

75 FR 70619, 11/18/2010

Handbook Mailing HM-10-13

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 612, 620, and 630

RIN 3052-AC41

Standards of Conduct and Referral of Known or Suspected Criminal Violations; Disclosure to Shareholders; and Disclosure to Investors in System-wide and Consolidated Bank Debt Obligations of the Farm Credit System; Compensation, Retirement Programs, and Related Benefits

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking (ANPRM).

SUMMARY: The Farm Credit Administration (FCA, we, or our) is requesting comments on ways to clarify or otherwise enhance our regulations related to Farm Credit System (System) institutions' disclosures to shareholders and investors on compensation, retirement programs and related benefits for senior officers, highly compensated individuals, and certain individual employees or other groups of employees. We are also seeking comments on whether we should issue new regulations in related areas. 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 consider the information and suggestions we receive in response to this ANPRM when developing a rulemaking on compensation disclosures and related areas.

DATES: You may send comments on or before March 18, 2011.

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: Gary K. Van Meter, 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 e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

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or

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SUPPLEMENTARY INFORMATION:

I. Objective

The objective of this ANPRM is to gather information for the development of a rulemaking that could result in:

- Enhancing the transparency and consistency of disclosures related to System institution compensation policies and practices¹ for senior officers,² highly compensated individuals,³ and/or certain other groups of employees whose activities, either individually or in the aggregate, are reasonably likely to materially impact an institution’s financial performance and risk profile;
- Clarifying and enhancing the authorities and responsibilities of System institution compensation committees⁴ in furtherance of their oversight activities;
- Increasing user-control in System institutions’ compensation policies and practices by providing for a non-binding shareholder vote on senior officer compensation;
- Requiring timely notice to interested parties of significant events, facts or circumstances occurring at a System institution between required reporting periods;
- Addressing the appropriateness of, and enhancing the disclosure of, certain payments to System institution directors; and
- Providing audit committees greater authority to access external resources when needed.

II. Background

The Farm Credit Act of 1971, as amended (Act),⁵ authorizes the FCA to issue regulations implementing the provisions of the Act, including those provisions that address System institution disclosures to shareholders and investors. Our regulations are intended to ensure the safe and sound operations of System institutions and govern the disclosure of financial information to shareholders of, and investors in, the Farm Credit System.⁶ Congress explained in section 514 of the Farm Credit Banks

and Associations Safety and Soundness Act of 1992 (1992 Act)⁷ that disclosure of financial information and the reporting of potential conflicts of interest by institution directors, officers, and employees help ensure the financial viability of the System. In the 1992 Act, Congress required that we review our regulations to ensure that System institutions provide adequate disclosures to shareholders and other interested parties. We completed this initial review in 1993 making appropriate amendments to our “Standards of Conduct” regulations (59 FR 24889, May 13, 1994), our “Disclosure to Shareholders” regulations (59 FR 37406, July 22, 1994), and our “Disclosure to Investors in System-wide and Consolidated Bank Debt Obligations of the Farm Credit System” regulations (59 FR 46742, September 12, 1994). We continue to periodically review and update our disclosure regulations to ensure they are appropriate for current business practices, that they ensure System institutions provide their shareholders with information to assist them in making informed decisions regarding the operations of the institutions, and that the disclosures provide investors with information necessary to assist them in making investment decisions.

In keeping with today's economic and business environments and in accordance with the findings of Congress under the 1992 Act, we believe it is prudent and timely to undertake a review of our regulatory guidance related to senior officer compensation. The recent turmoil within the financial industry and the ensuing decline in the economy highlight the need to ensure that shareholders and investors are informed of compensation policies and practices. Shareholders and investors need information that allows them to assess which policies and practices encourage excessive risk-taking at the expense of the institution's safety and soundness. With appropriate information, shareholders and investors can evaluate whether the institution's compensation policies and practices create an environment in which employees take imprudent risks in order to maximize their expected income at the expense of the institution's earnings performance and shareholder return. Similar efforts are in process at other regulatory agencies. For example, the Securities and Exchange Commission (SEC) recently revised its regulations to require that issuers disclose their compensation policies and practices as they relate to the company's risk management.⁸ Likewise, the Board of Governors of the Federal Reserve System (FRB) has undertaken two supervisory initiatives involving a review of incentive compensation practices at certain banking organizations. The FRB has issued supervisory guidance designed to ensure that incentive compensation policies at banking organizations supervised by the FRB do not encourage imprudent risk-taking and are consistent with the safety and soundness of the organization.⁹ Also, the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform Act)¹⁰ includes amendments to the Securities Exchange Act of 1934 requiring, among other things, a separate resolution subject to a non-binding shareholder vote on the compensation of executive officers of a SEC issuer.¹¹ In addition, under the Wall Street Reform Act, each SEC issuer is required to disclose information that shows the relationship between executive compensation actually paid and the financial performance of the reporting entity.¹²

Active, effective oversight of senior officer compensation policies and practices will help align those policies and practices with safe and sound operations. Providing transparent, timely and accurate disclosures of senior officer compensation policies and practices will help ensure an institution adequately fulfills its obligation to its shareholders and investors.

III. Areas of Consideration

We are reviewing our regulations in order to identify where our disclosure regulations might be amended to enhance the transparency of an institution's compensation policies and practices and if those practices affect the safety, soundness and financial performance of the institution. Also, we are reviewing our regulations to determine if they should be amended to facilitate qualified, objective and active

compensation committees that are tasked to oversee an institution's compensation programs. We are interested in public response to the questions contained in this ANPRM, including ways in which our regulations might further enhance disclosures of senior officer compensation policies and practices. We are also interested in the ways in which an institution's compensation committee might further engage in active and effective oversight of those policies and practices.

A. Enhanced Disclosures of Senior Officer Compensation

Our existing disclosure regulations at §§ 620.5(i) and 630.20(i) require that certain disclosures of compensation paid to, or earned by, senior officers and other highly compensated employees (hereinafter collectively referred to as "senior officers") be included in an institution's annual report to shareholders (or an association's annual meeting information statement). Our regulations also require disclosure of certain benefits paid to senior officers pursuant to a plan or arrangement in connection with resignation, retirement, or termination. However, depending on when an officer retires (or otherwise terminates employment with the institution), the payment may not be disclosed or it may not be disclosed in a timely manner due to the timing of the actual payment to the officer. As a result, shareholders and investors may not have all the information they need to make informed decisions on an institution's compensation policies and practices for senior officers.

We are considering whether current required disclosures should be changed to include quantitative and qualitative information on the obligations that have accrued to an institution from senior officers' supplemental retirement and deferred compensation plans. Also, we want to identify how the disclosures could provide greater clarity to the variable components of senior officers' compensation packages. We believe disclosures should provide information that assists shareholders and investors in understanding the impact of compensation programs on an institution's operations. Shareholders and investors require sufficient information to assess whether senior officers' compensation is appropriate in view of the institution's financial condition, risk profile, and business activities. This information enables shareholders to understand how an institution's board or compensation committee exercises its oversight responsibilities of ensuring a comprehensive and balanced compensation program that holds management accountable for an institution's financial performance.

Questions (1) through (8) of Section IV of this ANPRM address this topic.

B. Compensation Committees

Our existing rules at §§ 620.31 and 630.6(b) require that System institutions have compensation committees and that these committees be responsible for reviewing the compensation policies and plans for senior officers and employees, as well as approving the overall compensation program for senior officers. Compensation committee oversight is critical in ensuring compensation policies and practices do not jeopardize an institution's safety and soundness. In FCA booklet, "Compensation Committees" (BL-060), dated July 9, 2009, we issued guidance on how compensation committees could fulfill these duties. We are considering incorporating this guidance into our existing rules. We are also considering additional ways to enhance the authorities and responsibilities of System institution compensation committees to continue to achieve active and effective oversight of senior officers' compensation policies and practices. For example, in order for compensation committees to effectively fulfill their role, they must be specifically tasked with ensuring that compensation policies and practices do not jeopardize the safety and soundness of the institution. We are considering ways to re-emphasize that oversight responsibility. Understanding the financial commitment and total cost to the institution of the compensation programs and verifying that the institution is providing accurate and transparent disclosures on compensation are appropriate tasks for a compensation committee.

We are aware that some System institutions engage compensation consultants to make recommendations on compensation programs, plans, policies and practices. Compensation consultants can provide significant expertise to the board or compensation committee on compensation matters. These same consultants may also provide additional services, such as administration of compensation and benefit programs or actuarial services, on behalf of an institution's management. The degree of reliance placed on the consultant's expertise by the compensation committee may be a function of the consultant's independence from management influence. Therefore, we are considering requiring disclosure of the additional services provided to management by the consultant and requiring that the related fees paid to the consultant be disclosed. We are also considering if the significance of these additional services should impact whether they are included in the compensation disclosures.

Questions (9) through (13) of Section IV of this ANPRM address this topic.

C. Shareholder Approval of Senior Officers' Compensation

Recent initiatives, such as the Wall Street Reform Act, require entities that are SEC issuers to include a separate resolution in their proxy solicitations subject to shareholder vote on the compensation of the entities' executives. We are considering whether the FCA should issue regulations requiring a separate, non-binding, advisory shareholder vote on senior officer compensation and, if so, what those regulations should require. By providing for a non-binding advisory vote, shareholders would have a process through which they could express their approval or disapproval of an institution's compensation policies and practices. Board oversight and governance of compensation policies and practices may be more effective and enhanced if the board is explicitly informed of shareholder approval or disapproval. A non-binding, advisory shareholder vote would not bind the board of directors or compensation committee to any particular course of action and would not overrule any board or committee decisions related to senior officers' compensation.

Submitting senior officer compensation to a non-binding, advisory shareholder vote may be a practice that is appropriate for institutions that are cooperatively structured. One of the core cooperative principles is that those who use the cooperative should also control it. Submitting senior officer compensation to an advisory vote by System institution shareholders may promote member participation in their institution.

Question (14) of Section IV of this ANPRM addresses this topic.

D. Notice of Significant or Material Events

The FCA promotes sound governance practices. In doing so, we believe interested parties deserve timely notice and disclosure of any event, fact or circumstance that boards and management consider material or significant to the operations or financial condition of their institution. The SEC requires its registrants to file, in a timely manner, a current report to announce major events that occur between reporting periods (i.e., the Form 8-K, Current Report). We are considering requiring System institutions to provide similar current reporting on intervening events that occur between annual and quarterly reporting periods. The intervening events we are considering include enforcement actions taken by or supervisory agreements with the FCA, departure of an institution's director or an officer, results of matters an institution may submit to a vote by its shareholders, and other similar events.

Question (15) of Section IV of this ANPRM addresses this topic.

E. Remuneration to Boards of Directors in Connection with Conclusion of Services

Section 612.2130(b) of our regulations defines a conflict of interest, or the appearance thereof. The rule states that a conflict exists, or may appear to exist, when a person has a financial interest in a transaction, relationship or activity that actually affects, or has the appearance of affecting, the person's ability to perform official duties and responsibilities in a totally impartial manner and in the best interest of the institution. Payments to a director in connection with a restructuring or downsizing of the board or as a result of a merger, consolidation or other form of institutional reorganization may result in a board member having, or appearing to have, a conflict of interest or lack of total independence related to the transaction or board action. Shareholders and boards have approved such payments for economic reasons or when they wanted to recognize the contributions of directors stepping down from the board. We are considering regulating payments to directors under certain circumstances and also considering how or if these payments should be disclosed.

Question (16) of Section IV of this ANPRM addresses this issue.

F. Audit Committees

Sections 620.30(c) and 630.6(a)(3) of the FCA's regulations require a two-thirds majority vote of the full board of directors of a bank, an association or the Federal Farm Credit Banks Funding Corporation (Funding Corporation) to deny its respective audit committee's request for resources. We are considering whether we should remove the ability of the full board to deny a request from its audit committee for external resources.¹³ We are considering this matter based on a May 7, 2010, request from the Funding Corporation submitted on behalf of the System Audit Committee (SAC), asking us to amend § 630.6(a)(3) of our regulations to remove the authority of the board of directors of the Funding Corporation to deny the SAC certain resources.

Question (17) of Section IV of this ANPRM addresses this request.

IV. Request for Comments

We request and encourage any interested person(s) to submit comments on the following questions and ask that you support your comments with relevant data or examples. We remind commenters that comments, and data submitted in support of a comment, are available to the public through our rulemaking files.

(1) Should FCA enhance senior officer compensation disclosure requirements to improve transparency and current practices? Specifically, should the FCA consider enhancing disclosures on:

(a) The significant terms of senior officers' employment arrangements, whether or not dollar amounts are paid or earned during the reporting year, including components related to deferred compensation plans, supplemental retirement plans, performance agreements, and incentive or bonus compensation based on financial information; and

(b) The position titles of officers included in the aggregated group's compensation reported under existing § 620.5(i)(2)(i)(B) of our regulations?

(2) Should the FCA remove from § 620.5(i)(2) the option that allows associations to disclose senior officer compensation information in annual meeting information statements instead of disclosing it in annual reports?

(3) What additional disclosures (qualitative and quantitative) are needed to ensure that all compensation, including deferred compensation and supplemental retirement benefits, are fully disclosed in a timely manner and that an institution's total compensation policies, practices, and obligations for senior officers are effectively communicated in a transparent and timely manner?

(4) Should FCA require the disclosure of compensation policies and practices related to the activities of certain employees, other than senior officers, which, either individually or in the aggregate, may expose the institution to a material amount of adverse risk? If so, what disclosures are needed to ensure the compensation programs, practices, and incentives for such employees are adequately disclosed so that shareholders and investors are informed of the potential risk areas?

(5) To enhance transparency and a comprehensive understanding of the link between risk, return, and compensation incentives, should a discussion of an institution's overall risk and reward structure for senior officer compensation and benefit policies and practices be a required disclosure and, if so, what level of disclosure or qualitative information should be required?

(6) To ensure that all sources of compensation are disclosed, should institutions be required to disclose estimated payments to be made in the future to each senior officer in connection with deferred compensation arrangements, performance or incentive awards, and/or supplementary retirement benefits? If so, how should the disclosures be presented and for what periods? What other sources of senior officer compensation should be captured in current financial disclosures to shareholders?

(7) To ensure that shareholders and investors have an appropriate understanding of the assumptions used by the institution to determine estimated future payments for compensation or benefits, if disclosed, should the assumptions used to determine the future payments also be disclosed? If so, should the disclosure include why the assumptions used to determine the estimated payments are different from those used to determine the present value of dollar amounts disclosed in the Summary Compensation Table?

(8) Should institutions be required to disclose:

(a) The dollar amount of any tax reimbursements (such as Internal Revenue Code Section 280G tax gross-ups) provided by the institution to a senior officer;

(b) The business reason(s) for any material or significant change or adjustment to compensation or benefit programs from prior periods that increase or decrease salaries or compensation programs (individually or in the aggregate);

(c) Quantitative and qualitative benchmarks used to determine senior officer compensation and performance and incentive bonuses, if and why benchmarks used in the current reporting period were different from those used in prior periods, the business reason(s) for changing the benchmarks used, whether the individual officer was successful in attaining the requirements of the benchmark used, and if and how each benchmark relates to the financial performance of the institution;

(d) Significant events, trends or other information necessary to understand the institution's senior officer compensation policies and practices; and

(e) The vesting periods for long-term incentive and/or performance compensation or retirement benefits?

(9) To support the compensation committee's review and accountability processes, should compensation committees be required to certify compensation disclosures? If so, should the certification include a statement to the effect that:

(a) The compensation disclosures are true, accurate, and complete, and that the disclosures are in compliance with all applicable regulatory requirements;

(b) Comparable compensation practices used by the institution to develop its compensation policies support the valuation of senior officer compensation; and

(c) The institution's compensation policies and practices are consistent with the adverse risk-bearing capacity of the institution (as determined by the institution's board) and do not pose a threat to the safety and soundness of the institution?

(10) If compensation committees are required to certify compensation disclosures, what other areas should be addressed in the certification and what related statements should the committee certify?

(11) Would it strengthen the operation and independence of the compensation committee if the FCA required that at least one of the compensation committee members be an outside director (independent of any affiliation with the institution other than serving as a director)? What would be the benefits and/or concerns with such a requirement?

(12) If a System institution compensation committee uses the services of a compensation consultant, would the disclosure of that information be meaningful to shareholders and investors? What types of disclosures should be provided?

(13) If institution management engages the services of a compensation consultant that is also used by the compensation committee, or vice versa, should that fact be disclosed? If so, should the disclosure include a description of the additional services provided by the consultant for management that:

(a) Benefits the institution as a whole, and

(b) Are provided solely for management's benefit? Should the consultant's fees for the additional services be disclosed if those fees are in excess of de minimis amounts?

(14) To enhance transparency and shareholder understanding of compensation programs and practices, should FCA's regulations provide for a separate, non-binding advisory vote by System institution voting shareholders on senior officer compensation? If so:

(a) When and how should the vote occur;

(b) Within what timeframe should the results of the vote be reported to shareholders;

(c) Should certain System institutions be exempt from the voting requirement and, if so, what criteria should be used to exempt those institutions; and

(d) If a vote is required, should institutions be required to identify senior officer compensation amounts on an individual basis to facilitate the vote?¹⁴

(15) Should System institutions be required to issue current reports on events, facts, or circumstances that management considers material or significant to the operations or financial condition of a System institution, similar to the notice on changes in capital levels described in § 620.15?¹⁵ If so, what form should the report take, what types of events should be reported, and what timeframe would be appropriate for its issuance?

(16) To ensure that certain payments to institution directors do not create the potential for a conflict of interest, or appearance thereof, should payments made to System institution directors in connection with a restructuring or downsizing of the board, or as a result of a merger, consolidation or other form of institutional reorganization be allowed or disallowed?

(a) Under what circumstances would such payments constitute a conflict of interest or an appearance thereof?

(b) If allowed, how and when should such payments be disclosed?

(17) Should FCA remove from §§ 620.30(c) and 630.6(a)(3) the ability of a board of directors to deny a request for resources from its audit committee?

Dated: November 12, 2010

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

¹12 CFR 620.5(i).

²All references to senior officer(s) in this ANPRM refer to a senior officer as defined in 12 CFR 619.9310.

³All references to highly compensated individuals in this ANPRM refer to those officers described in 12 CFR 620.5(i)(2)(i)(B).

⁴All references to compensation committees in this ANPRM refer to compensation committees as set forth in 12 CFR 620.31 and 12 CFR 630.6(b).

⁵Pub. L. 92-181, 85 Stat. 583, 12 U.S.C. 2001 et seq.

⁶Section 5.17(a)(8), (9) and (10) of the Act. 12 U.S.C. 2252(a)(8)(9) and (10).

⁷Pub. L. 102-552, 106 Stat. 4131.

⁸See SEC Release No. 33-9089, “Proxy Disclosure and Enhancements,” issued February 28, 2010.

⁹Board of Governors of the Federal Reserve System, Docket No. OP-1374, “Guidance on Sound Incentive Compensation Policies,” June 21, 2010.

¹⁰Pub. L. 111-203, 124 Stat. 1376.

¹¹See section 951 of Subtitle E of Title IX, “Investor Protections and Improvements to the Regulation of Securities,” of the Wall Street Reform Act.

¹²See section 953 of Subtitle E of Title IX, “Investor Protections and Improvements to the Regulation of Securities,” of the Wall Street Reform Act.

¹³External resources may include, but not be limited to, outside advisors, consultants, or legal counsel.

¹⁴12 CFR 620.5(i)(2)(i)(B) allows aggregated disclosure in the annual report of compensation paid to senior officers.

¹⁵12 CFR 620.15 provides for the notice to the FCA and shareholders by System banks and associations when an institution is not in compliance with the minimum permanent capital standards required by the FCA.