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FARM CREDIT ADMINISTRATION

12 CFR Part 651

RIN 3052-AC89

Federal Agricultural Mortgage Corporation Governance;
Farmer Mac Corporate Governance and Standards of Conduct

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is considering issuing new regulations, or clarifying and enhancing existing regulations, related to the Federal Agricultural Mortgage Corporation (Farmer Mac) board governance and standards of conduct, including director election procedures, conflicts of interest and risk governance. We are requesting comments on ways to address these issues. In keeping with today's financial and economic environment, we believe it prudent and timely to undertake a review of our regulatory guidance on the identified areas. We intend to use the information and suggestions we receive in response to this Advance Notice of Proposed Rulemaking (ANPRM) for the development of guidance on Farmer Mac board governance and standards of conduct.

DATES: You may send comments on or before [Insert date that is 60 days after date of publication in the Federal Register].

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, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comments 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: Laurie A. Rea, Director, Office of Secondary Market Oversight, 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 on 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, including any supporting data provided, but for technical reasons we may omit items such as logos and special characters.

Identifying information that 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:

Joe Connor, Associate Director for Policy and Analysis,
Office of Secondary Market Oversight, Farm Credit
Administration, McLean, VA 22102-5090, (703) 883-4364, TTY
(703) 883-4056,

or

Laura McFarland, Senior Counsel, Office of General Counsel,
Farm Credit Administration, McLean, VA 22102-5090, (703)
883-4020, TTY (703) 883-4056.

SUPPLEMENTARY INFORMATION:

I. Objective

The purpose of this ANPRM is to gather public input on how FCA might:

- Enhance risk governance at Farmer Mac to further its long-term safety and soundness and mission achievement;
- Clarify the roles of the board and voting stockholders in the Farmer Mac director nomination and election process;
- Enhance the usefulness, transparency, and consistency of conflicts of interest reporting;
- Clarify conflicts of interest prohibitions; and
- Avoid repetitious disclosure and reporting requirements given the dual reporting responsibilities of Farmer Mac to the FCA and the Securities and Exchange Commission (SEC), while maintaining effective and efficient FCA oversight of Farmer Mac.

II. Background

A. Structure and Operation of Farmer Mac

Farmer Mac is a stockholder-owned, federally chartered instrumentality that is an institution of the Farm Credit System and a Government-sponsored enterprise (GSE). Farmer Mac was established and chartered by the Agricultural Credit Act of 1987 (1987 Act), which was enacted on January 6, 1988, to create a secondary market for agricultural real

estate mortgage loans, rural housing mortgage loans, and rural utilities loans.¹ Farmer Mac also facilitates the capital markets funding for USDA-guaranteed farm program and rural development loans. Title VIII of the Farm Credit Act of 1971, as amended, (Act) governs Farmer Mac.

As a GSE, Farmer Mac has a public policy purpose embedded in its corporate mission. One aspect of this public policy mission includes financial services to customer-stakeholders (institutions that lend to farmers, ranchers, rural homeowners, and rural utility cooperatives) and the resulting flow-through benefits to rural borrowers. Another key aspect is the protection of taxpayer-stakeholders because the risk that Farmer Mac accepts in the course of business exposes both investors (debt and equity purchasers) as well as taxpayers to potential loss. The taxpayer's exposure arises in part from Farmer Mac's authority to issue debt to the Department of the Treasury to cover guarantee losses under certain adverse circumstances.² Thus, an appropriately comprehensive approach to Board-level risk governance would acknowledge and consider all stakeholder groups.

¹ See Agricultural Credit Act of 1987 (Pub. L. 100-233).

² According to the 1987 Act, Farmer Mac, in certain circumstances, may borrow up to \$1.5 billion from the U.S. Treasury to guarantee timely payment of any guarantee obligations of the corporation. Pub. L. 100-233.

Farmer Mac has two classes of voting common stock: Class A and Class B. Class A voting common stock is owned by banks, insurance companies, and other financial institutions. Class B voting common stock is owned by Farm Credit System (System) institutions. In addition, Farmer Mac has nonvoting common stock (Class C), the ownership of which is not restricted and is a means for Farmer Mac to raise capital. Farmer Mac may also issue nonvoting preferred stock.

As a GSE, the structure of Farmer Mac's board of directors was established by Congress. The Farmer Mac board is, by statute, composed of 15 directors representing three segments: Class A stockholders, Class B stockholders, and the general public.³ Each segment has five directors on the board. The Class A and B segments each elect their representatives (elected directors) - that is, only Class A stockholders elect Class A directors, and only Class B stockholders elect Class B directors. The directors representing the general public are appointed by the President of the United States (appointed directors). The Act limits the terms of elected directors to 1 year, while appointed directors serve for an unlimited duration

³ Section 8.2(b) of the Act (12 U.S.C. 2279aa-2(b)).

"at the pleasure of the President" of the United States of America.⁴

Although the Farmer Mac board is representative in nature, Congress chose a corporate structure to govern the operations of Farmer Mac. Common law corporate principles affirm the fiduciary duty of directors to act in the best interests of Farmer Mac and all of its stockholders. However, this fiduciary duty to stockholders must be understood in the context of the duty of the directors to further the statutory purpose and public mission of Farmer Mac.⁵

B. FCA Oversight and Rulemaking

Farmer Mac is regulated by FCA through the FCA Office of Secondary Market Oversight (OSMO). Section 8.11 of the Act specifies that FCA provides oversight, regulation, examination, and enforcement authority over Farmer Mac to ensure it operates in a safe and sound manner. In addition, the Act requires Farmer Mac to register its equities with the SEC and be subject to SEC disclosure

⁴ Section 8.2(b)(6) of the Act (12 U.S.C. 2279aa-2(b)(6)).

⁵ Farmer Mac was created to provide a secondary market in agricultural real estate and rural home loans originated by System institutions and other lenders. Its statutory purpose is to: increase the availability of long-term credit to farmers and ranchers at stable interest rates; provide greater liquidity and lending capacity for lenders extending credit to farmers and ranchers; facilitate capital market investments in providing long-term agricultural funding, including funds at fixed rates of interest; and to enhance the ability of individuals in small rural communities to obtain financing for moderate-priced homes. See section 701 of the 1987 Act.

regulations under section 14 of the Securities and Exchange Act of 1934.⁶ Also, Farmer Mac's Class A and Class C stocks are publicly traded on the New York Stock Exchange (NYSE). Thus, Farmer Mac must comply with both FCA and SEC disclosure and reporting requirements. Notwithstanding the shared regulation of Farmer Mac's reports and disclosures to stockholders, FCA, acting through OSMO, is the safety and soundness and mission regulator of Farmer Mac. As such, FCA has the authority to regulate how Farmer Mac performs its powers, functions, and duties in furtherance of its public policy purposes.

When issuing regulations for Farmer Mac, the Act requires FCA to consider:

- The purpose of Farmer Mac's mission;
- If Farmer Mac's activities and practices are appropriate for an agricultural secondary market; and
- The reduced levels of risks associated with appropriately structured secondary market transactions.⁷

We last issued regulations on Farmer Mac board governance and standards of conduct on March 1, 1994 (59 FR 9622). In

⁶ See section 8.12 of the Act (12 U.S.C. 2279aa-12).

⁷ Section 8.11(a)(1) and (2) of the Act (12 U.S.C. 2279aa-11).

that rulemaking, we implemented the requirements of section 514 of the Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act)⁸ by requiring Farmer Mac to adopt a conflict-of-interest policy that defines the types of relationships, transactions, or activities that might reasonably be expected to give rise to potential conflicts of interest.

III. Areas of Consideration

Corporate governance can be defined as the set of processes, customs, policies, laws and institutions affecting the way a company is directed, administered or controlled. Corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that fosters good corporate performance. The essence of corporate governance is to ensure good performance by the entity, provide proper accountability to all stakeholders, and mitigate conflicts of interest. As part of this, it is essential that corporations practice strong risk management.

Risk management is the identification, assessment and prioritization of risks in an effort to minimize the impact of unfortunate events while maximizing opportunities. In

⁸ Pub. L. 102-552, 106 Stat. 4131.

financial institutions, risk can be categorized into three categories: credit risk, market risk, and operational risk. Usually, it is the board of directors who approve the overall risk-appetite of the company and monitor internal controls by ensuring necessary actions are taken. A strong board uses both risk management and corporate governance to steer the corporation towards policies supporting long-term sustainable growth in shareholder value, but not in a manner that promotes excessive risk-taking, particularly for short-term increases in stock price performance.⁹

Congress charged us to issue regulations to ensure mission compliance and the safety and soundness of Farmer Mac. With the recent events in the financial industry, increased sophistication in financial markets, and on-going scrutiny of public and agency financial activities and related reporting practices, we believe it is prudent to review our current regulatory standards related to Farmer Mac's board governance and standards of conduct reporting and disclosures, contained in part 651 of our rules, to ensure the continuing mission compliance and safety and soundness of Farmer Mac. We also believe using an ANPRM to solicit opinions and suggestions from investors,

⁹ See "Incorporating Risk Management into Corporate Governance," Enterprise Risk Management Initiative Staff (Sept. 23, 2010).

stockholders, and other interested parties will facilitate the planned rulemaking in this area.¹⁰

We have identified the following areas to address in this ANPRM:

- Conflicts of interest for directors, officers and employees;
- Director nominations and elections;
- Director representational and fiduciary duties;
- Board responsibilities in setting appropriate risk tolerance levels and overseeing risk management; and
- General board governance.

We encourage comments and suggestions on how to enhance regulations in the above-identified areas, emphasizing how those programs affect the safety and soundness of Farmer Mac, as well as comments on how to further facilitate transparent and comprehensive disclosure of Farmer Mac's standards of conduct policies and practices.

In particular, we are interested in what ways Farmer Mac's risk governance oversight at the board committee level can be enhanced. We are also seeking suggestions on how we might amend our regulations to address the director nomination and election process to ensure compliance with

¹⁰ See www.reginfo.gov, FCA Spring 2013 Unified Agenda, "Farmer Mac-- Corporate Governance and Standards of Conduct", dated April 24, 2013.

the plain meaning of the Act as well as whether we should address director removal and prohibited conduct in the planned rulemaking. Suggestions on how we might amend our regulations to address the interaction of representational duties, conflicts of interest, and corporate director fiduciary duties to ensure compliance with the Act are also sought.

IV. Request for Comments

We request and encourage any interested person(s) to submit comments on the following questions and ask that you support any comments you submit with relevant data and/or examples. We remind commenters that comments, and data submitted in support of a comment, are available to the public through our rulemaking files. We also invite comments and suggestions on any of the identified areas under consideration, regardless of whether specific questions have been asked.

Conflicts of Interests for Directors, Officers and

Employees:

(1) What, if any, recusal process should FCA require when there is an actual or potential conflict of interest?

(2) Should FCA regulations authorize bylaw provisions for the automatic removal of an elected director found to have violated conflicts of interest prohibitions? If so,

what types of prohibited actions related to conflicts of interest should warrant removal?

(3) Should bylaw provisions addressing disciplinary actions for prohibited actions related to conflicts of interest be regulated, such as reduced pay, loss of committee memberships, etc.? If so, please explain why and to what extent.

Director Nominations and Elections:

(4) How should the Farmer Mac nominating committee be structured and what duties should it have?

(5) To what extent, if any, should appointed directors be involved in the elected director nomination process? Please provide the reason(s) supporting your response.

(6) What, if any, additional process besides the nominating committee should there be for shareholders to add director-candidates to the ballot (e.g. floor nominations, petition)?

(7) What other director nomination guidelines should be considered to preserve the representational election of Class A and B directors on the Farmer Mac board?

Director Representational and Fiduciary Duties:

(8) Should the FCA amend its regulations to identify certain fiduciary responsibilities associated with serving as a director of a GSE? If so, how?

(9) How might FCA clarify existing Farmer Mac board responsibilities and authorities to improve the board's ability to carry out its fiduciary and oversight responsibilities?

(10) How might FCA facilitate maintaining a transparent representational relationship between elected directors and Class A and B stockholders while ensuring the protection of Farmer Mac's proprietary business information?

Board Responsibilities in Risk Governance:

(11) To what extent should Farmer Mac's risk tolerance consider its public policy purpose? How might that be measured?

(12) How might the FCA ensure that the Farmer Mac board establishes an effective risk governance framework, including risk measurements (e.g. data collection), risk controls and reporting, and clearly articulated statements of risk tolerance?

(13) If FCA requires the Farmer Mac board to have a risk committee, what guidelines should FCA provide regarding the formation and duties of the committee? What

qualifications should risk committee members possess? What resources should be available to the committee? Should the committee have direct access to all members of the Farmer Mac management team?

General Farmer Mac Board Governance:

(14) To what extent should FCA issue regulations to address difficulties Farmer Mac may have as a GSE in complying with modern governance standards because of statutory and regulatory requirements regarding the structure, selection, and composition of its board?

(15) How should FCA regulations require Farmer Mac to foster diversity in the selection of directors, officers and employees?

(16) What other Farmer Mac board governance and standards of conduct issues should FCA consider addressing through regulation?

With the benefit of information gained through this ANPRM and our internal analysis, we will consider changes

to the regulations to enhance their fundamental objective--
to ensure the safety and soundness of Farmer Mac's
operations and the furtherance of Farmer Mac's mission.

Date: February 19, 2014_

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

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