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[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 630

RIN 3052-AC77

Disclosure to Investors in System-wide and Consolidated Bank Debt Obligations of the Farm Credit System

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, us, we, or our) proposes to amend our regulations related to the Federal Farm Credit Banks Funding Corporation (Funding Corporation) System Audit Committee (SAC) and the Farm Credit System (System) annual report to investors. The proposed rule would remove the provision that a two-thirds majority vote of the Funding Corporation board of directors be required to deny a request for resources by the SAC to engage independent legal counsel, outside advisors or consultants. The proposed rule would instead require appropriate funding to the SAC to perform these duties, quarterly reporting by the SAC to the Funding Corporation board on resources used, and annual reporting to investors.

DATES: Submit comments on or before April 16, 2012.

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 no longer accept 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 an e-mail 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."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, 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:

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.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Allow the SAC unrestricted access to resources to engage legal counsel, consultants and outside advisors,
- Ensure that investors are provided transparent and complete disclosure on the safe and sound use of resources by the SAC, and
- Clarify that the appointment, compensation, and retention of the external auditor for the System-wide reports cannot be changed without the agreement of both the SAC and the Funding Corporation board.

II. Background

The Farm Credit Act of 1971, as amended (Act),¹ authorizes the FCA to issue regulations implementing the Act’s provisions.² Our regulations are intended to ensure the safe and sound operations of System institutions and to govern the disclosure of financial information to shareholders of, and investors in, the System. In 2006, we issued a final rulemaking on the governance of System institutions.³ Those regulations changed the structure, responsibilities, and authority of existing audit committees at the banks and the SAC, and it required audit committees at System associations.

We explained in our 2006 rulemaking that an audit committee is the guardian of an institution’s financial integrity, and its independence is essential to investor confidence in the transparency of audited financial statements. The 2006 rulemaking required that audit committees at banks and associations be comprised solely of well-qualified board members,⁴ but made an exception to the composition of the SAC. Section 630.6(a) requires that only one-third of the SAC membership be composed of directors from the Funding Corporation board. This exception was in response to comments received on the 2006 rulemaking that audit committee composition derived solely from the board of directors may be

appropriate for individual System institutions, but not for the SAC. Commenters believed that the duties of the SAC require broader representation and greater financial experience of its members due to its oversight for the preparation of System combined financial statements.

The 2006 rulemaking required that the SAC be permitted to contract for independent legal counsel and expert advisers and that the Funding Corporation provide monetary and nonmonetary resources for these activities. Also, the rulemaking required a two-thirds super majority vote, in lieu of a simple majority vote, of the full Funding Corporation board to deny an SAC request for resources. In a petition dated May 2010, the SAC requested that we amend § 630.6 to allow it unfettered ability to engage outside advisors, consultants and legal counsel in the performance of its duties. On November 18, 2010, we issued an advance notice of proposed rulemaking (ANPRM) on senior officer compensation disclosures and related topics in order to gather information for the development of a proposed rulemaking.⁵ Part of the ANPRM discussed the authority of the SAC to obtain resources. Among the comment letters received in response to the ANPRM, several responders, including the Farm Credit Council (Council) acting for its membership, and the Funding Corporation, addressed the ability of the SAC to have unfettered ability to access resources. The Council expressed the view of its membership that existing FCA regulations appropriately balance audit committee need with the board's ultimate responsibility to the customer-shareholder for the safety and financial stability of the institution. However, the Council also noted that its membership supported the SAC's request.

This proposed rule would expand the authority of the SAC related to its use of Funding Corporation resources for consultants, legal counsel and outside advisors. In its petition, the SAC asserted that expanding its authority on the use of resources would:

- Avoid any future potential conflict that could arise between it and the Funding Corporation board on SAC requests for resources,
- Enhance its independence, and
- Promote the integrity of the System both in fact and perception to investors in System-wide debt securities.

We considered these views in proposing this rule. The rule proposes that the SAC report to the board at least quarterly on its use of resources, and the Funding Corporation disclose the uses and their benefits in the System annual report to investors. Further, we propose to clarify that the SAC appoint, compensate, retain and oversee the System's independent accountants with the agreement of the Funding Corporation board.

III. Section-by-Section Analysis

We request and encourage any interested person to submit comments on this proposed rule and ask that you support your comments with relevant data or examples. We are especially interested in receiving comments related to the proposed clarification that the SAC appoint, compensate, and retain external auditors with the agreement of the Funding Corporation board of directors.

A. System Audit Committee Authority [§ 630.6(a)]

FCA regulations authorize the Funding Corporation board of directors to deny an SAC request for resources by a two-thirds majority vote of the full board. The proposed rule would provide the SAC with the unlimited ability to engage outside advisors, consultants and legal counsel in the performance of

its duties. This proposed rule would require that the SAC use Funding Corporation resources in a manner that would not adversely affect the safety and soundness of the System and that the use of resources complies with law and regulation. Also, it would require that the SAC report to the Funding Corporation board at least quarterly on resources used pursuant to this proposed rule.

This provision would not prevent the Funding Corporation from developing its own procedures to address the use of resources by the SAC. To facilitate an open and balanced discussion on the appropriate use of resources, we would expect the SAC to confer with the Funding Corporation board on its intent to use resources. We would also expect that in performing its fiduciary responsibilities, the full board would review the use of resources for any safety or soundness issues.

B. External Auditors [§ 630.6(a)(4)(ii)(A)]

The proposed rule would revise our regulation relating to the appointment, compensation and retention of the external auditor. The revision would clarify that the SAC perform this duty with the agreement of the Funding Corporation board. We believe this clarification will ensure that the SAC's appointment, compensation and retention of the external auditor for the System-wide report are executed with the agreement of the full board of the Funding Corporation. Since the SAC is a subset of the full board, we believe the SAC duties related to the external auditors are of such significance that they must remain under the direct oversight of the full board.

C. Disclosure of System Audit Committee Expenditures [§ 630.20(n)]

To ensure that investors are provided transparent and complete disclosure on the safe and sound use of resources by the SAC, we propose in § 630.20(n) that Funding Corporation resources used by the SAC be disclosed by category in the annual report to investors. The proposed categories would include, at a minimum, independent legal counsel and related services, consultants, actuaries, outside advisors and other services performed on behalf of the SAC. We propose that fees paid for the audit of the combined System-wide financial statements and any fees under \$5,000 per category need not be disclosed. In addition to disclosing the name of SAC members, we propose that experience and compensation for each member be included in the annual report. We propose this change for consistency with audit committee disclosures required at the bank and association level.

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the proposed rule would not have a significant economic 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, Farm Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

¹Pub. L. 92-181, 85 Stat. 583 (1971), 12 U.S.C. 2001 *et seq.*

²12 U.S.C. 2252(a)(8), (9) and (10).

³71 FR 5740 (Feb. 2, 2006).

⁴Section 620.6 of the FCA’s regulations states, “[e]ach member of an audit committee must be a member of the Farm Credit institution’s board of directors . . . All committee members should be knowledgeable in at least one of the following: public and corporate finance, financial reporting and disclosure, or accounting procedures.”

⁵75 FR 70619 (Nov. 18, 2010).

List of Subjects in 12 CFR Part 630

Accounting, Agriculture, Banks, banking, Organization and functions (Government agencies), Reporting and recordkeeping requirements, Rural areas.

For the reasons stated in the preamble, part 630 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 630—DISCLOSURE TO INVESTORS IN SYSTEM-WIDE AND CONSOLIDATED BANK DEBT OBLIGATIONS OF THE FARM CREDIT SYSTEM

1. The authority citation for part 630 is revised to read as follows:

Authority: Secs. 4.2, 4.9, 5.9, 5.17, 5.19 of the Farm Credit Act (12 U.S.C. 2153, 2160, 2243, 2252, 2254); sec. 424 of Pub. L. 100-233, 101 Stat. 1568, 1656; sec. 514 of Pub. L. 102-552, 106 Stat. 4102.

Subpart A--General

2. Section 630.6 is amended by revising paragraphs (a)(3) and (a)(4)(ii)(A) to read as follows:

§ 630.6 Funding Corporation committees.

(a) System Audit Committee. * * *

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(3) Resources. The Funding Corporation must provide the SAC monetary and nonmonetary resources the SAC determines necessary to enable it to perform the duties listed in paragraph (a)(4) of this section. The Funding Corporation must permit the SAC to contract, for reasons directly related to the duties listed in paragraph (a)(4), the services of external auditors, independent legal counsel, and outside advisors. The SAC must not use the resources of the Funding Corporation in a manner that would adversely affect the safety and soundness of the System or be contrary to law and regulation. The SAC must provide the Funding Corporation board of directors a quarterly accounting of expenditures made pursuant to this section.

(4) Duties. * * *

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(ii) External auditors . The external auditor must report directly to the SAC. The SAC must:

(A) Determine, with the agreement of the Funding Corporation board of directors, the appointment, compensation, and retention of the external auditors issuing System-wide audit reports;

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Subpart B--Annual Report to Investors

3. Section 630.20 is amended by revising paragraph (n) to read as follows:

§ 630.20 Contents of the annual report to investors.

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(n) System Audit Committee. The Funding Corporation must include in the System-wide Report to Investors a description of the System Audit Committee and its activities during the reporting period. At a minimum, the report must:

(1) List the names of the System Audit Committee members, including each member’s term of

office and principal occupation during the past 5 years. For each member, state the total cash and noncash compensation paid for services on the System Audit Committee during the reporting period.

(2) Categorize and disclose the dollar value of monetary and nonmonetary resources used by the System Audit Committee during the reporting period. Describe the benefit(s) obtained from expenditures made under each category. Disclosures of fees paid for the audit of the System-wide financial statements and those categories of expenses having an annual aggregate dollar value of less than \$5,000 are not required. At a minimum, there must be separate categories for:

- (i) Administrative expenses,
- (ii) Contracted legal services,
- (iii) Contracted consultants and advisors, and
- (iv) Other contracted services, identifying the services.

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Date: February 9, 2012

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