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FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 612, 619, 620, and 630

RIN 3052-AC41

Compensation, Retirement Programs, and Related Benefits

AGENCY: Farm Credit Administration.

ACTION: Notice of petition for regulatory change and request for comment.

SUMMARY: On December 4, 2012, the Farm Credit Council (Council) filed a Petition for Regulatory Change (Petition) with the Farm Credit Administration (FCA, we, or our) on behalf of its Farm Credit System (System) members. The Council requested in the Petition that we repeal the provisions of the recently effective final rule regarding “Compensation, Retirement Programs, and Related Benefits,” that require a non-binding, advisory vote on senior officer compensation. We are publishing the Petition and soliciting comments on the merits of the Petition.

DATES: Comments on this notice of petition must be received on or before April 22, 2013.

ADDRESSES: Comments may be submitted by any of the following methods:

- *Email:* Send an email to 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.”
- *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 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 email addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Deborah Wilson, Senior Accountant, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4414, TTY (703) 883-4434, or

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

I. Background

On October 3, 2012, the FCA issued a final rule amending our regulations in parts 611, 612, 619, and 620 regarding senior officer compensation disclosures and related topics.¹ The rule was effective December 27, 2012.² One provision of the rule requires that Farm Credit banks and associations hold non-binding, advisory votes on senior officer compensation.³ In accordance with the rule, associations must hold a vote on senior officer compensation when 5 percent of the voting stockholders petition for the vote. Also, associations and Farm Credit banks must hold a vote on chief executive officer (CEO) compensation, senior officer compensation, or both if compensation increases by 15 percent or more from the previous reporting period. On November 30, 2012, the FCA Board delayed the baseline year for the non-binding, advisory vote on increases in compensation to 2013.

Comments received on the non-binding, advisory vote during the rulemaking process objected to the provisions, but offered no alternative except that the FCA not finalize the provision. In the final rulemaking, we considered all comments received, made modifications to the proposed provision, but declined to withdraw the provision. We explained in the final

rule that the intent of the provision is to further the public policy mission of the System, which includes promoting shareholder involvement in the management, control, and use of System institutions. Also, we explained that drawing the shareholders’ attention to a matter through advisory voting was relevant to the core principle of System institutions being member-owned.

II. The Petition

Interested parties have the right to petition a federal agency to issue, amend, or repeal regulations.⁴ On December 4, 2012, the Council filed a Petition requesting that we repeal the provisions of the final rule regarding “Compensation, Retirement Programs, and Related Benefits,” that require a non-binding, advisory vote on senior officer compensation contained in §§ 611.360 and 611.410.

The Petition as filed with the FCA reads, in its entirety, as follows:

Petition for Regulatory Change Approved by The Farm Credit Council Board of Directors

December 4, 2012

On behalf of our membership, the board of directors of The Farm Credit Council hereby petitions the Farm Credit Administration (“FCA” or “Agency”) pursuant to 5 U.S.C. 553(e) to undertake a rulemaking that would revise portions of the recently adopted Compensation Disclosure Final Rule (the “Rule”), 77 FR 60582 (Oct. 3, 2012). We are asking that the Agency repeal the sections of the rule requiring advisory votes based on increases in compensation, as well as advisory votes based on petitions, pending the enactment into law of legislation that would specifically require such “say on pay” votes for Farm Credit System institutions.

As the Agency noted in adopting the Rule, it received 458 comment letters on the proposed rule (and 99 on the Advanced Notice of Proposed Rulemaking), none of which supported the provisions related to the “say on pay” requirements in the Rule. We noted in our comment letter on the Proposed Rule that the System is exempt from the provisions in Dodd-Frank requiring “say on pay.” We also noted that unlike the publicly-traded, SEC registered companies that are required to hold such votes, the System has no employees who serve on their institution’s board of directors or compensation committees, and that System institutions do not provide any compensation in the form of stock or stock options.

The “say on pay” requirements of the Rule go beyond those applicable to publicly traded companies by mandating a shareholder vote

¹ See 77 FR 60582.

² See 77 FR 76215.

³ 12 CFR 611.360 and 611.410.

⁴ 5 U.S.C. 553(e).

triggered by a specific change in compensation levels. We are aware of no precedent for this approach in corporate law or in practice. This requirement directly undermines the FCA supported concept of incentive compensation programs tied to performance. It risks System institutions either deemphasizing or eliminating incentive based programs that result in appropriate compensation volatility. Requiring "say on pay" votes when incentive compensation plans operate as intended—by reducing pay when performance does not meet standard and then rewarding recovery—is inconsistent with creating the optimum incentives for performance that excels.

The Rule is a precedent setting change that involves shareholders directly in the management of their institution. The Agency acknowledged in the Rule's preamble that "the election of the board of directors by members has been the primary means for member participation in the management of their institution." The Agency identifies no recent change in the Farm Credit Act justifying a change in policy towards direct shareholder management. By adopting this change in direction in the context of "say on pay," the Agency has obfuscated the full implication of the basic shift it has made. The Agency states that "[w]e encourage institutions to expand shareholder votes * * *," implying that institutions are encouraged to consider shareholder votes on all types of operational issues. We believe history has shown that the System is well served by a policy that allows shareholders to exercise their ownership role through the election of the board of directors, and allows the elected board to carry out its responsibilities on behalf of shareholders. Changing this policy and the long-standing precedent of clear director responsibility as the representatives of shareholders is ill considered and should only be accomplished following a far more extensive examination of its implications.

The Agency cites the Farm Credit Banks and Associations Safety and Soundness Act of 1992 as encouraging directly shareholder "involvement in the compensation practices of their institutions." Our review of the 1992 Act and its legislative history identified no language suggesting that it was intended to achieve direct shareholder "involvement" in the compensation practices of System institutions. The 1992 Act simply mandated that the Agency conduct a review of the disclosure requirements that were required of the System at that time and to amend its regulations within a year of the enactment of the legislation to address any deficiencies found some twenty years ago. Nothing in that law suggested that shareholders should vote on compensation practices, nor did the Agency's review conducted pursuant to this legislation identify this as an appropriate response to the legislation. To invoke that law today as the basis for a new say on pay requirement is inappropriate.

We also are very troubled by language in the preamble of the regulation that states: "As with other laws not directly involving the System, we consider the goals and objectives of those laws for applicability to the System." While we respect and support

the authority of the Agency to regulate and oversee the safety and soundness and the mission of the Farm Credit System, it is essential that the Agency respect the legal boundaries that Congress establishes for it. It is not the role or right of the Agency to arbitrarily apply to the Farm Credit System laws that do not directly involve the System, simply because the Agency believes the law should have applied to the System. It is up to the Congress to establish public policy in this manner. When the Congress does not involve the System in a law, the Agency must not do so on its own initiative. Congress made clear that the FCA board has the responsibility to recommend legislative changes to the Congress from time to time (Sec. 5.17(a)(3)). Nowhere does the Act state that FCA can or should apply laws to the System not directly involving the System.

We would suggest that if the Agency believes that the Farm Credit System should be subject to say on pay requirements, the Agency should develop a comprehensive legislative proposal to accomplish this goal and submit it to the Congress for their consideration, as contemplated by Section 5.17(a)(3). Doing so would ensure that appropriate consideration is given to any say on pay requirements and that necessary safeguards are built around such requirements.

Unlike the Dodd-Frank legislation, the regulation does not contain any safeguards for System directors or their institutions from shareholder lawsuits resulting from negative "say on pay" votes. The Agency in the preamble of the regulation does discuss briefly the interplay between the fiduciary duties of directors and a say on pay vote. Unfortunately, this discussion provides potential fodder for those who would suggest that a board that ignores the results of an advisory say on pay vote is acting inconsistent with its fiduciary duty. The preamble states in part that "fiduciary duties require consideration of * * * advisory vote results" that a board is required to "document how it used the vote results" and that the results of advisory votes must be reported to shareholders because of their importance.

Nowhere does the Agency discuss the potential that advisory votes can open boards of directors up to new litigation challenges nor does it address why the Dodd-Frank legislation saw fit to explicitly state that shareholder votes shall not interfere with the fiduciary duties of boards of directors. Even if the FCA were to adopt in a regulation safeguards similar to those of in Dodd-Frank, it is not clear that they would have the same legal standing as statutory protections. Moreover, there is no clear legal standard as to how System institutions and their directors will be judged in terms of exercising their fiduciary duties.

These concerns regarding fiduciary responsibility are particularly troublesome because of the unique characteristics of cooperative directors in contrast to those of publicly traded investor owned companies. In the Proposed Rule, FCA referenced "cooperative principles" as a basis for the action. However, comments submitted by several cooperative organizations noted that

they were unaware of any such "principles", or of any cooperative organization that has adopted a similar "say on pay" provision. Directors of cooperatives typically are elected by shareholders in accord with the one-person, one-vote rule, and FCA has directed that these votes occur on that basis. Publicly traded investor owned companies conduct their votes based on ownership interest. Also, most SEC registered companies do not have an independent regulator examining them for safety and soundness and overseeing their operations.

Both the directors and shareholders of System institutions have the benefit of the Agency's oversight. Within this framework, System shareholders, as with other farmer cooperatives, rely on their duly elected directors to establish safe and sound compensation programs. Shareholders simply do not have access to the wealth of information provided directors in general, and the compensation committee in particular, to make informed decisions on the subject, and they do not expect to be asked to make those decisions.

For all of the preceding reasons, we respectfully petition the Agency to modify the regulation to eliminate the advisory vote provisions including those on say on pay. Should the Agency believe that advisory votes are an appropriate policy guidance mechanism for System institutions, especially on compensation as required by the current rule, then the Agency should seek statutory revisions that would establish this requirement while also establishing clear guidance as to how it affects the fiduciary duty of directors. Thank you for your timely consideration of this petition.

Attest:

Kimberly J. Boscia,
Corporate Secretary.

We have received letters in support of the Petition from System institutions. The Petition and the letters may be viewed at our office in McLean, Virginia or on our Web site at <http://www.fca.gov>.

III. Request for Comments

Comments received during the rulemaking process and the letters received in support of the Petition objected to the non-binding, advisory vote provisions, but offered no alternatives. Therefore, we are inviting the public to comment on the Petition and the following question:

What reasonable alternative(s) to the non-binding, advisory vote provisions on senior officer compensation would comparably engage shareholders and provide them greater transparency in and disclosure of their institution's senior officer compensation practices?

Dated: February 11, 2013.

Mary Alice Donner,
Acting Secretary, Farm Credit Administration Board.

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