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December 15, 2006

To: Chairman, Board of Directors

Each Farm Credit Bank and Association

From: Nancy C. Pellett

Chairman and Chief Executive Officer

Subject: Farm Credit Bank and Association Appointed Directors

Congress recognized that, in a cooperative, a board of directors needs the authority to appoint a limited number of directors. In 1987, Congress added to the Farm Credit Act of 1971, as amended (Act), the authority for Farm Credit banks and associations to appoint directors, including at least one director who has no affiliation with the Farm Credit System (outside director). Congress explained that directors appointed under this authority are intended to provide an independent perspective and some additional expertise in appropriate areas.1  In January 2006, FCA issued a final rulemaking addressing the governance of Farm Credit banks and associations. In this rulemaking, the eligibility, term of office, number and selection of outside directors was addressed in § [611.220](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.220.docx) of FCA regulations and the definition of “outside director” was provided in FCA regulation § [619.9235](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/619.9235.docx).2  The rule is silent, however, on the eligibility, term of office, number and selection of other appointed directors.

**Background**

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), except that associations may only appoint voting stockholders under sections [2.1](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%202.01.docx) and [2.11](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%202.11.docx) of the Act. The overarching objectives in selecting outside directors and other appointed directors is to enhance and strengthen the governance of the institution as well as to enhance the capacity of the board of directors to represent the interests and concerns of the institution’s owner-borrowers. Consistent with these objectives, bank and association boards may appoint directors for specific public policy purposes, such as facilitating diversity or acquiring needed skills. In considering the selection of other appointed directors, each bank and association should balance the desire for optimum size boards against the identified need to add certain skills or improve diversity.

FCA believes that the authority to appoint directors, when used appropriately, does not impinge on corporate democracy or jeopardize the status of a Farm Credit bank or association as a cooperative. FCA emphasizes that stockholders in a cooperative have the right to vote for directors, and, therefore, use of director appointments is, by necessity, limited. Accordingly, FCA recently established a requirement that each Farm Credit bank and association board must consist of at least 60 percent stockholder-elected directors.3 Bank and association boards should carefully consider the overriding cooperative principle of stockholder control and should not treat the regulatory 60 percent stockholder-elected director requirement as a maximum requirement.

**Policy on Appointing Directors**

FCA expects each Farm Credit bank and association board to develop and adopt a policy that formalizes compliance with the appointed director provisions of the Act by addressing the purpose for, and the search and selection processes of, appointing directors to the board. The policy should describe the appointment process and explain how the appointed director(s) add diversity or skills to the board, thereby strengthening the board’s governance. To facilitate identifying the skills needed on the board of directors, each bank and association is required, under § [611.210](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.210.docx)(a), to establish a written policy identifying desirable director qualifications. This requirement is applicable to all director positions. As a result, banks and associations must make a reasonable effort to appoint outside directors and other appointed directors who have some or all of those desired qualifications.4

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. Accordingly, no director sitting on the board at the time of the vote should be denied the opportunity to vote on the appointment of additional directors.5

The policy should also address the removal procedures developed pursuant to § [611.220](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.220.docx)(b). Although § [611.220](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.220.docx)(b) requires Farm Credit banks and associations to establish and maintain procedures for the removal of outside directors, institutions may find the procedures appropriate for all appointed directors. The FCA believes that the term of office6  and basis for removal should be the same for all directors serving on the institution’s board. In addition, an outside director must be removed if the director becomes an officer, employee, stockholder, or agent of any Farm Credit institution or a director of another Farm Credit institution. FCA encourages institutions to amend their bylaws to address an appointed director's length of service and basis for removal.

**Conflicts of Interest**

Appointed directors must be willing and able to assume the responsibilities, exercise the authority, and comply with the same regulatory requirements, including standards of conduct and conflicts of interest, as stockholder-elected directors. Appointed directors are subject to FCA standards-of-conduct (Part 612) regulations and disclosure regulations (Part 620). Farm Credit institution boards must exercise diligence in the selection of appointed directors to avoid any conflicts of interest, whether actual or perceived, and to ensure that such individuals can function in a totally impartial manner. Selection of appointed directors who have ongoing business or borrowing relationships with the institution demands increased caution to ensure compliance with applicable regulations. Boards of directors that are engaged in merger discussions should avoid using their appointment authority to transition the boards just because they cannot agree on a governance plan for the continuing institution.

Institutions are reminded that § [611.310](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.310.docx), which prohibits a person from serving as a director if that person was a salaried officer or employee of any Farm Credit bank or association at any time during the previous year, applies to all directors, including appointed directors. Banks and associations might use a similar cooling-off period prior to appointing any individual who unsuccessfully sought a stockholder-elected seat on the board in a recent election. Use of this type of a cooling-off period further preserves the cooperative principles on which the Farm Credit System is formed by honoring the voting stockholders’ decision not to elect the individual as a director in that election cycle.

**Use of the Term “Director”**

We are aware that some institutions have used terms such as “Associate Director” or “Director Emeritus” even though the designated individual does not have the same rights, duties, and responsibilities as other directors. Use of an honorific containing the term “director” creates confusion for stockholders, employees, and the FCA as to the person’s responsibilities and whether the person is subject to FCA rules on director qualifications, training, conflicts of interest, disclosures, and reporting. Therefore, we discourage institutions from using the term “director” for anyone not having a director’s full responsibilities.

If a Farm Credit bank or association board desires to include positions that are not full directorships, the board should use an alternate title, such as “advisor to the board.” If an institution decides to retain “director” in titles for positions that are not full directorships, then the institution should make it clear to all stockholders, employees, and the FCA what the limitations of the position are, as well as ensure the confidentiality of proprietary information that may be shared with individuals occupying such positions.

For further information on director conduct and responsibilities, please refer to the handbook titled The Director's Role available on FCA’s website at www.fca.gov. Any comments or questions on this communication should be addressed to Andrew D. Jacob, Director, or Gary Van Meter, Deputy Director, in the Office of Regulatory Policy at (703) 883-4414, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090, or by e-mail to jacoba@fca.gov or vanmeterg@fca.gov.

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1Congress “believed it would be prudent for all boards to have a disinterested, objective member . . . .” 133 *Cong. Rec.* S. 16831 (December 1, 1987).

212 C.F.R. [619.9235](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/619.9235.docx) defines “outside director” as “[a] member of a board of directors selected or appointed by the board, who is not a director, officer, employee, agent, or stockholder of any Farm Credit System institution.”

 312 C.F.R. [611.220](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.220.docx)(a)(2).

 412 C.F.R. [611.220](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.220.docx)(a)(1).

 5The only exception is that an appointed director cannot vote in his or her own selection and removal.

6Certain events, such as mergers, consolidations, or mid-term board vacancies, may cause a temporary difference in the terms of office for all directors; however, these events would apply to all directors whether elected or appointed.

Copy to: The Chief Executive Officer

 Each Farm Credit Bank and Association

 Federal Farm Credit Banks Funding Corporation