[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 611 and 619

RIN 3052-AC97

Organization; Definitions; Eligibility Criteria for Outside Directors

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is proposing to amend its regulations affecting the governance of Farm Credit System (System) institutions. The proposed rule would modify the existing outside director eligibility criteria by expanding the list of persons who would be excluded from nomination for an outside director's seat to ensure the independence of outside directors.

DATES: You may send comments on or before October 23, 2018.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act of 1973, as amended, we do not accept comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Darius Hale, Senior Policy Analyst, Office of Regulatory Policy, (703) 883-4165, TTY (703) 883-4056, Haled@fca.gov,

or

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Amend the eligibility criteria for outside director in § 611.220(a);
- Remove the definition of outside director in § 619.9235;
- Strengthen the safety and soundness of System institutions;
- Strengthen the independence of System institution boards; and
- Incorporate many of the best corporate governance practices for System institutions.

II. Background

The Farm Credit Act of 1971, as amended (Act),[1] establishes that System banks and associations must elect a board of directors with such qualifications as may be required by the institution's bylaws. Additionally, the Act specifies that at least one member must be appointed by the stockholder-elected directors and that such member must not be a director, officer, employee, agent, or stockholder of a System institution.[2]

Outside directors are appointed by stockholder-elected directors to provide independent perspective and expertise in appropriate areas. Outside directors achieve this by broadening the board's collective knowledge, enhancing the board's independence, and improving the board's ability to carry out its fiduciary duties to the System institution, stockholders and investors. Current FCA regulations, however, do not specify how far removed from the statutory prohibited relationships the outside director candidate must be to adequately fulfill the intended independent role of an outside director. This proposed rule seeks to clarify the eligibility requirements of an outside director to achieve the independence intended by the statutory requirements.

III. Section-by-Section Analysis of Proposed Regulatory Changes

A. Definitions [New § 611.220(a)]

As a result of the proposed changes in eligibility criteria for outside directors in § 611.220, discussed below, we are proposing to add a new definition section in § 611.220 that would only apply to that section. The newly defined terms are meant to provide clarity on the meaning of the new outside director eligibility criteria.

The proposed rule would add affiliated organizations to the definitions in § 611.220. The new term affiliated organization is defined to mean an entity that is legally distinct from any System institution, but is organized and operated for the benefit of, and in support of, an institution and conducts activities that advance the mission of an institution.

The proposed rule would add borrowers to the list of persons excluded from consideration for an outside director position under § 611.220. Accordingly, the new term borrower is added to the definitions in § 611.220 and is defined to mean an individual, sole proprietorship, partnership, joint venture, trust, corporation, or other business entity to which an institution has made a loan or a commitment to make a loan or purchased a loan or participation interest in a loan. The new term borrower would also include any person or entity to whom an institution has made a lease or a commitment to make a lease, or who guarantees repayment of a loan.

The proposed rule would add controlling interest to the definitions in § 611.220. The new term controlling interest is defined to mean an individual that, directly or indirectly, or acting through or in concert with one or more persons:

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[1] Pub. L. 92-181, 85 Stat. 583.

[2] Sections 1.4, 2.1, 2.11, 3.2, 3.21(b)(1)(C) and 7.12(c)(3)(A) of the Act.

(1) Owns 5 percent or more of the equity in an entity;

(2) Owns, controls, or has the power to vote 5 percent or more of any class of voting securities of an entity; or

(3) Has the power to exercise a controlling influence over the management of policies of such entity.

The new term controlling interest is consistent with the definition of controlled entity found in § 612.2130(c). The proposed rule would add the new term entity to the definitions in § 611.220. The new term entity means a corporation, company, association, firm, joint venture, partnership (general or limited), society, joint stock company, trust (business or otherwise), fund, or other organization or institution. This is consistent with the definition of entity found in § 612.2130(e).

The proposed rule would add the new term immediate family member to the definitions in § 611.220. The new term immediate family member is defined to mean spouse, parent(s), sibling(s), children, mother(s)- and father(s)-in-law, brother(s)- and sister(s)-in-law, and son(s)- and daughter(s)-in-law. This is consistent with the definition of immediate family member found in § 620.1(e).

As a result of the proposed changes in eligibility criteria for an outside director in § 611.220, we are proposing to delete the definition of outside director in § 619.9235. The current definition in § 619.9235 is not consistent with the changes proposed in § 611.220, and it is unnecessary to duplicate the same language as is proposed in that section. Deleting § 619.9235 will provide clarity in who may serve as an outside director and will avoid redundancy.

B. Eligibility Criteria of Outside Directors [New § 611.220(b)]

We propose modifying the existing outside director eligibility criteria in § 611.220(a)[3] by expanding the list of persons who would be excluded from nomination for an outside director's seat. The proposed rule would add the following to the list of persons excluded from consideration for an outside director position:

(1) Borrowers of the institution;

(2) Immediate family members of any director, officer, employee, agent, stockholder or borrower of a System institution; and

(3) Anyone who has a controlling interest in:

(i) An entity that borrows from a System institution; or

(ii) An affiliated organization of a System institution.

The purpose of expanding those individuals ineligible to serve in the outside director's role is to further strengthen the independence perspective on each System institution's board. Congress' intent on establishing the outside director role was to ensure an independent voice was brought to the boards of System institutions. As such, outside directors are only permitted to serve on the board of directors of one System institution or affiliated organization at a time.[4]

To maintain that independent voice, current FCA regulations specify that a candidate for outside director should not be a stockholder of a System institution. However, the regulations do not specifically exclude a borrower from serving as an outside director. Borrowers may not necessarily be stockholders in a System institution. We believe that to be truly independent of a System institution when being vetted for an outside director's seat, all borrowers should be specifically excluded from consideration. This addition would capture those individuals who have signed a promissory note in a joint capacity (i.e., co-applicant, guarantor), but do not own System stock.

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[3] Due to the addition of a new Definitions paragraph in § 611.220, we will re-designate the current § 611.220(a) as § 611.220(b) for Eligibility, Number, and Term.

[4] An agricultural credit association and its wholly owned subsidiary associations are treated as a single entity for examination and regulatory purposes. Therefore, there is no conflict with a director sitting on the board of an ACA and its wholly owned subsidiary associations.

To further ensure independence from System institutions, we propose excluding individuals from serving as an outside director if they have an immediate family member who is a director, officer, employee, agent, stockholder, or a borrower of a System institution. This would provide additional clarity to our existing rule as to which individuals would be ineligible to serve as an outside director.

We also propose that a person who has a controlling interest in an entity that borrows from a System institution or an affiliated organization of a System institution should not be eligible to serve as an outside director. Those persons who have a controlling stake in, or influence the decisions of, an entity should not be considered to serve as an outside director if that entity is a borrower of a System institution. A person who maintains a controlling interest in an entity who borrows from the System or in an affiliated organization does not have the independence meant to fill the outside director's role. The proposed rule would not limit employees of entity borrowers or affiliated organizations from consideration as an outside director. Instead, it aims to clarify that those persons who control or advance the financial or policy decisions of an entity, borrower, or affiliated organization must not be considered as an outside director because their controlling stake or position in the entity or affiliated organization could lessen their independence.

We believe that expanding the list of those excluded from outside director consideration will further improve the board's ability to carry out its fiduciary responsibilities to the System institution and its stockholders and investors. We do not believe that including additional eligibility criteria would adversely affect the board's ability to select a qualified candidate for an outside director seat.

IV. Compliance Date

System institutions would be required to comply with the changes in the eligibility criteria of outside directors at the next appointment of an outside director candidate after the effective date of the final rule. We invite your specific comments on the compliance timeframe if this rule becomes a final rule. If a later compliance date is suggested, please provide a specific burden that would be alleviated with any later compliance date.

V. Regulatory Flexibility Act

Pursuant to section 605(b)of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the proposed rule will not have a significant impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, Conflict of interests, Crime, Investigations, Rural areas.

12 CFR Part 619

Agriculture, Banks, banking, Rural areas.

For the reasons stated in the preamble, parts 611 and 619 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 611—ORGANIZATION

1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.2, 1.3, 1.4, 1.5, 1.12, 1.13, 2.0, 2.1, 2.2, 2.10, 2.11, 2.12, 3.0, 3.1, 3.2, 3.3, 3.7, 3.8, 3.9,3.21, 4.3A, 4.12, 4.12A, 4.15, 4.20, 4.21, 4.25, 4.26, 4.27, 4.28A, 5.9, 5.17, 5.25, 7.0-7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2002, 2011, 2012, 2013, 2020, 2021, 2071, 2072, 2073, 2091, 2092, 2093, 2121, 2122, 2123, 2124, 2128, 2129, 2130, 2142, 2154a, 2183, 2184, 2203, 2208, 2209, 2211, 2212, 2213, 2214, 2243, 2252, 2261, 2279a-2279f-1, 2279aa-5(e)); secs. 411 and 412 of Pub. L. 100-233, 101 Stat. 1568, 1638; sec. 414 of Pub. L. 100-399, 102 Stat. 989, 1004.

2. Section 611.220 is revised to read as follows:

§ 611.220 Outside directors.

(a) Definitions. For purposes of this section, the following definitions apply:

(1) Affiliated organization means an entity that is legally distinct from any Farm Credit System institution, but is organized and operated for the benefit of, and in support of, an institution and conducts activities that advance the mission of an institution.

(2) Borrower means an individual, sole proprietorship, partnership, joint venture, trust, corporation, or other business entity to which an institution has made a loan or a commitment to make a loan or purchased a loan or participation interest in a loan. The term borrower also includes any person or entity to whom an institution has made a lease or a commitment to make a lease, or who guarantees repayment of a loan.

(3) Controlling interest means an individual that, directly or indirectly, or acting through or in concert with one or more persons:

(i) Owns 5 percent or more of the equity in an entity;

(ii) Owns, controls, or has the power to vote 5 percent or more of any class of voting securities of an entity; or

(iii) Has the power to exercise a controlling influence over the management of policies of such entity.

(4) Entity means a corporation, company, association, firm, joint venture, partnership (general or limited), society, joint stock company, trust (business or otherwise), fund, or other organization or institution.

(5) Immediate family member means spouse, parent(s), sibling(s), children, mother(s)- and father(s)-in-law, brother(s)- and sister(s)-in-law, and son(s)- and daughter(s)-in-law.

(b) Eligibility, number and term--

(1) Eligibility. Eligibility to serve, and continue serving, as an outside director requires independence from affiliations with the Farm Credit System. Farm Credit banks and associations must make a reasonable effort to select outside directors possessing some or all of the desired director qualifications identified pursuant to § 611.210(a).

(i) No candidate for an outside director position may be a director, officer, employee, agent, stockholder, or borrower of an institution in the Farm Credit System or be an immediate family member of any of the above. An outside director candidate or an immediate family member of such candidate must not have a controlling interest in:

(A) An entity that borrows from a System institution; or

(B) An affiliated organization of a System institution.

(ii) At any given time, an outside director is eligible to serve on the board of directors of only one Farm Credit System institution or affiliated organization.

(2) Number. Stockholder-elected directors must constitute at least 60 percent of the members of each institution's board.

(i) Each Farm Credit bank must have at least two outside directors.

(ii) Associations with total assets exceeding $500 million as of January 1 of each year must have no fewer than two outside directors on the board. However, this requirement does not

apply if it causes the percent of stockholder-elected directors to be less than 75 percent of the board.

(iii) Associations with $500 million or less in total assets as of January 1 of each year must have at least one outside director.

(3) Terms of office. Banks and associations may not establish a different term of office for outside directors than that established for stockholder-elected directors.

(c) Removal. Each institution must establish and maintain procedures for removal of outside directors. When the removal of an outside director is sought before the expiration of the outside director's term, the reason for removal must be documented. An institution's director removal procedures must allow for removal of an outside director by a majority vote of all voting stockholders voting, in person or by proxy, or by a two-thirds majority vote of the full board of directors. The outside director subject to the removal action is prohibited from voting in his or her own removal action.

PART 619—DEFINITIONS

3. The authority citation for part 619 continues to read as follows:

Authority: Secs. 1.4, 1.5, 1.7, 2.1, 2.2, 2.4, 2.11, 2.12, 3.1, 3.2, 3.21, 4.9, 5.9, 5.17, 5.19, 7.0, 7.1, 7.6, 7.8 and 7.12 of the Farm Credit Act (12 U.S.C. 2012, 2013, 2015, 2072, 2073, 2075, 2092, 2093, 2122, 2123, 2142, 2160, 2243, 2252, 2254, 2279a, 2279a-1, 2279b, 2279c-1, 2279f); sec. 514 of Pub. L. 102-552, 106 Stat. 4102.

§ 619.9235 [Removed]

4. Remove § 619.9235.

Dated: August 21, 2018.

Dale L. Aultman,
Secretary,
Farm Credit Administration Board.