FARM CREDIT ADMINISTRATION

12 CFR Parts 613, 614, 615, 618, 619, 620, and 626

RIN 3052–AB10

Eligibility and Scope of Financing; Loan Policies and Operations; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; General Provisions; Definitions; Disclosure to Shareholders; Nondiscrimination in Lending; Capital Adequacy and Customer Eligibility

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA) through the FCA Board (Board) publishes for comment proposed amendments (reproposed rule) to the current regulations governing the capital adequacy provisions and the customer eligibility provisions for Farm Credit System (Farm Credit, FCS, or System) institutions. This rule adds core surplus and total surplus standards for banks, associations, and the Farm Credit Leasing Services Corporation (Leasing Corporation); adds a collateral ratio for banks; and adds procedures for setting higher capital standards for individual institutions and for issuing capital directives, when warranted. This rule also incorporates recent statutory amendments to the Farm Credit Act of 1971, as amended (Act), which govern the eligibility rules for lending under title III of the Act and provide Farm Credit banks and associations new authorities to participate with non-System lenders in loans to similar entities. Subsequent to the closing of the comment period for the original proposal, the Farm Credit System Reform Act of 1996 (1996 Reform Act) was enacted, necessitating certain conforming changes in the rule. The reproposal eliminates restrictions in the current eligibility regulations that are not required by the Act and makes other technical, clarifying, and conforming changes. This rule relocates the nondiscrimination in lending regulations to a new part without change.

DATES: Written comments should be received on or before September 12, 1996.

ADDRESSES: Comments may be mailed or delivered to Patricia W. DiMuzio, Associate Director, Regulation Development, Office of Examination, Farm Credit Administration, McLean, VA 22102–5090 or sent by facsimile transmission to FAX number at (703) 734–5784. Copies of all communications received will be available for examination by interested parties in the Office of Examination, Farm Credit Administration.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION: The FCA published proposed amendments to the capital provisions of its regulations for Farm Credit institutions on July 25, 1995. See 60 FR 38521. Proposed amendments to the eligibility and scope of financing provisions of its regulations were published on September 11, 1995. See 60 FR 47103. The 90-day comment periods expired on October 25 and December 11, 1995, respectively. The FCA received over 300 comment letters from a wide audience in response to these proposed amendments. In response to the concerns of the commenters, the FCA has decided to repropose the amendments. Additionally, the proposals regarding System capital adequacy and customer eligibility requirements have been combined in a single rulemaking.

I. Summary of the Reproposed Rule

A. The capital provisions of the reproposed regulations incorporate the following provisions:

1. The 7-percent total surplus ratio remains unchanged from the originally proposed regulations.

2. The unallocated surplus ratio contained in the originally proposed rule has been renamed the core surplus ratio and has been expanded to include other equities that are perpetual in nature and function. The minimum core surplus ratio would remain at 3.5 percent and include an institution's:

- Undistributed earnings/unallocated surplus;
- Perpetual stock; and
- Nonqualified allocated equities.

The aforementioned stock and equities could not be subject to an established practice or plan of retirement or distribution. For an association, the core surplus ratio would be calculated net of its net investment in its affiliated bank.

3. The computation of the net collateral ratio for banks excludes the effect of market fluctuations on the value of eligible investments, and the minimum standard is revised from the 104-percent standard in the original proposal to 103 percent of total liabilities.

4. The use of risk-sharing agreements or similar contractual arrangements would be permitted on a temporary basis as part of an association's initial effort to reach the 3.5-percent core surplus ratio. After building its core surplus to 3.5 percent, each association would be required to maintain capital at this level net of its bank investment.

5. The remaining provisions of the originally proposed regulations setting forth procedures for establishing individual institution capital ratios and for issuing capital directives are reproposed in substantially the same form as originally proposed.

B. The eligibility provisions applicable to title I and title II lenders have been substantially narrowed from the original proposal and incorporate the following changes:

1. All bona fide farmers, ranchers, and aquatic producers or harvesters remain eligible to borrow from the FCS for any agricultural or aquatic purpose. However, the reproposed regulation imposes additional restrictions on System loans for other credit needs. Under this reproposal, non-resident foreign nationals, farm owners who do not engage in agricultural production or farm management, and only legal entities meeting certain farmer ownership and agricultural activity tests could not obtain FCS financing for non-agricultural business needs. The reproposed regulation, however, permits individuals who are citizens and permanent residents of the United States and certain legal entities to obtain limited FCS financing for a non-agricultural business purpose if they actively farm, ranch, or fish. Non-agricultural business purposes could not exceed the market value of the borrower's agricultural assets. Under the reproposed regulation, active farmers could obtain System financing for their housing and domestic needs without restriction, but owners of agricultural land could borrow for their housing and domestic needs only in an amount that does not exceed the value of their agricultural assets. Non-resident foreign nationals could borrow for housing and domestic needs that are reasonably related to their agricultural operations. Finally, the FCA rescinds its original proposal to prohibit Farm Credit Banks (FCBs) and direct lender associations from extending credit to cooperatives and other entities that are eligible to borrow from a title III bank.

2. The reproposed regulation would permit a legal entity to obtain financing for a processing or marketing operation only if a majority of ownership is held by eligible borrowers.

3. The reproposed regulation clarifies that farm-related businesses can receive System financing only if they provide farm-related services that are directly related to the agricultural production of farmers and ranchers. No business activities unrelated to agriculture may be financed under this authority.

4. The reproposed regulation pertaining to rural housing would repeal a provision in the existing regulation that permits System lenders to finance non-farm rural homes in open country that has been annexed by a municipality of more than 2,500 persons. The FCA also would withdraw its original proposal to permit System lenders to offer home equity lines of credit without limitation on the borrower's use of the credit proceeds.

C. The reproposed regulations governing domestic and international lending by title III banks would implement the relevant provisions of the 1996 Reform Act and make other clarifying changes.

D. The reproposed regulation pertaining to the authority to participate in loans made to similar entities reflects two significant changes from the proposed regulation. First, the reproposed regulation would rescind a restriction in the original proposal that would have enabled a System institution to participate only in those similar entity loans that were compatible with its lending authority. Second, this reproposal would delete the non-statutory out-of-territory concurrence requirement in the proposed rule.

II. Public Comments Received

The FCA received 126 comments in response to the proposed capital adequacy regulations. Six were telephone inquiries from System institutions requesting clarification of specific provisions or providing general impressions of the proposed regulations. The FCA received 120 comment letters, including a comment letter from the System's Presidents' Finance Committee, which reflected the views of many System banks and associations (System joint comment). Of the remaining comments, three were from System banks (AgFirst FCB, Western FCB, and St. Paul Bank for Cooperatives (St. Paul BC)), one was from the Leasing Corporation, 37 were from System associations, 26 were from cooperatives that were borrowers/shareholders of a System bank, 46 were from borrowers/shareholders of a single agricultural credit association (ACA), five were from various state and national cooperative councils (the National Council of Farmer Cooperatives, the North Carolina State Grange, the Minnesota Association of Cooperatives, the Cooperative Council of North Carolina, and the Virginia Council of Farmer Cooperatives (VCFC)), and one was from the American Bankers Association (ABA) on behalf of its commercial bank members. In addition, several groups of System representatives made oral presentations of their views to Agency staff.

These commenters supported the general goals of the proposed capital regulations. The System, in its joint comment, stated that it was prepared to embrace regulations that encourage the building of a sound capital structure in System institutions and that promote confidence in the System by borrowers/shareholders, investors, and the public. The commenters noted specific areas of agreement with the FCA on a number of requirements. As described more fully below, however, each of the commenters objected to various provisions of the proposal. The ABA supported the proposed regulations to the extent that they ''stiffened'' capital requirements for System institutions but did not believe the proposal was sufficiently stringent.

The 191 comments received on the eligibility proposals included letters from seven Farm Credit banks: the FCB of Wichita; AgFirst FCB; the St. Paul BC; CoBank, Agricultural Credit Bank (CoBank); AgAmerica, FCB; the FCB of Texas; and AgriBank, FCB. Letters were also received from 70 Farm Credit associations, 29 commercial banks, 13 credit unions, 17 trade associations, 45 System borrowers, six members of Congress, and four government agencies. Trade association commenters were: the Farm Credit Council (FCC) on behalf of the eight banks and approximately 230 associations comprising the FCS; the Tenth District Federation of Production Credit Associations (Tenth District PCAs) representing the 17 production credit associations (PCAs) in Louisiana, New Mexico, and Texas; the Western District FCC representing the System lenders in Arizona, California, Hawaii, Idaho, Nevada, and Utah; the ABA, the Independent Bankers Association of America (IBAA), the Community Bankers of Kansas, the North Dakota Bankers Association (NDBA), the South Dakota Bankers Association, the Community Bankers Association of North Carolina (CBANC), each representing their member banks; the Credit Union National Association, representing more than 12,300 credit unions through their State league affiliates; the New York Credit Union League, the North Dakota Credit Union League (NDCUL), the Indiana Credit Union League, each on behalf of their member credit unions; the VCFC on behalf of 80 member cooperatives in Virginia; the Farmers' Legal Action Group, Inc. (FLAG), a non-profit law center of the National Family Farm Coalition, which represents 38 farm and rural advocacy organizations in over 30 States; and the Maine Potato Board (MPB).

Letters from government agencies included the North Dakota Department of Agriculture; the Vermont Department of Agriculture, Food and Markets; the Ohio Department of Commerce, Division of Financial Institutions; and the Federal Reserve Board. Six of the letters received from members of Congress transmitted letters on behalf of their constituents.

All of these commenters approved of the FCA's goals of consolidating, streamlining, and clarifying the eligibility regulations, and no commenter objected to regulatory relief for FCS banks and associations. Individual commercial banks, their trade associations, and FLAG, however, asserted that many of the proposed regulations exceed the FCA's objective of reducing regulatory burdens on the FCS and would expand System financing beyond the mandate of the Act. Some of these commenters recommended that the FCA withdraw the proposed eligibility regulations and refer these issues to Congress for hearings on rural credit.

III. The Reproposed Rule

After considering the comments received on the proposed regulations and further deliberating on the issues, the FCA reproposes a rule governing capital adequacy and customer eligibility for FCS financing as one. The FCA responds to the specific concerns of the commenters as it explains the provisions of the reproposal.

A. Core Surplus Ratio Capital Standard

The FCA originally proposed that institutions have unallocated surplus of at least 3.5 percent of risk-weighted assets. For this purpose, unallocated surplus included common stock and noncumulative perpetual preferred stock held by nonborrowers, provided that the institution adhered to a policy of not retiring the stock. For associations, the net investment in the affiliated bank would have been subtracted from the unallocated surplus.

A number of respondents (primarily agricultural cooperatives, cooperative councils, System associations, and association borrowers) commented on the proposed unallocated surplus ratio. They challenged the concept of differentiating between allocated and unallocated capital on the ground that it created a bias against cooperative principles. They argued that patron ownership, as characterized by allocated capital, provides the same protection to the institution as unallocated capital and should not be given a lower priority. Borrowers from the System that were themselves cooperatives expected this requirement of the originally proposed regulation to result in lower patronage distributions and, accordingly, to increase the effective interest rates of their loans. They were concerned that the regulations conveyed a message that allocated capital is of lower quality than unallocated. These groups provided the following comments:

- Allocated and unallocated capital provide the same level of institution protection.
- Cooperative principles are diluted if patron ownership is discouraged. Cooperative principles encourage matching of current earnings or losses with current patrons through earnings or loss distributions and discourage accumulation of high levels of unallocated capital. Unallocated surplus as defined in the proposed regulation would conflict with these principles.
- Subchapter T tax treatment under the Internal Revenue Code could be threatened if significant levels of earnings are diverted to unallocated surplus. The commenters viewed this as being detrimental to capital accumulation in the System and believed that such a treatment could result in double taxation of System earnings.

The commenters countered the FCA's statement that unallocated surplus provides a buffer to protect owners of allocated capital by stating that cooperative principles promote sharing the risks and rewards of the organization with patrons. Furthermore, some respondents stated that retaining substantial earnings that could otherwise be distributed to patrons might cause some business to move to competitors.

Forty-six (46) comments on this issue were from borrowers/shareholders of a single ACA. These borrowers expressed their view that the proposed unallocated surplus ratio requirement would greatly reduce patronage in their association. They objected to this result, stating that patronage allocations save taxes, enable the association to build capital, and have encouraged many borrowers who left their association in the 1980s to return.

Several of the associations and a bank suggested that all of the allocated surplus be counted in the 3.5-percent surplus requirement. However, some of the commenters also acknowledged that the FCA might be reluctant to include the entire amount of allocated equities and, therefore, suggested, at a minimum, counting nonqualified allocated equities. Nonqualified allocated equities are patronage allocations on which the institution generally pays no cash to patrons at the time of the allocation and which are included in the institution's taxable income. Should the institution make distributions of the allocations to the patrons/borrowers at some future date, the patrons/borrowers recognize taxable income at that time, and the institution may then recapture a substantial portion, if not all, of the taxes paid previously. One System association commented that nonqualified allocated surplus ''carries a much lower degree of sensitivity with members because they do not incur any tax liability until it is revolved.'' Numerous commenters, including the System in its joint comment, made similar statements regarding borrowers' reduced expectations of distributions with respect to nonqualified allocated equities.

Two commenters described classes of stock that they believe merit treatment as unallocated surplus. One association described a class of non-voting stock it has issued as patronage, rather than in connection with making a loan to a borrower. The association asserted that, because no shares have ever been retired, the stock has the same features of permanence and stability as unallocated surplus and thus should be included in the unallocated surplus ratio calculation. The association stated that it has informed the recipients of the stock that the stock will not be retired except in the unlikely event of liquidation of the association and that the value of the stock springs from the prospect of dividends that may be paid in the future, not from the prospect of retirement. The Leasing Corporation also asserted that the Class A stock and the Class C stock it has issued to Farm Credit banks have features of permanence and should likewise be included in the unallocated surplus ratio. Class A stock totaling $1.7 million is held equally by all Farm Credit banks, and such stock has been retired only in connection with bank mergers. Class C stock is issued and retired based on the amount of the net lease investments allocated to each bank.

Many System banks and associations objected to the requirement that an association deduct its net investment in its affiliated bank when computing its unallocated surplus ratio calculation. The following is a summary of the comments made by the commenters:

- The proposal would reduce the amount of earnings on which taxes could be minimized.
- The proposal could result in the elimination of noncash patronage distributions and provide an undesirable incentive to operate at or just above cost for the institutions. This could damage the financial position of the entire System.
- The proposal violates the provisions of the Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 amendments) and is contrary to the FCA Board's policy statement on regulatory burden.
- A significant tax consequence will be incurred and reduced retained earnings will result because of some possible future financial difficulty. This does not make good business sense.
- There is no evidence that the potential increased tax liability is offset by any safety and soundness benefits.

A number of commenters qualified their assertions that bank-equity assets should be included in an association's unallocated surplus ratio calculation. For example, one commenter stated that bank-equity assets should be counted as the same quality as other investments if the ''control issue'' were adequately addressed. Another commenter stated that there is no evidence that accumulating earnings at the bank has a negative impact on association survival, as long as earnings remain accessible to the association.

The System in its joint comment proposed an alternative method for calculating the unallocated surplus ratio for associations. It proposed that an association be permitted to count the after-tax value of its investment in its funding bank, so long as the bank would continue to meet all regulatory capital standards after a pro forma retirement of the association's allocated investment. Only if the bank would fail to meet one or more capital requirements, would the association be required to deduct the entire value of its allocated bank investment.

Several institutions also suggested that a portion of the investment in the bank be deducted from the unallocated surplus and the rest of the investment be deducted from the allocated surplus. This would, according to the commenters, accomplish what they

described as the FCA's goal of requiring adequate capital that is ''interchangeable'' or ''fungible.''

In response to all of these comments, the FCA has made a number of revisions in the reproposed rule. The term ''unallocated surplus ratio'' has been replaced with the term ''core surplus ratio,'' and the types of equities or accounts that may be included in the ratio have been expanded. The core surplus ratio minimum is 3.5 percent of the risk-adjusted asset base, unchanged from the minimum in the originally proposed rule, and includes all of the equities in the proposed rule's unallocated ratio, which are: Unallocated surplus, perpetual common stock held by non-borrowers, and noncumulative perpetual preferred stock held by non-borrowers, provided that the institution has no established plan or practice of retiring such stock. Core surplus includes three additional categories of equities or accounts that are considered by the FCA to be as permanent and stable as unallocated surplus. These equities or accounts are:

1. Nonqualified patronage allocations, allocated to institution borrowers other than other System institutions, made from earnings that the institution has included in its gross taxable income at the time of allocation and that are not subject to distribution according to an established plan or practice. An institution operating on a Subchapter T basis would not be able to take a tax deduction for these allocations until they are distributed, at which time the tax liability would be passed to the recipient. In the event that a nonqualified patronage allocation is distributed, other than as a part of a *pro rata* distribution of all nonqualified allocations that were allocated in the same year, any remaining nonqualified allocations allocated in the same year will be disallowed from treatment as core surplus.

2. Perpetual stock held by borrowers other than other System institutions that was not purchased as a condition of obtaining a loan, provided that the institution has no established plan or practice of retiring the stock. In the event that any such stock is retired other than on a *pro rata* basis, all other stock of the same class or series that was issued in the same year that the retired stock was issued will be disallowed from treatment as core surplus.

3. Newly developed or modified capital instruments or balance sheet entries or accounts that the FCA determines are the functional equivalent of a component of core surplus. The FCA may permit one or more System institutions to include all or a portion of such instrument, entry, or account as core surplus, permanently or on a temporary basis.

The reproposed rule also provides that, with respect to equities that are included in core surplus, if the FCA finds that a particular equity has characteristics or terms that diminish its contribution to an institution's ability to absorb losses, the FCA may require the deduction of all or a portion of such equity from core surplus.

The purpose of the conditions pertaining to retirement and distribution of equities held by borrowers is to assure that amounts treated as core surplus are not retired, canceled, or applied against a borrower's indebtedness on a defaulted loan or at the request of individual borrowers. These conditions would not prevent an institution from exercising its statutory right to make such retirements or cancellations. However, should such retirements or cancellations occur, the remaining allocated amounts and stock could not be counted in the core surplus ratio. They could, however, continue to be counted in the total surplus ratio and permanent capital of the institution. The conditions placed on the equities' inclusion in core surplus merely recognize that this practice negates the desired stability features of these types of equities. The provision would not apply to borrower equities canceled in connection with a restructured loan, if an association is required to cancel the equities pursuant to section 4.14B of the Act. If an association is statutorily *required* to cancel the equities, the remaining equities of the same class or series and issued in the same year as the canceled stock or equities will continue to be treated as core surplus.

The core surplus requirement would replace the current requirement in § 615.5330 that the BC and the agricultural credit bank (ACB) add at least 10 percent of net earnings after taxes to unallocated surplus until the unallocated surplus ratio reaches half of the minimum permanent capital requirement.

The reproposed rule adds a definition of ''perpetual stock or equity'' as stock or equity that does not have a maturity date, cannot be redeemed at the option of the holder, and has no other provisions that will require the future redemption of the issue.

The FCA continues to believe that institutions need a certain amount of capital that is not subject to regular distribution or retirement according to an established plan or practice. It is the FCA's position that such capital is necessary to protect institutions during periods of stress, which are part of the cyclical nature of the System institutions' business. In addition, System institutions are vulnerable to industry-wide or regional problems due to the high concentrations of certain commodities and loan volume in the agricultural sector. Consequently, in the reproposed rule the Agency excludes from the core surplus ratio any allocated equities that the recipient has included in his or her gross income and that the recipient can reasonably expect the institution to revolve in the near future.

The FCA is persuaded that the included types of equities are sufficiently permanent and stable and should qualify as core surplus when: No tax liability has yet been incurred by the recipient, there is no plan or practice of distributing or retiring them on an established or fixed basis, and there is no reasonable expectation by the recipient regarding when the equities will be distributed or retired. Several System institutions have issued such stock or nonqualified allocations. In those cases where the borrowers have been notified of such allocations, it is the FCA's understanding that the institutions have informed their borrowers that such equities may only be distributed or stock retired, if ever, at an unspecified date in the future and solely at the discretion of the institution's board of directors. None of these equities have been retired by the institutions, and, as one such institution stated, there is a much lower degree of ''sensitivity'' with members because they do not incur tax liability until the equity is revolved.

The FCA believes that permitting the inclusion of nonqualified equities meeting the reproposed rule's distribution conditions would eliminate most of the disincentives believed by several commenters to be embedded in the originally proposed rule for an institution to operate on a Subchapter T basis. The FCA believes that the revisions in the reproposed rule strike the appropriate balance between cooperative principles and safety and soundness objectives. The reproposed rule permits an institution to allocate its patronage-based income (using nonqualified allocations) and increase its core surplus ratio at the same time.

Although the reproposed rule does not limit the amount of nonqualified allocations that can be included in the core surplus, the FCA expects that institutions would retain a healthy portion of the core surplus in unallocated surplus. This completely uncommitted capital is especially important to the institution during periods of stress, when operating losses or provisions to the allowance for loan

losses may result. Accordingly, should the regulations be adopted, future FCA examinations would include an assessment of the composition of core surplus, which will be reflected in the evaluation of the institution's capital and operating performance.

The Class A stock issued by the Leasing Corporation and held by Farm Credit banks would qualify as core surplus. Class A stock represents the owner Farm Credit banks' initial investment in the Leasing Corporation, and retirement has occurred only with bank mergers. This stock has demonstrated a high degree of permanence and exhibits similar attributes to unallocated surplus. Accordingly, it would be eligible to satisfy the 3.5-percent core surplus and the 7-percent total surplus requirements. The Leasing Corporation's Class C stock, however, represents stock purchased by the owner banks based on lease activity in their respective trade/geographic territories. As a result, Class C stock fluctuates with lease volume (much the same as the level of borrower stock in associations fluctuates with the amount of outstanding loans), and the stock level is adjusted quarterly. Due to steadily increasing lease volume, Class C stock has increased over the past 5 years. Since Class C stock fluctuates with lease volume, however, it does not, as currently structured, have the stability and permanence attributes of surplus and consequently cannot be included in either surplus ratio.

The reproposed rule requires deduction of the association's net investment in its funding bank from core surplus for the purpose of computing the core surplus ratio for associations. This provision is unchanged from the proposed rule. The FCA required this deduction because of its strong belief that the retention of at least a minimum amount of capital that is not invested in (and therefore at risk and controlled by) the association's funding bank is critical to the financial health and autonomy of an association. When capital is retained at the bank, it is vulnerable to losses due to bank operations, as well as assistance programs for troubled associations in the district, and these are matters beyond the association's control. In a circumstance where most or all of the associations in a district become stressed, their investments in the bank could become most vulnerable at the time they are most needed.

The FCA considered proposals of commenters, including the proposals in the System's joint comment, to revise the calculation in the proposed rule to include a portion of the net investment in the bank. These proposals do not provide assurance that the association would be able to survive independently in the event of a bank's financial adversity or failure. Because one of the primary reasons for establishing the minimum core surplus requirement is to assure association access to stable capital at all times, the commenters' proposals do not fully achieve the purpose of the core surplus ratio standard. The FCA believes that the ''control issue'' cannot be adequately addressed.

Further, an association cannot have guaranteed access to its investment in the bank without the occurrence of a taxable event, the very situation some commenters seek to avoid by accumulating earnings at the bank.

The FCA does not favor the commenters' proposal to deduct the net investment in the bank partly from the core surplus and partly from the total surplus of an association. The proposal does not meet the FCA's goal to ensure that each institution holds a minimum level of capital that is neither at risk at another System institution nor subject to expected regular revolvement to borrowers.

As in the originally proposed rule, the reproposed rule will not permit inclusion of an association's net investment in its bank in the core surplus ratio calculation of either institution. The FCA has excluded the amount of the investment in the bank from both the bank's and the association's core surplus ratios because of the uncertainty of its accessibility by either institution. If an association were to fail, its investment in the bank would be offset against the bank's direct loan and thus eliminate that portion of capital on the bank's balance sheet. If the bank were to fail, the association's entire investment would become vulnerable to loss.

The FCA does not agree with comments that the originally proposed unallocated surplus ratio computation, including deduction of the net investment in the bank, is inconsistent with the provisions of the 1992 amendments to the Act. Those amendments provided that a bank and an association may, for the purpose of computing their permanent capital, agree on which institution could count as permanent capital the earnings of the bank that have been allocated to the association. The originally proposed rule did not make any changes to the permanent capital computation regarding the treatment of these allocated earnings to which the 1992 requirement relates, and neither would the reproposed rule. Measures such as the surplus ratios and the collateral ratio for banks are proposed to be added to better ensure the financial health of System institutions.

Furthermore, as described below, the total surplus ratio computation would include the association's investment in the bank in either the association's or the bank's allocated surplus, in conformity with the institution's allotment agreement. As importantly, the investment is counted in the net collateral ratio for banks, a critical ratio reflecting liquidity and access to financial markets by the System as a whole, to the same extent that it is included in bank permanent capital. However, the FCA believes that a measurement of capital not committed to the borrower and not available to absorb loss at another System institution is needed to adequately evaluate the ability of a direct lender association to survive independently of its funding bank.

The FCA notes that, despite some commenters' objections that the unallocated surplus ratio computation would inappropriately dissipate association capital by requiring that there be taxable earnings at the association level, nearly every taxable association in the System has had taxable earnings at the association level in the past 8 years. The FCA does not expect these associations to have to change their own capital adequacy plans significantly in order to achieve or maintain the minimum core surplus ratio standard (or, for that matter, the total surplus standard).

One of the frequently cited objections to the core surplus ratio calculation—that the requirement would result in higher interest rates or lower patronage distributions to borrowers—would be the result of any requirement that an institution accumulate and retain additional capital. Nevertheless, the goals of an institution to provide the lowest possible prices or the highest possible patronage distributions must be balanced against the obligation to maintain necessary reserves. The FCA has concluded, based on its experience as the regulator of System institutions as well as its knowledge of the problems that other types of financial institutions have faced, successfully and unsuccessfully, that a certain amount of the highest quality of uncommitted, accessible capital is critical to the long-term health and survival of institutions. The FCA believes that strong core surplus capital levels are necessary to ensure a viable System and minimize risk to its creditors and investors, including shareholders.

Under the reproposed rule, the core surplus ratio must be calculated by the institution as of each monthend as follows:

The ratio numerator:

Undistributed earnings/unallocated surplus (as defined in the FCA Call Report instructions);

Plus: Certain perpetual common or noncumulative preferred stock (held by entities other than System institutions) that was not purchased as a condition of obtaining a loan, provided that the institution has no established plan or practice of retiring the stock;

Plus: Nonqualified patronage allocations held by persons or entities other than other System institutions, provided that the institution has no established plan or practice of retiring such nonqualified patronage;

Less: For associations only, the net investment in its affiliated bank, which is—

Total investment in bank:

Less: Investment in association by bank;

Less: Agency/servicing investment in bank;

Less: Participations investment in bank;

Divided by—

The ratio denominator:

Risk-adjusted asset base per the permanent capital regulations, excluding the net impact of unrealized gains or losses on available-for-sale securities;

Less: For associations only, the net investment in its affiliated bank.

B. Total Surplus Ratio

The FCA originally proposed a requirement that each institution hold at least 7-percent total surplus, adjusted according to the permanent capital allotment agreement. Total surplus included the capital treated as unallocated surplus for the proposed unallocated surplus ratio, as well as certain allocated equities and stock.

No specific objections to the total surplus ratio were received. Accordingly, the total surplus ratio minimum of 7 percent of the risk-adjusted asset base and calculation of the ratio are reproposed without substantive change from the proposed rule. Equities that could be included in this ratio would be all of those equities that are included in core surplus for the core surplus ratio, as well as: (1) Allocated surplus and stock subject to a discretionary revolvement plan of 5 years or more; and (2) term stock with an original maturity of at least 5 years which is not retirable prior to its maturity (reduced by 20 percent in each of the last 5 years of the life of the instrument). Double-counting of capital would be eliminated according to applicable allotment agreements.

The calculation of the total surplus ratio, calculated by the institution as of each monthend with a minimum requirement of 7 percent, is as follows:

The ratio numerator:

Undistributed earnings/unallocated surplus per FCA Call Report;

Plus: Certain perpetual common or noncumulative perpetual preferred stock not purchased as a condition of obtaining a loan;

Plus: Certain nonqualified and qualified allocated equities;

Plus: Term stock with an original maturity of at least 5 years;

Less: For associations only, an amount equal to the amount of allocated bank equities counted as permanent capital by the bank;

Less: For banks only, an amount equal to the amount of bank equities counted as association capital.

Divided by—

The ratio denominator:

Risk-adjusted asset base per the permanent capital regulations, excluding the net impact of any unrealized gains or losses on available-for-sale securities;

Less: For associations only, allocated bank equities counted as permanent capital by the bank;

Less: For banks only, an amount equal to the amount of bank equities counted as association capital.

C. Collateral Ratio

The FCA originally proposed that all System banks should maintain a net collateral ratio of 104 percent of eligible assets (described in existing § 615.5050), less an amount equal to the amount of bank equities counted as association permanent capital, divided by total liabilities.

The FCA received numerous comments regarding the originally proposed 104-percent net collateral ratio requirement. All of the commenters on this issue took exception to the 104-percent level, asserting that the 103-percent level established by the System's Market Access Agreement (MAA) was sufficient. Commenters further asserted that the FCA had endorsed the MAA. They alleged that the higher regulatory requirement was inconsistent with the FCA's ''endorsement'' of MAA.

One commenter expressed concern that the 104-percent collateral ratio requirement was counterproductive to building capital at the association level. This commenter stated that the thrust of the FCA's proposed rule was to encourage associations to build higher levels of capital. However, the high bank collateral requirement would result in the banks accumulating more capital through higher direct loan rates, which would reduce the association's ability to be competitive and accumulate higher levels of capital.

The System's joint comment highlighted several perceived weaknesses in the wording of the originally proposed collateral requirement. Specifically, it said that the proposed rule incorrectly referred to a ''collateral position'' required by FCA regulations and the Act. The System pointed out that neither § 615.5050 nor the Act uses the term ''collateral position'' but rather compares certain assets defined as collateral with certain obligations requiring collateralization. The System added that the proposed regulation ''incorrectly'' used total liabilities as the denominator, rather than ''obligations requiring collateralization.'' The System recommended revising the proposed net collateral ratio definition to explicitly eliminate the application of FAS No. 115, in accordance with a statement in the proposed rule's supplementary information that the effect of FAS No. 115 was intended to be excluded from all of the proposed ratios. FAS No. 115 is a statement of generally accepted accounting principles (GAAP) requiring financial statements to include the net effect of unrealized gains and losses resulting from available-for-sale securities.

The FCA notes that its approval of the System banks' MAA did not constitute, and should not be interpreted as, a restriction on the FCA's authority to establish appropriate minimum capital or collateral standards. Moreover, any comparison of the rule's collateral ratio standard to the 103-percent collateral level in the MAA or the collateral calculation that is set forth for funding purposes in § 615.5050 is inappropriate because the standards are calculated differently. The MAA standards and funding requirement do not include a deduction for a bank's equities that are not counted as permanent capital by that bank according to its allotment agreement. The reproposed rule's collateral standard would require this deduction. Furthermore, the rule's denominator is total liabilities, not ''collateralized debt obligations'' as currently required by the MAA and § 615.5050.

The FCA reproposes a net collateral ratio requirement with substantially the same calculation as in the originally proposed rule. The FCA believes that the net collateral ratio in this rule would be a more precise measure of the

financial health of System banks than the collateral ratio in the MAA. A collateral ratio net of any bank assets counted as permanent capital by associations eliminates the double-leveraging of capital in System institutions. Using total liabilities as the denominator instead of ''collateralized obligations'' makes the ratio more meaningful as a safety and soundness measure and prevents a bank from leveraging its balance sheet by obtaining funds from non-System sources, which are not classified as ''collateralized obligations.'' The FCA strongly believes that the net collateral ratio is a critical measure of financial health and provides an early measure of a bank's ability to obtain funds from the market place. Severe safety and soundness concerns arise if sufficient collateral is not available for banks to offer investors who purchase System debt instruments. The net collateral ratio in this rule is intended to provide an early ''tripwire'' to help avoid such severe situations.

The FCA reproposes a minimum net collateral ratio standard of 103 percent, reduced from the 104-percent requirement in the originally proposed rule. In light of the increased capital requirements of the two surplus standards for both banks and associations that the FCA is reproposing, a collateral standard of 103 percent will be sufficient in most cases to ensure the maintenance of a minimum level of protection and implementation of supervisory measures should market forces cause a decline in the underlying value of collateral. This standard generally provides additional assurance that a bank will maintain sufficient collateral for continued access to capital markets, because the System banks' MAA does not limit access to the capital markets until a bank's collateral ratio, as defined in the MAA, drops below 102 percent.

The reproposed rule's net collateral requirement provides an earlier trigger for supervisory involvement than the MAA computation or the collateral requirement for funding purposes. It would provide a level of protection for operating and other forms of risk at the bank, and it is similar to the leverage ratios required by other regulators.

The FCA has determined that the exclusion of the effect of FAS No. 115 from the computation of the net collateral ratio could result in a differential treatment of eligible investments, according to whether they are designated as available for sale or held to maturity. Under § 615.5050, a bank's *entire* investment portfolio must be valued at the lower of cost or market. Accordingly, applying the exclusion of the effect of FAS No. 115 will not negate the effect of temporary fluctuations in the market value against a bank's entire investment portfolio, because unrealized holding gains and losses under FAS No. 115 apply only to the portion of a bank's investments classified as available for sale, not to investments classified as held to maturity. To ensure that the objective of this ratio is uniformly attained, the reproposed rule would require all eligible investments held by a bank to be valued based on their amortized costs for the purposes of calculating its net collateral ratio.

Under the reproposed rule, the net collateral ratio is calculated as follows:

The ratio numerator is a bank's net collateral, which equals:

A bank's total eligible collateral as defined by § 615.5050 (except that eligible investments as described in § 615.5140 are to be valued at their amortized cost),

Less: An amount equal to that portion of the allocated investments of affiliated associations that is not counted as permanent capital of the bank.

Divided by—

The ratio denominator, which equals:

The bank's total liabilities.

D. Compliance Issues

The originally proposed rule required institutions below applicable minimum surplus and collateral standards to develop and submit a capital plan acceptable to the FCA for achieving minimum standards. An association below the unallocated surplus standard on the effective date of the rule had the option of including a Risk-Sharing Agreement with its affiliated bank as part of its capital plan. An association falling below the minimum standard after the rule's effective date could include a Risk-Sharing Agreement only with FCA approval. Institutions meeting the goals of FCA-approved capital plans would be deemed to be in compliance with minimum surplus and collateral standards. In addition, the FCA sought comment on whether the Risk-Sharing Agreement should be a permanent option for associations.

Two issues pertaining to compliance were raised by commenters. The first issue concerned how much time institutions will have to come into compliance with the ratios. The originally proposed rule required an institution not meeting applicable surplus or collateral requirements to submit to the FCA a capital plan for achieving and maintaining the standards, with appropriate annual progress toward meeting the standards. In the supplementary information to the proposed rule, the FCA stated that it expected capital plans submitted by institutions below the minimum surplus or collateral requirements to include a reasonable timeframe for achieving the minimum surplus or collateral standards.

The St. Paul BC expressed significant concern about the ''subjective nature'' of the reasonable timeframe ''requirement'' for achieving the minimum capital standards. The BC stated that a timeframe set by the FCA could restrict the bank from adequately serving its membership, require the accelerated restructuring of the balance sheet (apparently by having to reduce assets), and require a significant amount of patronage earnings to be retained as unallocated surplus. The BC said that the impact would be to: (1) Reduce earnings and patronage refunds; (2) dissipate capital; (3) significantly weaken its competitive position; and (4) potentially jeopardize the advantages of operating on a Subchapter T basis for tax purposes. Over two dozen of the bank's stockholders sent letters with essentially the same comment as the bank. One respondent stated that the FCA would appear to have ''absolute discretion'' in determining what constitutes a reasonable timeframe. Two Farm Credit associations also expressed concern with the subjective nature of a ''reasonable timeframe.''

The System in its joint comment stated that the FCA has an obligation to document in the regulation, and provide opportunity for comment on, the standard of care that should uniformly be employed by FCA staff for determining the ''reasonable timeframe.'' Furthermore, the System said that, due to the very sensitive nature of the System's cooperative relationship with its stockholders, the determination of a reasonable timeframe should be specified or outlined in FCA policy or regulation rather than being potentially applied judgmentally by the FCA staff, which may result in an uneven application of the criteria.

The second compliance issue concerned whether an association could employ a Risk-Sharing Agreement as a permanent alternative to reaching a core surplus level of 3.5 percent. Some of the commenters stated that risk-sharing, if permitted on a permanent basis, would address the safety and soundness concerns raised by the FCA without an association's incurring a tax liability. Nevertheless, the proposed Risk-Sharing Agreement was criticized as too complicated and also as being a poor vehicle to recapture previously paid taxes. The proposed rule required risk-sharing to begin when losses exceeded

the current year's earnings. Commenters noted that this might prevent an association from recouping some of the taxes that might be recoverable from previous years and recommended that some mechanism be implemented to delay the risk-sharing trigger until all available taxes have been recouped.

The System's joint comment included a description of a ''contractual conversion mechanism'' that was, in its view, simpler than the proposed rule's Risk-Sharing Agreement and that contained activation provisions that would maximize tax benefits due to operating losses and help to mitigate an association's economic adversity. The System suggested that an association be permitted to include such a conversion provision in its capital plan until the end of 2006 without FCA approval.

In the reproposed rule, the FCA has made several significant changes to the compliance provisions from the originally proposed rule. First, the FCA believes that the use of a capital plan (which is referred to as a ''capital restoration plan'' in the reproposed rule to distinguish it from other capital plans) to achieve minimum surplus or collateral ratios should be an option only for those institutions that are below a minimum standard on the effective date of this rule. For institutions that fall below a minimum surplus or collateral standard subsequent to the effective date of this rule, the FCA would address the noncompliance in the same way it treats other instances of noncompliance with FCA regulations. The Agency would decide on a case-by-case basis what supervisory action, if any, to take with respect to the violation—from simply requiring the institution to submit a capital restoration plan to a more formal action. Any decision in this regard would depend on the level of an institution's capital and the severity of its problems. The FCA has proposed this change in order to have greater flexibility to impose requirements commensurate with the seriousness of the situation, or to take no formal action if the noncompliance appears minor, not due to mismanagement of the institution, and likely to be short-lived.

Second, the FCA has deleted from the reproposed rule the definition of ''Risk-Sharing Agreement'' in order to give associations more latitude in devising mechanisms to achieve initial compliance with the core surplus requirement. The FCA agrees with commenters that different types of contractual arrangements, including arrangements that enable an association to take advantage of tax provisions for distressed institutions, could be an acceptable part of an association's plan to restore capital.

Third, the FCA has added a requirement to report noncompliance with the surplus or collateral ratios to the FCA within 20 calendar days of the end of the month as of which the noncomplying ratio was computed.

Fourth, the FCA has placed a limit of 180 days from the effective date of the rule for an institution not in compliance on the effective date to submit, and the FCA to approve, a capital restoration plan. The FCA believes that placing a limit on the time during which an institution has to submit an acceptable plan adds certainty and finality to the initial approval process.

Finally, in response to commenters' suggestions, the FCA has added to the compliance provision in the reproposed rule a list of factors to be considered by the Agency in approving compliance plans. The factors include, as applicable:

1. The conditions or circumstances leading to the institution's falling below minimum levels (and whether or not they were caused by actions of the institution or were beyond the institution's control);
2. The exigency of those circumstances or potential problems;
3. The overall condition, management strength, and future prospects of the institution and, if applicable, affiliated System institutions;
4. The institution's capital, adverse asset (including nonaccrual and nonperforming loans), allowance for loss, and other ratios compared to the ratios of its peers or industry norms;
5. How far an institution's ratio is below the minimum;
6. The estimated rate at which the institution can reasonably be expected to generate additional earnings;
7. The effect of the business changes required to increase capital;
8. The institution's previous compliance practices, as appropriate;
9. The views of the institution's directors and senior management regarding the plan; and
10. Any other facts or circumstances that the FCA deems relevant.

Notwithstanding the concerns of commenters regarding the ''reasonable timeframe'' in which noncomplying institutions would be expected to achieve all minimum surplus and collateral standards, the FCA is not persuaded that the rule should specify a single timeframe in which institutions must meet the standards. The Agency continues to believe that not specifying a timeframe would allow maximum flexibility and latitude to determine the best course for building capital ratios to at least the minimum levels. In view of the wide range in both the amount of shortfall and the reasons for that shortfall among institutions not meeting the proposed requirements, the FCA concludes that no specific timeframe would be suitable in every case. The FCA anticipates that it would approve capital restoration plans that project appropriate annual progress toward compliance. The Agency recognizes that capital restoration plans must be realistic and that long-term plans may be appropriate in some circumstances.

E. Stock Retirement Provisions

The FCA originally proposed to permit institution boards of directors to delegate discretion in the retirement of borrower stock to management as long as, after retirement, an institution would meet all of its applicable surplus and collateral requirements and its permanent capital ratio would remain above 9 percent. The FCA received two comments on the proposal. The ABA was troubled by the possibility that System institutions would be able to continue to retire stock, albeit with the specific approval of the board of directors, if the institution's permanent capital were below 9 percent. The trade association's particular concern was apparently the potential for insider abuse. The ABA recommended that stock retirements be prohibited when permanent capital is below 9 percent and that the proposal be revisited by the FCA to prevent conflicts of interest with insiders. A System association criticized the FCA's proposal as eliminating any flexibility on the part of management with respect to stock retirements and as setting too high a standard that would result in inappropriate involvement by a regulator at a point where an institution still has a relatively strong permanent capital position. The association suggested that management be allowed to retire ''de minimis'' amounts of stock as long as the permanent capital remains above 8 percent.

The FCA reproposes the originally proposed stock retirement provisions without change. Accordingly, as long as after retirement an institution's core surplus and total surplus ratios (and, for banks, the collateral ratio) would meet or exceed applicable minimum standards, and the permanent capital position would remain above 9 percent, the retirement of borrower stock could be delegated by the institution's board of directors to its management.

The FCA notes that the ABA's proposal that no redemption of borrower stock be permitted if the association's capital falls below 9

percent is inconsistent with System institutions' statutory right to retire stock at the sole discretion of the board, as long as the institution meets its permanent capital standard. Although the FCA recognizes that there is a potential for abuse of discretion by institution board members in the retirement of their own equities, the FCA monitors retirements of stock owned by directors in the examination process and has never yet found this kind of abuse.

The System association's suggestion that institution management be allowed to retire ''de minimis'' amounts of stock under delegated authority until the institution's permanent capital falls to 8 percent was also not accepted because, as the FCA interprets this suggestion, a stock retirement in an amount equal to as much as 1 percent of permanent capital would be considered to be ''de minimis.'' Furthermore, the FCA does not believe that the restrictions the reproposed regulation would place on delegation of stock retirements would be onerous or would significantly affect the institution's ability to operate in a flexible manner.

F. Individual Institution Capital Ratios and Capital Directives

Subpart L, Establishment of Minimum Capital Ratios for an Individual Institution, and subpart M, Issuance of a Capital Directive, are reproposed in substantially the form in which they were originally proposed. The FCA does not agree with the suggestion of a commenter to eliminate the application of civil money penalties in cases where an individual institution capital ratio was not met but the otherwise applicable ratios were met, because the FCA's reason for setting a higher ratio in the first place would be its judgment that the institution would not be operating in a safe and sound manner if it were below the individually set ratio. The FCA also has not included a commenter's suggestion to establish an office of ombudsman. Should concerns arise regarding the fair application of individual institution ratios or capital directives to different institutions in the System, the FCA would address those concerns on a case-by-case basis.

G. Other Capital Issues

1. Nine commenters, including the System's joint comment, raised concerns with the current practice of risk-weighting unused loan commitments with remaining maturities in excess of 1 year. Because this issue requires further study, it will be considered by the FCA in the next phase of its review of capital regulations.

2. One commenter suggested that the surplus standards should not be applicable to Federal land bank associations (FLBAs) that do not have exposure to loan losses, as provided for in § 615.5210(e)(9). The reproposed rule would make no changes in the application of surplus requirements to all FLBAs, because the Agency believes that these requirements would be minimal and would pose no hardship on any FLBA. Furthermore, FLBAs with no exposure to loan losses have very minimal levels of risk-adjusted assets to capitalize. The FCA believes that it is appropriate for every institution to have at least some level of positive surplus funds based on the level of operations. For this reason, the FCA has concluded that it is appropriate to have the same requirement apply to all associations, including FLBAs. The FCA notes that funds that are earned at the bank and distributed to the FLBAs are not taxable, adding no tax burden to the FLBAs.

3. Other provisions of the proposed rule pertaining to the exclusion of the impact of unrealized gains and losses on available-for-sale securities, as well as technical and conforming changes, are reproposed in the same form in which they were proposed.

H. Limitations on Financing Non-Agricultural Credit Needs of Bona Fide Farmers, Ranchers, Aquatic Producers or Harvesters

Under reproposed § 613.3000, all bona fide farmers, ranchers, and aquatic producers or harvesters would be eligible for FCS financing of their agricultural or aquatic needs. The reproposal would place limitations on all other credit to farmers, however, using criteria that are more specific and appropriate than those in the existing regulation. The reproposed regulation would distinguish individual farmers who actively produce agricultural products or manage a farming operation from passive farm owners, who meet the definition of a *bona fide* farmer only because they own agricultural land. Retired farmers who have been engaged in agricultural production, including incapacitated farmers, who own agricultural land and assume some portion of their tenant's production risk, would also be considered active farmers. Under the reproposed rule, active farmers would be given limited access to FCS financing for their other credit needs, but access becomes more limited or completely precluded for passive farm owners and non-resident foreign nationals.

1. Non-Agricultural Business Needs of the Borrower

The reproposed regulation would allow FCS banks and associations to finance the non-agricultural business needs of citizens and permanent residents of the United States who are eligible under § 613.3000(a)(3)(i). This financing would be limited to an amount that does not exceed the market value of the borrower's agricultural assets. The reproposed regulation does not permit System lenders to offer non-agricultural business financing to non-resident foreign nationals or individuals who are eligible because they own agricultural land as a passive investment pursuant to § 613.3000(a)(3)(ii).

The reproposed regulation does not represent a substantial change from the existing regulation on this point. The reproposal continues to link a borrower's access to FCS financing to his or her involvement in agriculture. The existing regulation views a farmer's involvement in agriculture as a continuum, ranging from full-time, to part-time, to a person ''whose business is essentially other than farming.'' It states as a guiding principle that the purposes for which credit may be extended ought to become more restricted as a borrower's status becomes further away from being a full-time farmer. The reproposal distinguishes instead between a farmer who actively engages in agricultural production or farm management and one who simply owns farm land. Only the active farmer is permitted to borrow for non-agricultural business needs. Moreover, the reproposal contains a precise limit on the amount of such credit that may be extended. Although both the existing and reproposed regulations ensure that the System retains its focus on agricultural lending, the new approach relies on exact and objective standards that are more meaningful and easier to apply.

2. Housing and Domestic Needs

Reproposed § 613.3000(d)(1) would authorize citizens and permanent residents of the United States who are active farmers to obtain System financing for their housing and domestic needs without restriction other than their creditworthiness. Such borrowers have strong ties to agricultural or aquatic production and FCS financing for their housing and domestic needs should not alter their status as farmers, ranchers, and aquatic producers or harvesters.

Reproposed § 613.3000(d)(3) would allow individuals who own agricultural

land as a passive investment to obtain System financing for their housing and domestic needs in an amount that does not exceed the market value of their agricultural assets. Persons who are eligible solely because they own farm land are primarily engaged in vocations other than agriculture.

In addition, reproposed § 613.3000(d)(2) would allow non-resident foreign nationals who actively engage in agricultural or aquatic production in the United States to obtain System financing for housing and domestic needs that are reasonably related to their agricultural or aquatic operations located in the U.S.A.

More specifically, active farmers who are non-resident foreign nationals could obtain System financing only for a house that is located on or near their farm or ranch. Additionally, the FCA intends that the FCS extend credit to non-resident foreign nationals only for those housing and domestic needs that enable the borrower to conduct a farming operation in the United States. The FCA believes that non-resident foreign nationals who are active farmers should not be allowed unrestricted System financing for their housing and domestic needs because they lack a permanent presence in the United States.

Like the existing regulation, this proposal allows active farmers to obtain credit for their housing and domestic needs. It would expressly permit certain other farmers to borrow from the FCS for their housing and domestic needs but with the restrictions described above, which are intended to ensure that such credit is generally appropriate to their farming operations.

3. Definition of Agricultural Assets

Because the amount of financing to an eligible borrower for other credit needs is limited to the market value of the borrower's agricultural assets, this term was the subject of a number of comments. The FCA's originally proposed regulation did not define ''agricultural assets,'' although the preamble to proposed § 613.3000(a) stated that agricultural assets included ''real estate, a home that is located on a farm or ranch, equipment, chattel, and livestock.''

System commenters asked the FCA to define ''agricultural assets'' in the regulation. They proposed a more expansive definition of ''agricultural assets'' that, in their view, would reflect the diversity of agriculture. The FCC's comment suggested that ''agricultural assets'' include ''all tangible and intangible assets reasonably necessary to, derived from, used in, or available for use in the borrower's agricultural or aquatic operation, including the borrower's personal residence, regardless of its location.'' The comment recommended that tangible and intangible assets include all personal property and financial assets used in the borrower's operation and the proceeds that are derived from the sale of agricultural assets. Under the System's proposal, receivables, cash, investments purchased with proceeds from the sale of agricultural assets, trademarks, motor vehicles, aircraft, seagoing vessels, and other personal property would be agricultural assets. System commenters also believed that off-farm residences should qualify as agricultural assets because farmers and producers in the fishing, timber, and nursery industries often live off-site.

As requested by the commenters, the FCA has incorporated a definition of ''agricultural assets'' into the reproposed regulation. The definition in reproposed § 613.3000(a)(1), however, is more narrow than the FCC's recommendations. The FCA has excluded intangibles, such as goodwill and trademarks, from the definition of ''agricultural assets'' because the establishment of a definitive market value prior to sale is difficult to derive and, therefore, oftentimes unreliable. Personal property such as motor vehicles, aircraft, and seagoing vessels qualify as agricultural assets if the borrower uses them for agricultural or aquatic production. Similarly, cash, investments, and sale proceeds are not agricultural assets until they are reinvested in the borrower's farming, ranching, or aquatic operations. However, reproposed § 613.3000(a)(1) does classify working capital as an agricultural asset. Working capital includes accounts receivables from agricultural sales, inventory used in the borrower's agricultural or aquatic business, and cash proceeds that are reinvested in the farming, ranching, or aquatic enterprise.

Under the reproposed regulation, the principal residence of a farmer who is eligible under reproposed § 613.3000(a)(3)(i) would be considered an agricultural asset regardless of whether it is located on agricultural land. This approach treats all active farmers equitably irrespective of where they live or type of their agricultural endeavor. Because the value of agricultural assets will determine the amount of funds available for other credit needs, these assets must be valued appropriately. Documentary support for the value should be included in the loan file.

I. Financing for Legal Entities

The FCA proposed to allow any legal entity that is chartered in the United States to qualify as an eligible System borrower if it met the definition of a bona fide farmer, rancher, aquatic producer or harvester. Such legal entities would be able to obtain financing for any of their agricultural needs. The FCA proposed, however, to limit System financing of the non-agricultural credit needs of legal entities. Under the original proposal, legal entities would not have been eligible for financing for their other credit needs if they were publicly traded or less than 50 percent of the borrower's assets were used in agricultural or aquatic production. The FCA's original proposal would have allowed all other legal entities to receive financing for non-agricultural purposes in an amount that did not exceed the market value of their agricultural assets. The FCA reasoned that this approach would continue to authorize System banks and associations to finance the other credit needs of family farm corporations and other small- and medium-sized legal entities that are closely held by *bona fide* farmers, ranchers, and aquatic producers or harvesters. The restrictions in proposed § 613.3000(d)(3) were designed to ensure that previously ineligible agribusiness corporations and conglomerates could obtain FCS financing only for their agricultural or aquatic needs.

The FCA received 17 comments about its proposed limitations on the financing of legal entities. All System commenters supported the FCA's proposal to repeal the existing eligibility restrictions on legal entities because they believe that the organizational structure of the borrower should not determine eligibility. However, System commenters opposed various aspects of the proposed restrictions on their ability to finance the non-agricultural credit needs of certain legal entities.

In contrast, commercial banks, their trade associations, and FLAG opposed the FCA's proposal to revise the eligibility and scope of financing criteria for legal entities. These comments addressed whether certain legal entities should be eligible for agricultural credit and the extent to which they should be permitted to borrow from the System for their other credit needs. One commenter asserted that family farm corporations are the only legal entities that should qualify for System financing. Others believed a legal entity should be eligible for agricultural credit only if agriculture is its primary focus. Another commenter favored retaining the three-pronged

eligibility test in former § 613.3020(b). Two other commenters suggested that legal entities should be ineligible to borrow from Farm Credit banks and associations unless they are owned by farmers, ranchers, or aquatic producers or harvesters who actively engage in agricultural or aquatic production.

Both System and non-System commenters opposed the FCA's proposal to deny publicly traded corporations access to System funding for their non-agricultural credit needs. Some System commenters opposed excluding publicly traded corporations from such financing because they believe that current and potential System borrowers will, in the future, raise capital by selling their equities on public exchanges.

Other commenters opposed the FCA's approach toward publicly traded corporations because, in their view, it was not sufficiently restrictive. They expressed concern that a privately owned conglomerate would be able to obtain System financing for its non-agricultural activities by simply restructuring its subsidiaries so that 50 percent of their assets would be used in agricultural production.

After considering all the comments, the FCA has decided to: (1) Retain the eligibility criteria for legal entities in proposed § 613.3000(a)(4); and (2) revise proposed § 613.3000(d)(3), which addresses the authority of FCS banks and associations to finance the non-agricultural credit needs of legal entities. Under reproposed and redesignated § 613.3000(a)(5), a legal entity will qualify as a *bona fide* farmer if it meets the eligibility criteria in reproposed § 613.3000(a)(3)(i). Reproposed § 613.3000(a)(5) includes a technical correction that adds tribal authorities to the list of governmental units under whose laws legal entities can be organized. Reproposed § 613.3000(c) authorizes System banks and associations to extend credit to an eligible legal entity for any agricultural or aquatic purpose.

Reproposed § 613.3000(d)(4) would continue to restrict which legal entities could obtain financing for non-agricultural business needs and the amount of such credit. A legal entity could obtain non-agricultural financing only if more than 50 percent of its equity is owned by individuals who actively engage in agricultural or aquatic production to generate income *and* either more than 50 percent of its: (1) Assets are used in agricultural or aquatic production; or (2) income is derived from agricultural or aquatic activities. Moreover, the credit would be limited to an amount that does not exceed the market value of its agricultural assets at the time the loan is closed. Because the reproposed regulation would require the borrower to meet these requirements at the time the loan is closed, a System lender would not be able to finance the other credit needs of a legal entity unless its agricultural activities, after the extension of credit, would exceed its non-agricultural activities.

The FCA believes that the reproposed regulation will strike an appropriate balance among the concerns of all commenters. In response to System concerns, reproposed § 613.3000 would repeal all regulatory restrictions that previously prevented System banks and associations from providing agricultural credit to corporate farmers. The reproposed regulation permits all *bona fide* farmers, including all legal entities, to obtain System financing for any agricultural or aquatic purpose. However, both individual and corporate farmers must be eligible under § 613.3000(a)(3)(i) before they can borrow from the FCS for their non-agricultural business needs, and then only in an amount that does not exceed the market value of their agricultural assets. This ensures that only farmers who actively engage in agricultural or aquatic production could obtain System financing for their non-agricultural business needs.

The reproposed regulation effectively prevents publicly traded corporations from obtaining System financing for their non-agricultural needs unless more than 50 percent of the equity is held by active farmers, ranchers, and aquatic producers or harvesters are allowed to borrow from the FCS for such purposes. Additionally, these changes would keep lending to legal entities agriculturally focused because: (1) A majority of the income or assets of such borrowers must be related to agricultural or aquatic production; and (2) the amount of non-agricultural credit may never exceed the market value of any borrower's agricultural assets.

The FCA disagrees with commenters who favor enabling the System to finance the other credit needs of all legal entities engaged in agriculture. Because the primary mission of the FCS is to finance agriculture and aquaculture, FCA regulations have consistently imposed restrictions of some type on non-agricultural loan purposes to System borrowers. The FCA believes the availability of non-agricultural credit for both individuals and legal entities should be proportionally related to the borrower's involvement in agricultural or aquatic production. Farmer ownership, combined with agricultural assets or agricultural income, are the best measures of whether a legal entity focuses on agriculture. Accordingly, the reproposed regulation would ensure that such lending is proportional, while giving the FCS ample flexibility to respond to the evolving needs of all agricultural producers in a rapidly changing economic environment.

The FCA also disagrees with commenters who suggest that the regulation should favor individual borrowers over legal entities. The FCA observes that the Act does not accord individuals preference over legal entities. For this reason, FCA regulations should not influence the decision whether to conduct agricultural or aquatic operations in an individual capacity or as a legal entity.

J. Nationality of the Borrower

The FCA received ten comments about proposed § 613.3000(a)(3)(ii), which governs the eligibility of non-resident foreign nationals who have been admitted into the United States pursuant to a provision in 8 U.S.C. 1101(a)(15) that authorizes such individuals to own property, or to operate or manage a business in this country. System commenters generally supported the FCA's original proposal while other commenters opposed it. System commenters opined that the proposed regulation was consistent with the Act, which imposes no eligibility restriction on foreign nationals. Some System commenters suggested that the FCA extend eligibility to foreign national legal entities that have not established a domestic subsidiary because no Federal law precludes System banks or associations from lending to such parties.

In contrast, a commercial bank opined that the FCA's proposal was ''unfair and unwarranted'' because American citizens would compete with foreign nationals for funding from the FCS. Three commenters asserted that loans to non-resident foreign nationals are inherently unsafe and unsound. One commenter believes that System loans to non-resident foreign nationals slow the national economy and worsen the trade deficit between the United States and other countries. Two other commenters claimed that FCS financing to non-resident foreign nationals forces small family farms out of business. A trade association questioned whether the Act authorizes the FCS to finance foreign nationals.

The FCA disagrees with the argument that the FCS lacks the legal authority to extend credit to farmers, ranchers, and aquatic producers and harvesters who

are not American citizens. Section 1.1(a) of the Act states that the mission of the FCS is to improve the ''income and well-being of American farmers and ranchers.'' Neither that provision or any other provision of the Act explicitly or implicitly restricts eligibility for System loans to American citizens. The general rulemaking provisions of section 5.17(a)(9) of the Act allow the FCA to enact regulations that govern the eligibility of foreign nationals to borrow from FCS institutions.

Since 1976, FCA regulations have allowed certain foreign nationals who have been lawfully admitted into the United States for permanent residence and conduct agricultural or aquatic operations within its territory to borrow from System banks and associations that operate under titles I or II of the Act. Legal entities that are owned or controlled by eligible foreign nationals also qualify for System financing under existing FCA regulations.

Foreign nationals and foreign national legal entities that lawfully engage in agricultural or aquatic production in the United States invest their capital, labor, time, and effort in the American agricultural economy. In this context, these persons contribute primarily to the economy of the United States, not their country of origin. Contrary to the comments of commercial bankers, the United States benefits from the endeavors of these farmers, just as it does from any other farmer who helps supply abundant and affordable food to the American consumer.

The FCA also rejects arguments that loans to foreign nationals are inherently unsafe and unsound. Although loans to non-resident foreign nationals may expose System banks and associations to different risks, the FCA notes that the FCS, like all lenders, should have the capability to identify and manage the risks associated with lending to non-resident foreign nationals.

The reproposed regulation, however, further restricts the access of non-resident foreign nationals to the System for their other credit needs. The original proposal would have authorized non-resident foreign nationals to obtain System financing for their housing, domestic, and non-agricultural business needs in an amount that does not exceed the market value of their agricultural assets in the United States. In contrast, reproposed § 613.3000(d)(2) prohibits such borrowers from obtaining System financing in any amount for non-agricultural business needs. The FCA believes that the additional restriction on loans to non-resident foreign nationals is justified because their legal status limits their activities within the United States. As a general rule, the visas of non-resident foreign nationals do not allow them wide latitude to change their business activities within the United States. Accordingly, the reproposed regulation ensures that FCS lending to foreign nationals is limited to agricultural purposes and housing and domestic needs that are reasonably related to the borrower's farming operation in the United States.

The FCA does not agree with the commenters' recommendation that the regulation allow System lenders to finance foreign national legal entities that have not established a domestic subsidiary. Reproposed § 613.3000(b) treats all United States corporations exactly alike regardless of the nationality of their owners. This approach simplifies the regulation and avoids any safety and soundness issues that could arise from the absence of a domestic charter by the borrower. Because foreign corporations that produce agricultural products in the United States are able to establish a subsidiary under domestic laws, any such creditworthy enterprise that desires financing from an FCS lender will be eligible to obtain it.

One System association suggested that Mexican or Canadian farmers or ranchers who obtain farm-related services in the United States should be eligible for FCS financing. More specifically, the commenter recommended that the FCA authorize System banks and associations to finance Mexican ranchers who periodically bring their cattle into Texas to use local feedlots. The commenter believes that such an approach would be consistent with the spirit of the North American Free Trade Agreement (NAFTA).

The FCA does not accept this suggestion. Doing so would require the FCA to expand the definition of a *bona fide* farmer or rancher to individuals who neither conduct an agricultural operation inside the United States nor own agricultural land in the United States. Such parties farm or ranch outside of the United States, where the FCS has no authority to lend under titles I and II of the Act.

K. Legal Entities Eligible To Borrow From a BC or ACB

Under the FCA's original proposal, legal entities that are eligible to borrow from a BC or ACB would not have qualified for financing from an FCB or FCS association. Although the FCA acknowledged that some cooperatives have outstanding loans with FCBs and associations, the Agency expressed concern that the revised eligibility standard for legal entities might significantly expand competition within the FCS. Accordingly, the FCA invited comment on the appropriateness of a regulatory prohibition on FCB and association loans to cooperatives and asked commenters to offer alternative solutions.

The FCA received 84 letters of comment on its proposal to deny eligible title III borrowers access to financing at FCBs and direct lender associations. Although the St. Paul BC, CoBank, and a pair of jointly managed associations favored this proposal, six FCBs, 49 associations, the Tenth District PCAs, 16 agricultural cooperatives and one individual opposed it.

Most FCBs and direct lender associations contended that titles I and II of the Act permit them to lend to agricultural cooperatives and related entities that are also eligible BC or ACB borrowers. Many commenters claimed that a regulatory prohibition on FCB and association loans to cooperatives and their related entities is contrary to the language and intent of the Act. Many commenters asserted that this proposal was contrary to the FCA's Regulatory Philosophy Statement, because a ban on FCB and association loans to eligible title III borrowers is not necessary to implement or interpret the Act or promote safety and soundness. Some FCS associations claimed that the FCA's original proposed regulation lacked balance because it would allow a BC or ACB to serve FCB and association customers.

As requested by the FCA, several commenters offered alternatives that address the Agency's concerns about intra-System competition. Many commenters suggested that the FCA delete this prohibition from the regulation and initiate a negotiated rulemaking, or impanel an Advisory Committee pursuant to section 5.12 of the Act, to address all intra-System competition issues. Several associations suggested that the regulation require FCBs and their associations to obtain consent from a title III lender before they extend credit to a cooperative or related entity.[1] A jointly managed FLCA and PCA advised the FCA to allow an FCB or direct lender association to make loans below a specified dollar amount to cooperatives without the consent of a title III lender. If the loan exceeded this

[1] Former regulations in subpart B of part 616 controlled intra-System competition by allowing title I and II lenders to lend to small cooperatives with the concurrence of the district BC. 12 CFR 616.6040 was originally adopted by the FCA in 1979. *See* 44 FR 69633 (Dec. 4, 1979). It was repealed in 1990. *See* 55 FR 24888 (June 19, 1990).

threshold, the FCB or direct lender would be required to either: (1) Obtain consent from a title III lender; or (2) sell a participation interest in the loan to the St. Paul BC or CoBank. An FCB and one of its affiliated associations suggested that the regulation authorize FCBs and associations to lend only to those cooperatives that engage in or finance agricultural production.

The FCA has decided to withdraw the proposal to prohibit lending by FCBs and associations to borrowers also eligible under title III. The removal of this prohibition from the regulation acknowledges the status quo within the FCS. Currently, titles I and II lenders finance certain cooperatives and their related entities under their statutory powers. The FCA finds that permitting this continued overlap is preferable to the alternative approaches suggested by some commenters. The consent requirement could unacceptably burden the loan approval process for both System lenders and their borrowers. The FCA has no basis for setting a specific dollar limit for loans to cooperatives that would be responsive to smaller cooperatives' needs.

The FCA is aware that intra-System competition causes deep concern within the FCS and can have significant implications for the FCS as a whole. As noted earlier, many commenters have suggested that the FCA address intra-System competition issues, using a participatory approach, such as a negotiated rulemaking or an Advisory Committee. The FCA believes this recommendation merits further consideration. It will continue to monitor competition among System institutions and consider methods to address these issues. The FCA continues to encourage System institutions to resolve specific issues regarding intra-System competition by mutual agreement.

L. Other Issues Raised by Commenters

1. Definition of Bona Fide Farmer, Rancher, and Aquatic Producer or Harvester

Proposed § 613.3000(a)(2) would define a *bona fide* farmer, rancher, or aquatic producer or harvester as an individual or legal entity that either: (1) Produces agricultural products, or produces or harvests aquatic products to generate income; or (2) owns agricultural land. The preamble to the proposed regulation noted that this definition does not represent a significant departure from the existing regulation.

One FCB and several of its affiliated associations sought modification to this definition. First, these commenters recommended that the FCA change the term ''produces agricultural products'' to ''engages in the production of agricultural products,'' to clarify that eligibility is not determined by farmer's actual crop yield. These commenters expressed concern that proposed § 613.3000(a)(2) could result in a *bona fide* farmer becoming ineligible for an operating loan due to a crop failure in a previous year. Although the FCA has not incorporated the commenters' recommendation into the reproposed regulation, the Agency reaffirms its position that crop failures do not affect borrower eligibility.

The same FCB and an affiliated association requested that the FCA revise proposed § 613.3000(a)(2)(i) to encompass parties who provide for the husbandry of wild and domesticated animals. The FCA has always regarded husbandry of farm and ranch animals as an agricultural activity and believes that no additional regulatory changes are needed.

The FCB and many of its affiliated associations also asked the FCA to clarify whether the term ''eligible borrower'' in proposed §§ 613.3000(b) and 613.3010 refers to parties who already have outstanding System loans. The FCA responds that eligibility is not determined by whether the applicant is a current FCS borrower. Instead, ''eligible borrower'' refers to *bona fide* farmers, ranchers, and aquatic producers or harvesters who qualify for System financing under §§ 613.3000(b) and 613.3010.

2. GSE Status

Many commercial banks and credit unions questioned whether System financing for the other credit needs of agricultural and aquatic producers is compatible with GSE status because they believe GSE status gives the FCS unfair competitive advantages over commercial banks, credit unions, and other lenders. Some commenters asserted that the FCS should be allowed to compete with other lenders for non-agricultural loans to farmers only when such System lending will fulfill a market need that has been neglected by non-GSE lenders.

The FCA disagrees and observes that the Act expressly authorizes System lenders to finance a farmer's other credit needs. Section 1.1(c) of the Act reflects Congress' expectation that the FCS will be a competitive source of loans to agricultural and aquatic producers. It is precisely this competition that achieves the express objectives of Congress of increasing the availability and reducing the cost of credit to agriculture, aquaculture, and other rural needs that are specified by the Act. These comments overlook the primary purpose of the FCS, which is to provide reliable credit to agriculture at all times, including those periods when commercial lenders find it unprofitable or too risky to lend to agriculture. To continue to perform this function as the methods and modalities of agriculture change, the FCS must be free of unnecessary regulatory restrictions that impede its flexibility to meet the credit needs of agricultural producers.

3. Need for Outstanding Agricultural Loans

Two commercial bank trade associations objected to permitting System lenders to finance a farmer's other credit needs unless the borrower has an outstanding agricultural loan from the FCS.

The FCA believes that allowable financing for other credit needs should be related to the borrower's involvement in agriculture, rather than whether there is an agricultural loan outstanding to the borrower. Therefore, the FCA has responded to the commenters' concern by limiting FCS financing for a non-agricultural business need to active farmers eligible under § 613.3000(a)(3)(i). As in the proposed regulation, the amount of such credit would be limited to the market value of the borrower's agricultural assets. The reproposed regulation would not allow the FCS to extend non-agricultural business credit to passive owners of agricultural land.

The Act does not require that a borrower have an outstanding agricultural loan from a System lender in order to obtain financing for another purpose. Rather, it grants the FCA discretion to determine the limitations on non-agricultural lending to farmers and ranchers. The reproposed regulation would preserve the System's agricultural focus by limiting the amount of credit available for non-agricultural business purposes and would make it available only to active farmers. This approach ensures that non-agricultural business lending is proportional to each borrower's commitment to agriculture.

4. Partnership With Commercial Lenders

A State agency suggested that the regulation require System lenders to participate with commercial banks in non-agricultural business loans and use commercial bank underwriting standards for such loans. The FCA does not agree that this should be a requirement.

5. Asset Limitation for Non-Agricultural Lending

Two commercial bank commenters opposed the FCA's proposal to link the amount of non-agricultural credit to the market value of the borrower's agricultural assets. One commenter claimed that this proposal would establish a credit union bond for the FCS. This comment seems to indicate that any borrower who meets the regulatory definition of a ''*bona fide* farmer'' can obtain System financing for any credit need. The FCA disputes this allegation because the amount of a farmer's agricultural assets does not establish eligibility for a System loan, but rather limits the borrower's access to the FCS for non-agricultural business loans.

These commenters urged the FCA to use agricultural income, not agricultural assets, as the standard for limiting a farmer's access to the FCS for non-agricultural business credit because they believe that income is a better barometer of a borrower's relationship to agriculture. The commenters noted that an income test would more effectively ensure that System lending for non-agricultural purposes is not concentrated on older and wealthier part-time farmers, who may have substantial agricultural assets, but derive a small amount of income from these assets.

After considering this suggestion, the FCA continues to believe that agricultural assets, not agricultural income, provide a more useful and readily available measure of a borrower's involvement in agriculture. Agricultural income is too volatile to be an accurate measure of a borrower's overall commitment to agriculture because income tends to fluctuate from 1 year to the next. Further, agricultural income as a sole measure may not provide the FCS with sufficient flexibility to provide financing that enables farmers to remain on the farm, as Congress intended. In contrast, ownership of agricultural assets tends to increase gradually over time because a significant capital investment is needed to acquire agricultural land, equipment, and chattel. Assets generally collateralize debt and provide the financial means to borrow during periods of low income.

6. Loans to Certain Classes of Borrowers

Several commercial bank commenters favored retaining eligibility restrictions on part-time farmers and other types of farmers who they believe have tenuous ties to agriculture. For example, some comments stated that farmers with minimal agricultural production should be precluded from obtaining System financing for non-agricultural purposes. These commenters generally believed that Congress did not intend for the FCS to extend credit to passive owners of agricultural land, part-time farmers, or farmers with minimal production.

The Act does not require a minimum level of involvement in agriculture for a farmer to qualify for FCS financing. Section 1.1(b) of the Act specifically states that the objective is to provide ''[a] permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit.'' The FCA's proposal to update its eligibility regulations so they respond to the changes in agriculture is fully supported by the Act and its legislative history.

The reproposed regulation would implement sections 1.1(b), 1.9(1), 1.11(a), and 2.4(a) of the Act by enabling the FCS institutions to be responsive to the credit needs of all types of agricultural producers while diversifying repayment sources of its agricultural loan portfolios. The reproposal would ensure that the FCS can continue to fulfill its statutory mission to meet the credit needs of agriculture, which is undergoing significant restructuring and consolidation. Diversification of lending within the agricultural sector also promotes safety and soundness by reducing risks and increasing earnings and capital.

The FCA recognizes the increasingly important role that off-farm income plays in allowing farmers to stay on their farms. For this reason, reproposed § 613.3000 would grant Farm Credit banks and associations additional flexibility to finance part-time farmers than is allowed by existing regulations. Because the reproposed regulation limits the funds available for the borrower's non-agricultural business needs, FCS lending to such borrowers is kept well within the boundaries of the Act.

Other commercial banking interests expressed concerns about FCS loans to borrowers who plan to convert land to a non-agricultural use. They favor retaining a provision in existing § 613.3005(a), which states that ''credit shall not be extended where investment in agricultural assets for speculative appreciation is a primary factor.'' The FCA shares the commenters' concerns about loans to a party who purchases agricultural land with the intent to eventually convert it to a higher-valued, non-agricultural use. The reproposed regulation should effectively control this activity because it would prohibit a passive investor in agricultural land from obtaining System loans for a non-agricultural business purpose.

After considering the comments of all interested parties, the FCA has revised § 613.3000, and reproposes it for further comment. The FCA's approach is responsive to the credit needs of agriculture in today's environment, and it eliminates unnecessary paperwork requirements and reduces other regulatory burdens on System institutions. It balances the needs of System institutions and their borrowers with the concerns of commercial banks and credit unions. The reproposed regulation clearly recognizes that the primary mission of the FCS is to finance agricultural credit needs, while allowing limited financing of other credit needs, of farmers, ranchers, and aquatic producers or harvesters as specified by the Act.

M. Processing or Marketing Regulation

The FCA originally proposed to redesignate, restructure, and revise the regulation that enables FCBs, ACBs, and direct lender associations to finance the processing or marketing activities of *bona fide* farmers, ranchers, and aquatic producers or harvesters under titles I and II of the Act, simplifying and clarifying existing § 613.3045 and eliminating unnecessary regulatory burdens.

As originally proposed by the FCA, § 613.3010(a)(1) would have relaxed a regulatory requirement that *bona fide* farmers, ranchers, and aquatic producers or harvesters own 100 percent of an eligible processing or marketing operation. Instead, the FCA's original proposal would have required farmers, ranchers, and aquatic producers or harvesters to own a ''controlling interest'' in a processing or marketing operation, and the Agency sought input from interested parties about how this term should be defined.

Comments on proposed § 613.3010 were received from the FCC, three Farm Credit banks, 17 Farm Credit associations, seven Farm Credit borrowers, and the CBANC, IBAA, and MPB. Seven System borrowers and the MPB offered comments in general support of the amendments. One borrower stated that removing existing restrictions would strengthen the System's ability to finance emerging needs, and another borrower stated that the amendments would allow the financing of more value-added agricultural products. CoBank expressed concern that the proposed regulation would expand the authorities of FCBs and FCS associations to finance

processing or marketing enterprises and thereby increase intra-System competition. The CBANC opposed proposed § 613.3010 because it would broaden the authority of System banks and associations to finance processing or marketing operations.

The commenters identified three specific areas of concern related to proposed § 613.3010. First, System commenters and the IBAA responded to the FCA's request for guidance about how the term ''controlling interest'' should be defined in § 613.3010(a)(1). Second, System commenters questioned whether the Act requires borrowers to ''consistently'' supply throughput. Finally, the IBAA objected to the repeal of the documentation requirements of § 613.3045(e) raising a question about whether the paperwork obligations of § 613.3045(e) are required by law.

1. Farmer Control

The FCA requested guidance about how the regulation should define ''controlling interest'' in a separate processing or marketing unit that is eligible to borrow from an FCB, ACB, or direct lender association. Several FCS respondents urged the FCA to adopt the FCC's suggested definition of ''controlling interest,'' which is patterned after section 2(a)(2) of the Bank Holding Company Act, (BHCA), 12 U.S.C. 1841(a)(2), and section 10 of the Homeowners' Loan Act (HOLA), 12 U.S.C. 1467a. Although the St. Paul BC and CoBank did not oppose the FCC's recommendation, they expressed concern about intra-System competition for processing or marketing loans. These commenters cited passages in the legislative history to sections 1.11(a) and 2.4(a) of the Act to suggest that Congress may not have intended to expand eligibility beyond *bona fide* farmers, ranchers, and aquatic producers or harvesters to a new class of ''agribusiness'' borrower. The IBAA claimed that the Act requires *bona fide* farmers, ranchers, and aquatic producers or harvesters to own 100 percent of the processing or marketing unit, in order for the enterprise to be ''directly related'' to the borrowers' farming operations. Several respondents also asked the FCA to clarify whether § 613.3010(a)(1) requires a processing or marketing operator to have an outstanding FCS agricultural or aquatic loan.

Rather than define ''controlling interest,'' § 613.3010(a)(1) would require *bona fide* farmers, ranchers, and aquatic producers or harvesters to own more than 50 percent of the voting stock or equity of an eligible processing or marketing operation. This approach balances the needs of titles I and II lenders for greater flexibility to finance processing or marketing operations with the limitations in sections 1.11(a) and 2.4(a) of the Act. Sections 1.11(a) and 2.4(a) of the Act allow titles I and II lenders to lend only to processing or marketing operations that are ''directly related'' to the borrowers' agricultural or aquatic activities. According to several passages in the legislative history, Congress intended that titles I and II lenders would finance only the processing or marketing operations of farmers, ranchers, and aquatic producers or harvesters who are already eligible to borrow from these institutions for their agricultural or aquatic activities.[2] Another passage in the legislative history indicates that current sections 1.11(a) and 2.4(a) of the Act do not authorize FCBs and their affiliated associations to ''finance a new class of borrowers,''[3] while a colloquy between two Senators suggests that the intent was to prohibit ''agribusiness marketers and processors'' from borrowing from titles I and II institutions.[4]

The FCA disagrees with the view that the Act requires agricultural or aquatic producers to own all of the equity of a separate processing and marketing operation. Nothing in the plain language of sections 1.11(a) and 2.4(a) of the Act or their legislative history supports this position. In fact, a passage in the legislative history indicates that Congress expressly contemplated joint processing or marketing ventures between agricultural or aquatic producers and investors as long as ineligible parties do not ''exercise substantial control of the facility or activity financed by the loan.''[5] The 100-percent ownership requirement in existing § 613.3045(b)(2)(iii) is a regulatory policy, which the FCA has discretion to change.

The FCA believes that the 100-percent ownership requirement in existing § 613.3045(b)(2)(iii) is overly restrictive. For example, it denies otherwise eligible farmer-owned processing or marketing operations alternative credit options merely because employees or investors own a minority interest in the business. Agriculture and aquaculture would benefit from the relaxation of this ownership requirement because the reproposed regulation is designed to increase the availability of affordable and dependable credit for businesses that add value to farm products and commodities.

The FCA declines to adopt the System's suggestion that it define ''controlling interest'' units by importing provisions of the BHCA and the HOLA into § 613.3010(a)(1). Under the System's proposal, eligible borrowers would be deemed to hold a controlling interest in a processing or marketing unit if they: (1) Directly or indirectly or acting through one or more other persons own, control, or have power to vote 25 percent or more of the voting shares of the legal entity; (2) control in any manner the election of a majority of the directors, trustees, general partners, or managers of the legal entity; or (3) they own, control, or have power to vote at least 5 percent or more of the voting shares of the legal entity and directly or indirectly exercise a controlling influence over the management or policies of the legal entity. System commenters have not explained why the ''control'' standards in the BHCA and the HOLA are suitable for processing and marketing operations that would qualify for financing under sections 1.11(a) and 2.4(a) of the Act.

The FCA believes that the definition of ''control'' in the BHCA and the HOLA are inappropriate for § 613.3010, because it would enable System banks and associations to finance processing or marketing operations that are substantially controlled by parties who are not *bona fide* farmers, ranchers, and aquatic producers or harvesters.

In response to the inquiry from an FCB and some of its affiliated associations, the FCA confirms that this regulation would not require an applicant for a processing or marketing loan to have an outstanding agricultural or aquatic loan with a System bank or association.

2. Throughput Requirements

Fifteen System commenters objected to the proposed requirement for borrowers to ''consistently'' produce some of the throughput used in the processing or marketing operation. The FCC and most System banks and associations stated that neither the current regulation's use of the word ''sustained,'' nor the proposed regulation's use of the term ''consistently,'' are justified by the plain language of the Act. These commenters claim that sections 1.11(a)(1) and 2.4(a)(1) of the Act only require borrowers to ''supply some portion'' of the total throughput. Two commenters suggested the FCA amend § 613.3010(a)(2) so it would allow FCBs and associations to finance borrowers

[2] S.R. No. 96–837, 96th Cong., 2d. Sess. 47 (June 26, 1980).

[3] *Id.*

[4] Colloquy between Senators Stewart and Zorinsky, 126 Cong. Rec. 16560 (Dec. 13, 1980).

[5] *Id.*

who are ''capable of producing some portion of the throughput.'' Several commenters suggested that the FCA remove this requirement because it implied that the borrower would cease being eligible for financing when market conditions dictated that they process crops through another processor/marketer. All commenters, except the BC and ACB, would prefer to have the regulations restate the statutory language.

The FCA disagrees with the commenters. Although the words ''consistently'' or ''sustained basis'' do not appear in the text of sections 1.11(a) and 2.4(a) of the Act, such a term is needed in the regulation in order to implement the statutory requirement that eligible processing or marketing operations be ''directly related'' to the borrowers' agricultural or aquatic production activities. The legislative history explains that the Act requires ''a demonstrated relationship between the total processing and marketing activities and the applicant's own production.''[6]

In order to provide FCBs, ACBs, and direct lender associations with greater flexibility to finance processing or marketing operations under the scope of sections 1.11(a) and 2.4(a) of the Act, reproposed § 613.3010(a)(2) would require the borrower or its owners to ''regularly'' supply throughput. The term ''consistently'' implies that there can be no variation in the level or timing of the borrower's throughput contribution, whereas the term ''regularly'' provides the borrower with greater flexibility to address unexpected problems in supplying throughput.

The FCA does not accept the suggestion of several System commenters that the regulation confer eligibility on processing or marketing borrowers who are ''capable'' of producing throughput because the mere capacity to contribute throughput, without more, does not satisfy the Act's requirement that borrowers ''supply'' throughput.

3. Regulatory Burdens

The IBAA opposes the repeal of the documentation requirements in existing § 613.3045(e), asserting that this provision is necessary to implement statutory eligibility requirements. The FCA disagrees. Compliance with eligibility requirements is adequately assured through the lenders' internal policies and the examination and enforcement powers of the FCA. Existing § 613.3045(e) dictates detailed management and operational procedures to System institutions. Such ''command and control'' requirements are incompatible with the FCA's Regulatory Philosophy Statement and the President's initiative to reduce regulatory burdens under the National Performance Review. Accordingly, the FCA continues to propose the repeal of § 613.3045(e).

No comments were received on the provisions in paragraph (b) addressing the portfolio limitations and, therefore, the FCA has not revised this provision in its reproposal.

N. Farm-Related Business Regulation

The FCA originally proposed to redesignate and revise the regulation that authorizes FCBs, ACBs, and direct lender associations to make loans to farm-related businesses. Existing §§ 613.3050 and 619.9120 would have been replaced with a new regulation, § 613.3020, which is closely aligned with the plain language of sections 1.9(2), 1.11(c)(1), and 2.4(a)(3) of the Act. This change would have repealed existing regulatory requirements that are not required by the Act. The FCA proposed these revisions because existing §§ 613.3050 and 619.9120 are unnecessarily restrictive and appear to frustrate the ability of System banks and associations to finance statutorily eligible and creditworthy farm-related businesses, needlessly denying many farm-related businesses a competitive credit option. The preamble to the FCA's original proposal noted that farm-related business loans comprise less than 1 percent of all System loans, and many FCS banks and associations have no farm-related business loans in their portfolios.

The FCA received 58 comments about proposed § 613.3020. Of this total, 26 comments were received from System banks, associations, and the FCC. The FCA also received comments from three commercial banks and four banking trade associations, four credit unions and one of their trade associations, three State government agencies, 17 individuals, and FLAG.

Most of the comment letters from commercial banks, credit unions, and their trade association pertained to competition between private sector lenders and the FCS. FLAG opposed the proposed regulation because it would create opportunities for outside investors, who do not contribute to the prosperity of local farm communities, to obtain FCS funding for farm-related businesses. The FCA has already responded to these concerns in earlier sections of this preamble.

The individual commenters and three State government agencies supported proposed § 613.3020 because it would bolster the agricultural economy by enabling FCS banks and associations to provide affordable credit to local farm-related businesses that serve farmers and ranchers. These commenters stated that farm-related businesses provide essential services to production agriculture and rural America. One State Government agency asserted that the FCS should only finance businesses (other than farming, ranching, and aquatic operations) that add value to agricultural products.

A number of commenters requested clarifications or modifications to this regulation.

1. Types of Services

Under § 613.3020(a) of the original proposal, an individual or legal entity who furnishes services to farmers and ranchers that are directly related to their agricultural operations would be eligible to borrow from System lenders. Two commenters claimed that the language of proposed § 613.3020(a) is too broad and ambiguous because virtually any business in an agriculture community, including a gas station or accounting firm, could argue that it is an eligible farm-related business.

To prevent any such misinterpretation, the FCA revises proposed § 613.3020(a) to clarify that a business must furnish ''farm-related services'' in order to qualify for System financing. Businesses that offer non-agricultural services to farmers and ranchers do not qualify as eligible farm-related businesses under sections 1.11(c)(1) and 2.4(a)(3) of the Act. Some examples of ''farm-related services'' that would be covered by the reproposed regulation are: (1) Spraying crops; (2) harvesting; (3) transporting agricultural commodities to grain elevators, livestock markets or other markets, and other processing centers; (4) custom feed mixing operations; (5) veterinary services; (6) drying or preserving farm commodities or products; (7) repairing and servicing farm implements, equipment and machinery; (8) computer and aerial mapping of soil and crop conditions; (9) nutritional analysis for livestock production; and (10) specialized animal husbandry services. Reproposed § 613.3020 would no longer require an eligible farm-related business to furnish services on the farms or ranches of its customers because the plain language of sections 1.11(c)(1) and 2.4(a)(3) of the Act and their legislative history do not impose an ''on-farm'' requirement.

2. Custom-type Services

Commercial bank commenters opposed the FCA's proposal to repeal

[6] S.R. No. 96–837, *supra.*

§§ 613.3050(a) and 619.9120, which required eligible farm-related businesses to furnish ''custom-type services'' to farmers and ranchers. ''Custom-type services'' are functions that farmers and ranchers can perform for themselves, but instead hire outside contractors to perform these tasks. One commenter suggested that an amendment to the Act would be necessary before the FCA could repeal this regulatory requirement.

The FCA disagrees that sections 1.11(c)(1) and 2.4(a)(3) of the Act limit eligibility for financing to those businesses that furnish ''custom-type services'' to their customers. Although passages in the legislative history to the Act contain examples of ''custom-type services'' that farmers and ranchers may perform for themselves, these examples appear illustratory. The FCA finds no evidence to support the contention that sections 1.11(c)(1) and 2.4(a)(3) of the Act preclude System banks and associations from financing farm-related services that are directly related to agricultural production. Under the circumstances, the repeal of §§ 613.3020(a) and 619.9120 would advance the purpose and objectives of the Act because farmers today rely on technologically advanced services that they cannot perform for themselves. Such services enable farmers and ranchers to: (1) Increase their income; (2) reduce their operating costs; (3) improve farm productivity; and (4) satisfy consumer demands for improved food quality and specialty food products.

3. Financing Other Purposes

Several commercial bank trade associations asserted that proposed § 613.3020(b)(1) would actually enable an eligible borrower who derives more than 50 percent of its income from furnishing farm-related services to obtain System financing for non-agricultural purposes.

The FCA proposed § 613.3020(b)(1) so that FCS banks and associations could, to the extent allowed by sections 1.11(c)(1) and 2.4(a)(3) of the Act, finance farm-related businesses that sell some agricultural goods or inputs that are not consumed in its services to farmers and ranchers. The FCA intended that proposed § 613.3020(b)(1) would allow FCBs, ACBs, and direct lender associations to provide ''whole firm'' financing to businesses that primarily furnish farm-related services to farmers and ranchers. Under the FCA's proposal, the following farm-related businesses, for example, could become eligible for System loans because they derive more than half of their income from providing farm-related services separately from selling farm goods or inputs: (1) Veterinary services that sell medications and supplemental feed mixes directly to farmers and ranchers; (2) farm equipment repair and maintenance services that also sell spare parts to their customers; and (3) crop fertilizing services that sell mixtures that farmers will apply to the soil between routine service calls. Because the borrower must derive more than 50 percent of its income, as measured on a gross sales or net sales basis, from furnishing farm-related services, the proposed regulation was designed to ensure that System banks and associations extend ''whole firm'' financing only to a farm-related business that primarily provides services, rather than goods or inputs, to its customers.

Sections 1.11(c)(1) and 2.4(a)(3) of the Act do not authorize FCBs, ACBs, and direct lender associations to finance the non-agricultural activities of farm-related businesses, and this was not the intent of the FCA. The FCA has revised this provision to ensure that financing under this section is provided only for farm-related business purposes. Reproposed § 613.3020(b) would authorize an FCB, ACB, or direct lender association to finance: (1) All of the farm-related business activities of an eligible borrower who derives more than 50 percent of its annual income (as consistently measured on either a gross sales or net sales basis) from furnishing farm-related services that are directly related to the agricultural production of farmers and ranchers; or (2) only the farm-related services activities of an eligible borrower who derives 50 percent or less of its annual income (as consistently measured on either a gross sales or net sales basis) from furnishing farm-related services that are directly related to the agricultural production of farmers and ranchers. This revision will prevent System banks and associations from financing the borrower's non-agricultural enterprises.

4. Income Test

The FCC and most System commenters suggested that the FCA revise proposed § 613.3020(b) so that a farm-related business could obtain System financing for all of its needs if some minimum percentage of its operations, as measured either on an income or asset basis, consists of furnishing farm-related services to farmers and ranchers. The FCC and most System institutions suggested that the FCA authorize System lenders to finance all of the needs of a business that derived at least 20 percent of income from furnishing farmers and ranchers with farm-related services. Two other commenters suggested that the FCA set the threshold at 10 percent or lower.

These commenters urged the FCA to lower the 50-percent threshold in proposed § 613.3020(b) because they assert that System banks and associations will be unable to compete in this segment of the agricultural credit market unless they can finance all of the borrower's operations. These commenters note that farm-related businesses usually conduct diversified operations that include farm supply and other types of business in addition to farm-related services. The commenters believe that the proposed approach may be unworkable because these diversified operations experience seasonal fluctuations in demand and are unlikely to segregate their diversified operations in their financial statements.

The FCC and one FCS association suggested an alternative to the income percentage test that would prevent System banks and associations from becoming concentrated in loans to businesses that do not primarily furnish farm-related services to farmers and ranchers. Under this alternative, the total outstanding loans of each FCB, ACB, or direct lender association to farm-related businesses that devote less than 50 percent of their operations to farm-related services would be limited to 15 percent of the institution's total outstanding loans at the end of the preceding fiscal year.

Although a portfolio limitation could achieve this policy result, the FCA has not adopted this suggestion because it does not believe that safety and soundness concerns require such controls or that such a limitation would be consistent with Congressional intent. The reproposed regulation maintains the threshold for whole firm financing at 50 percent. Allowing whole firm financing to a business that derives only a minority of its income from providing agricultural services is difficult to reconcile with sections 1.11(a)(1) and 2.4(a)(3) of the Act.

The FCA also declines requests to include assets as an additional measure of whether a borrower primarily furnishes services or sells supplies because it is virtually impossible to distinguish whether certain assets are consumed in providing farm-related services or sold as supplies.

5. Intra-System Competition

The BC and ACB expressed concern about intra-System competition for farm-related business loans. Although these two commenters did not

specifically object to proposed § 613.3020 or the FCC's recommendations, they supported a provision in proposed § 613.3000(a)(4) that would prohibit FCBs and direct lender associations from extending credit to legal entities that are eligible to borrow from a BC or an ACB. As discussed earlier, reproposed § 613.3000 would not prohibit FCBs and direct lenders from lending to certain cooperatives and their related entities. Although the FCA acknowledges the small overlap of the authorities of System institutions that operate under titles I, II, or III of the Act to finance farm-related businesses, neither the Act nor the regulations permit FCBs and their affiliated direct lender associations to extend whole firm financing to entities that sell primarily farm supplies. Therefore, intra-System competition should be limited. The FCA intends to review this issue again when it considers all aspects of intra-System competition.

O. Rural Home Regulation

The FCA originally proposed to redesignate and substantially revise the regulations that govern System loans to non-farm rural homeowners. The FCA received general comments on rural home lending from 22 parties, including FCS associations, credit unions, commercial banks, trade associations, borrowers, and a State agency.

Many FCS commenters offered general support for the proposed revisions to the rural home financing regulations. Borrowers stated that the amendments would have a positive effect on the rural economy and may keep more people living in rural America. The FCC stated that the proposed regulations clarify the authority of the FCS to finance both non-farm rural homes and the housing needs of agricultural producers. The FCC also supported the repeal of several regulatory requirements that are not required by the Act, but restrict the ability of the FCS to finance the housing and domestic needs of rural home borrowers. Three borrowers, one trade organization, and one governmental agency supported the provisions allowing home equity loans.

Non-System lenders and their trade associations opposed the proposed amendments. Their comments addressed such topics as potential customers, the geographic areas where loans could be made, and other matters. A credit union stated that the proposed regulations would hurt credit unions because it believed that non-farmers could borrow from the FCS to build homes, condominiums, and duplexes in non-rural areas. Another credit union objected to the possibility of increased competition from FCS rural home financing. Several commercial banking interests commented that the proposed amendments would expand the number of non-farmer mortgage borrowers expected to use System resources, loosening the bond between farmers and ranchers and the FCS.

These comments reflect incorrect assumptions about the rural home provisions of the Act and FCA regulations. Sections 1.11(b) and 2.4(b) of the Act allow FCS banks and associations to finance single-family, moderately priced dwellings in rural areas where the population does not exceed 2,500 inhabitants for rural residents who are not agricultural or aquatic producers. The Act also limits such loans to 15 percent of the outstanding loans of System banks and associations.

The proposed regulations distinguished housing loans for farmers under sections 1.11(a) and 2.4(a) of the Act from home loans for non-farmers under sections 1.11(b) and 2.4(b) of the Act. Because rural home loans are limited to 15 percent of outstanding loans and because only farmer borrowers are voting stockholders of FCS institutions, the clear separation provided for in the proposed amendments would not dilute the agricultural focus of the FCS, as some commenters suggest.

1. Loan-to-Value Ratio

Two commercial banking interests commented that the proposed regulation would permit higher loan-to-value ratios on rural home loans.

Loan-to-value limitations are set by the Act and not altered by the regulation. Section 1.10(a) of the Act and § 614.4210(b) require a long-term mortgage loan to be secured by a first lien interest in real estate that does not exceed 85 percent of the appraised value of the mortgaged property, except that FCS banks and associations may finance up to 97 percent of the appraised value of the property if the loan is guaranteed by a governmental agency. In addition, section 12 of the 1996 Reform Act[7] recently amended section 1.10(a) of the Act so that System mortgage lenders can rely on private mortgage insurance when the loan-to-value exceeds 85 percent. Under these circumstances, the repeal of the loan-to-value ratio in existing § 613.3040(c) is compatible with section 1.10(a) of the Act.

[7] Pub. L. 104–105, 110 Stat. 162 (Feb. 10, 1996).

2. Owner-Occupied Dwellings

Two commenters objected to the proposed elimination of the regulatory requirement that the dwelling be owner-occupied. The FCA's original proposal retained the existing requirement that the home be used as the primary residence of a rural resident but it would permit the owner to lease the property to another rural resident. The FCA believes that eliminating the regulatory owner-occupancy requirement advances the rationale for this authority, which is to ensure the availability of housing for rural residents. Therefore, the reproposal would also repeal the existing regulatory requirement that the borrower occupy the dwelling.

3. Consumer Protection Laws

A commercial banker questioned whether consumer protection laws apply to FCS rural home loans. The FCS's rural home lending practices are subject to the same Federal consumer protection laws and implementing regulations of the Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development as are commercial banks. The FCA proposed to relocate the nondiscrimination in lending regulations in subpart E of part 613 to a new part 626 to give them more prominence. These regulations address the prohibitions of the Equal Credit Opportunity Act (15 U.S.C. 1601 *et seq.*) and the Fair Housing Act (42 U.S.C. 3601 *et seq.*). In addition, rural home lending transactions are subject to the requirements of the Truth-in-Lending Act (implemented at 12 CFR 226) and the Real Estate Settlement Procedures Act (implemented at 24 CFR 3500).

4. Agricultural Loan Priority

One commenter objected to the FCA's decision to delete existing § 613.3040(d)(3), which reflects the Agency's policy commitment to Congress that agricultural loans will have priority over non-farm rural home loans.

The FCA is not rescinding its policy commitment to Congress that agricultural loans will always have priority over rural home loans. Indeed, the preamble discussing the proposed deletion of § 613.3040(d)(3) stated that ''the FCA continues to adhere to this commitment.'' The FCA's decision to propose deletion § 613.3040(d)(3) is unchanged because it is a policy statement rather than an enforceable regulation. The deleted provision added nothing to the FCA's statutory powers to ensure that the credit needs of

agricultural or aquatic producers received priority during a financial crisis. For these reasons, no party should be concerned by the repeal of former § 613.3040(d)(3).

5. Definition of Rural Area

The FCA originally proposed to define a ''rural area'' as ''a designated rural area within a State or the Commonwealth of Puerto Rico including communities that have a population of not more than 2,500 inhabitants based on the latest decennial census of the United States.'' The FCA received comments from 17 parties on the definition of rural area in proposed § 613.3030(a)(3).

No commenters supported the FCA's proposal to rely on the Census to identify rural areas where the population does not exceed 2,500 inhabitants. Both System and non-System commenters stated that sparse population is not the sole determinant of a rural area. These commenters claimed that reliance on the Census ignores the social and economic characteristics of a rural area. Commercial banks, credit unions, and their trade associations opposed the FCA's original proposal because it would allow System banks and associations to finance housing in the rural pockets of metropolitan areas, where the commenters claim credit from other lenders is readily available. System commenters asserted that the Census designations would increase their regulatory burdens, but decrease their flexibility to offer home financing to residents of communities that are rural in nature. Some FCS associations claimed that the proposed regulation would require them to consult a Census map for each loan application to determine if the borrower's home is located in a designated rural area. Other FCS commenters advised the FCA that Census data is not updated frequently enough to reflect the changing demographics of rural areas. All commenters advised the FCA that the existing § 613.3040 provides the most workable definition of a rural area.

These comments have persuaded the FCA that Census information may not adequately implement the provision of the Act that defines a rural area. For this reason, the FCA withdraws its original proposal to rely solely on the Census for determining rural areas.

Reproposed § 613.3030(a)(3) would define a rural area as ''open country within a State or the Commonwealth of Puerto Rico, and may include communities that have a population of not more than 2,500 persons.'' The FCA has decided to delete the passage in § 613.3040(a)(3) that authorized Farm Credit banks and associations to make loans in open agricultural areas within ''towns'' where the population exceeds 2,500 inhabitants, subject to Agency prior approval. This provision addressed special situations where a municipality annexed the surrounding countryside or two municipalities merged, and as a result, the population of the new political entity exceeded 2,500 inhabitants. The FCA has rarely used this prior approval authority during the past 25 years. The reproposed regulation would delete this provision because it creates unnecessary confusion.

6. Definition of Moderately Priced Housing

The FCA originally proposed a two-part definition for moderately priced housing. The first part was a safe harbor provision, and it would have applied to the price of any home that satisfies the criteria in section 8.0 of the Act pertaining to rural home loans that collateralize securities that are guaranteed by the Federal Agricultural Mortgage Corporation (Farmer Mac). Under the second part of the original proposal, FCS banks and associations would be authorized to finance ''moderately priced'' rural homes that have a value no higher than the 75th percentile of housing values in the rural area where the dwelling is located in accordance with the most recent edition of the Census of Housing.

The FCA received several comments criticizing this proposed change. Two FCS associations commented that the amendment would impose restrictions not found in the Act or in existing regulations and would limit FCS's ability to serve rural residents. Some FCS associations commented that proposed § 613.3030(a)(4) is flawed because they believe that it is neither possible nor desirable to devise a clear single standard for moderately priced housing in rural areas across the United States. Although the FCC agreed with FCA's objective of establishing a clear standard, it stated that the proposal does not meet this objective because the proposed regulation would provide the FCS with less flexibility than the former regulation to finance moderately priced homes.

A commercial bank trade association objected to the definition of ''moderately priced'' homes in proposed § 613.3030(a)(4) because it allows System lenders to make home loans in rural pockets of metropolitan areas where the population does not exceed 2,500 persons pursuant to the latest Census of the United States. This commenter expressed concern that the proposal would allow the FCS to finance moderately priced housing on the fringes of urbanized areas, and could redirect the System away from lending to rural America, farmers and ranchers.

The FCA received comments from four parties, including three FCS associations and one trade organization about the use of Farmer Mac criteria as a safe harbor provision. The FCC supported this provision because the Farmer Mac criteria have a Congressionally mandated relationship to the FCS's rural home authorities and are thus suitable as one possible measure of moderately priced housing. This commenter urged the FCA to allow additional standards, as well, that would take into account geographical differences in housing values. Several associations shared the view that an additional standard is needed that would recognize higher housing costs in certain areas. As an example, one association noted that a 2000 square foot home in its territory would exceed the Farmer Mac criteria.

The FCA also received comments from 22 parties objecting to the use of Census data to determine the value of moderately priced housing. Many System institutions commented that the use of Census data is not required by the Act or the existing regulations. Moreover, they observed that Census data are not useful for a number of reasons, including: (1) They are based on subjective estimates of the homeowners rather than market transactions; (2) the Census survey is conducted every 10 years and thus the data are soon outdated; and (3) the data cut across market boundaries which leads to wide and arbitrary differences in the definition of moderate price between counties or census blocks.

Six FCS associations provided examples of the adverse effects of using the Census housing data to determine the value of moderately priced housing. They commented that using Census data would: (1) Restrict the market, competitiveness, and spreads; (2) reduce the current maximum limit the FCS institutions use for moderately priced housing in some areas by 50 percent or more; and (3) result in a significant increase in administrative work.

Most System commenters offered specific recommendations for how the FCA could revise this regulation to determine the value of moderately priced housing. Fourteen commenters recommended that the Federal Home Loan Mortgage Corporation (Freddie Mac) or Federal National Mortgage Association (Fannie Mae) limits determine the moderately priced

standard for System rural home lending. These commenters believed that the Freddie Mac and Fannie Mae thresholds would avoid the defects of the Census data and would provide for a level playing field with competitors. Other commenters suggested that FCA retain the definition in the existing regulation to provide System lenders with greater flexibility to use other reasonable methods to determine moderately priced values. Another frequent suggestion was to authorize System institutions to rely on any accepted independent study or formula from a credible regional or national source.

The FCC offered two approaches. First, the Farmer Mac limit would be used as a safe harbor provision and a higher limit could be adopted if it were supported by a study that established local standards for moderately priced housing, based on actual sales. In the alternative, the FCC suggested that the System could use any combination of Farmer Mac criteria, Freddie Mac or Fannie Mae guidelines, information provided by the Department of Housing and Urban Development, information on income provided by the Census, local sales data, or market studies.

The FCA continues to believe that the Farmer Mac standard for the value of a rural home is a useful method for determining moderately priced housing because the criteria in section 8.0 of the Act are directly related to home financing in rural areas of 2,500 inhabitants and the System's rural housing authorities. For this reason, homes that satisfy the Farmer Mac criteria would be considered moderately priced under reproposed § 613.3030(a)(4)(i). In response to System comments that Farmer Mac criteria ignore variations in housing costs in different rural areas, the FCA points out that section 101 of the 1996 Reform Act clarifies that the Farmer Mac limit of $100,000 (as adjusted for inflation since 1988) refers to the value of the dwelling only, exclusive of the value of the land on which it is situated.[8] This statutory clarification provides flexibility for lending in areas where land values are higher.

Reproposed § 613.3030(a)(4)(ii) would also allow FCS lenders to finance rural homes that are below the 75th percentile of housing values for the rural area where it is located, as determined by data from a credible, independent, and recognized national or regional source, such as a Federal, State, or local government agency, or an industry source. Each System bank or association will bear the burden of demonstrating that the price range it selects reflects moderately priced housing in the specific locale where its rural home loans are made. FCS institutions may use the Census of Housing data for their studies but are not be required to do so. If this reproposal is adopted as a final regulation, the FCA will review the methods used during examinations of FCS institutions.

The FCA has decided not to incorporate the maximum loan amount used by Freddie Mac or Fannie Mae into the reproposed regulation. The FCA believes that the Freddie Mac and Fannie Mae maximum loan amounts may not be representative generally of moderately priced housing in rural areas because they include housing values in urban and suburban communities. Furthermore, the Freddie Mac and Fannie Mae maximum loans amounts are not necessarily a measure of moderately priced housing.

7. Home Equity Lending

The FCA's original proposal would have allowed non-farm rural homeowners to obtain home equity loans and lines of credit from System lenders, secured by the rural home, without a restriction on the borrower's use of the proceeds.

The FCA received comments from seven parties, including one commercial bank, five trade associations, one borrower, and one governmental body on the eligibility requirements for rural home lending. A Farm Credit borrower supported home equity loans because the commenter believes that this authority would enhance the ability of the FCS to finance the agricultural community. The FCC, commenting generally on the amendments to the rural home lending regulations, stated that the proposed regulations clarify that FCS institutions may offer equity line-of-credit loans to rural homeowners. The FCC agreed that equity line-of-credit loans would enable FCS to better fulfill its statutory mission of providing an adequate and flexible flow of credit into rural areas.

The NDCUL and a commercial banker stated without explanation that the FCS should not be allowed to make home equity loans for consumer purposes to rural residents who are not farmers, ranchers, or aquatic producers or harvesters. A State governmental agency opposed the FCA's proposal as presenting unfair competition with commercial banks and credit unions. Another commenter contended that home equity consumer loans to borrowers who are not farmers, ranchers, or aquatic producers or harvesters are not within the System's statutory mission.

Three banking trade associations also opposed this proposal. One stated that it does not believe that ''home equity lending comports with this GSE's statutory reasons for existence.'' It expressed concern that home equity lending may be used for consumer purposes rather than housing purposes and that home equity lending would reduce available FCS funds for rural housing loans because of the portfolio limitation. The commenter stated that the FCA presents no evidence that such home equity lending is an unmet need in a very competitive home equity lending market. Another commenter objected because it does not believe that there is express authority for home equity lending and that being a full-service lender to rural residents does not comport with the System's reason for existence. A third trade association stated that several of its members questioned the advisability of FCS making home equity loans because they believe that such loans are risky. This commenter asked that the FCA provide a detailed explanation of the underwriting standards that are envisioned for home equity lending. It also noted that loan proceeds could be for consumer goods, which it deems as inappropriate for the FCS.

In response to the comments from banking interests, the FCA rescinds its original proposal regarding home equity lending and restores the purpose restrictions contained in existing § 613.3040(c) as reproposed § 613.3030(c). The FCA notes that System lenders are not precluded from extending authorized credit to rural homeowners through revolving lines of credit. The reproposal would, however, require that such credit extensions be limited to the purposes specified. This change to the proposed rule on home equity lending makes unnecessary the proposed conforming amendments to § 614.4222, and those proposed amendments are now withdrawn.

No comments were received on proposed § 613.3030 (a)(1) or (a)(2), and it is included in the reproposed regulation without revision. No comments were received on proposed § 613.3030(c), and it is redesignated as reproposed § 613.3030(d).

P. Allowable Real Estate Security

The FCA received 12 comments about the requirements for the type of allowable real estate security for long-term mortgage loans in § 614.4210(a). Most commenters requested that the FCA clarify that housing for agricultural producers is not subject to the

[8] *Ibid.*

limitations on location, type of housing, or price for rural home lending. Many commenters also supported increased flexibility in the types of real estate collateral that could be counted toward the statutory 85-percent loan-to-value limitation.

The FCA reaffirms that the limitations for the type of house and the value of the house for rural home lending apply only to housing for individuals who are not farmers, ranchers, or aquatic producers or harvesters. As stated in the discussion of financing a farmer's housing and domestic needs, such housing can be financed under farm lending authorities for a *bona fide* farmer, rancher, or aquatic producer or harvester.

The FCA has considered the issue of allowable collateral for long-term mortgage lending under title I of the Act when it proposed amendments to the loan underwriting regulations on March 12, 1996. *See* 61 FR 16403 (April 15, 1996). Under that proposed rule, the FCA would continue to limit the types of collateral that can secure a mortgage loan, but it allows flexibility so that the collateral remains primarily agricultural in nature. The rule also would continue the requirement that the loan-to-value ratio not exceed 85 percent. The FCA will consider comments to its proposal of March 12, 1996, before it adopts final amendments to § 614.4210(a) and other regulations that govern loan underwriting and collateral standards.

Q. Title III Domestic Lending Regulation

The FCA's original proposal would significantly restructure and clarify the regulations that govern eligibility and scope of financing for BCs and ACBs. More specifically, the FCA initially proposed to redesignate existing § 613.3110 as § 613.3100, and rearrange this regulation so it addresses the authority of BCs and ACBs to finance the following class of borrowers: (1) Cooperatives, their parents, subsidiaries and other related entities that serve agricultural or aquatic producers; (2) electric, telecommunication, and cable television utilities; (3) water and waste disposal facilities; and (4) domestic lessors.

As noted in the preamble to the original proposal, many proposed revisions reflect provisions of the 1992 amendments[9] and the Farm Credit System Agricultural Export and Risk Management Act (1994 Act).[10] After the comment period for this proposed rulemaking expired, the 1996 Reform Act was enacted into law. The 1996 Reform Act amended two provisions in section 3.8 of the Act that govern the eligibility of certain cooperatives and rural utilities to borrow from banks that operate under title III of the Act. Accordingly, the FCA has incorporated these statutory amendments into reproposed § 613.3100.

Comments were received from the St. Paul BC, CoBank, ABA, IBAA and NDBA. In general, the comments from the St. Paul BC and CoBank supported the proposed regulation. These commenters, however, requested clarification or modification of certain provisions of the original proposal. CoBank and the St. Paul BC supported the FCA's proposal to repeal existing §§ 613.3005 and 613.3110(b)(2), which prescribe business objectives and management practices for title III banks.

The three commercial bank trade associations endorsed all revisions that implement amendments to the Act. Otherwise, these three commenters opposed revisions concerning service cooperatives that provide financially related services and cable television utilities.

1. Definitions

CoBank objected to the FCA's decision to delete the words ''a combination of such associations and farmers, ranchers, or producers or harvesters of aquatic products'' from the definition of a cooperative in proposed § 613.3100(a)(1). The commenter claimed that this revision is a ''step backwards'' for certain cooperative combinations. Because of the commenter's concern, the previous wording is reinserted into the reproposed regulation with minor stylistic revisions.

The comments from bank trade associations opposed § 613.3100(a)(5) as proposed, because it would allow a BC or ACB to finance cooperatives that provide business and financially related services to their members. These commenters claim that Congress intended that the BCs and ACBs only finance cooperatives that aid production agriculture and that such service cooperatives should be served exclusively by commercial lenders.

CoBank objected that proposed § 613.3100(a)(5) would require an eligible service cooperative to be ''predominantly'' involved in providing business and financially related services to farmers, ranchers, and aquatic producers or harvesters. The commenter observes that the word ''predominantly'' does not appear in section 3.8(a) of the Act. CoBank asserted that including it in the definition converts a scope of financing question into an eligibility issue.

The arguments against permitting title III lending to cooperatives that provide business and financial services to farmers are not supported by the Act and its legislative history. Section 3.8(a) of the Act expressly authorizes BCs and ACBs to finance eligible cooperatives that furnish ''business services or services'' to farmers, ranchers, aquatic producers or harvesters, or their cooperatives. This authority to finance service cooperatives has its origins in the Farm Credit Act of 1935.[11] The legislative history to this provision reveals that Congress contemplated that these System banks would lend to service cooperatives that offered financially related services, such as insurance, to their members.[12] In 1980, Congress amended section 3.8(a)(4) of the Act so that service cooperatives would continue to qualify for FCS loans so long as 60 percent of their members are farmers, ranchers, or aquatic producers or harvesters. The 1996 Reform Act enables existing cooperative borrowers to retain their eligibility for BC or ACB loans if more than 50 percent of their members are agricultural or aquatic producers. Thus, the Act and its legislative history clearly refute the belief that BCs and ACBs lack authority to finance business and financially related service cooperatives. Furthermore, nothing in the Act or its legislative history supports the commenters' contention that a BC or ACB is authorized to finance only cooperatives that assist ''on-farm'' agricultural production. For these reasons, the FCA rejects the view that FCS banks operating under title III of the Act lack authority to finance cooperatives that furnish business and financially related services to agricultural and aquatic producers.

The FCA agrees with the comment that the word ''predominantly'' in proposed § 613.3100(a)(5) is more restrictive than the statute, since section 3.8(a) of the Act, as amended, establishes specific thresholds for farmer membership in an eligible service cooperative. Thus, the FCA deletes the word ''predominantly'' from reproposed § 613.3100(a)(5).

2. Cooperatives and Other Entities Serving Other Agricultural or Aquatic Producers

Section 613.3100(b) governs the eligibility of agricultural or aquatic

[9] Pub. L. 102–552, 106 Stat. 4102 (Oct. 28, 1992).

[10] Pub. L. 103–376, 108 Stat. 3497 (Oct. 19, 1994).

[11] P.L. No. 87–74, 49 Stat. 317 (June 3, 1935).

[12] H.R. 155, 74th Cong., 1st Sess. (Feb. 18, 1935) p. 9; *Farm Credit Act of 1935: Hearings on S. 1384 Before the Senate Committee on Banking and Currency*, 74th Cong., 1st Sess. p. 22 (Jan. 29, 1935).

cooperatives and their related entities to borrow from title III lenders. Other eligible entities include: (1) The parent of an eligible cooperative; (2) a subsidiary or other legal entity in which an eligible cooperative has an ownership interest; and (3) a non-profit entity that satisfies the criteria in section 3.8(b)(1)(D) of the Act.

Section 14 of the 1996 Reform Act amended section 3.8(a) of the Act to permit the continued eligibility of pre-existing cooperative borrowers as long as at least 50 percent of the voting control is held by farmers, ranchers, aquatic producers or harvesters, or their cooperatives. Section 14 of the 1996 Reform Act also amended section 3.8(b)(1)(D) of the Act so that eligible non-profit entities and their subsidiaries also benefit from this statutory change. Accordingly, reproposed § 613.3100(b)(1)(i) and (b)(2)(iii) incorporates these statutory provisions of the 1996 Reform Act.

Both System commenters expressed support for proposed § 613.3100(b)(2)(ii), which allows a title III bank to extend credit to an entity in which an eligible cooperative is a minority owner. Such financing is limited to the cooperative's percentage of ownership multiplied by the borrowing entity's total assets. CoBank asked for clarification on three questions about how title III banks should measure the borrower's total assets: (1) Are the entity's total assets measured at the beginning or the end of a capital project? (The commenter suggested that the end of a project is the better measure.) (2) How should assets be measured for borrowers with wide seasonal fluctuations in assets? (The commenter recommended that the seasonal peak in assets be the appropriate measure.) (3) Should the borrower's assets be measured according to their book or market value? (The commenter believes that book value, as the more conservative standard, is appropriate.)

The FCA believes each of the suggested clarifications is reasonable and consistent with the intent of section 3.7(b)(2)(A)(ii) of the Act. However, a uniform method of calculating total assets cannot be developed for all three scenarios. Thus, the FCA believes that each title III lender should establish in its lending policies the most appropriate measure of the borrower's assets depending on the nature of the credit request. For this reason, the FCA makes no modification to the reproposed regulation at this time. However, the FCA may issue regulatory guidance on asset measurement practices in the future.

3. Electric and Telecommunication Utilities

Section 613.3100(c) of the original proposal and the reproposal contains rural utility lending authorities. The FCA received comments from CoBank, the St. Paul BC, and the IBAA on proposed § 613.3100(c). One comment suggested that the FCA retitle the section to read ''Electric and telecommunications utilities,'' because cable television is widely recognized as a subset of telecommunications. The FCA accepts this recommendation and has incorporated this change into the title of reproposed § 613.3100(c).

CoBank objected to the FCA's proposal to delete from the regulations explicit reference to farmer-owned utility cooperatives that are eligible to borrow from a BC or ACB under section 3.8(a) of the Act, instead of the Rural Utilities Service (RUS) provisions in section 3.8(b)(1)(A) of the Act. CoBank asserts that such authority exists in the statute, and therefore, it should be retained in the regulation even though it is not likely to be used frequently. The FCA accedes to the commenter's request and incorporates this statutory authority into reproposed § 613.3100(c)(1)(i). The remaining provisions of reproposed § 613.3100(c)(1) have been renumbered accordingly.

The 1996 Reform Act repealed the RUS and Rural Telephone Bank (RTB) certification requirements in section 3.8(b)(1)(A) of the Act. Accordingly, reproposed § 613.3100(c)(1)(ii)(C) revises the original proposal to conform with the revised statute. The St. Paul BC suggested that the FCA relocate the phrase ''other entities, or the subsidiaries of such cooperatives'' in paragraph (c)(1)(i)(C) to the end of that paragraph with appropriate stylistic revisions. The commenter observed that section 3.8(b)(1)(A) of the Act does not require the subsidiary of a cooperative or other entity to be eligible for a RUS or RTB loan. The FCA agrees with the commenter, and reproposed § 613.3100(c)(1)(iii) will specifically govern loans by title III banks to subsidiaries of cooperatives and other entities that are eligible to borrow from the RUS or RTB. The FCA has, accordingly, renumbered the remaining provisions of reproposed § 613.3100(c)(1).

The St. Paul BC and CoBank requested that the FCA delete references to RUS and RTB regulations in proposed § 613.3100(c)(2) because the Act does not subject BCs and ACBs to the scope of financing provisions of the Rural Electrification Act of 1936, as amended (REA Act). One comment letter included selected passages from the legislative history that indicate that Congress did not intend that title III banks adhere to the same loan purpose restrictions as the RUS or RTB. These commenters claimed that proposed § 613.3100(c)(2) is more restrictive than the Act and would deny creditworthy and eligible rural utilities access to System credit to the full extent of the law.

The commenters have persuaded the FCA that the references in proposed § 613.3100(c)(2) to RUS and RTB regulations could prevent BCs and ACBs from financing rural utilities to the extent allowed by the Act. For this reason, references to the REA Act and RUS and RTB regulations are omitted from reproposed § 613.3100(c)(2). Instead, the reproposed regulation would authorize lending for electric or telecommunication services in a rural area as allowed by the Act.

The IBAA opposed provisions in proposed § 613.3100(c)(2), which would authorize BCs and ACBs to finance a subsidiary of a rural electric or telecommunications utility that operates a licensed cable television carrier. This commenter claimed that the proposed regulation appears to conflict with the REA Act because it would allow a cable television subsidiary of a rural utility to borrow from a BC or ACB even though the REA Act expressly prohibits the RUS and RTB from financing cable television. In this commenter's view, the proposed regulation circumvents the REA Act by severing eligibility from scope of financing.

The IBAA also notes that the System sought legislation in the spring of 1995 to enhance the ability of the title III banks to finance the ''rural information highway,'' including telecommunications services beyond basic telephone service to rural communities. Because no such legislation was enacted, or introduced, the commenter believes that title III banks lack the current authority to finance cable television carriers.

Section 3.8(b)(1)(A) of the Act authorizes BCs and ACBs to finance rural utilities that are eligible to borrow from the RUS and RTB, and their subsidiaries. A cable television carrier qualifies for financing from a title III bank if it is the subsidiary of a rural utility that is eligible to borrow from the RUS or RTB. Although the Rural Electrification Act of 1936, as amended, prohibits the RUS or RTB from financing the cable television subsidiary, section 3.8(b)(1)(A) of the Act expressly authorizes a BC or ACB to extend credit to the same subsidiary. The FCA's position is clearly supported by the legislative history to section

3.8(b)(1)(A) of the Act, which reveals that Congress specifically intended to authorize title III banks to finance cable television carriers that are ineligible for RUS or RTB loans. The sponsor of section 3.8(b)(1)(A) stated:

> In addition, this authority will enable rural telephone systems and their subsidiaries to obtain financing for certain projects that contribute to the economic well-being of the telephone system's service area. Many of these projects undertaken by rural telephone systems involve so-called non-Act purposes-meaning that such projects are ineligible for REA financing under the Rural Electrification Act. *These non-Act purposes usually involve providing of communication services such as cable television facilities and cellular radio facilities* * * * (emphasis added)

The System's 1995 legislative initiative does not affect this existing authority. The legislative proposal would have expanded the lending authority of title III banks in a number of respects, including permitting them to finance cable television carriers that are not subsidiaries of entities eligible to borrow under the REA Act. Thus, the comment that FCA's regulation exceeds statutory authority lacks merit.

The St. Paul BC notes that the restriction on financing to entities that are partially owned by an eligible utility appears in proposed § 613.3100(c)(3), but no provision of this regulation expressly declares such entities to be eligible borrowers.

The FCA agrees that the regulation would be clearer if the eligibility of such entities were set forth in § 613.3100(c)(1). Accordingly, the FCA has added a new paragraph (c)(1)(iv), to reproposed § 613.3100. This addition makes proposed § 613.3100(c)(3) unnecessary, and it is deleted from the reproposed regulation.

4. Water and Waste Disposal Facilities

CoBank provided the only comment on this section of the regulation. The commenter objected to the word ''solely'' in proposed § 613.3100(d)(2), which governs the financing authority for water and waste disposal facilities for title III banks. The commenter argues that such a restriction is not in the Act and that title III banks need the flexibility to finance ownership transfers so that water and waste disposal utilities can adjust to changes in their rural customer base and continue as viable entities. CoBank urges the FCA to construe the terms ''maintaining'' and ''operating'' in section 3.7(f) of the Act as allowing title III lenders the flexibility to finance ownership transfers for water and waste disposal facilities. The commenter expressed concern that the use of the word ''solely'' in § 613.3100(d)(2) will have a chilling effect on the types of prudent financing that BCs and ACBs can provide these borrowers.

Both section 3.7(f) of the Act and § 613.3100(d)(2) authorize title III banks to extend financing to certain entities for the purpose of ''installing, maintaining, expanding, improving or operating water and waste disposal facilities in rural areas.'' As the FCA interprets section 3.7(f) of the Act, the sale of ownership interests in such entities is reasonably within the scope of ''maintaining'' or ''operating'' a rural water or waste disposal facility. Therefore, revision of § 613.3100(d)(2) is unnecessary.

5. Domestic Lessors

The FCA received no comments about proposed § 613.3100(e), which authorizes BCs and ACBs to make loans to domestic lessors, pursuant to section 3.7(a) of the Act. This provision remains in the reproposed regulation without revision.

R. Title III International Lending Regulation

The FCA originally proposed to redesignate and substantially revise the regulation that implements the international lending authorities of BCs and ACBs. The new regulation would implement provisions in the 1994 Act, which expanded the authority of BCs and ACBs to finance the import, export, and international business operations of cooperatives and other eligible borrowers. The FCA also proposed several conforming and technical amendments to §§ 614.4010(d), 614.4020(a), 614.4233, and subpart Q of part 614 to reflect the expanded international lending powers of title III banks.

Section 3.7(d) of the Act requires the FCA to consult with the Board of Governors of the Federal Reserve System (Board of Governors) whenever it formulates regulations pertaining to the international lending activities of title III banks so that the new ''regulations conform to national banking policies, objectives, and limitations.'' The FCA submitted the proposed international lending regulations to the Board of Governors for review and evaluation on August 9, 1995. On December 8, 1995, the Board of Governors informed the Chairman of the FCA, by letter, that it had no objection to the new regulations. The Board of Governors, however, advised the FCA that increased international lending increased the risk of loss to BCs and ACBs, which should be closely monitored.

Comments about the original proposal were received from a commercial banker, a member of the CoBank board, CoBank, the ABA, IBAA, and the NDBA. The three commercial bank trade associations supported § 613.3200 because it implements the 1994 Act. The commercial banker, however, commented that the expansion or FCS powers would place the FCS in direct competition with commercial banks for international loans without any of the regulatory mandates and responsibilities that commercial bankers face. The FCA responded to similar comments earlier in this preamble and finds the commercial banker's comment without foundation. The CoBank board member supported the proposed regulation as important to the evolving international business environment. CoBank's response supported most of the proposed regulation, including the definition of farm supply cooperatives and the treatment of import and export transactions. CoBank, however, had substantive comments on the two provisions which are discussed below.

CoBank asserted that provisions in proposed §§ 613.3200 (d) and (e), which limit subsidiary financing to international business ''transactions,'' are more narrow than the Act. The comment states that the Act contains no such limitation and only requires that, subject to limitations regarding percentage of ownership and plant relocation, the financing be ''for the purpose of facilitating its domestic or foreign *business operations* * * *'' (emphasis added). CoBank also cites a technical analysis attached to an FCA letter dated August 17, 1994, to then House Agriculture Committee Chairman de la Garza in support of its position.

The FCA's use of the terms ''transactions involving international business operations'' and ''international business transaction'' referred to the foreign business operations of the domestic or foreign entities, and it was not intended to limit the type of financing that is authorized by the Act. In order to clear up any confusion, the FCA has revised the title to reproposed § 613.3200(d) by omitting the words ''transactions involving.'' Furthermore, the FCA has substituted ''operations'' for ''transaction'' in reproposed § 613.3200(e).

S. Similar Entity Participation Regulation

The FCA proposed § 613.3300 to implement the new authority of System banks and associations to participate in loans made by non-System lenders to ''similar entities''—ineligible persons whose operations are functionally

similar to those of eligible borrowers. The proposed definition of ''similar entity'' requires that a majority of the entity's income be derived from, or a majority of its assets be invested in, the conduct of activities that are performed by eligible borrowers. The FCA solicited comments on: (1) Whether the regulation should provide a specific listing of the parties who qualify as similar entities; (2) whether the regulation ought to provide further guidance about the new financially related service (FRS) authority; (3) how the regulation can best accord equitable treatment to both the funding banks and their affiliated associations; and (4) whether consent for out-of-territory participations on similar entity loans ought to be required.

The FCA received 37 comment letters on its original proposal concerning similar entity authority. Comment letters were received from the FCC, six Farm Credit banks, 27 FCS associations, the ABA, IBAA, and NDBA.

Comments by FCS institutions were mixed. Some institutions supported the various definitions and provisions in proposed § 613.3300, whereas others recommended a broader interpretation of the statutory provision. The ABA, IBAA, and NDBA believe that the proposal to permit System banks to participate with non-System lenders in loans to similar entities exceeds the authority that Congress has granted. Although the ABA stated that the proposal appears to comply with recent amendments to the Act, it claims that the expanded eligibility rules in §§ 613.3000, 613.3010, and 613.3020 negate the need for similar entity authority. The IBAA stated that the proposal appears to go much further in the types of similar entities than Congress originally anticipated to be eligible. The commenter also requested more definition and a more narrow interpretation of the statutory language.

The FCA affirms that its original proposal regarding similar entities is within the parameters of the Act. Proposed § 613.3300 closely tracked the language of the Act. The fact that System banks and associations may have greater flexibility to finance eligible borrowers within the scope of their statutory powers does not render their similar entity participation authorities unnecessary.

1. Providing a List

Twenty-nine FCS commenters opposed incorporating a specific list of the parties who qualify as similar entities in the regulation, because they saw no need for or discernible benefit from having such a list. Some System institutions commented that to the extent that a list may be useful, similar entities can be identified through a bookletter or other guidance. System commenters perceived that any list of eligible similar entities could be unduly restrictive and that the similar entity authorities should provide maximum latitude for risk diversification. The IBAA suggested that the regulation provide such a listing.

The FCA concludes that the inherent difficulty of anticipating every type of entity that might qualify and the time required to amend regulations makes a regulatory listing impracticable for this authority. Accordingly, the reproposed regulation does not list similar entities. However, the FCA will monitor such activity through its examination process and evaluate the need for further guidance.

2. Guidance on Financially Related Services (FRS) Authority

Four FCS associations commented that further guidance on FRS authorities is not needed because the approved list of services already exists. CoBank requests that the FCA clarify that the related services regulations of part 618 do not apply to transaction-type items for similar entity loans. The commenter believes that unless the lender can react quickly to a request, the opportunity for participation may be lost.

The reproposed regulation does not provide any further guidance on FRS authorities as they pertain to similar entity transactions. The FCA may, however, provide such other forms of guidance as may be determined necessary in the future.

3. Definitions

The FCA received no comment on the definition of ''participation'' in § 613.3300(a)(1), which mirrors provisions in sections 3.1(11) and 4.18A of the Act. Thus, the reproposed regulation does not change this definition.

Although System institutions generally were supportive of the FCA's original proposal, many considered the definition of ''similar entity'' to be more narrow and restrictive than the Act. These commenters asserted that it provides System lenders with little opportunity to participate in loans to similar entities, because most persons or legal entities involved in production agriculture already qualify as eligible borrowers under title I or II. These commenters also recommended that the FCA revise § 613.3300(a)(2) so it treats a party who is eligible to borrow directly from certain FCS associations engaged in short-term lending under §§ 613.3000, 613.3010, or 613.3020 as a similar entity for an association engaged in long-term mortgage lending, and vice versa. In other words, the commenters suggested that a party who is an eligible borrower for an FCS institution that operates under title I should qualify as a similar entity for a title II association and a title II borrower as a similar entity for title I associations. Other System commenters disagreed with this approach and supported the FCA's proposal on this issue.

The St. Paul BC commented that the proposed definition could be read to mean that a party eligible for a loan from an association would not qualify as a ''similar entity'' with respect to a BC, and vice versa. Therefore, the commenter proposed specific regulatory language that would classify an eligible title III borrower as a similar entity for FCBs and direct lender associations, and vice versa.

The definition of ''similar entity'' in § 613.3300(a)(2) closely tracks sections 3.1(11)(B)(ii) and 4.18A(a)(2) and provides FCS institutions with the flexibility allowed by law. The FCA disagrees with those commenters who assert that the same borrower may be an eligible borrower under title I, but a similar entity under title II of the Act. The plain language of section 4.18A(a)(2) of the Act makes it clear that a similar entity is one who is *ineligible* to borrow directly from a title I bank or a direct lender association. Section 4.18A(a)(2) of the Act makes it equally clear that the eligibility of the borrower, not the lending powers of a System institution, determines similar entity status. There is no distinction in the Act between the types of borrowers who are eligible for financing under title I and title II.

The FCA agrees with the St. Paul BC that a party who is eligible to borrow under title III of the Act can qualify as a similar entity under titles I and II of the Act. However, the FCA declines to amend § 613.3300(a)(2) as the commenter suggests because the commenter's concerns already are adequately addressed by proposed § 613.3300 (e)(3) and (e)(4), which is redesignated in the reproposed regulation as § 613.3300 (d)(2) and (d)(3), respectively.

4. Similar Entity Transactions

Ten System commenters considered § 613.3300(b), as originally proposed, to be too restrictive and they urged the FCA to delete the words ''for purposes similar to those for which an eligible borrower could obtain financing from the participating FCS institutions.'' These commenters believe that the Act

imposes no such limitation on the phrase ''functionally similar.'' In addition, the commenters believe that the FCA's original proposal contradicts the intent of Congress because section 4.18A(b) of the Act grants title I banks and direct lender associations similar entity authority ''notwithstanding any other provision of this Act.'' The commenters strongly supported a broader interpretation of section 4.18A of the Act.

CoBank objected to a statement in the preamble that identified certain rural utilities as similar entities. CoBank commented that there is no statutory basis for limiting participations in similar entity loans to electric utilities in rural areas. The FCA assures the commenter that the preamble passage to the proposed regulation only provided one example of a similar entity. This illustration was not intended to limit the authority of title III banks to participate in loans to similar entities.

In conjunction with its recommended definition of similar entity, the St. Paul BC also recommended a corresponding change be made to § 613.3300(b) by deleting the language ''that is not eligible to borrower directly under §§ 613.3000, 613.3010, 613.3100, or 613.3200.''

The FCA believes that its interpretation clarifying ''functionally similar'' is consistent with the plain language of the Act and complies with Congressional intent. The ''notwithstanding'' language in section 4.18A does not negate the rest of this same provision, which states that FCBs, ACBs, and direct lender associations ''may participate in any loan of a type otherwise authorized under title I or II. * * *'' Section 4.18A of the Act did not alter the lending authorities of title I and II lenders. Instead, the similar entity provisions of the Act authorize such banks and associations to participate with non-System lenders in loans to ineligible borrowers. Although many commenters stated that the Act does not define and therefore does not limit the phrase ''functionally similar,'' the fact that the Act contains this phrase implies there are some restrictions. For this reason, the FCA continues to believe that similar entity loans must be for purposes that are similar to those for which an eligible borrower could obtain FCS financing. In addition, the FCA did not adopt the recommendation to eliminate the references to the regulations defining ''eligible borrower.'' However, the FCA notes that these references do not prevent a title III bank from participating in a similar entity loan to a party who is eligible to borrow under titles I and II of the Act but ineligible to borrow under title III, and vice versa. Therefore, reproposed § 613.3300(b) is unchanged from the original proposal.

5. Compatibility With Lending Authorities Under Titles I and II of the Act

System commenters were evenly divided about proposed § 613.3300(c), which would have required an institution to participate in only those loans it is authorized to make; i.e., short- and intermediate-term versus long-term loans. Two FCS banks and several associations supported the FCA's approach as a reasonable interpretation of the Act. The commenters believe that proposed § 613.3300(c) implements the passage in section 4.18A(b) of the Act that refers to ''any loan of a type otherwise authorized under title I or II of the Act.'' One commenter states that the term ''authorized'' in the Act implies that a particular institution has the authority in question to make the loan except for the fact that the borrower is ineligible, and thus is a similar entity. These commenters also expressed concern about intra-System competition for similar entity loans. Some commenters opined that proposed § 613.3300(c) promotes safety and soundness by requiring System institutions to participate in loans that are compatible with their expertise.

Two FCBs and six associations opposed proposed § 613.3300(c), and they asked the FCA to delete it from the regulation. These commenters assert that § 613.3300(c) is incompatible with the underlying purpose of sections 3.1(11)(B) and 4.18A of the Act, which was to promote risk diversification. These commenters believe that the risk diversification purpose is best served if a System bank or association can participate in similar entity loans that are incompatible with their short-, intermediate-, or long-term lending powers. These commenters opined that proposed § 613.3300(c) is contrary to the FCA's Regulatory Philosophy Statement of eliminating regulatory restrictions that neither implement or interpret the Act nor promote safety and soundness. These commenters claim that proposed § 613.3300(c) unduly restricts their ability to exercise their statutory powers.

The FCA has concluded that, while both interpretations of the Act are reasonable, eliminating this restriction in proposed § 613.3300(c) gives better effect to the statutory language and the Congressional purpose of section 4.18A of the Act. The express purpose of this provision is to assist FCS banks and associations in managing risk. The FCA agrees that participation in similar entity loans that differ from an institution's portfolio of either short- and intermediate-term loans or long-term loans promotes risk diversification. Additionally, the FCA notes that credit facility loan transactions, which comprise separate loans with different terms to a single borrower, are often the subject of loan participations. A rule that would permit only ACAs, but not FCBs or other associations, to participate in such transactions could substantially limit the ability of titles I and II lenders to make use of their similar entity participation authority. Accordingly, the FCA has omitted this restriction from the reproposed regulation.

6. Restrictions on Similar Entity Participations

No comments were received on proposed § 613.3300(d), and this paragraph has been redesignated as paragraph (c) in the reproposed regulation.

7. Funding Bank Approval

The FCA originally proposed a requirement that a direct lender association obtain approval from its funding bank before it could participate in a similar entity loan. The FCA further proposed that a request for approval from an association could only be denied for safety and soundness reasons affecting the bank.

The FCC, CoBank, and an FCS association supported proposed § 613.3000(e)(1). The FCC commented that its members support the paragraph as written because it provides adequate safeguards. One association believes that direct lenders should have maximum freedom to participate in similar entity loans without the regulation specifying funding bank approval.

The FCA redesignates proposed § 613.3300(e)(1) as reproposed § 613.3300(d)(1) without further revision. Further, reproposed § 613.33300(d)(1) directly implements the statutory requirement that an association obtain approval from its funding bank.

8. Territorial Concurrence

The FCA proposed that the out-of-territory concurrence requirements in § 614.4070 apply to all titles I and II institutions that participate with non-System lenders in loans to similar entities.

Ten System institutions supported FCA's territorial concurrence requirement, but many of these

commenters suggested some modifications to avoid unnecessary burdens. These commenters advised the FCA that the consent requirement could prove burdensome for titles I and II lenders when a similar entity has operations spread throughout several States. These commenters recommended that the FCA amend the regulation so it requires consent only from the FCS lender where the site of the similar entity's home office is located.

The FCB of Texas believes that the proposed territorial concurrence requirement is both appropriate and consistent with the Act, because there is no intrinsic difference between the operations of similar entities and eligible borrowers that justify different treatment.

Six System institutions opposed the territorial concurrence requirement in proposed § 613.3300(e)(2), because they believe operational matters are more appropriately addressed between respective banks and associations. Another FCS association believes that territorial concurrence should not be imported from § 614.4070 because it would impede the statutory mandate allowing similar entity participations and would not further any legitimate anti-competition policy. AgAmerica, FCB, does not believe that the territorial concurrence requirement in § 614.4070 should be extended to similar entity participations because Congress imposed concurrence requirements only between BCs and FCBs. Therefore, the commenter believes the regulation should not require titles I and II lenders to obtain any type of territorial concurrence from each other. One FCS association requested greater flexibility and recommended that institutions operating under joint management be allowed to offer products over the largest territory served by either association.

Several institutions also stated that a relationship with the original lender would be impaired if the association must seek the consent of other System institutions, because the originator usually has a very short time period to line up participants. However, another FCS association believes that FCS institutions generally should not be in competition with each other, because the System was created to serve the same specific public purpose. Many FCS commenters recommended that FCA address these intra-System competition issues at a later time and in a broader context. Some commenters suggested that a negotiated rulemaking be undertaken by the FCA.

After considering these comments, the FCA is persuaded that the territorial concurrence requirements between title I and II institutions for similar entity participations is not advisable. As noted by many commenters, the Act contains no territorial restriction on similar entity participations other than requiring consensual arrangements only between title I institutions and title III banks. Indeed, the Act indicates that the Congress granted this authority in order to assist System institutions in managing risk. Geographical diversity is a useful tool for agricultural lenders to reduce their concentration of risk, and a concurrence requirement could frustrate an institution's goal to achieve portfolio diversity.

Moreover, the policy reason for imposing the territorial concurrence requirement for eligible loans do not apply to participations in loans to ineligible borrowers. The concurrence requirement in § 614.4070 precludes a System lender from making a loan to an out-of-territory borrower who is the potential customer of another System institution without that institution's consent. When the borrower whose loan is the subject of the participation would not be eligible for a loan from the System institution serving the borrower's territory, this concern is not present. In other words, because the System lender has no authority to make the loan in the first instance, it has no claim to relinquish through territorial concurrence. Furthermore, since the amount of such participations is limited to 15 percent of the portfolio, competition for similar entity participations is not likely to have a serious adverse effect on any institution.

The FCA's decision is also influenced by the concern that a concurrence requirement could seriously impede the System's ability to use its new authority to participate in loans to similar entities. Institutions are often given only a brief opportunity to buy a participation in a transaction, and the delay resulting from seeking concurrence may effectively preclude involvement in the transaction. This outcome is even more likely when the participation involves an interest in a pool of loans covering a broad geographical territory and requires the consent of more than one System lender. For these reasons, the FCA has deleted the territorial concurrence requirement between titles I and II lenders in reproposed and redesignated § 613.3300(d), and the remaining paragraphs are renumbered accordingly.

9. Method of Approval

The FCA originally proposed that all approvals required by § 613.3300 could be granted on an annual basis and under such terms and conditions as the various FCS institutions may agree.

Eight System commenters encouraged FCA to promote the development of standing agreements between entities or even Systemwide agreements. CoBank recommended a standing agreement rather than annual agreements for various concurrences because the parties could develop parameters for all transactions.

The FCA believes that its original proposal provides FCS institutions with ample flexibility to develop agreements required by the Act. Agreements among System institutions can specify that consent by the FCS lender where the similar entity is located will suffice. No further FCA direction is needed at this time. The other approvals provided for in this paragraph are consistent with the statutory requirements. Therefore, proposed § 613.3300(e)(5) is reproposed and designated as § 613.3300(d)(4) without revision.

10. Borrower Rights

AgFirst and three FCS associations stated that § 613.3300(f) creates the potential for confusion because it deals with matters that are clearly set forth in the Act and otherwise in FCA regulations. In response to the commenters' concern, the FCA agrees and has deleted this section from the reproposed regulation.

11. Borrower Stock

Twenty-one FCS commenters requested deletion of proposed § 613.3300(g) because it creates the potential for confusion and deals with matters that are clearly set forth in the Act and otherwise in FCA regulations. All commenters also stated that it is not necessary to reflect in an institution's capitalization bylaws whether or not participation certificates are required for similar entity loans. Both the FCC and CoBank indicated that stockholder approval of revisions to the bylaws under these circumstances is excessive and costly.

The FCA noted in the preamble to the proposed rule that the requirements of this paragraph are consistent with section 4.3A of the Act and § 615.5220 of the FCA regulations. The FCA accepts the commenters justification for deleting this paragraph. However, a System institution must comply with section 4.3A of the Act if it needs to sell equities for similar entity participations to meet its capital requirements, but its current

bylaws do not already address this matter.

T. Other Proposed Amendments

The FCA received no comments on the proposed amendments to parts 614, 618, 619, and 626. These regulations, except for § 614.4222, are reproposed without revision. The proposal to amend § 614.4222 is withdrawn.

IV. Regulatory Impact and FCA Regulatory Philosophy

These reproposed regulations are consistent with the FCA Board's Policy Statement on Regulatory Philosophy and achieve the Board's objective of creating an environment that promotes the confidence of borrowers/shareholders, investors and the public in the System's financial strength and future viability. See 60 FR 26034, May 16, 1995. The objective of the reproposed revisions to the capital regulations is to establish standards that encourage the building of a sound capital structure in System institutions. The building of a sound capital structure at each institution would improve the likelihood of an institution's survival during periods of economic stress and thereby improve the safety and soundness of the System as a whole. The FCA believes that these reproposed regulations provide a meaningful measurement of capital adequacy and would be appropriate for all System institutions to which they would apply.

The capital provisions of this rule would apply to all System banks, associations, and the Leasing Corporation. During the last 5 years, most of these institutions have been steadily increasing both types of surplus identified by the reproposed regulations, and the FCA estimates that most, if not all, of the institutions would achieve the minimum standards in 7 years or less if these trends continue.

The reproposed amendments to the customer eligibility regulations would remove many of the existing restrictions that are not required by the Act or necessary to implement it. The objective of these reproposed provisions is to implement the Act's broad authority to finance the agricultural, aquatic, and other credit needs of *bona fide* farmers, ranchers, and aquatic producers or harvesters. These regulations respond to the concerns of commenters by balancing the rights of System and non-System lenders.

Most importantly, however, the reproposed regulations would permit the System to continue to fulfill its statutory mission of providing a dependable and competitive source of credit for American agriculture as it evolves in a rapidly changing market place.

List of Subjects

12 CFR Part 613

Agriculture, Banks, banking, Credit, Rural areas.

12 CFR Part 614

Agriculture, Banks, banking, Flood insurance, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 615

Accounting, Agriculture, Banks, banking, Government securities, Investments, Rural areas.

12 CFR Part 618

Agriculture, Archives and records, Banks, banking, Insurance, Reporting and recordkeeping requirements, Rural areas, Technical assistance.

12 CFR Part 619

Agriculture, Banks, banking, Rural areas.

12 CFR Part 620

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 626

Advertising, Aged, Agriculture, Banks, banking, Civil rights, Credit, Fair housing, Marital status discrimination, Sex discrimination, Signs and symbols.

For the reasons stated in the preamble, parts 613, 614, 615, 618, 619, 620, and 626 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended to read as follows:

PART 613—ELIGIBILITY AND SCOPE OF FINANCING

1. The authority citation for part 613 is revised to read as follows:

Authority: Secs. 1.5, 1.7, 1.9, 1.10, 1.11, 2.2, 2.4, 2.12, 3.1, 3.7, 3.8, 3.22, 4.18A, 4.25, 4.26, 4.27, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2017, 2018, 2019, 2073, 2075, 2093, 2122, 2128, 2129, 2143, 2206a, 2211, 2212, 2213, 2243, 2252).

2. Subparts A, B, C, and D of part 613 are revised to read as follows:

Subpart A—Financing Under Titles I and II of the Farm Credit Act

Sec.
613.3000 Financing for farmers, ranchers, and aquatic producers or harvesters.
613.3010 Financing for processing or marketing operations.
613.3020 Financing for farm-related service businesses.
613.3030 Rural home financing.

Subpart B—Financing for Banks Operating Under Title III of the Farm Credit Act

613.3100 Domestic lending.
613.3200 International lending.

Subpart C—Similar Entity Authority Under Sections 3.1(11)(B) and 4.18A of the Act

613.3300 Participations and other interests in loans to similar entities.

Subpart A—Financing Under Titles I and II of the Farm Credit Act

§ 613.3000 Financing for farmers, ranchers, and aquatic producers or harvesters.

(a) *Definitions.* For purposes of this subpart, the following definitions apply:

(1) *Agricultural assets* means agricultural land including facilities and improvements thereon; livestock, machinery, equipment, working capital, chattel, and vessels that are used for agricultural or aquatic production; and the principal residence of an individual borrower who qualifies under paragraph (a)(3)(i) of this section.

(2) *Agricultural land* means land that is devoted to or available for the production of agricultural or aquatic products.

(3) *Bona fide farmer, rancher, or producer or harvester of aquatic products* means:

(i) An individual or legal entity that generates income by actively producing agricultural products, producing or harvesting aquatic products, managing an agricultural or aquatic operation, or an individual who is a retired farmer who owns agricultural land and assumes some portion of the production risk of a tenant; or

(ii) An individual or legal entity that owns agricultural land.

(4) *Individual* means a natural person who is either:

(i) A citizen of the United States; or

(ii) A foreign national who has been lawfully admitted into the United States for permanent residency pursuant to 8 U.S.C. 1101(a)(20) (permanent resident), or on a visa pursuant to a provision in 8 U.S.C. 1101(a)(15) (non-resident) that authorizes such individual to own property or operate or manage a business.

(5) *Legal entity* means any partnership, corporation, trust, estate, or other legal entity that is established pursuant to the laws of the United States, any State thereof, the Commonwealth of Puerto Rico, the District of Columbia, or any tribal authority and is legally authorized to conduct a business.

(b) *Eligible borrower.* A bona fide farmer, rancher, or producer or harvester of aquatic products is eligible

to borrow under either title I or II of the Act.

(c) *Financing for agricultural or aquatic needs.* A borrower who is eligible under paragraph (b) of this section may obtain financing for any agricultural or aquatic purpose.

(d) *Financing for other credit needs.*

(1) Individual eligible borrowers who are either citizens or permanent residents of the United States, and at a minimum satisfy the criteria of paragraph (a)(3)(i) of this section, may obtain financing for:

(i) Their housing and domestic needs; and

(ii) Other business needs in an amount that, at the time the loan is closed, does not exceed the market value of their agricultural or aquatic assets.

(2) Individual eligible borrowers who are non-resident foreign nationals and at a minimum satisfy the criteria of paragraph (a)(3)(i) of this section may obtain financing for their domestic needs and housing reasonably related to their agricultural or aquatic operations in the U.S.A.

(3) Individual borrowers who are eligible only under paragraph (a)(3)(ii) of this section may obtain financing for their housing and domestic needs in an amount that, at the time the loan is closed, does not exceed the market value of their agricultural or aquatic assets.

(4) A legal entity may obtain financing for its other credit needs in an amount that, at the time the loan is closed, does not exceed the market value of its agricultural assets, only if more than 50 percent of voting stock or equity of the borrowing legal entity is owned by individuals who comply with the requirements in paragraph (a)(3)(i) of this section and either:

(i) More than 50 percent of the assets of the borrowing legal entity is used in agricultural or aquatic production; or

(ii) More than 50 percent of the annual income of the borrowing legal entity is derived from agricultural or aquatic activities.

§ 613.3010 Financing for processing or marketing operations.

(a) *Eligible borrowers.* A borrower is eligible for financing for a processing or marketing operation under titles I and II of the Act, only if the borrower meets the following requirements:

(1) The borrower is either a bona fide farmer, rancher, or producer or harvester of aquatic products, or is a legal entity in which eligible borrowers under § 613.3000(b) own more than 50 percent of the voting stock or equity; and

(2) The borrower or an owner of the borrowing legal entity regularly produces some portion of the throughput used in the processing or marketing operation.

(b) *Portfolio restrictions for certain processing and marketing loans.* Processing or marketing loans to eligible borrowers who regularly supply less than 20 percent of the throughput are subject to the following restrictions:

(1) *Bank limitation.* The aggregate of such processing and marketing loans made by a Farm Credit bank shall not exceed 15 percent of all its outstanding retail loans at the end of the preceding fiscal year.

(2) *Association limitation.* The aggregate of such processing and marketing loans made by all direct lender associations affiliated with the same Farm Credit bank shall not exceed 15 percent of the aggregate of their outstanding retail loans at the end of the preceding fiscal year. Each Farm Credit bank, in conjunction with all its affiliated direct lender associations, shall ensure that such processing or marketing loans are equitably allocated among its affiliated direct lender associations.

(3) *Calculation of outstanding retail loans.* For the purposes of this paragraph, ''outstanding retail loans'' includes loans, loan participations, and other interests in loans that are either bought without recourse or sold with recourse.

§ 613.3020 Financing for farm-related service businesses.

(a) *Eligibility.* An individual or legal entity that furnishes farm-related services to farmers and ranchers that are directly related to their agricultural production is eligible to borrow from a Farm Credit bank or association that operates under titles I or II of the Act.

(b) *Purposes of financing.* A Farm Credit Bank, agricultural credit bank, or direct lender association may finance:

(1) All of the farm-related business activities of an eligible borrower who derives more than 50 percent of its annual income (as consistently measured on either a gross sales or net sales basis) from furnishing farm-related services that are directly related to the agricultural production of farmers and ranchers; or

(2) Only the farm-related services activities of an eligible borrower who derives 50 percent or less of its annual income (as consistently measured on either a gross sales or net sales basis) from furnishing farm-related services that are directly related to the agricultural production of farmers and ranchers.

§ 613.3030 Rural home financing.

(a) *Definitions.*

(1) *Rural homeowner* means an individual who is not a bona fide farmer, rancher, or producer or harvester of aquatic products.

(2) *Rural home* means a single-family moderately priced dwelling located in a rural area that will be the occupant's principal residence.

(3) *Rural area* means open country within a State or the Commonwealth of Puerto Rico, which may include a town or village that have a population of not more than 2,500 persons.

(4) *Moderately priced* means the price of any rural home that either:

(i) Satisfies the criteria in section 8.0 of the Act pertaining to rural home loans that collateralize securities that are guaranteed by the Federal Agricultural Mortgage Corporation; or

(ii) Is below the 75th percentile of housing values for the rural area where it is located, as determined by data from a credible, independent, and recognized national or regional source, such as a Federal, State, or local government agency, or an industry source.

(b) *Eligibility.* Any rural homeowner is eligible to obtain financing on a rural home. No borrower shall have a loan from the Farm Credit System on more than one rural home at any one time.

(c) *Purposes of financing.* Loans may be made to rural homeowners for the purpose of buying, building, remodeling, improving, repairing rural homes, and refinancing existing indebtedness thereon.

(d) *Portfolio limitations.* (1) The aggregate of retail rural home loans by any Farm Credit Bank or agricultural credit bank shall not exceed 15 percent of the total of all of its outstanding loans at any one time.

(2) The aggregate of rural home loans made by each direct lender association shall not exceed 15 percent of the total of its outstanding loans at the end of its preceding fiscal year, except with the prior approval of its funding bank.

(3) The aggregate of rural home loans made by all direct lender associations that are funded by the same Farm Credit bank shall not exceed 15 percent of the total outstanding loans of all such associations at the end of the funding bank's preceding fiscal year.

Subpart B—Financing for Banks Operating Under Title III of the Farm Credit Act

§ 613.3100 Domestic lending.

(a) *Definitions.* For purposes of this subpart, the following definitions apply:

(1) *Cooperative* means any association of farmers, ranchers, producers or

harvesters of aquatic products, or any federation of such associations, or a combination of such associations and farmers, ranchers, or producers or harvesters of aquatic products that conducts business for the mutual benefit of its members and has the power to:

(i) Process, prepare for market, handle, or market farm or aquatic products;

(ii) Purchase, test, grade, process, distribute, or furnish farm or aquatic supplies; or

(iii) Furnish business and financially related services to its members.

(2) *Farm or aquatic supplies and farm or aquatic business services* are any goods or services normally used by farmers, ranchers, or producers and harvesters of aquatic products in their business operations, or to improve the welfare or livelihood of such persons.

(3) *Public utility* means a cooperative or other entity that is licensed under Federal, State, or local law to provide electric, telecommunication, cable television, water, or waste treatment services.

(4) *Rural area* means all territory of a State that is not within the outer boundary of any city or town having a population of more than 20,000 inhabitants based on the latest decennial census of the United States.

(5) *Service cooperative* means a cooperative that is involved in providing business and financially related services (other than public utility services) to farmers, ranchers, aquatic producers or harvesters, or their cooperatives.

(b) *Cooperatives and other entities that serve agricultural or aquatic producers.*—(1) *Eligibility of cooperatives.* A bank for cooperatives or an agricultural credit bank may lend to a cooperative that satisfies the following requirements:

(i) Unless the bank's board of directors establishes by resolution a higher voting control threshold for any type of cooperative, the percentage of voting control of the cooperative held by farmers, ranchers, producers or harvesters of aquatic products, or cooperatives shall be 80 percent except:

(A) Sixty (60) percent for a service cooperative;

(B) Sixty (60) percent for local farm supply cooperatives that have historically served the needs of a community that would not be adequately served by other suppliers and have experienced a reduction in the percentage of membership by agricultural or aquatic producers due to changed circumstances beyond their control; and

(C) Sixty (60) percent for local farm supply cooperatives that provide or will provide needed services to a community, and are or will be in competition with a cooperative specified in § 613.3100(b)(1)(i)(B);

(ii) The cooperative deals in farm or aquatic products, or products processed therefrom, farm or aquatic supplies, farm or aquatic business services, or financially related services with or for members in an amount at least equal in value to the total amount of such business it transacts with or for non-members, excluding from the total of member and non-member business, transactions with the United States, or any agencies or instrumentalities thereof, or services or supplies furnished by a public utility; and

(iii) The cooperative complies with one of the following two conditions:

(A) No member of the cooperative shall have more than one vote because of the amount of stock or membership capital owned therein; or

(B) The cooperative restricts dividends on stock or membership capital to 10 percent per year or the maximum percentage per year permitted by applicable State law, whichever is less.

(iv) Any cooperative that has received a loan from a bank for cooperatives or an agricultural credit bank shall, without regard to the requirements in paragraph (b)(1)(i) of this section, continue to be eligible for as long as more than 50 percent (or such higher percentage as is established by the bank board) of the voting control of the cooperative is held by farmers, ranchers, producers or harvesters of aquatic products, or other eligible cooperatives.

(2) *Other eligible entities.* The following entities are eligible to borrow from banks for cooperatives and agricultural credit banks:

(i) Any legal entity that holds more than 50 percent of the voting control of a cooperative that is an eligible borrower under paragraph (b)(1) of this section and uses the proceeds of the loan to fund the activities of its cooperative subsidiary on the terms and conditions specified by the bank;

(ii) Any legal entity in which an eligible cooperative has an ownership interest, *provided that* if such interest is less than 50 percent, financing shall not exceed the percentage that the eligible cooperative owns in such entity multiplied by the value of the total assets of such entity; or

(iii) Any creditworthy private entity operated on a non-profit basis that satisfies the requirements for a service cooperative and complies with the requirements of either paragraphs (b)(1)(i)(A) and (b)(1)(iii) of this section, or paragraph (b)(1)(iv) of this section, and any subsidiary of such entity. An entity that is eligible to borrow under this paragraph shall be organized to benefit agriculture in furtherance of the welfare of the farmers, ranchers, and aquatic producers or harvesters who are its members.

(c) *Electric and telecommunication utilities.*—(1) *Eligibility.* A bank for cooperatives or an agricultural credit bank may lend to:

(i) Electric and telephone cooperatives as defined by section 3.8(a)(4)(A) of the Act that satisfy the eligibility criteria in paragraph (b)(1) of this section;

(ii) Cooperatives and other entities that:

(A) Have received a loan, loan commitment, insured loan, or loan guarantee from the Rural Utilities Service of the United States Department of Agriculture to finance rural electric and telecommunication services;

(B) Have received a loan or a loan commitment from the Rural Telephone Bank of the United States Department of Agriculture; or

(C) Are eligible under the Rural Electrification Act of 1936, as amended, for a loan, loan commitment, or loan guarantee from the Rural Utilities Service or the Rural Telephone Bank.

(iii) The subsidiaries of cooperatives or other entities that are eligible under paragraph (c)(1)(ii) of this section.

(iv) Any legal entity that holds more than 50 percent of the voting control of any public utility that is an eligible borrower under paragraph (c)(1)(ii) of this section, and uses the proceeds of the loan to fund the activities of the eligible subsidiary on the terms and conditions specified by the bank.

(v) Any legal entity in which an eligible utility under paragraph (c)(1)(ii) of this section has an ownership interest, provided that if such interest is less than 50 percent, financing shall not exceed the percentage that the eligible utility owns in such entity multiplied by the value of the total assets of such entity.

(2) *Purposes for financing.* A bank for cooperatives or agricultural credit bank may extend credit to entities that are eligible to borrow under paragraph (c)(1) of this section in order to provide electric or telecommunication services in a rural area. A subsidiary that is eligible to borrow under paragraph (c)(1)(iii) of this section may also obtain financing from a bank for cooperatives or agricultural credit bank to operate a licensed cable television utility.

(d) *Water and waste disposal facilities.*—(1) *Eligibility.* A cooperative or a public agency, quasi-public agency,

body, or other public or private entity that, under the authority of State or local law, establishes and operates water and waste disposal facilities in a rural area, as that term is defined by paragraph (a)(5) of this section, is eligible to borrow from a bank for cooperatives or an agricultural credit bank.

(2) *Purposes for financing.* A bank for cooperatives or agricultural credit bank may extend credit to entities that are eligible under paragraph (d)(1) of this section solely for installing, maintaining, expanding, improving, or operating water and waste disposal facilities in rural areas.

(e) *Domestic lessors.* A bank for cooperatives or agricultural credit bank may lend to domestic parties to finance the acquisition of facilities or equipment that will be leased to shareholders of the bank for use in their operations located inside of the United States.

§ 613.3200 International lending.

(a) *Definition.* For the purpose of this section only, the term ''farm supplies'' refers to inputs that are used in a farming or ranching operation, but excludes agricultural processing equipment, machinery used in food manufacturing or other capital goods which are not used in a farming or ranching operation.

(b) *Import transactions.* The following parties are eligible to borrow from a bank for cooperatives or an agricultural credit bank pursuant to section 3.7(b) of the Act for the purpose of financing the import of agricultural commodities or products therefrom, aquatic products, and farm supplies into the United States:

(1) An eligible cooperative as defined by § 613.3100(b);

(2) A counterparty with respect to a specific import transaction with a voting stockholder of the bank for the substantial benefit of the shareholder; and

(3) Any foreign or domestic legal entity in which eligible cooperatives hold an ownership interest.

(c) *Export transactions.* Pursuant to section 3.7(b)(2) of the Act, a bank for cooperatives or an agricultural credit bank is authorized to finance the export (including the cost of freight) of agricultural commodities or products therefrom, aquatic products, or farm supplies from the United States to any foreign country. The board of directors of each bank for cooperatives and agricultural credit bank shall adopt policies that ensure that exports of agricultural products and commodities, aquatic products, and farm supplies which originate from eligible cooperatives are financed on a priority basis. The total amount of balances outstanding on loans made under this paragraph shall not, at any time, exceed 50 percent of the capital of any bank for cooperatives or agricultural credit bank for loans that:

(1) Finance the export of agricultural commodities and products therefrom, aquatic products, or farm supplies that are not originally sourced from an eligible cooperative; and

(2) At least 95 percent of the loan amount is not guaranteed by a department, agency, bureau, board, or commission of the United States or a corporation that is wholly owned directly or indirectly by the United States.

(d) *International business operations.* A bank for cooperatives or an agricultural credit bank may finance a domestic or foreign entity which is at least partially owned by eligible cooperatives described in § 613.3100(b), and facilitates the international business operations of such cooperatives.

(e) *Restrictions.* (1) When eligible cooperatives own less than 50 percent of a foreign or domestic legal entity, the amount of financing that a bank for cooperatives or agricultural credit bank may provide to the entity for imports, exports, or international business operations shall not exceed the percentage of ownership that eligible cooperatives hold in such entity multiplied by the value of the total assets of such entity; and

(2) A bank for cooperatives or agricultural credit bank shall not finance the relocation of any plant or facility from the United States to a foreign country.

Subpart C—Similar Entity Authority Under Sections 3.1(11)(B) and 4.18A of the Act

§ 613.3300 Participations and other interests in loans to similar entities.

(a) *Definitions.*

(1) *Participate* and *participation,* for the purpose of this section, refer to multi-lender transactions, including syndications, assignments, loan participations, subparticipations, other forms of the purchase, sale, or transfer of interests in loans, or other extensions of credit, or other technical and financial assistance.

(2) *Similar entity* means a party that is ineligible for a loan from a Farm Credit bank or association, but has operations that are functionally similar to the activities of eligible borrowers in that a majority of its income is derived from, or a majority of its assets are invested in, the conduct of activities that are performed by eligible borrowers.

(b) *Similar entity transactions.* A Farm Credit bank or a direct lender association may participate with a lender that is not a Farm Credit System institution in loans to a similar entity that is not eligible to borrow directly under §§ 613.3000, 613.3010, 613.3020, 613.3100, or 613.3200, for purposes similar to those for which an eligible borrower could obtain financing from the participating FCS institution.

(c) *Restrictions.* Participations by a Farm Credit bank or association in loans to a similar entity under this section are subject to the following limitations:

(1) *Lending limits.*

(i) *Farm Credit banks operating under title I of the Act and direct lender associations.* The total amount of all loan participations that any Farm Credit Bank, agricultural credit bank, or direct lender association has outstanding under paragraph (b) of this section to a single credit risk shall not exceed:

(A) Ten (10) percent of its total capital; or

(B) Twenty-five (25) percent of its total capital if a majority of the shareholders of the respective Farm Credit bank or direct lender association so approve.

(ii) *Farm Credit banks operating under title III of the Act.* The total amount of all loan participations that any bank for cooperative or agricultural credit bank has outstanding under paragraph (b) of this section to a single credit risk shall not exceed 10 percent of its total capital;

(2) *Percentage held in the principal amount of the loan.* The participation interest in the same loan held by one or more Farm Credit bank(s) or association(s) shall not, at any time, equal or exceed 50 percent of the principal amount of the loan; and

(3) *Portfolio limitations.* The total amount of participations that any Farm Credit bank or direct lender association has outstanding under paragraph (b) of this section shall not exceed 15 percent of its total outstanding assets at the end of its preceding fiscal year.

(d) *Approval by other Farm Credit System institutions.* (1) No direct lender association shall participate in a loan to a similar entity under paragraph (b) of this section without the approval of its funding bank. A funding bank shall deny such requests only for safety and soundness reasons affecting the bank.

(2) No Farm Credit Bank or direct lender association shall participate in a loan to a similar entity that is eligible to borrow under § 613.3100(b) without the prior approval of the bank for cooperatives or agricultural credit bank

that, at the time the loan is made, has the greatest volume of loans made under title III of the Act in the State where the headquarters office of the similar entity is located.

(3) No bank for cooperatives or agricultural credit bank shall participate in a loan to a similar entity that is eligible to borrow under §§ 613.3010 or 613.3020 without the prior consent of the Farm Credit Bank(s) in whose chartered territory the similar entity conducts operations.

(4) All approvals required under paragraph (d) of this section may be granted on an annual basis and under such terms and conditions as the various Farm Credit System institutions may agree.

Subpart E—Nondiscrimination in Lending

§§ 613.3145, 613.3150, 613.3151, 613.3152, 613.3160, 613.3170, 613.3175 (Subpart E) [Redesignated]

3. Subpart E of part 613, consisting of §§ 613.3145, 613.3150, 613.3151, 613.3152, 613.3160, 613.3170, and 613.3175 is redesignated as new part 626, consisting of §§ 626.6000, 626.6005, 626.6010, 626.6015, 626.6020, 626.6025, and 626.6030 respectively.

PART 614—LOAN POLICIES AND OPERATIONS

4. The authority citation for part 614 is revised to read as follows:

Authority: 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128; secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 1.11, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.7, 7.8, 7.12, 7.13, 8.0, 8.5 of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2096, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2199, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2206a, 2207, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279b-1, 2279b-2, 2279f, 2279f-1, 2279aa, 2279aa-5); sec. 413 of Pub. L. 100–233, 101 Stat. 1568, 1639; sec. 207 of Pub. L. 104–105, 110 Stat. 162.

Subpart A—[Amended]

5. Subpart A of part 614 is amended by removing the reference ''613.3020'' each place it appears and adding in its place ''613.3000''; by removing the reference ''613.3045'' each place it appears and adding in its place ''613.3010''; by removing the reference ''613.3040'' each place it appears and adding in its place ''613.3030''; by removing the reference ''613.3050'' each place it appears and adding in its place ''613.3020''; by removing the reference ''613.3110'' each place it appears and adding in its place ''613.3100(b)(1)''; and by removing the reference ''613.3110(c)'' each place it appears and adding in its place ''613.3100(b)(2), (c) and (d)''.

6. Section 614.4010 is amended by removing the words ''export or'' each place they appear in paragraphs (d)(4) and (d)(5); by removing the reference ''(d)(3)'' and adding in its place ''(d)(4)'' in paragraph (d)(5); and by adding new paragraphs (d)(6) and (d)(7) to read as follows.

§ 614.4010 Agricultural credit banks.

* * * * *

(d) * * *

* * * * *

(6) Any party, subject to the requirements in § 613.3200(c) of this chapter, for the export (including the cost of freight) of agricultural commodities or products therefrom, aquatic products, or farm supplies from the United States to any foreign country, in accordance with § 614.4233 and subpart Q of this part 614; and

(7) Domestic or foreign parties in which eligible cooperatives, as defined in § 613.3100 of this chapter, hold an ownership interest, for the purpose of facilitating the international business operations of such cooperatives pursuant to the requirements of § 613.3200(d) and (e) of this chapter.

* * * * *

7. Section 614.4020 is amended by removing the words ''export or'' each place they appear in paragraphs (a)(4) and (a)(5); by adding after the words ''bank's board'', the reference '', § 614.4233,'' in paragraph (a)(4); by removing the words ''board policy'' and adding in their place, the words ''policies of the bank's board, § 614.4233,'' in paragraph (a)(5); and by adding new paragraphs (a)(6) and (a)(7) to read as follows:

§ 614.4020 Banks for cooperatives.

(a) * * *

* * * * *

(6) Any party, subject to the requirements in § 613.3200(c) of this chapter, for the export (including the cost of freight) of agricultural commodities or products therefrom, aquatic products, or farm supplies from the United States to any foreign country, in accordance with § 614.4233 and subpart Q of this part 614; and

(7) Domestic or foreign parties in which eligible cooperatives, as defined in § 613.3100 of this chapter, hold an ownership interest, for the purpose of facilitating the international business operations of such cooperatives pursuant to the requirements in § 613.3200(d) and (e) of this chapter.

* * * * *

Subpart E—Loan Terms and Conditions

8. Section 614.4233 is amended by revising the introductory paragraph to read as follows:

§ 614.4233 International loans.

Term loans made by banks for cooperatives and agricultural credit banks under the authority of section 3.7(b) of the Act and § 613.3200 of this chapter to foreign or domestic parties who are not shareholders of the bank shall be subject to following conditions:

* * * * *

Subpart P—Farm Credit Bank and Agricultural Credit Bank Financing of Other Financing Institutions

§ 614.4610 [Amended]

9. Section 614.4610 is amended by removing the words ''an association in the district'' and adding in their place, the words ''any association funded by the bank'' in the first sentence and removing the reference ''§ 613.3040(d)(2)'' and adding in its place the reference ''§§ 613.3010(b)(1) and 613.3030(d)''.

Subpart Q—Banks for Cooperatives Financing International Trade

10. The heading for subpart Q is amended by adding after the words ''Banks for Cooperatives'' the words ''and Agricultural Credit Banks''.

§ 614.4700 [Amended]

11. Section 614.4700 is amended by adding after the words ''banks for cooperatives'' the words ''and agricultural credit banks'' each place they appear in paragraphs (a), introductory text, (b), and (h).

§ 614.4710 [Amended]

12. Section 614.4710 is amended by adding after the words ''banks for cooperatives'' the words ''and agricultural credit banks'' each place they appear in the introductory paragraph and paragraph (c); by adding after the words ''bank for cooperatives''' the words ''or agricultural credit bank's'' in paragraph (a)(1)(ii); by adding after the words ''bank for cooperatives'' the words ''or an agricultural credit bank'' each place they appear in paragraphs (a)(1), (a)(1)(i), (a)(3), (a)(5) and (b)(1).

§ 614.4720 [Amended]

13. Section 614.4720 is amended by adding after the words ''Banks for cooperatives'' the words ''and

agricultural credit banks'' in the first sentence of the introductory paragraph.

§ 614.4800 [Amended]

14. Section 614.4800 is amended by adding after the words ''A bank for cooperatives'' the words ''or an agricultural credit bank'' in the first sentence.

§ 614.4810 [Amended]

15. Section 614.4810 is amended by adding after the words ''banks for cooperatives'' the words ''and agricultural credit banks'' each place they appear in paragraphs (a), introductory text, and (b).

§ 614.4900 [Amended]

16. Section 614.4900 is amended by adding after the words ''a bank for cooperatives'' the words ''or an agricultural credit bank'' each place they appear in paragraphs (a) through (d); and by adding after the words ''banks for cooperatives'' the words ''and agricultural credit banks'' in the first sentence of paragraph (i).5

PART 615—FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

17. The authority citation for part 615 continues to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b–6, 2279aa, 2279aa–4, 2279aa–6, 2279aa–7, 2279aa–8, 2279aa–10, 2279aa–12); sec. 301(a) of Pub. L. 100–233, 101 Stat. 1568, 1608; sec. 105 of Pub. L. 104–105, 110 Stat. 162, 163–64.

Subpart H—Capital Adequacy

§ 615.5201 [Amended]

18. Section 615.5201 is amended by adding the words ''Federal land credit association,'' after the words ''Federal land bank association,''; and by removing the words ''National Bank for Cooperatives,'' and adding in their place, the words ''agricultural credit bank,'' in paragraph (g).

19. Section 615.5205 is revised to read as follows:

§ 615.5205 Minimum permanent capital standards.

Each Farm Credit System institution shall at all times maintain permanent capital at a level of at least 7 percent of its risk-adjusted asset base.

20. Section 615.5210 is amended by removing paragraphs (f)(2)(i)(D) and (f)(2)(v)(D); redesignating paragraph (f)(2)(v)(E) as new paragraph (f)(2)(v)(D); adding a new paragraph (e)(2)(ii)(G)(*10*); and revising paragraphs (e)(2)(ii)(G)(*7*) and (f)(2)(i)(C) to read as follows:

§ 615.5210 Computation of the permanent capital ratio.

* * * * *

(e) * * *

(2) * * *

(ii) * * *

(G) * * *

(*7*) Each institution shall deduct from its total capital an amount equal to any goodwill.

* * * * *

(*10*) The permanent capital of an institution shall exclude the net impact of unrealized holding gains or losses on available-for-sale securities.

(f) * * *

(2) * * *

(i) * * *

(C) Goodwill.

* * * * *

§ 615.5216 [Removed and reserved]

21. Section 615.5216 is removed and reserved.

Subpart I—Issuance of Equities

§ 615.5220 [Amended]

22. Section 615.5220 is amended by removing paragraph (f), redesignating existing paragraphs (g), (h), and (i) as paragraphs (f), (g), and (h), respectively; removing the words ''may be more than, but'' each place they appear in paragraphs (d) and (e); by adding the words '', agricultural credit banks (with respect to loans other than to cooperatives),'' after the words ''For Farm Credit Banks'' in paragraph (d); by adding the words ''and agricultural credit banks (with respect to loans to cooperatives)'' after the words ''For banks for cooperatives'' in paragraph (e); and by removing the words ''(including interim standards)'' in newly designated paragraph (f).

§ 615.5230 [Amended]

23. Section 615.5230 is amended by removing the words ''preferred stock to be issued to the Farm Credit System Financial Assistance Corporation and'' in paragraph (b)(1).

24. Section 615.5240 is amended by removing paragraph (b); redesignating the introductory paragraph and paragraph (a) introductory text as paragraphs (a) and (b) introductory text, respectively; adding a new paragraph (c); and revising newly designated paragraph (a) to read as follows:

§ 615.5240 Permanent capital requirements.

(a) The capitalization bylaws shall enable the institution to meet the minimum permanent capital adequacy standards established under subparts H and K of this part and the total capital requirements established by the board of directors of the institution.

* * * * *

(c) An institution's board of directors may delegate to management the decision whether to retire borrower stock, provided that:

(1) The institution's permanent capital ratio will be in excess of 9 percent after any such retirements;

(2) The institution meets and maintains all applicable minimum surplus and collateral standards;

(3) Any such retirements are in accordance with the institution's capital adequacy plan or capital restoration plan; and

(4) The aggregate amount of stock purchases, retirements, and the net effect of such activities are reported to the board of directors each quarter.

§ 615.5250 [Amended]

25. Section 615.5250 is amended by removing paragraph (c); redesignating paragraphs (d) and (e) as paragraphs (c) and (d), respectively; by removing the words ''(including interim standards)'' in paragraphs (a)(4)(ii) and newly designated (c)(3); and by removing the words '', including interim standards'' in paragraph (a)(4)(iii).

Subpart J—Retirement of Equities

§ 615.5260 [Amended]

26. Section 615.5260 is amended by adding the word ''or'' at the end of paragraph (a)(2)(i); removing ''; or'' at the end of paragraph (a)(2)(ii) and inserting a period in its place; and by removing paragraphs (a)(2)(iii) and (d).

§ 615.5270 [Amended]

27. Section 615.5270 is amended by removing the words ''(including interim standards)'' in paragraph (b).

28. Subpart K is revised to read as follows:

Subpart K—Surplus and Collateral Requirements

Sec.
615.5301 Definitions.
615.5330 Minimum surplus ratios.
615.5335 Bank net collateral ratio.
615.5336 Reporting and compliance.

Subpart K—Surplus and Collateral Requirements

§ 615.5301 Definitions.

For the purposes of this subpart, the following definitions shall apply:

(a) The terms *institution, permanent capital, risk-adjusted asset base,* and *total capital* shall have the meanings set forth in § 615.5201.

(b) *Core surplus.*

(1) Core surplus includes:

(i) Undistributed earnings/unallocated surplus;

(ii) Perpetual common or noncumulative perpetual preferred stock that is not retired according to an established plan or practice, *provided that,* in the event that stock held by a borrower is retired, other than as required by section 4.14B of the Act or as a part of a *pro rata* retirement of all stock of the same class or series that was issued in the same year as the retired stock, the remaining perpetual stock shall be excluded from core surplus.

(iii) Nonqualified allocated equities that are not distributed according to an established plan or practice, *provided that,* in the event that a nonqualified patronage allocation is distributed, other than as required by section 4.14B of the Act or as a part of a pro rata distribution of nonqualified allocations that were allocated in the same year as the distributed allocation, the remaining nonqualified allocations will be excluded from core surplus.

(iv) A newly developed or modified capital instrument or a particular balance sheet entry or account that the Farm Credit Administration has determined to be the functional equivalent of a component of core surplus. The Farm Credit Administration may permit one or more institutions to include all or a portion of such instrument, entry, or account as core surplus, permanently, or on a temporary basis, for purposes of this subpart.

(2) Core surplus shall not include equities held by other System institutions.

(3) The net impact of unrealized holding gains or losses on available-for-sale securities shall be excluded from core surplus.

(4) The Farm Credit Administration may, if it finds that a particular component, balance sheet entry, or account has characteristics or terms that diminish its contribution to an institution's ability to absorb losses, require the deduction of all or a portion of such component, entry, or account from core surplus.

(c) *Net collateral* means the value of a bank's collateral as defined by § 615.5050 (except that eligible investments as described in § 615.5140 are to be valued at their amortized cost), less an amount equal to that portion of the allocated investments of affiliated associations that is not counted as permanent capital by the bank.

(d) *Net collateral ratio* means a bank's net collateral, divided by the bank's total liabilities.

(e) *Net investment in the bank* means the total investment by an association in its affiliated bank, less reciprocal investments and investments resulting from a loan originating/service agency relationship, including participations.

(f) *Nonqualified allocated equities* means allocations of earnings that are not deducted from the gross taxable income of the allocating institution at the time of allocation.

(g) *Perpetual stock or equity* means stock or equity not having a maturity date, not redeemable at the option of the holder, and having no other provisions that will require the future redemption of the issue.

(h) *Total surplus* means:

(1) Undistributed earnings/unallocated surplus;

(2) Allocated equities, including allocated surplus and stock which, if subject to revolvement, have a revolvement of not less than 5 years and are eligible to be included in permanent capital pursuant to § 615.5201(j)(4)(iv); and

(3) Stock that is not purchased or held as a condition of obtaining a loan, provided that it is either perpetual stock or term stock with an original maturity of at least 5 years, and provided that the institution has no established plan or practice of retiring such perpetual stock or of retiring such term stock prior to its stated maturity. The amount of term stock that is eligible to be included in total surplus shall be reduced by 20 percent in each of the last 5 years of the life of the instrument.

The total surplus of an institution shall exclude the net impact of unrealized holding gains or losses on available-for-sale securities.

§ 615.5330 Minimum surplus ratios.

(a) *Total surplus.* Each institution shall achieve and maintain a ratio of at least 7 percent of total surplus to the risk-adjusted asset base.

(b) *Core surplus.*

(1) Each institution shall achieve and maintain a ratio of core surplus to the risk-adjusted asset base of at least 3.5 percent.

(2) Each association shall compute its core surplus ratio by deducting an amount equal to the net investment in its affiliated Farm Credit bank from both its core surplus and its risk-adjusted asset base.

(c) An institution shall compute its total surplus and core surplus ratios as of the end of each month.

§ 615.5335 Bank net collateral ratio.

(a) Each bank shall achieve and maintain a net collateral ratio of at least 103 percent.

(b) A bank shall compute its net collateral ratio as of the end of each month.

§ 615.5336 Reporting and compliance.

(a) *Reporting and noncompliance.* An institution that falls below any applicable minimum surplus or collateral standard shall report its noncompliance to the Farm Credit Administration within 20 calendar days following the monthend that the institution initially determines that it is not in compliance with the standard.

(b) *Initial institution compliance requirements.* Each institution that fails to satisfy any of its minimum applicable surplus and net collateral ratios upon the effective date of these regulations shall submit a capital restoration plan for achieving and maintaining the standards, demonstrating appropriate annual progress toward meeting the goal, to the Farm Credit Administration within 60 days of the effective date of the regulations. If the capital restoration plan is not approved by the Farm Credit Administration, the Agency shall inform the institution of the reasons for disapproval, and the association shall submit a revised capital restoration plan within the time specified by the Farm Credit Administration.

(c) *Approval of compliance plans.* In determining whether to approve a capital restoration plan submitted under this section, the FCA shall consider the following factors, as applicable:

(1) The conditions or circumstances leading to the institution's falling below minimum levels (and whether or not they were caused by actions of the institution or were beyond the institution's control);

(2) The exigency of those circumstances or potential problems;

(3) The overall condition, management strength, and future prospects of the institution and, if applicable, affiliated System institutions;

(4) The institution's capital, adverse assets (including nonaccrual and nonperforming loans), allowance for loss, and other ratios compared to the ratios of its peers or industry norms;

(5) How far an institution's ratios are below the minimum requirements;

(6) The estimated rate at which the institution can reasonably be expected to generate additional earnings;

(7) The effect of the business changes required to increase capital;

(8) The institution's previous compliance practices, as appropriate;

(9) The views of the institution's directors and senior management regarding the plan; and

(10) Any other facts or circumstances that the FCA deems relevant.

(d) *Initial compliance.* An institution that fails to meet either or both of the minimum applicable surplus ratios or net collateral ratio established in § 615.5330 on the effective date of such section shall be deemed to be in compliance with such section, *provided that* the institution is in compliance with a capital restoration plan that is approved by the Farm Credit Administration within 180 days of the effective date of these regulations.

(e) *Noncompliance.* An institution that has met the minimum applicable surplus ratios and net collateral ratio established in § 615.5330 on or after the effective date of this section and subsequently falls below one or more minimum ratios shall be in violation of § 615.5330.

29. Subparts L and M are added to read as follows:

Subpart L—Establishment of Minimum Capital Ratios for an Individual Institution

Sec.
615.5350 General—Applicability.
615.5351 Standards for determination of appropriate individual institution minimum capital ratios.
615.5352 Procedures.
615.5353 Relation to other actions.
615.5354 Enforcement.

Subpart M—Issuance of a Capital Directive

615.5355 Purpose and scope.
615.5356 Notice of intent to issue a capital directive.
615.5357 Response to notice.
615.5358 Decision.
615.5359 Issuance of a capital directive.
615.5360 Reconsideration based on change in circumstances.
615.5361 Relation to other administrative actions.

Subpart L—Establishment of Minimum Capital Ratios for an Individual Institution

§ 615.5350 General—Applicability.

(a) The rules and procedures specified in this subpart are applicable to a proceeding to establish required minimum capital ratios that would otherwise be applicable to an institution under §§ 615.5205, 615.5330, and 615.5335. The Farm Credit Administration is authorized to establish such minimum capital requirements for an institution as the Farm Credit Administration, in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the institution. Proceedings under this subpart also may be initiated to require an institution having capital ratios greater than those set forth in §§ 615.5205, 615.5330, or 615.5335 to continue to maintain those higher ratios.

(b) The Farm Credit Administration may require higher minimum capital ratios for an individual institution in view of its circumstances. For example, higher capital ratios may be appropriate for:

(1) An institution receiving special supervisory attention;

(2) An institution that has, or is expected to have, losses resulting in capital inadequacy;

(3) An institution with significant exposure due to operational risk, interest rate risk, the risks from concentrations of credit, certain risks arising from other products, services, or related activities, or management's overall inability to monitor and control financial risks presented by concentrations of credit and related services activities;

(4) An institution exposed to a high volume of, or particularly severe, problem loans;

(5) An institution that is growing rapidly; or

(6) An institution that may be adversely affected by the activities or condition of System institutions with which it has significant business relationships or in which it has significant investments.

§ 615.5351 Standards for determination of appropriate individual institution minimum capital ratios.

The appropriate minimum capital ratios for an individual institution cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. The decision is necessarily based in part on subjective judgment grounded in Agency expertise. The factors to be considered in the determination will vary in each case and may include, for example:

(a) The conditions or circumstances leading to the Farm Credit Administration's determination that higher minimum capital ratios are appropriate or necessary for the institution;

(b) The exigency of those circumstances or potential problems;

(c) The overall condition, management strength, and future prospects of the institution and, if applicable, affiliated institutions;

(d) The institution's capital, adverse assets (including nonaccrual and nonperforming loans), allowance for loss, and other ratios compared to the ratios of its peers or industry norms; and

(e) The views of the institution's directors and senior management.

§ 615.5352 Procedures.

(a) *Notice.* When the Farm Credit Administration determines that minimum capital ratios greater than those set forth in §§ 615.5205, 615.5330, or 615.5335 are necessary or appropriate for a particular institution, the Farm Credit Administration will notify the institution in writing of the proposed minimum capital ratios and the date by which they should be reached (if applicable) and will provide an explanation of why the ratios proposed are considered necessary or appropriate for the institution.

(b) *Response.*

(1) The institution may respond to any or all of the items in the notice. The response should include any matters which the institution would have the Farm Credit Administration consider in deciding whether individual minimum capital ratios should be established for the institution, what those capital ratios should be, and, if applicable, when they should be achieved. The response must be in writing and delivered to the designated Farm Credit Administration official within 30 days after the date on which the institution received the notice. In its discretion, the Farm Credit Administration may extend the time period for good cause. The Farm Credit Administration may shorten the time period with the consent of the institution or when, in the opinion of the Farm Credit Administration, the condition of the institution so requires, provided that the institution is informed promptly of the new time period.

(2) Failure to respond within 30 days or such other time period as may be specified by the Farm Credit Administration shall constitute a waiver of any objections to the proposed minimum capital ratios or the deadline for their achievement.

(c) *Decision.* After the close of the institution's response period, the Farm Credit Administration will decide, based on a review of the institution's response and other information concerning the institution, whether individual minimum capital ratios should be established for the institution and, if so, the ratios and the date the requirements will become effective. The institution will be notified of the decision in writing. The notice will include an explanation of the decision, except for a decision not to establish individual minimum capital requirements for the institution.

(d) *Submission of plan.* The decision may require the institution to develop and submit to the Farm Credit Administration, within a time period specified, an acceptable plan to reach

the minimum capital ratios established for the institution by the date required.

(e) *Reconsideration based on change in circumstances.* If, after the Farm Credit Administration's decision in paragraph (c) of this section, there is a change in the circumstances affecting the institution's capital adequacy or its ability to reach the required minimum capital ratios by the specified date, either the institution or the Farm Credit Administration may propose a change in the minimum capital ratios for the institution, the date when the minimums must be achieved, or the institution's plan (if applicable). The Farm Credit Administration may decline to consider proposals that are not based on a significant change in circumstances or are repetitive or frivolous. Pending a decision on reconsideration, the Farm Credit Administration's original decision and any plan required under that decision shall continue in full force and effect.

§ 615.5353 Relation to other actions.

In lieu of, or in addition to, the procedures in this subpart, the required minimum capital ratios for an institution may be established or revised through a written agreement or cease and desist proceedings under part C of title V of the Act, or as a condition for approval of an application.

§ 615.5354 Enforcement.

An institution that does not have or maintain the minimum capital ratios applicable to it, whether required in subparts H and K of this part, in a decision pursuant to this subpart, in a written agreement or temporary or final order under part C of title V of the Act, or in a condition for approval of an application, or an institution that has failed to submit or comply with an acceptable plan to attain those ratios, will be subject to such administrative action or sanctions as the Farm Credit Administration considers appropriate. These sanctions may include the issuance of a capital directive pursuant to subpart M of this part or other enforcement action, assessment of civil money penalties, and/or the denial or condition of applications.

Subpart M—Issuance of a Capital Directive

§ 615.5355 Purpose and scope.

(a) This subpart is applicable to proceedings by the Farm Credit Administration to issue a capital directive under sections 4.3(b) and 4.3A(e) of the Act. A capital directive is an order issued to an institution that does not have or maintain capital at or greater than the minimum ratios set forth in §§ 615.5205, 615.5330, and 615.5335; or established for the institution under subpart L, by a written agreement under part C of title V of the Act, or as a condition for approval of an application. A capital directive may order the institution to:

(1) Achieve the minimum capital ratios applicable to it by a specified date;

(2) Adhere to a previously submitted plan to achieve the applicable capital ratios;

(3) Submit and adhere to a plan acceptable to the Farm Credit Administration describing the means and time schedule by which the institution shall achieve the applicable capital ratios;

(4) Take other action, such as reduction of assets or the rate of growth of assets, restrictions on the payment of dividends or patronage, or restrictions on the retirement of stock, to achieve the applicable capital ratios; or

(5) A combination of any of these or similar actions. A capital directive may also be issued to the board of directors of an institution, requiring such board to comply with the requirements of section 4.3A(d) of the Act prohibiting the reduction of permanent capital.

(b) A capital directive issued under this rule, including a plan submitted under a capital directive, is enforceable in the same manner and to the same extent as an effective and outstanding cease and desist order which has become final as defined in section 5.25 of the Act. Violation of a capital directive may result in assessment of civil money penalties in accordance with section 5.32 of the Act.

§ 615.5356 Notice of intent to issue a capital directive.

The Farm Credit Administration will notify an institution in writing of its intention to issue a capital directive. The notice will state:

(a) The reasons for issuance of the capital directive;

(b) The proposed contents of the capital directive, including the proposed date for achieving the minimum capital requirement; and

(c) Any other relevant information concerning the decision to issue a capital directive.

§ 615.5357 Response to notice.

(a) An institution may respond to the notice by stating why a capital directive should not be issued and/or by proposing alternative contents for the capital directive or seeking other appropriate relief. The response shall include any information, mitigating circumstances, documentation, or other relevant evidence that supports its position. The response may include a plan for achieving the minimum capital ratios applicable to the institution. The response must be in writing and delivered to the Farm Credit Administration within 30 days after the date on which the institution received the notice. In its discretion, the Farm Credit Administration may extend the time period for good cause. The Farm Credit Administration may shorten the 30-day time period:

(1) When, in the opinion of the Farm Credit Administration, the condition of the institution so requires, provided that the institution shall be informed promptly of the new time period;

(2) With the consent of the institution; or

(3) When the institution already has advised the Farm Credit Administration that it cannot or will not achieve its applicable minimum capital ratios.

(b) Failure to respond within 30 days or such other time period as may be specified by the Farm Credit Administration shall constitute a waiver of any objections to the proposed capital directive.

§ 615.5358 Decision.

After the closing date of the institution's response period, or receipt of the institution's response, if earlier, the Farm Credit Administration may seek additional information or clarification of the response. Thereafter, the Farm Credit Administration will determine whether or not to issue a capital directive, and if one is to be issued, whether it should be as originally proposed or in modified form.

§ 615.5359 Issuance of a capital directive.

(a) A capital directive will be served by delivery to the institution. It will include or be accompanied by a statement of reasons for its issuance.

(b) A capital directive is effective immediately upon its receipt by the institution, or upon such later date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, or terminated by the Farm Credit Administration.

§ 615.5360 Reconsideration based on change in circumstances.

Upon a change in circumstances, an institution may request the Farm Credit Administration to reconsider the terms of its capital directive or may propose changes in the plan to achieve the institution's applicable minimum capital ratios. The Farm Credit Administration also may take such action on its own motion. The Farm

Credit Administration may decline to consider requests or proposals that are not based on a significant change in circumstances or are repetitive or frivolous. Pending a decision on reconsideration, the capital directive and plan shall continue in full force and effect.

§ 615.5361 Relation to other administrative actions.

A capital directive may be issued in addition to, or in lieu of, any other action authorized by law, including cease and desist proceedings, civil money penalties, or the conditioning or denial of applications. The Farm Credit Administration also may, in its discretion, take any action authorized by law, in lieu of a capital directive, in response to an institution's failure to achieve or maintain the applicable minimum capital ratios.

PART 618—GENERAL PROVISIONS

30. The authority citation for part 618 continues to read as follows:

Authority: Secs. 1.5, 1.11, 1.12, 2.2, 2.4, 2.5, 2.12, 3.1, 3.7, 4.12, 4.13A, 4.25, 4.29, 5.9, 5.10, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2019, 2020, 2073, 2075, 2076, 2093, 2122, 2128, 2183, 2200, 2211, 2218, 2243, 2244, 2252).

Subpart A—Related Services

§ 618.8005 [Amended]

31. Section 618.8005 is amended by removing the reference ''§§ 613.3010, 613.3020(a)(1), (a)(2), (b), and 613.3045'' in paragraph (a) and adding in its place, the reference ''§§ 613.3000(a) and (b), 613.3010, and 613.3300'' and by removing the reference ''§§ 613.3110 and 613.3120'' and adding in its place, the reference ''§§ 613.3100, 613.3200, and 613.3300'' in paragraph (b).

Subpart J—Internal Controls

§ 618.8440 [Amended]

32. Section 618.8440 is amended by removing the reference ''§ 615.5200(b)'' and adding in its place, the references ''§§ 615.5200(b), 615.5330 (c) or (d), and 615.5335(b)'' in paragraph (b)(6).

PART 619—DEFINITIONS

33. The authority citation for part 619 is revised to read as follows:

Authority: Secs. 1.7, 2.4, 4.9, 5.9, 5.12, 5.17, 5.18, 7.0, 7.6, 7.7, 7.8 of the Farm Credit Act (12 U.S.C. 2015, 2075, 2160, 2243, 2246, 2252, 2253, 2279a, 2279b, 2279b-1, 2279b-2).

§§ 619.9025, 619.9030, 619.9040, 619.9065, 619.9080, 619.9090, 619.9100, 619.9120, 619.9150, 619.9160, 619.9190, 619.9220, 619.9270, 619.9280, 619.9300, and 619.9310 [Removed]

34. Sections 619.9025, 619.9030, 619.9040, 619.9065, 619.9080, 619.9090, 619.9100, 619.9120, 619.9150, 619.9160, 619.9190, 619.9220, 619.9270, 619.9280, 619.9300, and 619.9310 are removed.

PART 620—DISCLOSURE TO SHAREHOLDERS

35. The authority citation for part 620 continues to read as follows:

Authority: Secs. 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2254, 2279aa-11); sec. 424 of Pub. L. 100–233, 101 Stat. 1568, 1656.

Subpart B—Annual Report to Shareholders

36. Section 620.5 is amended by revising paragraphs (d)(1)(ix) and (g)(4)(ii) to read as follows:

§ 620.5 Contents of the annual report to shareholders.

* * * * *

(d) * * *

(1) * * *

(ix) The statutory and regulatory restriction regarding retirement of stock and distribution of earnings pursuant to § 615.5215, and any requirements to add capital under a plan approved by the Farm Credit Administration pursuant to §§ 615.5330, 615.5335, 615.5351, or 615.5357.

* * * * *

(g) * * *

(4) * * *

(ii) Describe any material trends or changes in the mix and cost of debt and capital resources. The discussion shall consider changes in permanent capital, core and total surplus, and net collateral requirements, debt, and any off-balance-sheet financing arrangements.

* * * * *

PART 626—NONDISCRIMINATION IN LENDING

37. The authority citation for part 626 is added to read as follows:

Authority: Secs. 1.5, 2.2, 2.12, 3.1, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2073, 2093, 2122, 2243, 2252); 42 U.S.C. 3601 *et seq.*; 15 U.S.C. 1691 *et seq.*; 12 CFR 202, 24 CFR 100, 109, 110.

§ 626.6025 [Amended]

38. Newly designated § 626.6025 is amended by removing the reference ''§ 613.3160(b)'' and adding in its place, the reference ''§ 626.6020(b)'' in paragraph (b).

* * * * *

Dated: July 31, 1996.

Nan P. Mitchem,

Acting Secretary, Farm Credit Administration Board.

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