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April 22nd, 2013

Emailed to: reg-comm@fca.gov

Mr. Barry F. Mardock
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Notice of petition for regulatory change and request for comment, RIN 3052-AC41; Compensation, Retirement Programs, and Related Benefits; *Federal Register*, Vol. 78, No. 33, Tuesday, Feb. 19, 2013, pgs 11551-11552.

Dear Mr. Mardock:

We are sending this letter on behalf of the Independent Community Bankers of America (ICBA)¹ pertaining to the Farm Credit Administration's (FCA) request for public comment on a petition against the regulation finalized October 3, 2012, pertaining to senior officer and executive compensation.

This regulation requires that Farm Credit System (FCS or FCSLs) lenders, both banks and associations, hold nonbinding, advisory votes on senior officer compensation. 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 nonbinding, advisory vote on increases in compensation to 2013.

¹ The Independent Community Bankers of America®, the nation's voice for more than 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. With nearly 5,000 members, representing more than 24,000 locations nationwide and employing more than 300,000 Americans, ICBA members hold more than \$1.2 trillion in assets, \$1 trillion in deposits, and \$750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

The intent of the FCA's regulation was simply to promote shareholder involvement in the management, control, and use of FCS institutions. In addition, the FCA explained that drawing the shareholders' attention to such issues through advisory voting was relevant to the core principle of System institutions that are supposedly "member-owned."

Yet, surprisingly, on December 4, 2012, the Farm Credit Council (Council or FCC) filed a Petition for Regulatory Change (petition) with the FCA on behalf of FCS lenders. The Council's petition requested that FCA repeal the provisions of the recently adopted final rule that require a non-binding, advisory vote on senior officer compensation. FCA published the petition in the *Federal Register* to solicit public comments on the merits or lack thereof of FCC's petition.

Comments received during the rulemaking period by FCS lenders objected to the nonbinding, advisory voting provisions, but offered no alternative except that FCA withdraw the provision. After considering FCS comments, FCA appropriately declined to withdraw the provision.

ICBA Perspective

ICBA believes the FCA acted appropriately in adopting the final rule since the regulation would appropriately allow a necessary degree of involvement by member owners of the System and would provide greater transparency to FCS shareholders. The objections raised in the petition appear to be an effort to to hide large pay increases and other benefits from FCS grassroots cooperative members in hopes these large bonuses and pay increases either go unnoticed or are protected from potentially strong member objections. Without the regulation either kept as it is or strengthened, few if any means of discussion and debate will be available by concerned cooperative members even though they are the ones who must ultimately pay the price tag inappropriate compensation packages.

Furthermore, given the recent history of the FCA bending over backwards to accommodate FCS lenders in their attempt to skirt statutory lending constraints, we find the petition's arguments, quite frankly, disingenuous and duplicitous.

Rationale for 'Say on Pay' is Sound

We agree with FCA's rationale there needs to be an appropriate level of transparency and member involvement in various FCS operational matters. The FCS, as FCA noted, is a Government Sponsored Enterprise (GSE). Their GSE status provides FCS with government derived benefits and advantages not granted to the private sector. These benefits include the ability to acquire funding from Wall Street at very low cost just slightly above the U.S. government's borrowing costs. Additionally, FCS lenders are exempt from most taxes paid by the private sector including tax free income on mortgages and tax-free growth of retained earnings.

As a GSE, the FCS should be held to the highest possible standards for transparency reasons. This is not the case today as the FCS makes every effort to shroud its activities in a cloak of secrecy to keep its activities unknown to and unscrutinized by the public. Furthermore, FCS lenders are cooperatives, which are designed to be democratically controlled and operated entities. FCS's arguments against greater member-involvement would result in

keeping relevant and important information and voting access from its member-owners, who supposedly control the (FCS) cooperatives.

Additional Comments Against the Petition

The FCC's petition requests that FCA 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 FCSIs.

The petition's request by FCS management is hypocritical. There have been numerous instances in recent years in which the FCA has sought to illegally expand the lending powers of FCSIs. The 'Investments in Rural America' proposal and pilot projects are perfect examples of where FCA clearly has not had legal authority to expand FCS lending powers or the scope and eligibility of FCS lending but has done so contrary to statute.

Yet, the FCC and FCSIs did not object to FCA's actions in these instances, revealing the self-serving manner in which FCS officials view the constraints of the Farm Credit Act. However, in this case the FCA clearly appears to have legal authority to formulate and implement a regulation relating to whether or not member-owners of the System will be allowed certain voting rights and whether the FCS is required to follow basic cooperative tenets.

If the FCC and FCSIs claim that FCA does not have legal authority pertaining to regulating the voting rights of member-owners, then the same rationale would need to apply to the FCA's regulation constraining FCSIs from exiting the System as that regulation placed very stringent and onerous voting requirements upon any FCSI that wanted to exercise the option to withdraw from the System. The petition's argument of needing specific statutory authority lacks merit, and if relied upon by FCA, will lend greater credibility to repeal efforts by the general public regarding FCA's recent expansion efforts on behalf of FCS lending powers.

The petition also suggests the FCA's rule is inappropriate since there were few if any comments in favor during the rulemaking process. However, in the past FCA has adopted proposals with strong opposition from the public including the banking industry and little if any letters of support from FCS lenders (e.g. FCA preferred stock proposal).

The petition suggests the rule should not be implemented as the FCS was exempted from the Dodd-Frank Act (DFA). However, ICBA agrees with the FCA's explanation the regulation was not proposed and finalized based on the DFA. ICBA also points out that the FCC has in the past told Congress they have an equal regulatory regime as bankers but then lobbied Congress for an exemption to the DFA to avoid any added regulatory burden.

The petition claims the rule is inappropriate because FCSIs do not provide any compensation in the form of stock or stock options to employees. This argument ignores the fact the borrowers/shareholders of the FCS are owners of the FCS who should be entitled to vote on significant pay packages and other issues of concern to a significant portion of owner members.

The five percent threshold for advisory voting is significant enough to warrant a mandatory vote yet provides a difficult logistical hurdle for FCS shareholders to achieve.

ICBA disagrees with the erroneous contention in the Petition that the rule directly undermines the FCA supported concept of incentive compensation programs tied to performance. The final rule requires nonbinding advisory voting only if five percent of an FCSI's members petition for a vote or in an instance where an executive or senior officer receives a pay/compensation package greater than 15 percent from the previous reporting period.

The FCC also seems to be suggesting by this line of argumentation it desires FCS executives to regularly or annually receive pay/benefit increases above 15 percent while denying FCS member owners any say in such pay packages.

Clearly, the rule's criteria do not undermine incentive based compensation but only requires oversight where a significant portion of members petition for a vote or if pay packages rise appreciably. Incentive compensation pay would still be applicable to FCS employees. Perhaps FCS executives fear that most senior officers regularly receive pay and benefits increases that might be viewed by typical member-owners as being excessive. Even if that is the case, FCS shareholders should be able to review such matters and have a say if they believe certain situations warrant closer scrutiny.

The petition asserts the Rule is "a precedent setting change" that involves shareholders directly in the management of their institution. The petition's assertion is illogical since the voting required is advisory and nonbinding and pertains to instances of significant pay increases.

The likelihood is that such voting would not actually occur on a regular basis, unless FCC and FCS executives are planning a series of significant pay increases for themselves from which they wish to block FCS shareholders from having meaningful say. This would be all the more reason why FCA should deny the petition and implement the final rule. Furthermore, if FCS boards respect the say and involvement of the member-owners who elected them, then they would welcome such voting because it would, in the modest number of instances where it would be used, give the board clear direction and greater confidence in knowing that board actions are clearly backed by their membership.

The petition's arguments suggest that FCS executives and senior officers who work more closely with the board members of the FCSI would be able to inappropriately influence the boards and the compensation committees. The matter of inappropriate influence by FCS CEOs and senior officers is of great concern since FCS board members receive compensation and payment of expenses for their service and meeting attendance.

Board member compensation amounts to tens of thousands of dollars and board members may be inappropriately pressured to approve CEO and senior officer pay and benefit packages.² The FCA's rule therefore would be a practical, yet minimal, safeguard against these potential conflicts of interest.

² [fca.gov/handbook.nsf/24123e431e73ccdb8525643c007e3fec/5bc85100b6dae13e8525643c007e0659?OpenDocument](https://www.fca.gov/handbook.nsf/24123e431e73ccdb8525643c007e3fec/5bc85100b6dae13e8525643c007e0659?OpenDocument)
12 U.S.C. 2209 SEC. 4.21. COMPENSATION OF BANK DIRECTORS

The further assertion in the petition there has been no change in the Farm Credit Act to warrant the imposition of the regulation is duplicitous as the same could be argued for many other actions the FCA has taken in recent years, particularly those expanding the lending powers of FCSIs. If this regulation is weakened or withdrawn, so should the other FCA regulations that have unlawfully expanded FCS lending powers.

The petition complains the FCA misunderstands the Farm Credit Banks and Associations Safety and Soundness Act of 1992, stating the agency errs in its interpretation of the Act. If it can be argued the FCA is in error in this legislative interpretation, then the same argument could be made regarding the FCA's interpretation of its "investment" authorities since FCA's interpretation allows FCS lenders to inappropriately make illegal loans if labeled as investments. Moreover, the law referenced in the petition confirms FCA's position in this regulation:³

SEC. 514 – Congress finds that—

(1) the disclosure of the compensation paid to, loans made to, and transactions made with a Farm Credit System institution by, directors and senior officers of the institution provides the stockholders of the institutions with information necessary to better manage the institutions, provides the Farm Credit Administration with information necessary to efficiently and effectively regulate the institutions, and enhances the financial integrity of the Farm Credit System by making the information available to potential investors (emphasis added).

The law's language clearly reaffirms FCA's position by making clear Congress's intent that member-borrowers of the FCS are to be involved in the management of their institutions; that the FCA needs mechanisms to ensure access to information necessary to regulate the institutions and these types of governance procedures allow for greater financial integrity within the FCS. These goals are important to ensuring the safety and soundness of FCSIs.

The petition states that the FCS is "troubled" by the FCA's consideration of "other laws not directly involving the System" and considering these other laws' "goals and objectives" . . . "for applicability to the System." FCS petitioners add, "It is essential the Agency respects the legal boundaries that Congress establishes for it."

The same arguments could be made in reference to the FCA's interpretation of its "investments" authorities through which the agency has established pilot projects to allow for FCS lending that directly contradicts the Farm Credit Act.

If this argument were to be the basis by which the FCA were to withdraw or weaken its 'say on pay' regulation, then clearly the FCA should also withdraw or weaken the implementation of its "Investments in Rural America" pilot program as well as several other rules adopted recently.

ICBA notes the FCA has also expanded lending activities for FCSIs based on the applicability of other regulators' rules and relevant laws. Examples of these would be the FCA's granting FCSIs allowance to do internal audits on loans up to \$1 million in size based on FCA's rendering of a regulation by one or more banking agencies.

³ PL 102-552, Section 514

Another example is FCA allowing FCSIs to engage in 100 percent loan participations based on FCA's interpretation of a regulation by one or more banking agencies. If FCA repeals or weakens its 'say on pay' regulation based on this FCC/FCSI argument, then FCA must also repeal these and other similar regulations using the same logic.

The petition also shrilly lectures the FCA stating, "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."

The petition then argues, '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.' Again, where has the FCC and FCSIs been during the FCA's recent decisions to inappropriately expand FCS lending powers as noted above to adopt portions of the FCC's Horizons proposals when such proposals were sternly rejected by Congress?

Therefore, we logically conclude that the petition's arguments are self-serving and inconsistent. As stated previously, repeal or weakening of the 'say on pay' rule based on this, or similar, assertions would likewise demand repeal or weakening of numerous other FCA regulations adopted in recent years. The same logic can be applied to the petition's erroneous rationale that FCA should seek a law "passed by Congress to ensure necessary safeguards are built around such requirements." Based on this rationale, a law or laws would also need to be passed by Congress in regards to numerous other regulations adopted by the FCA in recent years.

ICBA disagrees with the petition's fears related to possible lawsuits if member-owners' votes are ignored by FCS boards. Indeed, as FCA explained, it is important for FCS boards to either follow the advice of member-owners in such votes or to adequately explain why they are not doing so. Further, ICBA agrees with the FCA that FCS boards should report to shareholders the results of such votes due to their importance.

The petition argues that FCA's adherence to one-member, one-vote in the 'say on pay' rule is not really a cooperative principle because other cooperatives do not have the same procedures. ICBA disagrees with this claim and notes that the rule is consistent with the nature of a cooperative.

Finally, the petition claims that "System shareholders . . . 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." ICBA disagrees and refers to our previous point that elected directors would welcome advisory votes by FCS shareholders to give them a stronger basis to oppose excessive pay packages and to avoid being 'strong-armed' and/or coerced by FCS CEOs and senior officers.

Further, it is offensive to claim that FCS shareholders are unable to “make informed decisions” on compensation practices. In addition, it is speculative on the part of the FCC/FCSIs that FCS shareholders “do not expect to be asked to make those decisions.” If this were true, then FCC/FCSIs have nothing to fear from the regulation since there would never be a petition by five percent of the shareholders if they have no expectations of ever making these types of decisions. However, if there were to be such a petition, it proves the petition’s claim is misinformed since members would be expressing their desire and intention to influence FCS compensation and pay packages, contrary to the petition’s argument.

Question Posed by FCA

As a result of the misguided FCC/FCSI petition, the FCA asks 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?

ICBA Recommendation(s)

The commentary provided in this letter reveals the lack of merit in the petition. There is certainly no reason to find a “reasonable alternative” to the rule as stated in the FCA’s above question unless the final rule is strengthened.

Frankly, ICBA believes the rule needs to be further strengthened. We are concerned the FCA’s final rule could be “gamed” by FCS CEOs and executives who could divide excessive annual pay, bonuses and benefits into, for example, four 10 percent quarterly increases for a total annual increase of 40 percent without forcing a vote under the rule as the quarterly increase would not equal or exceed 15 percent of the previous quarter’s increase (i.e. the previous period). Therefore, the final rule needs to be strengthened by changing the wording “from the previous period” to “on an annual basis.”

In addition, FCS shareholders may have a difficult time in amassing enough petitions to reach the 5 percent threshold, particularly if they do not have access to the borrower contact information of the FCSI. Therefore, FCA should require FCSIs to either post contact information so that it is available to FCS shareholders 60 days prior to the FCSI’s meeting or provide such information upon the request of an FCS shareholder.

Additionally, FCA should be concerned about the possibility that FCS CEOs or senior officers could be awarded golden parachutes and due to the timing of the executive’s departure, such compensation packages could be outside the reach of the ‘say on pay’ regulation. FCA should require the ‘say on pay’ regulation to apply to instances of recently employed, but now retired or departed executives. Members should have the ability to vote on significant pay packages.

These requirements would provide a voice to FCS shareholders rather than allowing FCS executives and senior officers to dismiss concerns by member-owners. FCS executives and senior officers go to great lengths touting the benefits of having a cooperative run by its farmer and rancher member-owners, but they appear, through this petition, to want to deny such member-owners any substantive voice on significant internal matters.

The fundamental objective of the petition is to prevent FCS shareholders from having real say in the pay of FCS executives. This allows for multi-million dollar pay packages for FCS executives. The petition also raises safety and soundness issues and allows excessive 'golden parachutes' for retiring or departing FCS CEOs.

The fundamental concern of the petition is the fear there may be, in a limited number of instances, situations in which FCS shareholders express opposition to excessive pay packages of FCS executives. However, from a broader perspective, the FCS's petition appears aimed at repelling any FCA regulation that could impose stricter accountability standards for System management.

Conclusion

Our recommendations would constitute a reasonable alternative added to the final regulation. If these recommendations are not adopted, then the rule should be left as is. If the FCA decides to weaken the final rule based on the FCC's petition, then ICBA likewise must also consider utilizing the petition process to seek repeal and weakening of numerous FCA regulations that have been adopted in recent years.

Thank you for consideration of our views. Should you desire to discuss this letter further, please feel free to contact Mark Scanlan at either 202-659-8111 or mark.scanlan@icba.org.

Sincerely,

Signed

Mark Scanlan
Sr. Vice President
Agriculture and Rural Policy
ICBA