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December 15, 2005

To: Chairman, Board of Directors

Chief Executive Officer

All Farm Credit Banks

From: Nancy C. Pellett

Chairman and Chief Executive Officer

Subject: Maximum Director Compensation for 2006

The members of the Farm Credit Administration (FCA) Board recognize the increased responsibilities, expertise, and time spent on board activities by Farm Credit System (FCS or System) bank directors. For safety and soundness reasons, we believe it is important that these directors be adequately compensated for their efforts. Adequate and appropriate compensation should reflect the significant nature of bank directors’ fiduciary duties and responsibilities. Adequate compensation is also critical to attract qualified individuals to consider serving as bank directors. As discussed below, compensation for FCS bank directors is limited by statute and FCA regulations. However, the statute and regulations provide the FCA Board the authority to waive the limit for exceptional circumstances or to adjust compensation limits for safety and soundness reasons.

The Farm Credit Act of 1971, as amended, states that “the Farm Credit Administration shall monitor the compensation of members of the board of directors of a System bank received as compensation for serving as a director of the bank to ensure that the amount of the compensation does not exceed a level of $20,000 per year, as adjusted to reflect changes in the Consumer Price Index for all urban consumers published by the Bureau of Labor Statistics, unless the Farm Credit Administration determines that such level adversely affects the safety and soundness of the bank.” The FCA Board finds that System bank director duties and responsibilities are an integral component to ensuring the safety and soundness of Farm Credit banks. Importantly, these duties and responsibilities have increased substantially over time. The increase in duties and responsibilities are associated with regulatory- and market-driven governance and reporting and disclosure requirements in an increasingly complex and sophisticated financial services sector, as well as an agricultural sector that is increasingly driven by technological change. Fulfillment of these increased duties and responsibilities is vital to the continued safety and soundness of System banks and related institutions.

Based on the comments we received in connection with our solicitation on Farm Credit bank director compensation, and data received and analyzed by the Agency, we have determined that this correlation between Farm Credit bank director duties and responsibilities and safety and soundness requires a one-time adjustment to the current limitation on director compensation. It is a matter of record that Farm Credit bank director compensation was capped at a level approximately 18 percent below that of commercial bank directors in 1992. Since that time, inflationary adjustments have increased the cap on System bank director compensation from $20,000 to $27,060, or approximately 35 percent. Comparable commercial bank director compensation has also risen due to inflation, but it has risen more dramatically due to legislative changes and investor expectations that increased director duties and responsibilities, out of concerns for bank safety and soundness. We estimate this latter effect has caused a 93 percent increase over the same time period.

During this time period, Farm Credit bank director compensation has not risen at all despite comparable increases in director duties and responsibilities arising out of concern for System bank safety and soundness. In addition, System bank consolidations and growth have contributed to the increasing complexity of bank operations and transactions. As a regulator, we expect a level of professionalism, commitment, and expertise on the part of System bank directors that compares favorably to commercial bank directors, notwithstanding the fact that commercial banks provide a broader range of financial services, many of which entail additional operational risk. After reviewing relevant director compensation information, we are authorizing System banks to pay fair and reasonable director compensation for 2006 at a level not to exceed $45,740 (as may be adjusted for inflation). We note that this adjustment also results in an amount that is about 18 percent below current commercial bank director compensation levels. This differential is consistent with what existed when Congress placed a cap on Farm Credit bank director compensation in 1992. As required by the Act, FCA will continue to provide annual adjustments to this bank director compensation level based on changes to the CPI.

While we believe this change is consistent with the limitation imposed by Congress in 1992, System boards will still need to assess their own unique circumstances and the demands placed upon their board members in setting director compensation levels within this authorized limitation. Under FCA regulation § [611.400](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.400.docx), bank boards will need to modify their written policy on director compensation to explain and support a higher level of compensation for their directors.

We are not changing § [611.400](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/611.400.docx) of our regulations dealing with preapproved waivers to this new limitation. We note, however, that System banks must be judicious when exercising this 30 percent waiver authority. Specifically, System banks must fully identify in their annual report, both the specific extraordinary event, or events, and the additional time and effort spent on those events that justify the higher compensation level through waiver. This justification must be provided individually for each director who is compensated under the regulatory waiver provision.