its shareholders with some of the proposed changes.

Code of Ethics, Policies and Procedures

AgSouth believes that it is critical to the maintenance of public confidence in Farm Credit that we have a mechanism for handling real and perceived conflicts of interest. Borrowers, loan applicants, employees and outsiders should always be assured that insiders do not receive preferential treatment. To that end, we applaud the proposed 612.2160(e), which would require directors and employees to certify annually that they will adhere to the institution's standards of conduct policy and Code of Ethics. Having a written Code of Ethics for all System employees sets the tone from the top that everyone is expected to do the right thing and that institution boards demand high standards of honesty and integrity.

However, requiring a Code of Ethics for an "agent" adds no value to the process and will simply create an unnecessary compliance burden. A Code of Ethics is designed to reflect values and policies intrinsic to an organization. As such, while that fits for directors and employees of the institution, it does not fit for third party providers. It would be more appropriate to have the agent represent that they have no known conflicts (other than dual representation) in the transaction in which they are engaged. Further, while the current definition of agent is less than clear, it has been generally understood that these are professionals that represent the System institution either regularly or on a transactional basis. The majority of these will be attorneys, accountants and appraisers who are already licensed, regulated and subject to professional and ethical standards.

We also support proposed 612.2165(b)(16), requiring annual training on standards of conduct to help ensure employees and directors understand their obligations. However, we would suggest that the Agency make clear that the training requirement be broad enough to include business ethics and related areas. It would not be of benefit to anyone to simply restate the regulations to employees and directors annually.

Lastly, requiring some sort of regular audit of the standards of conduct program, whether external as proposed under 612.2160(g) or internal, would help ensure that institutions were fulfilling their regulatory requirements. For that process to be meaningful in addressing potential weaknesses, it is important that such audit results be used by the institution to provide feedback on ways to improve or correct components of the program and not used against them by FCA as a substitute for their independent examination process.

Standards of Conduct Official

AgSouth supports proposed 612.2160(a)(1), requiring institutions to dedicate appropriate resources to support the standards of conduct program. This will help ensure adequate controls across the System and mitigate possible reputation risk. The task of the Standards of Conduct official can be a difficult one and assistance may be needed, especially in larger institutions, in order to fulfill all of the obligations set forth in the regulations and by institution policy.

Revised 612.2170(a) requires the board of directors to "designate an officer of the institution as the Standards of Conduct official". It would be more appropriate to simply require that the individual be "an employee of the institution" which would maintain the desired accountability, but give greater flexibility for the board of the institution to determine who best may fill that role. Further, many officers may have significant other responsibilities within the company that might not make them the best fit for serving as the Standards of Conduct official. This small change to replace

“officer” with “employee” would help ensure that the actual individual serving in this capacity had the adequate time to devote to his or her role.

If there is concern that such an individual might need some level of perceived comfort or protection from making controversial determinations or investigations, there are better alternatives than requiring them to be an officer of the institution. For example, you could modify the rule to restrict the termination or removal of the Standards of Conduct official to be an action of the board, along with mandatory reporting of any such removal (or voluntary withdrawal/resignation) and the reasons for the same to FCA within five (5) days of such action.

It would also be helpful to modify the proposal to permit exceptions under 612.2165(c)(1) as recommended by the Standards of Conduct official and approved by the board to extend beyond one year, if appropriate. Further, if these exceptions are reported to FCA and are subject to examination, then it would seem reasonable for FCA to modify the rule to permit a mechanism by which an institution could seek prior clearance from the Agency before the board acts to avoid later issues with examiners.

As to the role of the Standards of Conduct official, we would request that the Agency clarify in the final rule comments that it is not one of enforcement but rather is primarily advisory. In that regard, it is also important to clarify in guidance to examiners that accountability for violations, if any, rests with the institution or the specific employee, director or agent and not with the Standards of Conduct official. The rule reads as if the Standards of Conduct official is to be held responsible for the above, which would not be appropriate unless he or she willfully failed to discharge the duties set forth in the regulations and/or institution policy. Additionally, proposed 612.2170(d) is largely duplicative with the language in new 612.2170(a) and the two should be consolidated in the final rule.

Insider Loans and Transactions with Borrowers

While greater flexibility is needed in the context of permitting some level of transactions between insiders and borrowers, the proposal to delegate the definition of “material” to the institution would leave us exposed to the possibility of regulation by examination without clearer direction from FCA. A suggested fix would be minimum pre-approved amounts or the ability to submit their proposed policies and practices for prior approval by the Agency. Creating such guidance also provides uniformity from an examination perspective for the System.

The rule should clarify in proposed 612.2165(b)(2) that as to the Standards of Conduct official’s review of loans to insiders, while these credits should be made without favoritism or special terms, employees and directors should never receive less favorable terms than similarly situated borrowers. When Congress created the System, they did so with the full understanding that as a cooperative, directors serving on the board of such institutions would have inherent conflicts of interest due to the required borrowing relationship.

Similarly, employees who meet the definition of farmer and are eligible to borrow are entitled to have their credit needs met under the Act. Loan pricing, as well as the review process, should never become overly burdensome so as to be punitive to insiders. For instance, subordinations, releases and loan repricings for insiders done under a uniform program for all borrowers and reviewed by the institution’s Standards of Conduct official should not be subject to additional levels of scrutiny, such

as requiring prior approval by a district bank. Such an additional review adds no value (the association Standards of Conduct official is accountable for the review) and creates delay and burden by having to wait for the additional review. It would be helpful to have FCA provide guidance to the district banks to limit requiring secondary review of insider transactions to situations that are appropriate, and not arbitrarily for all matters, such as the routine servicing actions as described above.

Other issues related to Agents

The proposal to include agents and other consultants under new 612.2136 should be removed. System institutions do not have the ability to control, enforce or manage agents as the proposed rule seeks to require. Very often, attorneys represent the borrower in a transaction while also fulfilling some ministerial duties of closing a loan or issuing a title policy to the lender. In many instances, this is required by the laws of a particular jurisdiction. While they would likely be agents under the FCA regulations, they would primarily be representing the borrower in the loan closing and would be inherently conflicted and unable to comply with this rule, as proposed.

Expanding coverage of the regulation to include consultants and others who do not represent institutions to third parties will be overly burdensome and nearly impossible for System institutions to comply with. For instance, many individuals and entities provide advice to various institutions within the System as well as to companies that do business with us or who borrow from us. Requiring a disclosure or full conflict checks, etc. for these consultants will either result in institutions not having access to some of these critical resources (who likely may not consent to reveal such information), delay the ability to get timely assistance, and create an additional supervisory or audit burden for the institution and Standards of Conduct official.

The specific requirement under proposed 612.2160(f) to have documentation that agents (1) are subject to applicable industry or professional ethics standards, or (2) have certified to adhere to the provisions of the System institution's Code of Ethics applicable to agents again simply creates a compliance burden with no appreciable benefit to the System or public. Just as with any other lender, an institution should be able to reasonably rely on an appraiser or attorney's good standing with their respective licensing board or bar, without having to require documentation.

It would also be burdensome, if not impractical, to enforce the proposed restriction on sales of acquired property other than some ministerial process of having an acknowledgement signed. While System institutions could internally manage and restrict the direct sale of acquired property, there is no way to be responsible for enforcing the potential sale by a third-party, several months later to a party who may have acted as an agent.

Furthermore, the proposed rule should make clear that any such restriction applies to acquired property that was taken by foreclosure, etc. and which the agent "participated actively" in the process or transaction. As written, an agent working on an unrelated transaction at the same time as the acquired property was taken in would be covered by the prohibition.

Reporting and Handling Violations

Proposed 612.2160(a)(3) would require the institution to notify the FCA immediately of any known or suspected "material" standards of conduct violations. No definition of material is provided, other

than under 612.2130, which relates to material in the context of a financial interest or transaction. We would request additional clarity so that Standards of Conduct officials will understand what circumstance should trigger reporting. It is also suggested that FCA consider some process whereby facts or questions regarding circumstances that may give rise to a violation could be sent up to FCA via a hotline or other immediate response mechanism so that certain items could be cleared before proceeding.

Alternately, it would be more appropriate to simply permit the Standards of Conduct official a reasonable amount of time to conduct an investigation of any suspected material violations, before being required to report to FCA. Not only will this avoid misunderstandings and overreaction to situations that might easily be cleared, it permits the Standards of Conduct official to discharge their obligations under 612.2170.

Ratifying Transactions

Under proposed 612.2145(b)(4), there should be a process or mechanism for the Standards of Conduct official to take a matter before the institution's board to ratify a transaction after it has occurred. For instance, facts and circumstances might arise where a director or employee learns that the other party to a transaction which they have already completed is owned by or controlled by a borrower or other insider, despite reasonable due diligence and efforts to avoid such occurrences. This is especially true, given the rather counterintuitive and overreaching definition of a "controlled entity" under the regulation (addressed below). As to the restriction on ratification, please reconsider this arbitrary limitation and provide an alternative "cure" such as ratification by the board upon recommendation of the Standards of Conduct official.

Controlled Entity

The preamble to the final rule in 1994 states: "The purpose of the definition of control in the standards of conduct regulations is to identify when an interest is so significant that if an individual were to act on a matter concerning the related party, there would be an appearance of a conflict of interest." In that rulemaking, FCA made reference to a provision applicable to publicly traded companies whereby the Securities and Exchange Commission requires individuals or entities to file a beneficial ownership report for any person or entity who directly or indirectly shares voting power or investment power (the power to sell the security) in an amount equal to 5% or more. Arguably in the context of a publicly traded entity, this amount of ownership would be considered significant, especially in the financial valuation of such an interest. In the context of family enterprises, however, which would be the more typical entity owned by Farm Credit directors and employees, a 5% ownership test doesn't reflect any type of "control" whatsoever.

In reviewing the Securities and Exchange Act of 1934, rather than the 5% rule that was identified by the Agency in the prior rulemaking, it would have been more appropriate to utilize the threshold applicable to directors, officers and principal shareholders under Section 16, which is a 10% ownership threshold. Another threshold to consider would be something similar to the one used by banks, which among other things looks at a 25% ownership or the ability to vote 25% or more of the voting, ability to direct control, management, etc. of the entity (See 12 CFR 215.2(c)).

In the preamble to this rule, it states "FCA believes that a reasonable person could conclude that a director or employee could be influenced to act favorably toward an entity in which he or she had an

economic interest of 5 percent or more.” We respectfully disagree and would submit that it would be a challenge to find a “reasonable person” who has not been exposed to the present regulation that when asked, would either define control at a 5% ownership or would reach the conclusion that someone with such an ownership interest would risk their job or position on the board by acting favorably towards that entity.

FCA should take this opportunity to modernize the definition to one that is both more meaningful and consistent with the intent of the stated purpose of regulation, which is to identify “an interest so significant” as to create an appearance of a conflict to a reasonable person. We would note that because the *de minimis* level is so low, it is easy to be missed by employees or directors in completing their disclosures in good faith. Further, dealing with such minor interests places further demands on the Standards of Conduct official, whose time is better spent reviewing material matters.

Lastly, from a standpoint of clarification, whether you raise the threshold to a more appropriate level or leave it unchanged, it would also help to resolve confusion by modifying the term to something such as “disclosable entity.”

Assistance from FCA

Given the importance of this issue and the focus that the Agency has placed on the same, we encourage FCA to take a leadership role in providing guidance to the System and public. Proposed 612.2135, adds the term “guidance” to the existing list of items that institutions should follow. An advisory opinion database or series of frequently asked questions would assist both lenders and examiners by providing a common point of reference on topics already addressed. FCA could scrub confidential information such that only fact patterns and/or hypothetical illustrations are utilized. Further, institutions should be encouraged to submit questions for consideration without reprisal. While addressing the need for additional “official” guidance, above, it is also requested that FCA make clear that guidance does not include the opinions of individual examiners, to avoid inconsistency and regulation by examination.

We also encourage FCA to prepare and publish a handbook for System employees similar to what it has done for board members in the Directors Role. This would assist institution Standard of Conduct officials in providing consistent guidance across the System and serve as reference material to aid in the required training, as set forth in the proposed regulation. It would further improve consistency if FCA prepared and published model disclosure forms for employees and directors. Institutions could remain free to develop their own disclosures, but would enjoy the benefit of a “safe harbor” if the Agency’s model form was utilized. This will not only provide uniformity in the examination process, but it will help ensure that the Standards of Conduct official receives all of the information he or she needs to make informed determinations and improve public confidence in the System.

Other Technical Notes

The proposed rule did not change the time permitted under 612.2150(d) for a newly hired employee to complete his or her disclosure form. It is recommended that the Agency consider modifying this regulation to permit up to fifteen business days for a new employee to receive training, complete their disclosure and have their disclosure reviewed by the Standards of Conduct official. Most human resources systems and the new hire on-boarding process make it impractical to obtain a

meaningful disclosure in the short time frame. It would be better to permit the appropriate education and training, along with having the form not only sent to the Standards of Conduct official but reviewed for issues or conflicts. It would also be helpful to clarify that for purposes of the disclosures (but not prohibited conduct) interns, temporary contactors and the like are not required to comply, given the nature of their temporary or transitional employment.

While addressing definitions, we also request that FCA remove the proposed expanded "family" definition. Attempting to add non-traditional relationships which generally are non-formal or not recognized legally puts a burden on the Standards of Conduct official and the institution to determine the degree to which romantic or co-habitation arrangements should be disclosed and further delve into the nature of such arrangements. This could have unintended and embarrassing consequences for an employee and may create a perception of discrimination or disparate treatment. The present regulation already goes farther than is practical in most cases in requiring an employee to identify and disclose very distant and non-material relationships.

Lastly, FCA should consider combining proposed 612.2160(h) which requires institutions to establish an effective method of internal controls over the reporting, disclosing, and other requirements of the standards of conduct program, with proposed 612.2160(g) which mandates external audits. Requiring both an internal and external audit function along with regular FCA examination creates undue burden on the institutions, both from a cost and compliance standpoint.

Thank you again for the opportunity to provide feedback on the proposed rule and we hope that the Agency finds value in our observations, requests and comments.

Respectfully Submitted,



Wesley D. Sutton
Executive Vice President & General Counsel
AgSouth Farm Credit, ACA