Rules and Regulations

Federal Register
Vol. 63, No. 124
Monday, June 29, 1998

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DEPARTMENT OF JUSTICE

8 CFR Part 3

[EOIR No. 121P; AG Order No. 2162–98]

RIN 1125–AA23

Executive Office for Immigration Review; Motion To Reopen: Suspension of Deportation and Cancellation of Removal; Corrections

AGENCY: Executive Office for Immigration Review, Justice.

ACTION: Interim rule; Corrections.

SUMMARY: The Department of Justice published in the **Federal Register** of June 11, 1998 (63 FR 31890) a document which amended the regulations of the Executive Office for Immigration Review by establishing a new procedure for the filing and adjudication of motions to reopen to apply for suspension of deportation and cancellation of removal pursuant to the Nicaraguan Adjustment and Central American Relief Act. That document, which is an interim rule, contains technical errors that are corrected in this document.

EFFECTIVE DATES: June 29, 1998.

FOR FURTHER INFORMATION CONTACT: Rosemary Hart, Senior Counsel, Office of Legal Counsel, U.S. Department of Justice, 950 Pennsylvania Avenue, NW., Washington, DC 20530, (202) 514–2027 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Need for Correction

As published in the **Federal Register** on June 11, 1998 (63 FR 31890), the interim rule amending part 3 of title 8, Code of Federal Regulation contains technical errors that are in need of correction.

Correction of Publication

Accordingly, the publication on June 11, 1998 (63 FR 31890) of the interim rule that was the subject of FR Doc. 98–15588 is corrected as follows:

PART 3—EXECUTIVE OFFICE FOR IMMIGRATION REVIEW

§ 3.43 [Corrected]

1. On page 31894, in the third column, in § 3.43(b), the paragraph designated as (b)(4)(iv)(c) is correctly redesignated as paragraph (b)(4)(iv)(C).

2. On page 31895, in the first column, in § 3.43, the paragraphs designated as (c) and (d) are correctly redesignated as paragraphs (d) and (e), respectively.

Rosemary Hart,

Federal Register Liaison Officer.

[FR Doc. 98–17108 Filed 6–26–98; 8:45 am]

BILLING CODE 4410–30–M

FEDERAL HOUSING FINANCE BOARD

12 CFR Parts 933 and 935

[No. 98–15]

[RIN 3069–AA69]

Eligibility for Membership and Advances

AGENCY: Federal Housing Finance Board.

ACTION: Final rule.

SUMMARY: The Federal Housing Finance Board (Finance Board) is amending the definitions in its membership and advances regulations relating to combination business or farm properties on which a residence is located. For institutions with total assets of $500,000,000 or less, the amendments eliminate the requirement that at least 50 percent of the value of such properties be attributable to the residential portion of the property, and require instead that the residence constitute an integral part of the property. The amendments are intended to assist smaller depository institutions, particularly those located in rural areas, that have combination farm or business property loans in their portfolios, to qualify for Federal Home Loan Bank (FHLBank) membership and, once admitted, to provide the collateral necessary to obtain FHLBank advances. For those institutions with assets in excess of $500,000,000, the amendments retain the existing 50 percent of value requirement. The amendments also allow loans that would satisfy the statutory and regulatory requirements under the Community Investment Program, or under the community investment cash advance provisions, of the Federal Home Loan Bank Act (Bank Act), to qualify for membership eligibility purposes.

DATES: Effective July 29, 1998.

FOR FURTHER INFORMATION CONTACT: Julie Paller, Senior Financial Analyst, Office of Policy, (202) 408–2842; Neil R. Crowley, Associate General Counsel, (202) 408–2990, Sharon B. Like, Senior Attorney-Adviser, (202) 408–2930, Office of General Counsel; Federal Housing Finance Board, 1777 F Street, N.W., Washington D.C. 20006.

SUPPLEMENTARY INFORMATION:

I. FHLBank System and Finance Board Roles and Responsibilities

Under the Bank Act, the Finance Board is responsible for the supervision and regulation of the 12 FHLBanks. *See* 12 U.S.C. 1422a(a), 1422b(a)(1). Specifically, the Finance Board is responsible for ensuring that the FHLBanks operate in a financially safe and sound manner and carry out their housing finance and community investment mission, and that they remain adequately capitalized and able to raise funds in the capital markets. *See id.* section 1422a(a)(3). The Bank Act also empowers the Finance Board to promulgate and enforce such regulations and orders as are necessary from time to time to carry out the provisions of the Bank Act, including regulations on FHLBank membership eligibility and advances collateral requirements. *See id.* section 1422b(a)(1).

II. Current 50 Percent Test For Loans Secured By Combination Property Under the Membership and Advances Regulations

The regulations of the Finance Board allow certain types of mortgage loans to be used in determining an institution's eligibility to become a FHLBank member and its ability to borrow from the FHLBank, after becoming a member. As described below, loans secured by combination properties can be used for these purposes only if at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property (50 percent test). *See* 12 CFR

933.1(n)(1)(iii), 935.1. For both purposes, that test is the same.

A. Membership Eligibility

Section 4(a) of the Bank Act establishes the eligibility criteria for institutions to become members of the FHLBank System. *See* 12 U.S.C. 1424(a). Section 4(a)(2)(A) of the Bank Act requires, in part, that an insured depository institution have ''at least 10 percent of its total assets in *residential mortgage loans*'' in order to be eligible for FHLBank membership (10 percent requirement). *See id.* section 1424(a)(2)(A) (emphasis added). The Bank Act does not define the term ''residential mortgage loan.'' The Finance Board's current membership regulation defines ''residential mortgage loan'' to include, among other things, a ''home mortgage loan.'' *See* 12 CFR 933.1(bb)(1). The Bank Act defines a ''home mortgage loan'' as ''a loan made by a member or a nonmember borrower upon the security of a home mortgage.'' *See* 12 U.S.C. 1422(5). The Bank Act defines a ''home mortgage'' generally as a mortgage upon real estate ''upon which is located, or which comprises or includes, one or more homes or other dwelling units, all of which may be defined by the [Finance] Board.'' *See id.* section 1422(6). The membership regulation implements these statutory provisions by defining ''home mortgage loan'' to include, in part, a loan secured by a first lien on ''[c]ombination business or farm property where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property.'' *See* 12 CFR 933.1(n)(1)(iii). The term ''combination business or farm property'' means ''real property for which the total appraised value is attributable to residential, and business or farm uses.'' *Id.* § 933.1(i).

B. Eligible Collateral for Advances

Section 10(a) of the Bank Act authorizes a FHLBank to make secured advances to its members and specifies the types of collateral that a FHLBank may accept when originating or renewing an advance. *See* 12 U.S.C. 1430(a). Section 10(a)(1) of the Bank Act requires a FHLBank making or renewing an advance to its members to obtain and maintain a security interest in certain specified types of collateral, among which are ''[f]ully disbursed, whole first mortgages on *improved residential property* (not more than 90 days delinquent).'' *See id.* section 1430(a)(1) (emphasis added). The Bank Act does not define ''residential property'' or ''improved residential property.'' The Finance Board's current advances regulation defines ''improved residential real property'' to mean ''residential real property excluding real property to be improved, or in the process of being improved, by the construction of dwelling units.'' 12 CFR 935.1. The advances regulation defines ''residential real property'' to include, among other things, ''combination business or farm property, provided that at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property.'' *See id.* The term ''combination business or farm property'' means ''real property for which the total appraised value is attributable to the combination of residential, and business or farm uses.'' *Id.*

Thus, in order for a combination farm or business loan to qualify as a ''residential mortgage loan'' for purposes of satisfying the 10 percent requirement under the current membership regulation, or to qualify for purposes of satisfying advance collateral requirements under the current advances regulation, the combination farm or business property securing the loan must meet the 50 percent test.

III. Proposed Rulemaking

A. Derivation and Description of Proposed Rule

In early 1997, the Finance Board was approached by representatives of community depository institutions, particularly those located in rural areas, who advised that they have a need for alternative funding sources to meet credit demands in their communities, which they believed the FHLBank System was well-suited to provide. As discussed in the preamble to the proposed rule, they indicated that community depository institutions, particularly those in rural areas, often are essential to the housing finance activities and the broader economic well being of the communities they serve. Such institutions have less demand for conventional single family and multifamily mortgage credit and their service areas often are characterized by low population density and a low level of economic activity. In such circumstances, those institutions have not been able to originate a substantial number of residential first mortgage loans. Moreover, many loans originated by rural banks are made on the security of family farms, which are in part residential but which often do not meet the 50 percent test. They stated that the 50 percent test thus hinders the ability of rural banks to become FHLBank System members or to take full advantage, as FHLBank members, of the opportunity to obtain advances and thereby serve the credit needs of their communities.

In response to these concerns, the Finance Board had reason to believe that the 50 percent test may operate to exclude some number of residential properties beyond what was intended when the Finance Board adopted the test. Accordingly, the Finance Board reviewed the relevant statutory and regulatory provisions governing membership eligibility and advances collateral and determined, as discussed in greater detail below, that the statute affords sufficient latitude to address the issues by making changes to the current regulations.

In order to confirm whether the concerns raised by the community institutions were well-founded, the Finance Board issued the proposed rule, which would have eliminated the 50 percent test in both the membership and advances regulations, and replaced it with a provision permitting a loan to be eligible if it is secured by ''combination business or farm property, on which is located a permanent structure actually used as a residence, other than for temporary or seasonal housing.'' *See* 62 FR 53251—53 (Oct. 14, 1997). The objective of the proposal was to ease the burdens of the 50 percent test, within the parameters of the statute. Doing so would allow more institutions with combination family farm/residential loans or combination family business/residential loans (such as loans secured by businesses where the family owns and lives in a residential unit above the store) to be eligible for FHLBank membership and borrowing from the FHLBanks. The requirement that any eligible combination property must have a permanent structure actually used as a residence was intended to ensure that the property retained the requisite residential character required by the statute, which was one reason why the Finance Board adopted the 50 percent test. The proposal was not intended to allow large agribusiness or other large commercial loans to be used for membership eligibility and advances collateral purposes.

In addition, the proposed rule defined ''residential mortgage loan,'' for membership eligibility purposes, to include ''[l]oans that finance properties or activities that, if made by a member, would satisfy the statutory requirements for the Community Investment Program [(CIP)] established under section 10(i) of the Bank Act, or the regulatory requirements established for any community investment cash advance program authorized by section 10(j)(10)

of the Bank Act.'' *See* 62 FR 53251—53; 12 U.S.C. 1430(i), (j)(10). The intent of this proposed amendment was to allow such community investment loans to be considered for purposes of eligibility for membership, and to conform the membership regulation more closely to the advances regulation, which already includes loans financed by section 10(i) or section 10(j)(10) advances within the definition of ''residential housing finance assets.'' *See* 12 CFR 935.1.

B. General Discussion of Comments on Proposed Rule

The Finance Board received over 290 comment letters on the proposed rule, which were split relatively evenly between those supporting and those opposing the proposal. The commenters supporting the proposal included five FHLBanks, FHLBank members, prospective members, banking trade associations, and state finance departments. The overwhelming majority of the letters supporting the proposal came from small community banks and thrifts, predominantly in rural areas. The remaining letters supporting the proposal followed closely a comment letter submitted by a banking trade association.

All but one of the comment letters opposing the proposal were from persons or entities associated with the Farm Credit System, a nationwide network of federally chartered, borrower-owned cooperative financial institutions and related service organizations specializing in agricultural loans. The Farm Credit System institutions are major competitors of commercial banks and other farm and rural housing lenders within agricultural credit markets. *See* USDA Economic Research Service Agricultural Economic Report Number 749, ''Credit in Rural America'' (April 1997) at 42–43 (USDA Report). The trade association for the Farm Credit System submitted a detailed comment letter opposing the proposed rule. Nearly all of the remaining comment letters opposing the proposed rule raised substantially the same issues, and many of them were identical.

Commenters supporting the proposal confirmed the views expressed in the proposed rule that there is a need for additional funding sources in rural markets and that the proposal would further the FHLBank System's housing finance mission by making available such funding for combination farm/residential loans, which are important to rural communities. Commenters confirmed that the 50 percent test is under-inclusive, allowing only those combination loans secured by very small farms to be used for membership eligibility and advances collateral purposes. No commenter contended that the 50 percent test adequately captures all of the family farms or businesses that make up combination properties.

Commenters also stated that the 50 percent test may discriminate against lower income individuals, who can afford only a modest residence on their farm, in favor of more affluent persons, who can place a more expensive residence on the same acreage. They contended that the rule has the effect, in practice, of encouraging the FHLBanks and their members to ignore the housing finance needs of the lower income segments of their communities in favor of more wealthy individuals, which is inconsistent with the FHLBanks' housing finance mission. A banking trade association also emphasized that the 50 percent test may be unworkable in practice because even family farms often are appraised based on their ability to generate income, using the ''capitalization approach.'' Under that approach, the residential portion rarely would be valued at a level approaching the 50 percent test, notwithstanding that the residential portion of the property is integral to the success of the farm on which it is located.

Representatives of the Farm Credit System contended, however, that the proposal goes too far in the opposite direction and is apt to be over-inclusive by allowing the use of loans secured by a combination farm or business property with little or no residential value. They argued that eliminating the 50 percent test is inconsistent with the housing finance mission of the FHLBank System, that the test does not hinder rural banks' ability to become FHLBank members, and that rural banks do not have less demand for conventional single family and multifamily mortgages. They also argued that the Finance Board failed to consider the practical consequences and safety and soundness risks of the proposal.

IV. Adoption of Revised Standard in the Final Rule

After considering the information received in the comment letters, as well as its own resources, the Finance Board has decided to adopt the final rule with one substantive change from the proposed rule, and to limit the applicability of that change to community financial institutions, which are defined as those of a certain asset size or less. Each of those actions is intended to address concerns raised by commenters about the possible overbreadth of the proposed rule. The changes will apply to both the membership and advances collateral provisions, and are intended to limit qualifying loans to combination farm/residence and combination business/residence loans that have the requisite residential nexus, and to exclude large agribusiness and other large commercial loans, which do not. Specifically, the final rule amends the definition of ''home mortgage loan'' in § 933.1(n)(1)(iii) of the membership regulation to include a loan secured by ''combination business or farm property, on which is located a permanent structure actually used as a residence (other than for temporary or seasonal housing), *where the residence constitutes an integral part of the property.*'' *See* § 933.1(n)(1)(iii) (emphasis added). That revision would apply only to ''community financial institutions,'' which the final rule defines as institutions with average total assets of $500,000,000 or less, based on the average of total assets over the prior three years. For larger institutions, the current 50 percent test would continue to apply. The definition of ''residential mortgage loan'' in § 933.1(bb)(1) of the membership regulation, because it already includes ''home mortgage loans,'' as defined by these amendments, need not be specifically amended. *See* 12 CFR 933.1(bb)(1). The final rule amends the definition of ''residential real property'' in § 935.1 of the advances regulation in the same manner. Thus, eligible collateral will include loans secured by ''combination business or farm property, on which is located a permanent structure actually used as a residence (other than for temporary or seasonal housing), *where the residence constitutes an integral part of the property.*'' *See* § 935.1 (emphasis added). As with the membership provisions, this amendment would apply only for institutions with average total assets of $500,000,000 or less over the prior three years; larger institutions would remain subject to the 50 percent test.

V. Authority and Reasons for Changing the 50 Percent Test

A. Finance Board's General Statutory Authority

Congress has offered no guidance on how the Finance Board should deal with combination properties. The Bank Act provides no definition of ''residential mortgage loan,'' which is the operative term for purposes of the 10 percent requirement, nor does it speak to what combination properties may be encompassed by the term. *See* 12 U.S.C. 1424(a)(2)(A). The Bank Act does define a ''home mortgage loan'' as ''a loan

made by a member or a nonmember borrower upon the security of a home mortgage.'' *See id.* section 1422(5). The Bank Act also defines a ''home mortgage'' generally as a mortgage upon real estate ''upon which is located, or which comprises or includes, one or more homes or other dwelling units, all of which may be defined by the [Finance] Board.'' *See id.* section 1422(6). The statute does not speak directly to the issue of what constitutes a combination property for purposes of these definitions, nor does the language used by Congress (''upon which is located, or which comprises or includes'') suggest that the residential portion of a combination property must meet any specified threshold in order for a mortgage on such property to qualify as a ''home mortgage.'' Indeed, the only statutory mandate, with respect to eligibility for membership, is that the loan must be secured by real estate on which there is located, or which comprises or includes, a home or dwelling unit. *See id.* Moreover, the statute expressly authorizes the Finance Board to define all of those terms.

Congress has offered no more guidance in the context of eligible collateral for advances. Section 10(a) of the Bank Act authorizes each FHLBank to make secured advances to its members upon collateral sufficient, in the judgment of the FHLBank, to fully secure the advances. *See id.* section 1430(a). The Bank Act sets forth the types of collateral that may secure an advance, including ''[f]ully disbursed, whole first mortgages on *improved residential property* (not more than 90 days delinquent).'' *See id.* section 1430(a)(1) (emphasis added). Again, with regard to what is encompassed by ''residential property'' or ''improved residential property,'' Congress has opted to remain silent and has not defined the terms. Thus, with respect to the use of whole first mortgages as collateral for advances, the only statutory mandate is that they attach to real property that previously has been improved by the construction of a residence. *See id.*

In considering the comments and determining the terms of the final rule, the Finance Board has been mindful of the requirement that it is bound ultimately by the ''unambiguously expressed intent of Congress.'' *See Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842–43 (1984) (*Chevron*); *Independent Banks Association of America, and American Bankers Association* v. *Farm Credit Administration*, Civil Action No. 97–00695 (Memorandum Opinion) (Nov. 24, 1997) at 8 (*IBAA*). As noted previously, Congress has opted not to define ''residential mortgage loan'' and ''improved residential property,'' which are the operative terms in the Bank Act underlying these amendments to the membership and advances regulations. Moreover, the only terms that Congress has defined, ''home mortgage'' and ''home mortgage loan,'' are not implicated in the statutory provisions here at issue. Even if they were, Congress has defined them in such a way that does not address combination properties, and Congress has expressly authorized the Finance Board to define the terms of the definitions. Because there is nothing in the plain language of the Bank Act that mandates that the residential portion of combination properties constitute a specified percentage of the property's total appraised value, the Finance Board, in the exercise of its informed discretion, must interpret ''residential mortgage loan'' and ''improved residential property'' for this purpose and must do so in a manner that is ''permissible'' in light of the statute's structure and purpose. *See Chevron*, 467 U.S. at 843–45; *IBAA* at 8.

B. Reasons for Changing the 50 Percent Test

1. Bank Act and Legislative History Do Not Provide Particular Direction

Just as there is nothing in the plain language of the Bank Act that suggests how to define ''residential mortgage loan'' and ''improved residential property,'' there is nothing in the legislative history of the Bank Act that indicates an intent of Congress about how to define these terms, both of which were adopted by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. Law 101–73, 108 Stat. 183 (August 9, 1989). *See* FIRREA, §§ 704(a), 714(a). FIRREA added the 10 percent ''residential mortgage loans'' requirement to section 4 of the Bank Act. *See* FIRREA, § 704(a). The Conference Report accompanying FIRREA states that, in order to qualify for membership in a FHLBank, insured depository institutions ''must have at least 10 percent of their assets in residential mortgage loans, including 1–4 family, multifamily and funded residential construction loans, to qualify for membership.'' *See* Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. 101–222, 101st Cong., 1st Sess. at 424 (1989) (FIRREA Conference Report). That statement is not particularly helpful because the use of the term ''including'' indicates that it is at best a non-exclusive illustrative list of some types of loans that Congress viewed as qualifying as ''residential mortgage loans.''

The legislative history also indicates that the 10 percent requirement was the product of a legislative compromise. The Senate bill would have required a commercial bank to meet the Qualified Thrift Lender (QTL) test, as revised by the Senate bill, in order to be eligible for FHLBank membership. The QTL test, both before and after FIRREA, required a savings association to maintain a certain percentage of its assets in ''qualified thrift investments'' (QTIs), which FIRREA defined in some detail. The FIRREA Conference Report describes QTIs as ''housing finance and related activities.'' *See id.* at 407. The House bill would not have required commercial banks to meet any quantitative assets test to be eligible for FHLBank membership. In conference, the agreed upon compromise was to replace the Senate's QTL threshold test with the 10 percent residential mortgage loans requirement.

The understanding of the Congress in reaching this compromise is not evident from the legislative history. What is evident from the statutes, however, is that Congress chose diametrically opposed approaches for dealing with the concepts of QTIs and ''residential mortgage loans'' or ''improved residential property,'' respectively. Congress took great care to define by statute the categories of assets that could be considered to be QTIs. *See* FIRREA, § 303(a). Moreover, Congress quite clearly expressed its intent that the QTI categories established by statute were not to be modified, stating that the QTI assets ''are specifically defined so as to prevent the inclusion of other assets by regulatory interpretation.'' *See* FIRREA Conference Report at 407. In contrast, Congress did not define what may be included in ''residential mortgage loans'' for purposes of the 10 percent requirement, nor did it include any comparable language in the FIRREA Conference Report. If any inference can be drawn from this meager legislative history, it is that Congress must have intended to leave the implementation of these terms to the informed judgment of the Finance Board. Had it intended otherwise, it could have defined the terms by statute or unequivocally expressed its intent as to how the provisions are to be applied, both of which it did, in the same law, for the QTL test.

Regarding eligible collateral for advances, prior to FIRREA each FHLBank was authorized to make

secured advances to its members upon such security as the Federal Home Loan Bank Board (FHLBB) may prescribe. *See* 12 U.S.C. 1430(a) (1989). FIRREA amended section 10(a) to establish specific categories of eligible collateral that a FHLBank may accept as security for advances to members. *See* FIRREA, § 714(a). Section 10(a)(1) eligible collateral includes ''fully disbursed, whole first mortgages on *improved residential property* (not more than 90 days delinquent). *See* 12 U.S.C. 1430(a)(1) (emphasis added). The FIRREA Conference Report refers to the eligible collateral as ''low risk assets'' and describes the section 10(a)(1) collateral generally as ''current first residential mortgage loans.'' *See* FIRREA Conference Report at 427. The FIRREA Conference Report does not further define ''improved residential property'' or ''residential mortgage loans'' for advances collateral purposes. For the reasons described for membership purposes, it appears as well that Congress intended to allow the Finance Board to further define these terms.

2. The 50 Percent Test Is Purely a Regulatory Creation That Can Be Changed for Good Reason

The 50 percent test was purely a regulatory creation of the Finance Board, adopted on the assumption that requiring at least half of the value of the combination property to be attributable to a residence would ensure that such properties possess the residential nexus required by the statute and still meet the housing finance needs of rural and other communities. In retrospect, it appears that the decision to rely on the 50 percent test in all cases was unduly restrictive, because properties not meeting the test still might possess substantial residential characteristics that could be recognized for membership and advances collateral purposes, consistent with the statute. After considering the comments in favor of the proposal, the Finance Board is persuaded that the 50 percent test is not operating in practice to serve the purposes intended. Indeed, it appears more likely that the test operates in some cases to frustrate the mission of the FHLBank System by excluding important elements of both rural and urban housing finance markets. The Finance Board is particularly concerned about comments indicating that the test discriminates against lower income persons, effectively precluding current and prospective FHLBank members from using FHLBank services to address the housing finance needs of that segment of the population.

As a general matter, an agency is free to change its interpretation of its statute so long as its actions are rational, reasonable, not arbitrary and capricious, involve no clear error of judgment, and a satisfactory explanation for its actions is included in the record. *See, e.g.,* 5 U.S.C. 706(2)(A); *Motor Vehicle Mfrs. Ass'n of United States, Inc.* v. *State Farm Mutual Auto. Ins. Co.,* 463 U.S. 29, 41–43 (1983); *Camp* v. *Pitts,* 411 U.S. 138, 142 (1973) (per curiam); *IBAA,* at 8–9. This test is ''not particularly demanding,'' even when the agency action consists of a change in a long-standing regulatory position on a particular issue. *See, e.g., Republican Nat. Committee* v. *Federal Election Com'n.,* 76 F.3d 400, 407 (D.C. Cir. 1996), *cert. denied,* 117 S.Ct. 682 (1997); *IBAA* at 9. In fact, an agency is charged with the responsibility of continually evaluating the appropriateness of its regulatory policy, even regulatory policy already adopted. *See Chevron,* 467 U.S. at 863–64; *IBAA* at 9.

3. Specific Reasons for Changing the 50 Percent Test

Commenters supporting the proposal confirmed that it would further the FHLBank System's housing finance mission by making available a needed source of funding for combination farm/residential loans, which are important to rural communities. Commenters also confirmed that the 50 percent test is under-inclusive, allowing only those combination loans secured by very small farms to be used for membership eligibility and advances collateral purposes. No commenter contended that the 50 percent test precisely captures all of the family farms or businesses that make up combination properties having a sufficient residential nexus. The Finance Board is of the view that the 50 percent test is unnecessarily severe in excluding bona fide residences simply because the non-residential portion may have a greater value than the residential portion.

One difficulty in relying exclusively on an objective test, such as the 50 percent test, is that it is apt to be over- or under-inclusive because of geographic variations. Another difficulty with the 50 percent test is that it may discriminate against lower income individuals, who can afford only a modest residence on their farm, in favor of more affluent persons, who can place a more expensive residence on the same acreage. One commenter raised precisely that issue, providing examples of the value of certain types of residences in relation to given acreage of farmland. A rule that encourages the FHLBanks and their members to ignore the housing finance needs of the lower income segments of their communities in favor of more wealthy individuals is not consistent with carrying out the housing finance and community investment mission of the FHLBanks, which relates to all segments of the market.

Farm Credit System commenters contended, however, that the proposal to eliminate the 50 percent test without providing a substitute standard went too far in the opposite direction and is apt to be over-inclusive by allowing the use of loans secured by a combination business or farm property, even if the property were to possess only the barest of residential characteristics. The Finance Board believes that there may be merit in that argument, at least on the point that the proposed rule might be construed by some as allowing properties with only the slightest residential component to be included as residential property. The proposal was not intended to be applied in the manner suggested by the commenters. Nor was it intended to allow a FHLBank to characterize large agribusiness and other large commercial loans as residential loans. Instead, it was intended to make the definitions recognize and conform to the practical realities of the residential housing finance markets in rural communities. The Finance Board agrees that the final rule should incorporate some further standard that more clearly expresses the Finance Board's intention to preclude the use of loans having only minimal residential characteristics.

Therefore, the Finance Board is revising the definitions of ''home mortgage loan'' and ''residential real property'' in the final rule to include a standard that would limit qualifying loans to combination farm/residence and combination business/residence loans with a sufficient residential nexus. The final rule also limits the application of the revised definition to institutions with assets of $500,000,000 or less. By narrowing the substance of the definition and by limiting its applicability, the Finance Board intends to target the benefits of the rule change more precisely on the housing finance and community investment mission of the FHLBank System, and to exclude the types of large agribusiness and other large commercial loans that were of concern to some commenters. Specifically, the final rule amends the definition of ''home mortgage loan'' in § 933.1(n)(1)(iii) of the membership regulation to include a loan secured by ''combination business or farm property, on which is located a permanent structure actually used as a residence

(other than for temporary or seasonal housing), *where the residence constitutes an integral part of the property.*'' *See* § 933.1(n)(1)(iii) (emphasis added). The amended rule would apply only to institutions with average total assets of $500,000,000 or less, determined over a three-year period; for larger institutions, the current 50 percent test would remain in effect. The definition of ''residential mortgage loan'' in § 933.1(bb)(1) of the membership regulation includes the term ''home mortgage loans,'' as defined in § 933.1(n)(1)(iii), and therefore, need not be specifically amended in order to include these revisions. *See* 12 CFR 933.1(bb)(1). The final rule amends the definition of ''residential real property'' in § 935.1 of the advances regulation in a similar manner. *See* § 935.1.

The intent of the Finance Board in adding the ''integral'' requirement is to create a standard that will include only those combination properties where the residence is inextricably linked to the non-residential portion, such as in what is commonly understood as a family farm or a family business with a residence ''above the store.'' What constitutes such a property will vary from region to region across the country; what constitutes a family farm in the western states, for example, might well be larger in size than what constitutes a family farm in New England, although the residential portion of each property may be of comparable size. The Finance Board believes adding the ''integral'' requirement will allow additional latitude for the FHLBanks by providing for the inclusion of loans secured by property containing a residence whose value cannot be inconsequential in relation to the overall value of the property, while excluding the types of large agribusiness and other large commercial loans that concerned the commenters.

By adopting a more subjective standard, the Finance Board intends to allow the FHLBanks, which are in a better position to know what constitutes a family farm or business within their districts, to determine for themselves which combination properties include a residence that is so inextricably linked to the remainder of the property as to be integral to the property as a whole. That is a particularly fact-specific determination. For example, the ''integral'' standard would not necessarily preclude non-contiguous farm parcels that secure the same loan, so long as, in the judgment of the FHLBank, all of the parcels satisfy the ''integral'' standard. Clearly, a parcel's proximity to the residence is apt to be a principal consideration in determining whether the two properties are ''inextricably linked'' for these purposes. In any event, these would be matters for the FHLBank to address. Likewise, the FHLBank must determine how much documentation shall be provided by prospective and current members in order to show that particular loans and their collateral satisfy the standard. The Finance Board expects to review the FHLBanks' implementation of the standard as part of the annual examination process and will monitor compliance with this provision.

Limiting the applicability of the revised definitions to institutions with assets of $500,000,000 or less would further address the concerns of some commenters that the proposed rule could be manipulated to allow very large commercial and large agribusiness loans to be considered as ''residential'' simply by including a residence on the underlying property. The Finance Board never intended the proposed rule to encompass purely commercial or business loans, and has incorporated the ''integral'' standard into the final rule in order to ensure that any combination loan used for membership or collateral purposes would have the requisite residential nexus. Nonetheless, the Finance Board also believes that the inclusion of an additional safeguard against the concerns expressed by the commenters would be consistent with its goals and with the Bank Act.

One means of lessening the likelihood that an institution could mischaracterize large commercial or large agribusiness loans as ''residential'' is to limit the maximum size of the loans that may qualify under the ''integral'' standard. That result may be achieved indirectly by limiting the size of the institutions that may take advantage of the amended rule, because the maximum dollar amount of loans that a depository institution may make is tied to its capital levels, which in turn are a function of its size. As a general matter, depository institutions are barred from extending credit to any one borrower in an amount exceeding 15 percent of their capital and surplus. 12 U.S.C. 84(a)(1). That lending limit applies to the aggregate amount of all loans made to a single ''borrower,'' which term may encompass other related persons and entities. *See* 12 CFR 32.5.

Although the dollar amount of the lending limit will vary from institution to institution, the approximate cap for institutions with assets of $500,000,000 or less should be sufficiently small to preclude the type of large commercial and large agribusiness loans cited by the commenters. For example, a depository institution must maintain minimum total capital equal to 8 percent of its ''risk-weighted assets.'' *Id.* Part 3, App. A, Sec. 4(b). Using that as a proxy for actual capital, and assuming a 100 percent risk-weighting (which in practice is unlikely to be the case), an institution with assets of $500,000,000 might have capital of approximately $40,000,000, with a lending limit of approximately $6,000,000. An institution with $100,000,000 in assets might have a lending limit of approximately $1,200,000. Those limits would apply to the total amount of all loans made to a single borrower, and thus would encompass both residential loans of the type permitted under these amendments, as well as any commercial or personal loans. Moreover, as a matter of sound banking practice, depository institutions do not generally lend to the full amount permitted under their lending limit, so the Finance Board anticipates that the dollar amounts of loans made are apt to be considerably smaller than these rough estimates. The Finance Board believes that effectively placing the qualifying loans within the lending limits of members and prospective members should help ensure that the loan amounts, and hence their purposes, are more likely to be for bona fide residential combination properties and not for large commercial or large agribusiness loans.

4. Other Alternatives Considered

In attempting to reconcile the competing interests of commenters, the Finance Board considered various other options for defining qualifying ''residential mortgage loans'' and ''residential real property.'' As discussed further below, in the Finance Board's view, none of these alternatives would satisfactorily achieve the goal of including true combination family farm and business loans, both of which have the residential nexus required by the Bank Act, while excluding large agribusiness and other large commercial loans, which do not.

For example, the Finance Board considered adopting a specific percentage test other than the 50 percent test. Such a test would ensure that the property securing the loan has a greater residential component than under the proposal, while continuing to qualify more loans that now fail the 50 percent test. However, such a test would establish a national standard that likely would remain under-inclusive, that could not reflect differences in local real estate values, and would continue to exclude from membership and borrowing any rural institutions with combination farm or business loans that

could not meet the reduced percentage test, regardless of whether the underlying properties included bona fide residences. For example, as a commenter pointed out, even such a modified test likely would exclude family ranches in areas where the land is very valuable relative to the residence. The test also would create operational difficulties where the existing appraisals held by the members originating the loan do not separate the value of the residence from the value of the entire property.

The Finance Board also considered adopting a specific acreage limit or dollar limit as a proxy for identifying a family farm or business, *i.e.*, the combined farm property securing the loan could not exceed a specific acreage limit, or the combination farm or business loan could not exceed a specific dollar amount. If the acreage limit or dollar limit were set low enough, the standard likely would qualify small combination family farm or business loans, while excluding large agricultural and other business loans. However, as pointed out by a commenter, such limits once again would establish national standards that cannot reflect differences in local business operations and real estate values. The acreage size limit likely would be under-inclusive, excluding some large-acreage farms that would be considered to be family farms in certain locales, such as ranching areas. The dollar limit likely would have the same problem, effectively requiring the establishment of a nationwide standard that would not necessarily reflect local market differences. In addition, an acreage limit or dollar limit, by itself, would not necessarily guarantee an adequate residential nexus, which the statute requires.

One FHLBank commenter suggested that the Finance Board adopt an employee-based or ownership-based standard as a surrogate for small combination family farm and business loans. Such an approach would limit a qualifying farm or business obtaining the loan to no more than a specific number of full-time equivalent employees. The commenter suggested using 100 employees as an appropriate level. The commenter also proposed limiting a farm or business corporation obtaining the loan to no more than a specific number of shareholders, such as 10 shareholders. Such standards likely would encompass many of the type of loans intended by the Finance Board, while excluding large agricultural and other large business loans. However, again, this approach would establish a national standard that would not work in all locales. It also would be very difficult for the Finance Board to ascertain how many employees or shareholders are typical for a family farm or business throughout the country, and then craft a regulation based on that information. In addition, an employee or shareholder test, by itself, would not necessarily guarantee an adequate residential nexus, which the statute requires.

Another option considered was to require that the combination farm or business property securing the loan be owner-occupied. Such a standard would exclude loans secured by large farms with only a caretaker's residence located on the property. However, a commenter indicated that this standard would be under-inclusive because it would exclude a significant number of combination family farm or business loans where a family member lives in the residence on the property but the residence is owned in the name of another family member or a family-owned corporation. Defining ownership also could create problems in implementation of the standard, and possible conflicts with state laws.

Another option presented was to limit the farm or business obtaining the loan to family partnerships or proprietorships, *i.e.*, not corporations, on the theory that this would serve as a surrogate for small combination family farm and business loans. However, as a commenter pointed out, such a standard also would be under-inclusive because it would eliminate many small family farms that are incorporated for tax or other reasons.

The Finance Board also considered an option supported by a FHLBank commenter to establish a ''materiality'' standard for the residential portion of the combination property, with each FHLBank adopting its own criteria for determining ''materiality'' based on local conditions. Such a standard could be an independent requirement or combined with a reduced percentage test. The standard would ensure that the property securing the loan has a ''material'' residential component, and would reflect differences in local combination farm or business properties, which a national standard cannot do, thereby qualifying more combination farm or business loans held by rural institutions that might otherwise fail the 50 percent test or a reduced percentage test. However, the term ''material'' is a term of art in other areas of the law, such as the federal securities laws, and its use here might prompt unintended and undue reliance on a standard established under a body of law unrelated to the FHLBanks.

C. Comments on Finance Board's Authority to Change the 50 Percent Test

1. Mission and Goals of the FHLBank System

The Farm Credit System commenters contended that the proposed rule would be inconsistent with the housing finance mission of the FHLBank System, principally because it would have allowed the use of loans for membership and collateral purposes that are not predominantly residential in nature. As described previously, the final rule requires not only that any eligible combination property must include a bona fide permanent residence, but that the residential component of the property must be ''integral'' to, or inextricably linked with, the overall parcel.

The Finance Board believes that the ''integral'' standard will ensure that any loan secured by such combination property will have the necessary residential nexus required by the Bank Act, and thus will be consistent with the FHLBanks' housing finance mission. The ''integral'' standard may well allow the use of some loans secured by combination properties even if the value of the residential portion of the property does not predominate, but the Bank Act clearly permits that possibility, for reasons discussed previously. Moreover, the housing finance mission of the FHLBanks includes a community investment component, and the final rule is consistent with that aspect of the mission as well. In 1989, the Congress mandated that each FHLBank must establish a Community Investment Program (CIP); Congress also expressly permitted the FHLBanks to establish additional community investment cash advance programs (Section 10(j)(10) programs). *See* 12 U.S.C. 1430(i), (j)(10).

Under the CIP, ''community-oriented mortgage lending'' includes loans to finance commercial and economic development activities that benefit low- and moderate-income families or activities that are located in low- and moderate-income neighborhoods. *Id.* at 1430(j)(2). The Finance Board previously has determined that such targeted commercial and economic development lending constitutes ''residential housing finance,'' for purposes of allowing long-term CIP advances. *See* CIP Policy Statement, Board Resolution No. 92–533 (July 17, 1992); 12 CFR 935.1, 935.14(b)(2). The section 10(j)(10) provisions do not specify any targeting requirements, which suggests that Congress contemplated that Section 10(j)(10) programs need not have the same targeting or other eligibility

requirements as are required under the CIP.

It is possible under these provisions for a FHLBank to fund targeted commercial or economic development that has no ''residential'' component, at least in the sense contemplated by the Farm Credit System commenters. Yet, the Finance Board has determined that such funding would be part of the FHLBank's housing finance mission, as described above. It would be anomalous to find that a targeted loan for wholly commercial or economic development purposes is so clearly within the mission of the FHLBanks, but that a combination loan, even if similarly targeted, would somehow be beyond the housing finance mission because it may be in part related to a commercial business or farm property. The Finance Board believes that some number of rural and urban combination properties will necessarily be located in low-and moderate-income neighborhoods. Further, limiting the size of the institutions eligible to use the revised standard, and thereby limiting the size of the combination loans to be made by these institutions, is itself a method of targeting the use of this standard to the communities and uses most in need of the relief. To accept the reasoning of the Farm Credit System commenters and conclude otherwise would require the Finance Board to ignore the community investment aspect of the housing finance mission, which it is not prepared to do. In the view of the Finance Board, the final rule is consistent with both the historical concept of residential housing finance, as well as the more broadly defined concept incorporated by Congress into the Bank Act in 1989.

2. ''Rational'' Basis for Changing Prior Agency Statutory Interpretation

Some of the commenters opposing the proposed rule contended that the proposal should be withdrawn as inconsistent with the Finance Board's prior interpretations of the statutory provisions, suggesting that the Finance Board has ignored those interpretations and is obliged to adhere to them. The commenters noted, for example, that in the original rulemaking when the 50 percent test for advances collateral purposes was adopted, the Finance Board rejected a commenter's suggestion to set the limit at 10 percent, explaining that the higher percentage better reflected the FHLBanks' focus on housing finance. *See* 58 FR 29456, 29462 (May 20, 1993). Opposing commenters now question the authority of the Finance Board to take what they believe is a conflicting position.

The Finance Board by no means has ignored its prior positions and interpretations relating to the 50 percent test. To the contrary, the Finance Board has carefully and thoroughly considered its past approaches to this issue, all of the comments and suggestions received in response to the proposed rule, and various alternative approaches. The Finance Board has elected now to adopt an approach that is consistent with its prior intentions yet, at the same time, better accomplishes its intentions, is more flexible and allows for more subjective analysis in lieu of rigid adherence to a fixed percentage test.

As previously noted, an agency is free to change its interpretation of its statute so long as its actions are rational, reasonable, not arbitrary and capricious, involve no clear error of judgment, and a satisfactory explanation for its actions is included within the record. *See, e.g.,* 5 U.S.C. 706(2)(A); *Motor Vehicle Mfrs. Ass'n,* 463 U.S. at 41–43; *Camp,* 411 U.S. at 142; *IBAA,* at 8–9.

Nothing in the Bank Act or in the Administrative Procedure Act alters the agency's authority in this regard. In fact, deference is given to the administering agency's construction of an ambiguous statute if it is ''permissible'' or ''reasonable'' in light of the statute's overall structure and goals. *Chevron,* 467 U.S. at 843–45. Deference to the Finance Board's policy judgments is particularly appropriate given its expertise and the broad discretion Congress has conferred upon it. The Finance Board regulates in an area—the financial services context where courts have customarily deferred to evolving administrative interpretations of statutory language as a means of accommodating changes in the market place and customers' service needs. *See, e.g., Clarke* v. *Securities Industry Ass'n,* 479 U.S. 388, 403–09 (1987); *Board of Governors of Federal Reserve System* v. *Investment Company Institute,* 450 U.S. 46, 56–58, 68 (1981). A notable example of such deference is *IBAA* v. *Clarke,* where the court, deferring to a statutory construction by a federal banking regulatory agency that recognized ''the realities of banking in the nineties'' and that ''the financial industry is complex and changing,'' concluded that ''[t]his kind of regulatory and competitive environment is especially suited to the expert judgment of regulators accustomed to dealing with the industry day to day.'' 917 F.2d 1126, 1129 (8th Cir. 1990). Thus, it is firmly established that the Finance Board is entitled to deference as the agency charged with administering the Bank Act. *See Rust* v. *Sullivan,* 500 U.S. 173, 184, 186–187 (1991).

Change in statutory interpretation is not a problem ''since the whole point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agency.'' *Smiley* v. *Citibank (South Dakota), N.A.,* 116 S.Ct. 1730, 1734 (1996). As the U.S. Supreme Court emphasized in *Chevron,* ''an initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis.'' 467 U.S. at 863–64. That is what the Finance Board is doing through this rulemaking.

3. Ability of Rural Banks to Become FHLBank Members; Need for FHLBank Credit

Some commenters argued that the Finance Board offered no reasoned explanation or empirical data to support its departure from prior practice. The Farm Credit System trade association argued that the 50 percent test should be retained because it does not hinder rural banks' ability to become FHLBank members, and rural banks do not have less demand for conventional single family and multifamily mortgages.

As an initial matter, there is nothing that requires the Finance Board to conduct empirical studies as a prerequisite to conducting a rulemaking proceeding. Indeed, there are any number of issues on which an agency may regulate, such as interpretations of a statute, where empirical analysis would have little relevance or benefit. An empirical study of rural credit and housing markets might better inform the Finance Board about certain aspects of those markets. It would be of no use, however, in determining what minimum residential characteristics are required by Congress in order for loans on combination properties to be eligible for membership and advances collateral purposes, which is the issue addressed by this rule.

That said, in adopting this final rule, the Finance Board has considered studies prepared by other parties as sources of information about the need for alternative funding sources for rural banks and the state of rural credit markets. *See* USDA Report; ''Second Annual Community Bank Competitiveness Study,'' ABA/ABA Banking Journal (Feb. 1998); Farm Credit Situation Survey Report 1997 (American Bankers Association 1997). The Finance Board also has taken into consideration its initial discussions with industry representatives about the shortcomings of the 50 percent test, as well as the comments supporting the proposal, which confirm the need for

alternative funding sources for rural banks and the likelihood that the proposal would address that need. The Finance Board does not believe that it is required to undertake further independent empirical research of the rural credit and housing markets in order to exercise its rulemaking authority.

The Farm Credit System trade association cited to a statement in the USDA Report that, ''[n]ationwide, rural-headquartered commercial banks are as likely to be members of the [FHLBank System] as are other banks'' to support its views. *See* USDA Report at 48 n.19. However, the commenter also acknowledged in a footnote that, ''[n]otwithstanding this conclusion, the [USDA] Report noted that 'rural access' to FHLBank membership was of 'some concern' in three isolated markets.'' What the commenter characterizes as three ''isolated markets'' are in fact three FHLBank districts—Des Moines, Dallas and Topeka—which encompass 14 states. Moreover, the USDA Report indicates that there are a total of 900 ineligible rural banks in these districts. *See id.* The purpose of the Finance Board's rule is to assist some of these 900 rural banks in joining and borrowing from the FHLBank System, as well as to assist current members in increasing their borrowing capacity. Two of the FHLBanks cited in the USDA Report, Des Moines and Topeka, submitted comment letters strongly supporting the proposal. The Des Moines letter stated that eliminating the current 50 percent test will enable over 600 of the FHLBank's current small community bank members with assets under $100 million to fully use FHLBank funding. In addition, the FHLBank estimated that the expansion of the membership eligibility criteria to include these combination loans will enable approximately 700 more financial institutions to join the Des Moines FHLBank. (The USDA Report estimated 322 ineligible rural banks in the Des Moines district, *see id.;* therefore, it is assumed that the estimate of 700 ineligible institutions provided by the Des Moines FHLBank covers non-rural as well as rural institutions.)

In addition, the USDA Report states that there are concerns about whether rural offices of large urban banks effectively serve their rural customers. *See id.* at 63. The USDA Report also states that rural FHLBank members are larger and hold a greater ratio of mortgage-related assets than other rural banks that are not FHLBank members. *See id.* at 48 n.19. This suggests that smaller banks and their rural customers may be underserved at present and that increased FHLBank access by small rural banks is needed. Notwithstanding the arguments of the Farm Credit System commenters, it appears that the information in the USDA Report actually supports the Finance Board's view that the 50 percent test operates in practice to hinder the ability of rural banks to become FHLBank members.

In addition, in a subsequent comment letter the Farm Credit System trade association suggested that it is concerned with commercial bank competition in the agricultural markets and indicated that there are already two government sponsored enterprises (GSEs) serving the credit needs of agriculture—the Farm Credit System and the Federal Agricultural Mortgage Corporation (Farmer Mac). As previously stated, many family farm/residential loans, while not meeting the 50 percent test, have a sufficient residential nexus to ensure consistency with the FHLBank System's housing finance and community investment mission. Because it is within the missions of the Farm Credit System and Farmer Mac, as well as the FHLBank System, to support the rural housing markets, there is clearly some overlap in the markets served by different GSEs. Such overlap can result in competition among GSEs.

The primary benefit afforded to GSEs is the ability to borrow at rates only slightly higher than Treasury borrowing rates. The Farm Credit System, Farmer Mac and the FHLBanks all receive this benefit by virtue of their GSE status. In return for this benefit, GSEs have a responsibility to fulfill a public policy mission. One of the ways that GSEs fulfill their mission is by passing along their funding advantage to the end user. The FHLBank System's housing finance and community investment mission requires the FHLBanks to provide funds to financial institutions in all markets, including rural markets that also may receive some assistance from one or more other GSEs. To the extent that other GSEs also provide government subsidized assistance to certain rural markets, the revisions to the FHLBanks' membership and collateral provisions do not result in an introduction of a new subsidy to these markets, but rather provide another source of government-subsidized funding. In fact, competition among GSEs can be viewed as a positive development because it helps ensure that government subsidies flow to the end user and not to the GSE's managers and shareholders.

The Farm Credit System trade association also argued that its analysis of the likely membership effects of the proposed rule does not suggest that rural banks would uniquely benefit from elimination of the 50 percent test. The commenter indicated that, based on its own analysis of the loan portfolios of non-metropolitan and metropolitan banks, membership eligibility for non-metropolitan banks would increase approximately 10.5 percent, while membership eligibility for metropolitan banks would similarly increase by more than 8 percent.

Although the proposed rule was issued in response to concerns raised by rural banks, and is intended specifically to assist rural banks in accessing the FHLBank System, the Finance Board did not intend that such benefits accrue solely to rural banks. These amendments apply as well to combination properties involving a non-farm business and a residence, and it is anticipated that loans secured by such properties located in urban areas also will be used by members and prospective members as a result of this rule. The mission of the FHLBank System includes the provision of funds to financial institutions located in all areas of the country, and to the extent the rule assists non-rural, as well as rural, banks, it is entirely consistent with the FHLBank System's mission.

The Farm Credit System trade association also claimed that statements made in support of the proposed rule contradict and must be reconciled with past Finance Board statements to Congress. Specifically, the Finance Board has stated that ''[e]ligible [other real estate related] collateral for [FHLBank] System advances is already very broad,'' and ''[t]here is no evidence that advance demand is constrained by a lack of eligible collateral.'' *See* Finance Board *Report on the Structure and Role of the Federal Home Loan Bank System* at 167 (March 19, 1993).

The advantages of expanding the scope of that category of eligible collateral were not considered to be significant at that time. *See id.* However, as acknowledged by the commenter, the Finance Board separately recommended that Congress permit the FHLBanks to accept a broader range of collateral to secure advances in order to carry out the FHLBank System's mission as defined by the Finance Board. *See id.* In addition, as explained in the proposed rule, since adoption of the 50 percent test, the Finance Board has received new information from members and nonmembers of the FHLBank System indicating that the 50 percent test has proven to be under-inclusive and, consequently, is constraining advance demand in certain markets. This was confirmed by a significant number of commenters, many of whom contend

that eliminating the 50 percent test would further the FHLBank System's housing finance mission by making available a needed source of funding for combination farm/residential loans.

4. Practical Consequences of Changing the 50 Percent Test

The Farm Credit System trade association also argued that the Finance Board failed to consider the practical consequences of the proposal. For instance, the commenter stated that the proposed rule did not indicate how, with a substantial increase of eligible collateral, the Finance Board would reconcile the credit demand in rural markets with the potential impact on credit supply. The commenter estimated that more than $18 billion in loans held by non-metropolitan banks could be newly pledged as collateral for FHLBank advances. The commenter argued that such an analysis is one essential predicate to deciding whether the proposed rule is appropriately tailored to the Finance Board's statutory housing mission.

The most likely practical consequences resulting from the final rule are that some number of rural institutions will become eligible to become members of the FHLBank System, will do so, and will borrow from their FHLBank to finance residential housing within their communities. Obviously, if the rule has the desired effect, there should be some corresponding increase in the aggregate amount of advances outstanding, which currently total approximately $208 billion System-wide. The Finance Board has no reason to believe that an additional $18 billion of collateral, assuming for the sake of argument that $18 billion is an accurate figure, will overwhelm the credit markets. For one thing, some portion of that amount will be owned by institutions that choose not to become members, and some will be owned by members who will not borrow to their full potential. Additionally, the FHLBanks all have credit policies that establish discounts for various types of collateral. Given the circumstances and the prudent underwriting by the FHLBanks, the Finance Board would expect that any FHLBank accepting newly-authorized loans on combination properties would significantly discount those loans pledged as collateral. This discounting, or overcollateralization, would further diminish the amount of credit that the newly-authorized collateral could support. Moreover, the insured depository institutions that presumably would be borrowing against this collateral are regulated by other agencies, which require the institutions they regulate to limit asset growth to what is prudent. *See* 12 CFR Part 30, App. A, § II.F. The Finance Board believes that those operational and regulatory checks will preclude any undue consequences in the rural credit markets as a result of this rule.

5. Safety and Soundness Risks of Changing the 50 Percent Test

The Farm Credit System trade association also stated that the Finance Board did not indicate how it will address the fact that a mortgage on a combination property may be less liquid and marketable than a conventional home mortgage. The commenter stated that a safety and soundness issue may arise where a prospective member lender lacks the necessary understanding of the agricultural lending process, which may result in compromised underwriting practices and poor credit decisions in pursuing loans on newly eligible combination properties, increasing the likelihood of loan losses incurred by the FHLBanks.

In fact, the proposed rule discussed at length the fact that any additional risks that might arise if such mortgage loans are used as collateral for advances should be adequately managed in accordance with the current provisions of the advances regulation and FHLBank credit policies. The FHLBanks already accept combination loans, and have expertise in underwriting advances secured by such loans. The final rule, like the current advances regulation, does not mandate that the FHLBanks accept combination farm or business loans as collateral for advances. It merely includes such loans in the category of loans eligible to be accepted by a FHLBank to secure advances.

The FHLBanks already are permitted to accept as collateral for advances to members ''other real estate related collateral'' (provided aggregate outstanding advances secured by such collateral do not exceed 30 percent of the member's capital). *See* 12 U.S.C. 1430(a)(4); 12 CFR 935.9(a)(4). Included in this category of permissible collateral are loans on farms and other agricultural property, commercial mortgage loans, construction loans, land development loans, and second mortgage loans including home equity loans. *See* 12 CFR 935.9(a)(4)(ii). The FHLBanks also may accept multifamily loans as eligible collateral, without being subject to the 30 percent member capital limit. *See* 12 U.S.C. 1430(a)(1); 12 CFR 935.9(a)(1)(i). With respect to each of those types of collateral, the FHLBanks already manage the credit, liquidity, and marketability risks cited by the commenter, as well as other risks, associated with non-one-to-four family residential mortgage collateral. There is no evidence that these revisions will subject the FHLBanks to underwriting tasks that are beyond their ability to manage.

The Finance Board requires that the FHLBanks have such underwriting expertise and credit policies before accepting such loans as collateral. Specifically, the advances regulation requires, among other things, that the FHLBanks establish written procedures for determining the value of collateral securing advances, and that the FHLBanks follow those procedures in ascertaining the value of particular assets offered as collateral. *See* 12 CFR 935.12. The regulation also permits the FHLBanks to require a member to support the valuation of any collateral with an appraisal or other investigation of the collateral as the FHLBank deems necessary. *See id.*

Rural lending often requires collateral valuation practices that may differ significantly from those typically employed in lending on the security of one-to-four family homes. The Finance Board expects each FHLBank to review its collateral valuation procedures, and amend them as necessary to reflect the changes made in the final rule, before accepting as collateral any newly authorized combination properties. The Finance Board also expects that the FHLBanks, as a matter of practice, will conduct careful review and, if necessary, require an appraisal of such collateral, taking into account the additional risks inherent in rural lending and each FHLBank's own capability to evaluate those risks. In addition, the FHLBanks generally require that members pledge additional collateral if the value of their original collateral declines.

Finally, as the regulator of the FHLBanks, the Finance Board's primary responsibility is to ensure that the FHLBanks operate in a financially safe and sound manner. *See* 12 U.S.C. 1422a(a)(3)(A). The Finance Board's oversight of the FHLBanks includes annual on-site examinations and regular off-site review of FHLBank operations. Emphasis is placed on areas of FHLBank operation that could potentially expose the FHLBank and the FHLBank System to risk. As part of the examination process, the Finance Board reviews and evaluates the FHLBanks' management of collateral. Examiners review valuation methodology, discounts applied to collateral, and frequency of review or re-valuation for various types of collateral. Moreover, the loan quality and underwriting practices of the individual members are reviewed regularly by the

primary banking regulators through periodic examinations.

In short, the above-described FHLBank practices, regulatory requirements, and Finance Board examination oversight, do not encourage FHLBank members to approve unsafe or unsound loans that could be pledged to the FHLBanks to secure advances.

In addition, increasing access to the FHLBank System would provide current and prospective members with enhanced risk management options. The USDA Report states that access to funds from GSEs, such as the FHLBanks, enhances liquidity and can improve profitability and risk management of depository financial intermediaries, including commercial banks, credit unions, and thrifts. *See* USDA Report at 97. Risk management is enhanced because GSE funds are available with longer maturities than are usually available on deposits at commercial banks. *See id.* at 98. Advances can be used to control interest rate risk by allowing member banks to match the funding to the maturity, payment structure, prepayment options, and other features of the loans they make. *See id.*

The Finance Board specifically requested comment on whether elimination of the 50 percent test might expose the FHLBanks to any undue risk of loss should a FHLBank need to liquidate the combination mortgage loans it holds as collateral for an advance. *See* 62 FR 53252. Many commenters stated that the proposal would not present safety or soundness risks for the FHLBanks because, as discussed above, the FHLBanks do not lend against the full value of collateral, but rather apply discounts depending on the riskiness of the collateral and the difficulties in valuing it. Commenters also pointed out that the FHLBanks obtain appraisals of collateral from members, and can require additional collateral if necessary.

In addition, commenters noted that combination loans at rural banks are solidly performing and generally exceed the loan quality of the rest of the banking industry, with 1996 net charge-offs on average loans at rural banks at 0.32 percent, while net charge-offs for banks overall were 0.61 percent. One FHLBank commenter noted that the experience of lenders in Iowa during the 1980s ''agricultural crisis'' was that, while there was a substantial decline in value of both one-to-four family properties in rural areas and combination farm/residence properties, the decline was not greater for the combination properties than it was for those that were solely residential. In fact, the combination properties were more likely to be sold since there remained buyers interested in the agricultural portion of the land. Based on this experience, the commenter did not believe that combination property is more volatile than solely residential property located in rural areas. The commenter stated that it planned to hire additional experienced personnel to ensure that, through proper due diligence, its practices are prudent and will not expose the FHLBank to undue risks of loss.

Accordingly, the Finance Board believes that through due diligence, overcollateralization, and prudent credit and collateral risk management procedures and practices, the FHLBanks can adequately prevent undue risk of loss on advances secured by combination loans. Therefore, the Finance Board does not believe that there are undue safety and soundness risks that would suggest that the Finance Board lacks the ''rational'' basis for changing the 50 percent test in the final rule.

VI. Definition of ''Residential Mortgage Loan'' in § 933.1(bb)(8) of the Final Rule

Consistent with the proposed rule, ''residential mortgage loan'' is defined in § 933.1(bb)(8) of the final rule to include, for membership eligibility purposes, loans that finance properties or activities that, if made by a member, would satisfy the statutory requirements for the CIP established under section 10(i) of the Bank Act, or the regulatory requirements established for any community investment cash advance program authorized by section 10(j)(10) of the Bank Act. *See* 12 U.S.C. 1430(i), (j)(10).

The intent of this amendment is to allow such community investment loans to be considered for purposes of eligibility for membership, and to conform the membership regulation more closely to the advances regulation, which already includes loans financed by section 10(i) or section 10(j)(10) advances within the definition of ''residential housing finance assets.'' *See* 12 CFR 935.1. A banking trade association specifically supported the proposed definition.

VII. Regulatory Flexibility Act

The final rule does not impose any additional reporting, recordkeeping, or compliance requirements on prospective or current FHLBank members. Although the Finance Board anticipates that the final rule will be of benefit primarily to small depository institutions, it will not have a disproportionate impact on small entities. Therefore, in accordance with the Regulatory Flexibility Act, the Finance Board hereby certifies that this final rule will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b).

VIII. Paperwork Reduction Act

The final rule does not contain any collections of information, as defined by the Paperwork Reduction Act of 1995. *See* 44 U.S.C. 3501 *et seq.* Consequently, the Finance Board has not submitted any information to the Office of Management and Budget for review.

List of Subjects

12 CFR Part 933

Federal home loan banks, Reporting and recordkeeping requirements.

12 CFR Part 935

Credit, Federal home loan banks, Reporting and recordkeeping requirements.

Accordingly, the Federal Housing Finance Board hereby amends title 12, chapter IX, parts 933 and 935 of the Code of Federal Regulations as follows:

PART 933–MEMBERS OF THE BANKS

1. The authority citation for part 933 continues to read as follows:

Authority: 12 U.S.C. 1422, 1422a, 1422b, 1423, 1424, 1426, 1430, 1442.

2. Amend § 933.1 by revising paragraph (n)(1)(iii), removing ''or'' at the end of paragraph (bb)(6)(iii), removing the period at the end of paragraph (bb)(7) and adding ''; or'' in its place, and adding paragraph (bb)(8) to read as follows:

§ 933.1 Definitions.

* * * * *

(n) Home mortgage loan * * *

(1) * * *

(iii) Combination business or farm property where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property or, in the case of any community financial institution, combination business or farm property, on which is located a permanent structure actually used as a residence (other than for temporary or seasonal housing), where the residence constitutes an integral part of the property. For purposes of this subparagraph, the term ''community financial institution'' means an institution that has average total assets of $500,000,000 or less, based on an average of total assets over the three preceding years. The Board shall adjust the limit annually based on the annual

increase, if any, in the Consumer Price Index for all urban consumers, as published by the Department of Labor; or

* * * * *

(bb) Residential mortgage loan * * *

(8) Loans that finance properties or activities that, if made by a member, would satisfy the statutory requirements for the Community Investment Program established under section 10(i) of the Act, or the regulatory requirements established for any community investment cash advance program authorized by section 10(j)(10) of the Act.

* * * * *

PART 935—ADVANCES

1. The authority citation for part 935 continues to read as follows:

Authority: 12 U.S.C. 1422a(a)(3), 1422b(a)(1), 1426, 1429, 1430, 1430b, 1431.

2. Amend § 935.1 by revising paragraph (1)(v) in the definition of ''Residential real property'' to read as follows:

§ 935.1 Definitions.

* * * * *

Residential real property * * *

(1) * * *

(v) Combination business or farm property where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property or, in the case of any community financial institution, combination business or farm property, on which is located a permanent structure actually used as a residence (other than for temporary or seasonal housing), where the residence constitutes an integral part of the property. For purposes of this subparagraph, the term ''community financial institution'' means an institution that has average total assets of $500,000,000 or less, based on an average of total assets over the three preceding years. The Board shall adjust the limit annually based on the annual increase, if any, in the Consumer Price Index for all urban consumers, as published by the Department of Labor.

* * * * *

Dated: April 14, 1998.

By the Board of Directors of the Federal Housing Finance Board.

Bruce A. Morrison,

Chairperson.

[FR Doc. 98–17163 Filed 6–26–98; 8:45 am]

BILLING CODE 6725–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 97–SW–25–AD; Amendment 39–10635; AD 98–14–01]

RIN 2120–AA64

Airworthiness Directives; Eurocopter France Model AS–350B, BA, B1, B2, and D, and Model AS–355E, F, F1, F2, and N Helicopters

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment adopts a new airworthiness directive (AD), applicable to Model AS–350B, BA, B1, B2, and D, and Model AS–355E, F, F1, F2, and N helicopters, that requires inspections of the main gearbox suspension bi-directional cross-beam (cross-beam) for cracks, and replacement of the cross-beam if a crack is found. This amendment is prompted by several reports of cracks in the cross-beam. The actions specified by this AD are intended to provide a terminating action to prevent failure of the cross-beam that could cause the main gearbox to pivot, resulting in severe vibrations and a subsequent forced landing.

DATES: Effective August 3, 1998.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of August 3, 1998.

ADDRESSES: The service information referenced in this AD may be obtained from American Eurocopter Corporation, 2701 Forum Drive, Grand Prairie, Texas 75053–4005, telephone (972) 641–3460, fax (972) 641–3527. This information may be examined at the FAA, Office of the Regional Counsel, Southwest Region, 2601 Meacham Blvd., Room 663, Fort Worth, Texas; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mr. Mike Mathias, Aerospace Engineer, FAA, Rotorcraft Directorate, ASW–111, 2601 Meacham Blvd., Fort Worth, Texas 76137, telephone (817) 222–5123, fax (817) 222–5961.

SUPPLEMENTARY INFORMATION: A proposal to amend part 39 of the Federal Aviation Regulations (14 CFR part 39) to include an airworthiness directive (AD) that is applicable to Model AS–355E, F, F1, F2, and N helicopters was published in the **Federal Register** on March 3, 1998 (63 FR 10349). That action proposed to require visual and dye-penetrant inspections of the cross-beam for cracks, and replacement with an airworthy cross-beam if a crack is found.

Interested persons have been afforded an opportunity to participate in the making of this amendment. Due consideration has been given to the comment received.

The commenter states that the applicability of the AD should exclude helicopters that have been modified in accordance with Eurocopter Service Bulletin No. 63.00.07, applicable to Model AS–350B, BA, B1, B2, and D helicopters, and Eurocopter Service Bulletin No. 63.00.13, applicable to Model AS–355E, F, F1, F2, and N helicopters, both dated April 7, 1997. The FAA agrees that helicopters having the modifications need not be inspected as prescribed in this AD, and that is why the applicability is limited to those model helicopters that have cross-beam, P/N 350A38–1018-all dash numbers, installed. However, a paragraph has been added stating that installation of cross-beams that have the modifications constitutes terminating action for the requirements of this AD.

After careful review of the available data, including the comment noted above, the FAA has determined that air safety and the public interest require the adoption of the rule as proposed with the change described previously. The FAA has determined that this change will neither increase the economic burden on any operator nor increase the scope of the AD.

The FAA estimates that 454 helicopters of U.S. registry will be affected by this AD, that it will take approximately 0.5 work hour per helicopter to accomplish each visual inspection with an estimated average of 150 visual inspections per helicopter, 3 work hours per helicopter to accomplish the dye-penetrant inspection, and 6 work hours per helicopter to replace the cross-beam, if necessary, and that the average labor rate is $60 per work hour. Parts costs will be approximately $6,000 per cross-beam. Based on these figures, the total cost impact of the proposed AD on U.S. operators is estimated to be $5,012,160 to perform an average of 150 visual inspections and one dye-penetrant inspection per helicopter, and to replace the cross-beam on all 454 helicopters.

The regulations adopted herein will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, in accordance with Executive Order 12612,