Farm Credit Administration

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BOOKLETTER

October 28, 2024

To: Chair, Board of Directors
Chief Executive Officer
Each Farm Credit System Institution

From: Vincent G. Logan
FCA Board Chairman and Chief Executive Officer

Subject: Farm Credit bank and association appointed directors (Revised bookletter 009)

The Farm Credit Administration has updated Bookletter 009 to remind each Farm Credit System bank or association that, under § 611.210(a)(1), your board of directors must periodically update your institution's policy on identifying desirable director qualifications for all types of directors.

As part of its fiduciary responsibilities, your board must also conduct an annual assessment of its needs under § 618.8440(b)(2)(ii); this assessment must identify needed skills and diversity. Additionally, this bookletter includes other updates to provide clarification and guidance on appointed directors.

Background

The Farm Credit System (System) is a cooperative, owned by its farmer-members. Boards of directors are key to effective governance and member-owner representation. They remain the cornerstone of member control, while also ensuring achievement of the System's mission.

Congress recognized that a cooperative's 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 (called an "outside director"). Congress explained that directors appointed under this authority are intended to provide an independent perspective and some additional expertise in appropriate areas.

In January 2006, we issued a final rule addressing the governance of Farm Credit banks and associations. In that rulemaking, the eligibility, term of office, and number and selection of outside directors were addressed in § 611.220, and a definition of "outside director" was provided in § 619.9235. Later in 2006, we revised Bookletter 009 to address similar provisions for other appointed directors (i.e., board-appointed stockholder directors) not addressed in that rulemaking.

We continue to believe it is permissible under the Act for your board of directors to appoint voting stockholders to serve as “other appointed directors” as a means of improving board diversity and subject-matter expertise. The overarching objective when selecting both outside directors and other appointed directors is to enhance the capacity of your board of directors, which strengthens the governance of your board and helps to maintain your institution’s autonomy. We emphasize that your board of directors — including both stockholder-elected and appointed directors — should represent the diversity, interests, and concerns of your owner-borrowers.

Consistent with these objectives, you may appoint directors for specific public policy purposes. In considering the selection of appointed directors, you should balance the desire for optimum-sized boards against an identified need to add specific skills, expertise, or perspective, or to improve diversity.

We believe 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. We emphasize that stockholders in a cooperative have the right to vote for directors; therefore, use of director appointments is, by necessity, limited. For this reason, we established in § 611.220(a)(2) a requirement that each Farm Credit bank and association board must consist of at least 60% stockholder-elected directors. You should carefully consider the overriding cooperative principle of stockholder control by not treating the regulatory 60% stockholder-elected director requirement as a maximum requirement.

Diversity of boards of directors

A System board represents member-owners and should reflect the diversity of the member-owners and eligible applicants in the institution’s chartered territory. Your voting stockholders control the overall composition of your board through elections, which is why § 611.325(e) requires you to provide to the nominating committee your policies on desirable director qualifications.

Additionally, by using these same director qualification policies, your institution’s board can add more diverse expertise, knowledge, and backgrounds through appointed directors. Using appointed directors in this way may improve your board’s operations, as well as foster diversity in the applicants and borrowers your institution serves.

In determining the ideal appointed directors to fill those roles, your board should consider whether it currently reflects all backgrounds and demographic groups that are included among your member-borrowers and potential applicants. Having directors who represent all current and potential borrowers is critical to ensuring that the System achieves its mission to serve all creditworthy eligible borrowers.

Also, diversity of expertise and knowledge remains critical to effective board governance. Our rule § 611.210(a)(2) requires institutions with more than $500 million in total assets to have a director with financial expertise. This financial expertise may be achieved from the stockholder election of a director or through your appointment of a director.

Diversity of thought, perspective, and experience is critical in establishing an effective business strategy and implementing objective decision-making processes in any industry. Your board should strive to include individuals with experience in subjects beneficial to its composition, needs, and desired director qualifications. Subjects that could benefit board decision making include areas of emerging risks, such as information technology and cybersecurity, or other areas of business operations focusing on innovation, specialty farming and lending programs, or underserved agricultural segments. We recommend appointing directors with knowledge or experience useful to your institution's strategic focus and key risk areas.

Policy on appointing directors

We expect each Farm Credit bank and association board to adopt a policy addressing its appointment of directors to the board. The policy should describe the appointment process and explain how the selection of appointed director(s) adds diversity or skills to the board, thereby strengthening the board's governance. Accompanying the policy with detailed procedures can help facilitate a consistent and effective process. Ideally, the process should include a search that strives for more than one qualified candidate per position, which provides the board a choice for each vacancy.

For any person under consideration, the process should also include an assessment by the board to ensure that both new candidates and incumbents up for reappointment meet the needs of the board.

To help identify the skills needed on the board of directors, each bank and association is required, under § 611.210(a), to establish a written policy identifying desirable director qualifications, which is applicable to all director positions. The board should review and update this policy periodically as the needs of the board change. You should also review other policies your institution has in place that may create barriers to greater diversity. Under § 611.220(a)(1), you must make a reasonable effort to appoint outside directors and other appointed directors who have some or all of the desired qualifications.

The policy should also address the removal procedures developed pursuant to § 611.220(b). Although this provision refers specifically to procedures for the removal of *outside* directors, you may find the procedures appropriate for *all* appointed directors. As a reminder, 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.

All directors, including appointed directors, have the same fiduciary responsibilities to their institution's stockholders, whether they are elected or appointed by the board. Since all directors have the same fiduciary duties, we believe the term of office and basis for removal should be the same for all directors. All directors must also have the same voting rights, related responsibilities and duties, and be subject to the same operational rules and requirements, including requirements for pledges of confidentiality, disclosures, and conflicts of interest. Therefore, an outside director or other appointed director has full voting rights on all matters that come before the board of directors, with the exception of a vote on his or her own 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 those related to standards of conduct and conflicts of interest, as stockholder-elected directors. Farm Credit institution boards must exercise diligence in the selection of appointed directors to avoid any conflicts of interest, whether actual or perceived, and ensure that these individuals can function in an impartial manner. If you select appointed directors who have ongoing business or borrowing relationships with your institution, you will need to exercise greater caution to ensure compliance with applicable regulations.

You are reminded that § 611.310 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; this rule applies to all directors, including appointed directors. We recommend that you consider a similar cooling-off period before appointing to the board any individual who unsuccessfully sought a stockholder-elected seat on the board in a recent election. 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"

The term "director" should be reserved for board positions held by stockholder-elected and appointed directors occupying full directorship positions. We are aware that titles like "associate director" or "director emeritus" are used in some corporate settings, even if the designated individual does not have the same rights, duties, and responsibilities as other directors. However, we discourage boards from using a title containing the term "director" because it creates confusion for stockholders, employees, and FCA as to the person's responsibilities and whether the person is subject to our rules on director qualifications, training, conflicts of interest, disclosures, and reporting. Positions that are not full directorships should use an alternate title, such as "advisor to the board."

For more information

For further information on director conduct and responsibilities, please refer to the handbook titled The Director's Role (PDF), which is available on our website (fca.gov). If you have any comments or questions on this bookletter, please contact either of the following individuals in the FCA Office of Regulatory Policy:

- Kevin J. Kramp, Director, at (703) 883-4018 or krampk@fca.gov
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