

Representative has concurred with the issuance of this final rule.

Pursuant to 5 U.S.C. 553, it is also found and determined that good cause exists for not postponing the effective date of this action until 30 days after publication in the **Federal Register** because: (1) This action was unanimously recommended by the Committee; (2) the new shipping season for the 1994-95 crop of Russet Burbanks began September 1, 1994, and this rule should be effective promptly to cover as many potatoes of the 1994-95 crop as possible; and (3) the proposed rule provided a 15-day comment period and no comments were received.

List of Subjects in 7 CFR Part 945

Marketing agreements, Potatoes, Reporting and recordkeeping requirements.

For the reasons set forth in the preamble, 7 CFR part 945 is amended as follows:

PART 945—IRISH POTATOES GROWN IN CERTAIN DESIGNATED COUNTIES IN IDAHO, AND MALHEUR COUNTY, OREGON

1. The authority citation for 7 CFR part 945 continues to read as follows:

Authority: 7 U.S.C. 601-674.

2. Section 945.341 is amended by removing paragraph (1) and revising paragraph (a)(2)(ii) to read as follows:

§ 945.341 Handling regulation.

* * * * *

(a) * * *

(2) * * *

(ii) *All other varieties.* 2 inches minimum diameter, or 4 ounces minimum weight: *Provided, That* at least 40 percent of the potatoes in each lot shall be 5 ounces or heavier.

* * * * *

Dated: September 8, 1994.

Eric M. Forman,

Director, Fruit and Vegetable Division.

[FR Doc. 94-22612 Filed 9-9-94; 8:45 am]

BILLING CODE 3410-02-P

Rural Electrification Administration

7 CFR Part 1700

General Information; Delegation of Authority

AGENCY: Rural Electrification Administration, USDA.

ACTION: Final rule.

SUMMARY: The Rural Electrification Administration (REA) hereby amends its Delegation of Authority to add the

authority to the Regional and Power Supply Directors to cancel or endorse due to payment on borrowers' notes which have been paid in full in connection with a discounted prepayment made under the REA electric program. These delegations and other minor technical corrections are being made to clarify the delegations of authority and further delegate authority downward.

EFFECTIVE DATE: This rule is effective September 12, 1994.

FOR FURTHER INFORMATION CONTACT: F. Lamont Heppe, Jr., Program Support Staff, Rural Electrification Administration, Room 2234-S, U.S. Department of Agriculture, 14th and Independence Avenue, SW., Washington, DC 20250-1500, Telephone: (202) 720-0736.

SUPPLEMENTARY INFORMATION:

Executive Order 12866

This final rule has been determined to be not significant for purposes of Executive Order 12866 and therefore has not been reviewed by OMB.

Regulatory Flexibility Act Certification

The Administrator of REA has determined that this final rule will not have a significant economic impact on a substantial number of small entities as defined in the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*).

National Environmental Policy Act Certification

The Administrator of REA has determined that this final rule will not significantly affect the quality of the human environment as defined by the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.*). Therefore, this action does not require an environmental impact statement or assessment.

Catalog of Federal Domestic Assistance

The programs described by this final rule are listed in the 1991 Catalog of Federal Domestic Assistance Programs under No. 10.850, Rural Electrification Loans and Loan Guarantees; No. 10.851, Rural Telephone Loans and Loan Guarantees; No. 10.852, Rural Telephone Bank Loans; and No. 10.854, Rural Economic Development Loans and Grants. This catalog is available on a subscription basis from the Superintendent of Documents, the United States Government Printing Office, Washington, DC 20402.

Executive Order 12778

This rule has been reviewed under Executive Order 12778, Civil Justice

Reform. This rule: (1) Will not preempt any State or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule; (2) will not have any retroactive effect; and (3) will not require administrative proceedings before parties may file suit challenging the provisions of this rule.

Executive Order 12372

This final rule is excluded from the scope of Executive Order 12372, Intergovernmental Consultant. A Notice of Final rule entitled Department Programs and Activities Excluded from Executive Order 12372 (50 FR 47034) exempts REA electric loans and loan guarantees from coverage under this Order.

Information Collection and Recordkeeping Requirements

This final rule contains no information collection or recordkeeping provisions requiring the Office of Management and Budget approval under the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*).

This final rule revises and reflects the current organizational structure of REA and methods of by which its functions are channeled. Accordingly, since this action is a " * * * rule of the agency organization, procedure, or practice * * *" this rule is being issued as a final rule without providing the public with an opportunity to comment.

List of Subjects in 7 CFR Part 1700

Electric power, Freedom of information, Loan programs—communication, Loan programs—energy, Organization and functions (Government agencies), Rural areas, Telephone.

For the reasons set out in the preamble, REA hereby amends 7 CFR chapter XVII as follows:

PART 1700—GENERAL INFORMATION

1. The authority citation for 7 CFR part 1700 continues to read as follows:

Authority: 7 U.S.C. 901 *et seq.*; Delegation of Authority by the Secretary of Agriculture, 7 CFR 2.23; Delegation of Authority by the Under Secretary of Agriculture for Small Community and Rural Development, 7 CFR 2.72; 7 U.S.C. 1921 *et seq.*; 5 U.S.C. 301, 552; 7 CFR 1.1-1.16.

Subpart D—Delegations of Authority; General

2. The second sentence of § 1700.41 is revised to read as follows:

§ 1700.41 Presons serving in acting capacities.

* * * If an incumbent of a position to whom delegations are made in subparts

D through L of this part is absent or is unable to carry out such delegations, the person designated authority to act for the incumbent shall exercise the authority conferred by such delegations.

Subpart E—Delegations of Authority; Agency Issuances and Certain Correspondence

§ 1700.73 [Amended]

3. In § 1700.73, remove paragraph (c)(3), and redesignate paragraph (c)(4) as paragraph (c)(3).

Subpart I—Delegations of Authority; Electric Program

4. Section 1700.124 is amended by adding paragraph (b)(10) to read as follows:

§ 1700.124 Regional Directors.

(b) * * *

(10) Cancellation or endorsement due to payment on borrowers' notes which have been paid in full in connection with a prepayment made under the provisions of 7 CFR part 1786, subpart F.

5. Section 1700.127 is amended by adding paragraph (b)(10) to read as follows:

§ 1700.127 Director—Power Supply Division.

(b) * * *

(10) Cancellation or endorsement due to payment on borrower's notes which have been paid in full in connection with a prepayment made under the provisions of 7 CFR part 1786, subpart F.

Subpart J—Delegations of Authority; Telephone Program

6. Section 1700.145 is amended by removing paragraph (d)(12), and redesignating paragraphs (d)(13), (d)(14), and (d)(15) as paragraphs (d)(12), (d)(13), and (d)(14), and by adding a new paragraph (c)(8) to read as follows:

§ 1700.145 Regional Directors.

(c) * * *

(8) Complete releases of lien and satisfaction when a borrower has paid in full its indebtedness.

§ 1700.146 [Amended]

7. Section 1700.146(c) is amended by removing from the text the term

"§ 1700.148" and adding in its place "§ 1700.148 (a) and (b)".

8. Section 1700.147(c) is amended by removing from the text the term "§ 1700.148" and adding in its place "§ 1700.148(c)", by revising paragraph (b)(5), by removing the term "and" from the end of paragraph (b)(6), by removing the period from the end of paragraph (b)(7) and by adding a semicolon in its place and adding the term "and" after the semicolon, and by adding a new paragraph (b)(8) to read as follows:

§ 1700.147 Chiefs, Regional Operations Branches—Telephone.

(b) * * *

(5) Borrowers' lease agreements;

(8) Management and operating agreements. When the borrowers involved are in more than one region, both chiefs must approve.

Dated: September 1, 1994.

Bob J. Nash,
Under Secretary, Small Community and Rural Development.

[FR Doc. 94-22317 Filed 9-9-94; 8:45 am]
BILLING CODE 3410-15-P

Animal and Plant Health Inspection Service

9 CFR Part 92

[Docket No. 93-110-2]

Importation of Horses; Quarantine Requirements

AGENCY: Animal and Plant Health Inspection Service, USDA.

ACTION: Affirmation of interim rule as final rule.

SUMMARY: We are adopting as a final rule, without change, an interim rule that amended the regulations concerning the importation of horses by adding Bosnia and Herzegovina, Croatia, Finland, Guinea-Bissau, the Member States of the European Union, Slovenia, The Former Yugoslav Republic of Macedonia, and the nonrecognized areas of the former Yugoslavia (Montenegro and Serbia) to the list of countries where contagious equine metritis (CEM) exists, and by adding Oman, Qatar, and the United Arab Emirates to the list of countries considered to be affected with African horse sickness (AHS). Outbreaks of CEM, a highly transmissible venereal disease, have been reported in Bosnia and Herzegovina, Croatia, Finland, Guinea-Bissau, Slovenia, The Former Yugoslav Republic of Macedonia, and

the nonrecognized areas of the former Yugoslavia (Montenegro and Serbia). The Member States of the European Union either are affected with CEM or trade horses freely with other Member States that are affected with CEM, without testing the horses for the disease. Oman, Qatar, and the United Arab Emirates trade horses freely with other countries where AHS, a fatal viral disease, exists. The interim rule imposed prohibitions or restrictions on the importation of horses that have been in these countries to protect horses in the United States from CEM and AHS. Neither disease is known to exist in the United States.

EFFECTIVE DATE: October 12, 1994.

FOR FURTHER INFORMATION CONTACT: Dr. Joyce Bowling, Staff Veterinarian, Import-Export Animals Staff, National Center for Import-Export, Veterinary Services, APHIS, USDA, room 766, Federal Building, 6505 Belcrest Road, Hyattsville, MD 20782, (301) 436-8170.

SUPPLEMENTARY INFORMATION:

Background

In an interim rule effective and published in the *Federal Register* on May 13, 1994 (59 FR 24886-24889, Docket No. 93-110-1), we amended the regulations in 9 CFR part 92 concerning the importation of horses by adding Bosnia and Herzegovina, Croatia, Finland, Guinea-Bissau, the Member States of the European Union, Slovenia, The Former Yugoslav Republic of Macedonia, and the nonrecognized areas of the former Yugoslavia (Montenegro and Serbia) to the list of countries where contagious equine metritis exists. The interim rule also added Oman, Qatar, and the United Arab Emirates to the list of countries considered to be affected with African horse sickness.

Comments on the interim rule were required to be received on or before July 12, 1994. We did not receive any comments. The facts presented in the interim rule still provide a basis for the rule.

This action also affirms the information contained in the interim rule concerning Executive Order 12866 and the Regulatory Flexibility Act, Executive Order 12778, and the Paperwork Reduction Act.

Further, for this action, the Office of Management and Budget has waived the review process required by Executive Order 12866.

List of Subjects in 9 CFR Part 92

Animal disease, Imports, Livestock, Poultry and poultry products,

Quarantine, Reporting and recordkeeping requirements.

PART 92—IMPORTATION OF CERTAIN ANIMALS AND POULTRY AND CERTAIN ANIMAL AND POULTRY PRODUCTS; INSPECTION AND OTHER REQUIREMENTS FOR CERTAIN MEANS OF CONVEYANCE AND SHIPPING CONTAINERS THEREON

Accordingly, we are adopting as a final rule, without change, the interim rule that amended 9 CFR 92.301 and 92.308 and that was published at 59 FR 24886-24889 on May 13, 1994.

Authority: 7 U.S.C. 1622; 19 U.S.C. 1306; 21 U.S.C. 102-105, 111, 114a, 134a, 134b, 134c, 134d, 134f, 135, 136, and 136a; 31 U.S.C. 9701; 7 CFR 2.17, 2.51, and 371.2(d).

Done in Washington, DC, this 6th day of September 1994.

Terry E. Medley,

Acting Administrator, Animal and Plant Health Inspection Service.

[FR Doc. 94-22496 Filed 9-9-94; 8:45 am]

BILLING CODE 3410-34-P

FARM CREDIT ADMINISTRATION

12 CFR Parts 614 and 618

RIN 3052-AB51

Loan Policies and Operations; General Provisions; Collateral Evaluation Requirements, Actions on Applications, Review of Credit Decisions, and Releasing Information

AGENCY: Farm Credit Administration.

ACTION: Interim rule with request for comments.

SUMMARY: The Farm Credit Administration (FCA), by the Farm Credit Administration Board (Board), adopts interim regulations that amend FCA regulations relating to collateral evaluation requirements for Farm Credit System (FCS or System) institutions engaged in lending or leasing. The FCA Board also requests comments on these regulations. The amendments respond to issues raised by regulatory revisions recently adopted by the other Federal financial institutions' regulatory agencies (Federal regulatory agencies),¹ comments received in response to the FCA's published request for "regulatory burden" comments (58 FR 34003, June 23, 1993), and amendments made to regulations of the Board of Governors of the Federal Reserve (Regulation B)

interpreting the Equal Credit Opportunity Act (ECOA).²

DATES: The regulations shall become effective October 31, 1994, or upon the expiration of 30 days after publication during which either or both Houses of Congress are in session, whichever is later. Written comments must be submitted on or before October 10, 1994. Notice of the effective date will be published in the *Federal Register*.

ADDRESSES: Comments should be submitted in writing, in triplicate, to Patricia W. DiMuzio, Associate Director, Regulation Development, Office of Examination, Farm Credit Administration, McLean, Virginia 22102-5090. 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:

Dennis K. Carpenter, Senior Policy Analyst, Office of Examination, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TDD (703) 883-4444,

or

James M. Morris, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TDD (703) 883-4444.

SUPPLEMENTARY INFORMATION:

I. General

The FCA Board adopted final collateral evaluation regulations on November 12, 1992. The regulations were published in the *Federal Register* on November 20, 1992 (57 FR 54683), and became effective March 1, 1993. The regulations addressed the System's collateral evaluation practices and procedures, including the need for: (1) Consistent methodology; (2) independence and controls; and (3) consistent educational and qualification requirements. The regulations set basic requirements for real property appraisals, including the use of State licensed and/or certified appraisers, functional independence, and compliance with Uniform Standards of Professional Appraisal Practices (USPAP). The real property appraisal requirements adopted were similar to the requirements of the other Federal regulatory agencies.

The objective of the present amendments is to provide additional

flexibility in appraisal and independence requirements, without jeopardizing the overall integrity or enforceability of the FCA's collateral evaluation regulations. By providing additional flexibility in the use of State-sanctioned appraisers and relief from the more stringent real estate appraisal requirements, the FCA addresses regulatory burden concerns.

The amendments are being adopted as interim regulations with a delayed effective date and request for comments in order to provide interested parties an opportunity to comment on the regulations. However, the FCA believes adopting the regulations in final is required to provide System institutions with the necessary guidance to address revisions to their collateral evaluation requirements and necessary staffing needs. The regulatory revisions also establish requirements that are similar to the requirements recently adopted by the Federal regulatory agencies.

The FCA adopted, on May 5, 1994, a "no action" position relative to the System institutions' compliance with certain real estate appraisal requirements in response to the then-pending regulatory revisions by the Federal regulatory agencies. The FCA's "no action" position was intended to serve as a temporary means of eliminating any competitive disadvantage suffered by System institutions. However, the "no action" position provides more flexibility than the FCA would consider a prudent long-term regulatory position. Therefore, these regulatory revisions are intended to eliminate any competitive disadvantage for the System institutions and establish the necessary guidance and parameters for the System's collateral evaluation practices and procedures.

These revisions to the FCA's collateral evaluation regulations only address the issues associated with the real estate appraisal requirements and do not lessen the overall requirements that have been established for the basic collateral evaluation requirements or the collateral valuation process. The FCA Board is aware of the System's concern about informational requirements for small loans. The FCA has received comments requesting consideration of guidance for "minimum information" loan programs (including financial reporting and collateral evaluation information) and related underwriting standards. The FCA believes these regulations provide flexibility to accommodate minimum information loan programs. However, the FCA will consider these issues at a later date in response to the "regulatory burden"

¹ The Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), and the Office of Thrift Supervision (OTS).

² The FRB published final regulations on December 16, 1993 (58 FR 65657) implementing the Equal Credit Opportunity Act, 15 U.S.C. 1691-1691f, as amended by the FDIC Improvement Act of 1991, Pub. L. 102-242, 105 Stat. 2236.

notice published in the *Federal Register* on June 23, 1993 (58 FR 34003).

The regulations also make technical revisions to part 614, subpart L, concerning credit denials and independent appraisal requirements. Finally, the regulations reconcile FCA regulations pertaining to the release of collateral evaluation information (part 618, subpart G), with the requirements of the Equal Credit Opportunity Act as interpreted by Regulation B.³

II. Background

A. Bank and Thrift Federal Regulatory Agencies' Positions

On March 10, 1993, the four Federal regulatory agencies responsible for regulating banks and thrifts issued a joint interagency statement that eased certain regulatory constraints on the availability of credit for small business loans (including farm loans). The "Interagency Policy Statement on Credit Availability" ("Policy Statement") identified five areas of concern for possible regulatory and operational revisions. The five areas are: (1) Lending to small- and medium-sized businesses; (2) real estate lending and appraisals; (3) appeals of examination decisions and complaint handling; (4) examination processes and procedures; and (5) paperwork and regulatory burdens.

While FCA was not a party to the Policy Statement released on March 10, 1993, it does have real property appraisal regulations in place that are similar to those of the Federal regulatory agencies. In addition, the Policy Statement includes farming operations as a segment of the small- and medium-sized businesses to be covered by any revisions arising from the Policy Statement. Therefore, any change in the Federal regulatory agencies' real property appraisal requirements⁴ will impact the FCA and the System in terms of the consistency and application of the collateral evaluation requirements.

In discussing the real estate lending and appraisal concerns, the Policy Statement asserted that "in some cases currently required real estate appraisals may not add to the safety and soundness of the credit decision. Indeed, in some cases, appraisals may prove so

expensive that they make a sound small- or medium-sized business loan uneconomical."⁵ President Clinton directed the Federal regulatory agencies to review the existing real property appraisal regulations and address changes as appropriate. The policy position implemented by the Federal regulatory agencies is considered to be "one aspect of an overall effort by the agencies to evaluate carefully and react appropriately to risk in the United States financial services industry. That overall effort envisions substantial oversight; in some cases, more than we have now, in areas that pose greater risk to the system. By the same token, regulatory burden will be reduced where risk is low, especially for strong, well-managed banks and thrifts * * *."⁶

The recent amendments to the other Federal regulatory agencies' real estate appraisal requirements relate to: (1) Appraisals of real estate offered as collateral for small- and medium-sized business loans; (2) appropriate appraisal threshold levels (*de minimis*); and (3) exemptions from requirements for the use of State-sanctioned appraisers. In addition, the agencies have eliminated the regulatory prohibition on the use of the Uniform Standards of Professional Appraisal Practices (USPAP) "departure provision"⁷ for real property appraisals.

On June 4, 1993, the bank and thrift Federal regulatory agencies published proposed regulations (58 FR 31878) to amend the existing real property appraisal regulations. On November 10, 1993, the Federal regulatory agencies solicited additional comments on the database supporting the *de minimis* level proposal (58 FR 59688). The OCC, FDIC, FRB, and OTS subsequently adopted final regulations, which were published on June 7, 1994 (59 FR 29482). The major changes made by the final regulations are:

1. Increasing the *de minimis* level to \$250,000 above which real estate appraisals using State licensed and/or certified appraisers are required.

³ Issue No. 2 as addressed in the "Interagency Policy Statement on Credit Availability," jointly released on March 10, 1993, by the OCC, FDIC, FRB, and the OTS.

⁶ *Ibid.*

⁷ As established by the Appraisal Standards Board of the Appraisal Foundation, the *Departure Provision* of USPAP (revised March 22, 1994, effective July 1, 1994) "permits limited departures from specific guidelines provided that the scope of the assignment is not so limited as to confuse or mislead the client or the intended users of the report; and provided that the appraiser advises the client of the limitations and that the limitations will be disclosed in the report; and the client has agreed that the limited appraisal or consulting services would be appropriate."

2. Providing an exception for small- and medium-sized "business loans," including loans to entities and individuals engaged in farming enterprises, with a transaction value of \$1.0 million or less.

3. Clarifying the "abundance of caution" exception.

4. Providing additional exceptions to the use of State licensed and/or certified real estate appraisers.

5. Clarifying appraisal standards and appraiser independence requirements.

B. FCA's Consideration

On June 10, 1993, the FCA Board adopted a policy position requesting public comment on possible regulatory burden issues addressing a variety of subjects. This "Regulatory Burden" statement was published on June 23, 1993 (58 FR 34003). On July 15, 1993, the FCA Board directed staff to begin considering appropriate revisions of the FCA's regulations and to monitor the progress of the regulatory revisions proposed by the Federal regulatory agencies.

The FCA received 15 comment letters in response to its regulatory burden statement from various System institutions and related parties addressing collateral evaluation related issues. The commenters, in general, supported the positions that had previously been proposed by the Federal regulatory agencies. The commenters also expressed concerns with the inclusion of specific standards of the collateral evaluation regulations (i.e., general valuation and personal property requirements) as well as specific requirements of part 614, subpart L, as they pertain to the appraisal requirements for reconsideration of loan denials. In addition, the FCA has received two additional sets of comments requesting that the FCA consider the positions proposed by the Federal regulatory agencies. The FCA responds to the comments received in Section IV, *Regulatory Revisions*, of this document.

III. Historical Analysis

The FCA has not identified any System institution that has failed solely because of poor or fraudulent appraisal activities. However, there have been institutions that have failed where poor collateral evaluation practices have been a contributing factor. A review of several of the institutions that failed during the 1980s has indicated that when such institutions failed, they exhibited characteristics such as: (1) Poor credit administration practices; (2) poor internal controls; (3) poor collateral evaluation practices; and (4)

³ The ECOA requires creditors to provide copies of real estate appraisals to applicants/borrowers when the appraisal covers residential collateral. The Federal Reserve Board, on December 16, 1993, published final regulation revisions (58 FR 65657) (Regulation B) implementing this requirement. Institutional compliance was required by June 14, 1994.

⁴ The OCC, FDIC, FRB, and OTS jointly published revised real estate appraisal regulations on June 7, 1994 (59 FR 29482), which were effective on that date.

lack of credit expertise to handle increased debt levels and loan volume. The majority of the institutions that failed or required some form of assistance did so because of losses experienced in a few large, complex, and/or specialized loans. Poor collateral evaluation practices coupled with one or more of the other characteristics described above contributed to the problems faced by the institutions.

With the implementation of the FCA's collateral evaluation regulations, the institutions have been required to establish and implement appropriate collateral evaluation policies and procedures. Such policies and procedures are needed to address collateral evaluation independence requirements and basic evaluation and appraisal standards, as well as educational and qualification requirements. The development of such policies and procedures coupled with appropriate internal controls, credit controls, and underwriting standards (i.e., lending limits, financial and repayment analysis, loan inspections, etc.) will help ensure that past problems are not repeated.

The FCA's collateral evaluation regulations require that all System institutions will perform a collateral evaluation on all secured loans and leases. Such collateral evaluations will take the form of a basic valuation or a more detailed real estate appraisal, depending on the loan collateral and the specifics of the loan decision. The basic requirements concerning individuals responsible for collateral evaluations address minimum education, qualification, independence, and methodology standards that are either established by the regulation or must be established by the institution's policies and procedures consistent with the requirements of the regulations.

The additional requirements for completion of real estate appraisals, including the use of State-sanctioned appraisers, require a higher degree of independence and higher education and methodology standards. While higher standards are desirable, it has been argued by the System, as well as by the banking and thrift industries, that universal application of these higher standards and the additional cost involved do not add to the safety and soundness of these institutions. They argue that such higher standards add unnecessary costs and delays to the credit process without providing a corresponding reduction in loan defaults and losses in the institutions' smaller loans. The System and commercial banking institutions further argue that collateral valuations

completed by qualified and experienced persons, other than State licensed or certified appraisers, are more appropriate and cost-effective for the majority of their loans and the associated risk.

The FCA believes that it is the responsibility of the institution to establish adequate policies and procedures for collateral evaluations, taking into consideration the basic requirements of the FCA's regulations. The institutions are responsible for determining the level of documentation required, depending on the size, complexity, and specialization of the loan transaction. As an example, a \$50,000 loan that qualifies for an institution's minimum information program could require considerably less support, information, and documentation than a \$500,000 loan to finance a large, complex dairy operation not typical of the operations within an institution's territory. Under these revised regulations, both loan transactions could qualify as collateral valuations rather than as real estate appraisals; but the complexity, size, and specialization of the loan for the dairy operation would call for a higher degree of support information development and documentation. The FCA notes that such flexibility already exists in the current regulations.

The lending institution, not the collateral evaluator, is ultimately responsible for its credit decisions. The collateral evaluation is only one of several factors that must be considered when making a credit decision. While the collateral evaluation report must be completed by a qualified individual, institutions should not assume that the acceptance of the collateral evaluation report substitutes for or completes the credit decision process. The FCA expects the institutions to consider all relevant credit factors (including the collateral evaluation) as part of the credit decision. If an institution is not comfortable with the reported value of the collateral, the institution can request another evaluation, decrease the loan amount accordingly, or, provided other statutory and regulatory requirements are satisfied, change the terms of the loan consideration in recognition of the perceived collateral risk.

An institution need not lend 85 percent of the value shown by an evaluation. Rather it should limit the credit to the amount that can be supported by consideration of the risk associated with all credit factors, including the collateral evaluation. It is important to note that as the complexity or specialization of the subject property increases, the degree of support

documentation should also increase and should take into account the unique characteristics of the property that make it complex or specialized.

IV. Regulatory Revisions

Taking into account the comments received in response to the FCA's "regulatory burden" notice, the FCA staff studied FCA's current collateral evaluation regulations, compared current regulations with those of the other Federal regulatory agencies, and completed a study of data submitted to the FCA by the System. Based on its study, the FCA has adopted the following positions.

A. Increased Appraisal Thresholds

The regulations amend § 614.4260(b) to increase the existing *de minimis* levels on the appraisal requirements of the System institutions to \$250,000. In addition, the threshold for the functional independence requirements would also be increased in connection with the appraisal *de minimis* level.

In 1992, the FCA completed an analysis to determine the segregation by size of the collateral securing the System's loan portfolio. The database for the analysis included a summary of the number and volume of loans within the FCS banks and associations as of December 31, 1991, that were unsecured, secured by personal property, secured by real property, or secured by a combination of security types.

The data were further segregated by loan-size categories. The FCA study has subsequently been updated to reflect the December 31, 1992, and December 31, 1993, loan-size and collateralization information.

The FCA has also recently received the results of a study it commissioned through the University of Illinois to perform independently of the development of these regulations (University of Illinois study). This study examined the loan origination volume, associated defaults, and loan losses for a specific Farm Credit district for a period between 1973 and 1992 to determine, among other things, whether large loans have a higher default rate than small loans.

In addition, the Farm Credit Council, on behalf of the System institutions, has provided additional loan-size and loan-loss data to the FCA for further consideration of the *de minimis* level. Finally, the American Bankers Association (ABA) has also completed a

survey,⁸ which included a sample of 246 commercial banks of various sizes and portfolio structures. The survey stratified the loan portfolios by loan size and by loan type (construction, farmland, multifamily, and nonfarm).⁹

Upon review of the available data, the University of Illinois' study data, the System's data, and the ABA's commercial bank data, several conclusions can be drawn. Each of the studies attempted to study the correlation between loan losses and loan size. There appears to be very little difference in the average size of the ABA reported farmland loans and the System institutions' loans. The establishment of a consistent threshold level would encompass similar percentages of the farmland-based loan portfolio of System institutions and commercial banks. However, the System institutions will have a greater percentage of farmland-based loan volume that would be in excess of a \$250,000 *de minimis* level. An increase in the *de minimis* level would result in the System institutions being afforded the same flexibility as the commercial lenders to perform collateral valuations rather than USPAP-based, State-sanctioned appraisals. This will result in a significant reduction in the number of loans that would require the use of a State-sanctioned appraiser¹⁰ and thus result in cost savings to the borrowers/consumers. The System data indicate that the difference in the cost of an appraisal versus a valuation averages approximately \$300 per evaluation. Such reported cost differences are consistent with cost data that have been reported by the commercial banking industry.

The FCA recognizes that increasing the *de minimis* level will reduce the number of transactions requiring a USPAP appraisal completed by a State-sanctioned appraiser. The FCA's analysis of the available data suggested that for loans in excess of \$250,000, the rate of loss justifies the cost of the USPAP appraisal requirement, while for loans of less than \$100,000, the cost of

requiring USPAP appraisals may exceed the volume of losses. For loans in the \$100,000 to \$250,000 range, the data do not clearly establish that the rate of loss justifies the cost of requiring USPAP appraisals. Therefore, the FCA believes that a *de minimis* level of \$250,000 is a reasonable point above which the additional appraisal requirements are justified. In addition, the FCA is comfortable that safety and soundness concerns at or below \$250,000 can be adequately addressed by the collateral valuation requirements of the regulations.

B. Business Loans

The regulations amend § 614.4260(b) to provide the System institutions with a \$1.0 million threshold for requiring appraisals for small- and medium-sized "business loans" where the loan repayment is not derived from the sale or cash rental of real estate.

The purpose of this exemption is to provide greater flexibility for institutions to provide credit to small- and medium-sized businesses where the owners are subject to the risk of operational losses. The exemption is not intended to ease credit requirements for real estate investors or passive landowners. A \$1.0 million exemption would be consistent with the positions taken by the Federal regulatory agencies and will afford the System institutions a "level playing field" with respect to the required use of State-sanctioned appraisers. Based on FCA's analysis of the data studies, it should be noted that, in addition to the additional 15 percent (by number) of System loans exempted by the new \$250,000 *de minimis* level exception, approximately an additional 5 percent of the number of loans will be exempted by the \$1.0 million "business loan" exemption.

However, within this \$250,000 to the \$1.0 million category, an additional 25 percent of loan volume will be exempted by the new business loan exemption. These additional loans represent a significant proportion of System loan volume and arguably pose significant additional risk for System institutions. Because of this concentration, the FCA has provided additional criteria for the completion of collateral evaluations for such small- and medium-sized business loans by requiring all real estate collateral evaluations in excess of \$250,000, not otherwise exempted by § 614.4260(c), to be completed in conformance with the USPAP. Such collateral evaluations of "business loans," while conforming with USPAP, will not necessitate the use of a State-sanctioned appraiser or

compliance with the functional independence requirements.

While the regulations allow institutions to use either a State licensed or State certified appraiser for loan transactions under the \$1.0 million level, the regulations require appraisals of real estate transactions over \$1.0 million to be completed by State certified appraisers. The FCA notes that this requirement is consistent with the requirements of the Financial Institutions Recovery, Reform, and Enforcement Act of 1989 (FIRREA),¹¹ which requires the use of a State certified appraiser for a real estate transaction appraisal of \$1.0 million or more.

C. Additional Collateral

The regulations expand the exceptions for the use of State licensed and certified appraisers to include those instances where the real estate is taken as additional collateral or where the loan is supported through conclusive documentation of earnings capacity and repayment ability evidencing that the real estate is not necessary to support the loan decision.

Adoption of the additional collateral exception and clarifying the "abundance of caution" exception gives System institutions more flexibility in relying on collateral valuations of real property rather than USPAP-based State-sanctioned appraisals. However, the FCA believes that the basic collateral valuation requirements and the institutions' policies and procedures will provide sufficient analysis and detail to address any safety and soundness concerns.

D. Limit Periodic Appraisals

The regulations amend § 614.4260(c) to permit the use of collateral valuations of real estate when a subsequent transaction is related to the advancement of additional funds, a servicing action, loan reamortization, etc., provided there has been no obvious and material change in the market conditions or physical aspects of the real estate that would threaten the adequacy of the institution's real estate collateral protection after the transaction. The regulations continue to require the institutions to develop appropriate policies and procedures addressing the circumstances and frequency for the completion of real property appraisals versus collateral valuations, subject to the specific requirements of the regulation.

¹¹ See Pub. L. 101-73, § 1113, 103 Stat. 183 (1989).

⁸ "Commercial Real Estate Appraisal Survey"; Surveys and Statistics Division, American Bankers Association; Report of Results, June 4, 1992.

⁹ The total sample of the ABA survey consisted of 9,329 banks of various sizes with 51,931 loans reported for a total sample volume of \$22 billion (average size loan is \$424,000, average size farmland loan is \$83,900, and average commercial loan is \$820,000).

¹⁰ Under the current FCA *de minimis* level of \$100,000 approximately 80 percent of the number (38 percent of the volume) of FCBs' and associations' real estate loans would be exempted. With an increase of the *de minimis* level to \$250,000, 95 percent of the number of loans and 66 percent of the loan volume would be exempted from the appraisal requirements.

This revision would provide greater flexibility to the System institutions in determining the appropriate collateral evaluation method to employ (valuation vs. appraisal) and the appropriate level of evaluator expertise required in relation to the associated credit risk. This revision would allow institutions to use collateral valuations instead of appraisals when a loan servicing action is required, a loan is being reamortized, or even when additional funds are advanced as long as the collateral risk has not materially increased. This revision would also eliminate the requirement that a new appraisal be completed if additional funds are advanced and an appraisal has not been completed within 2 years, as was previously required by the regulations.

These exemptions only address the use of real estate appraisals and are not intended to eliminate the need for a review and update of the value of the collateral through the use of a collateral valuation. The FCA's regulation (§ 614.4260(c)(5)) would require a new evaluation for reamortizations of loans if there has been a material increase in the associated risk in concert with the advancement of new funds. This position is consistent with the requirements of the Federal regulatory agencies for transactions where new funds are advanced and there has been a material increase in the associated risk. However, in addition, the FCA, based on safety and soundness concerns identified in previous System practices, has taken the position that any loan servicing action (including reamortizations, collateral releases, etc.) should be accompanied, at a minimum, by a collateral valuation that is consistent with the requirements of these regulations.

E. USPAP "Departure Provision"

The regulations amend § 614.4265(h) to remove the prohibition on the use of the USPAP "Departure Provision." The removal of the restriction will allow institutions to determine the best evaluation method to support the credit decision consistent with safe and sound lending practices that also best serves the borrower. The elimination of this restriction will also provide more flexibility for the institutions in the use of their appraiser resources by allowing State licensed and certified appraisers to complete updated appraisals and collateral valuations that would not otherwise meet the USPAP standards requirements.

The FCA and the Federal regulatory agencies originally included the restriction on the use of the "departure provision" because they were concerned

that the use of the provision would result in an evaluation that is less than reliable. However, upon further discussion and clarification from the Appraisal Foundation,¹² the Federal regulatory agencies now recognize that a "departure provision" appraisal provides the basic information and valuation criteria required to ensure a reliable valuation process.¹³ Therefore, the prohibition on the use of the "departure provision" has been removed.

F. Technical Amendments

The regulations make technical amendments to subpart F pertaining to issues such as an institution's review requirements for appraisals completed by other financial institutions or government agencies. The FCA has eliminated the review procedures from § 614.4255(d), because it is recognized that other U.S. Government agencies, Government-Sponsored Enterprises and/or Federally regulated financial institutions are all guided in their appraisal requirements by USPAP and FIRREA requirements, which are at least as encompassing as FCA's regulatory requirements.

In addition, the regulations make technical amendments to part 614, subpart L, concerning an institution's responsibilities for accepting an independent appraisal completed in response to a credit denial action. In addition, the regulations make changes to part 618, subpart G, concerning an institution's obligation to provide applicants with copies of collateral evaluations on residential properties as required by amended provisions of regulations implementing the Equal Credit Opportunity Act.

Commenters, responding to the FCA's "Regulatory Burden" notice, requested clarification as to the appropriateness of providing time limits on how long an applicant can delay a credit reconsideration while waiting for the completion of an independent appraisal. The FCA believes that this is a valid concern, which should be addressed by a revision to the regulation to require

the completion of the evaluation within a reasonable timeframe, depending on the nature and complexity of the appraisal assignment.

The FCA has also noted that the Federal Reserve Board's amendment of Regulation B, the regulations that implement the ECOA, requires that System institutions provide copies of collateral evaluation reports, containing all pertinent information, to unsuccessful applicants for credit that would have been secured by residential real property. Therefore, the FCA's current regulations pertaining to the release of information must be revised to expressly permit the release of collateral evaluation information when required by the provisions of the ECOA and related regulations. The ECOA regulations generally require the institution, in the case of residential properties, to provide the applicant a copy of the complete evaluation report including any third-party information if it is used as part of the institution's evaluation process.

System institutions should note that, in those cases where disclosure of such collateral evaluations is required by the ECOA, there is no protection for confidential third-party information. Therefore, System institutions should avoid the use of such confidential information where disclosure is likely under the ECOA (i.e., loans secured by residential properties, including farmland loans where a dwelling is taken as part of the security). Confidential third-party information does not include information that would otherwise be publicly available (e.g., contained in the public land records).

G. Other Comments

Several commenters have expressed concerns with the level of requirements and standards for collateral valuations on real estate and, in particular, the requirements for personal property valuations and the use of the income approach for evaluations. The commenters objected to requirements they felt were not consistent with the requirements imposed by the other regulators on their regulated banking institutions.

However, the General Accounting Office (GAO) has recently recommended that the bank and thrift Federal regulatory agencies establish a set of minimum standards for real estate evaluations where the use of State-sanctioned appraisers and compliance with USPAP are not required.¹⁴ The

¹² The Appraisal Foundation was established on November 30, 1987, by professional appraisal organizations, as a not-for-profit corporation under the laws of Illinois, in order to enhance the quality of professional appraisal practices. The USPAP standards were developed and published under the direction of the Appraisal Standards Board of the Foundation. The Foundation also consists of the Appraisal Qualifications Board, which establishes the education and qualification standards for appraisers.

¹³ Appraisal Standards Board's (ASB) statement on Appraisal Standards No. 7, *Permitted Departure from Specific Guidelines for Real Property Appraisals*, was adopted by the ASB on March 22, 1994, and became effective July 1, 1994.

¹⁴ GAO Report (GAO/GGD-94-144), May 25, 1994, *Better Guidance Is Needed For Real Estate Evaluations*.

FCA, by previously adopting and publishing the requirements of § 614.4250 of the regulations, has addressed similar concerns for the System institutions' valuation of real, personal, and intangible property in general.

In addition, the OCC has recently published proposed revisions to its lending limit regulations that would require appraisals/evaluations of collateral used to secure loans where the lender requires collateral (including personal property) to support lending in excess of the 15-percent lending limit. This position is also consistent with the regulatory standards and guidance previously established by the FCA in the collateral evaluation regulations. The FCA's willingness to adopt a 25-percent lending limit for FCBs and direct lender associations is supported by the recognition that collateral evaluation requirements serve as an essential control (58 FR 40311, July 28, 1993).

The FCA has also reviewed concerns previously expressed by the System, which pertain to the required use of the income approach for real estate evaluations in excess of the *de minimis* level (whether an appraisal is required or not). The FCA has clarified in the regulations that the income approach is one of the three prescribed methods of valuing collateral under USPAP. Therefore, whenever USPAP standards are employed the income approach must be considered. If it is not used as a valuation method, there must be an explanation of why it was not used, accompanied by the development of the initial income-producing information to support its lack of relevance as a valuation method.

In § 614.4265(d) the FCA requires the institution to develop and document, as part of the supporting information for the credit analysis, the income-producing capacity of the subject real estate as well as the operations of the business. This information may or may not be derived directly from the real estate evaluation process, but is required as part of the credit analysis to support the debt repayment analysis. Such information is intended to assist in identifying debt coverage shortages that must be addressed by other sources of income. However, the FCA strongly suggests that the income approach be used on agricultural properties where the loan transaction exceeds the \$250,000 *de minimis* level.

The income analysis requirement contained in the regulation does not apply to loan transactions at the \$250,000 *de minimis* level and below. However, prudent business practices

may dictate the development and use of such information in a much wider range of loan transactions. The institutions have the responsibility to identify those instances where the credit risk and the associated credit decision would require the support of the income and debt coverage analysis.

V. Summary

The present revisions of the FCA collateral evaluation requirements will benefit the System institutions by allowing them to enjoy a competitive playing field with the commercial banking industry and relieving some requirements that have been identified as burdensome and unnecessary. The FCA Board believes that these revisions can be made without undermining the basic collateral evaluation requirements or jeopardizing safety and soundness. Therefore, the FCA Board is able to increase the flexibility of the regulations in order to ensure the effectiveness and efficiency of the System's collateral evaluation practices.

List of Subjects

12 CFR Part 614

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

12 CFR Part 618

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

For reasons stated in the preamble, parts 614 and 618 of chapter VI, title 12 of the Code of Federal Regulations are amended to read as follows:

PART 614—LOAN POLICIES AND OPERATIONS

1. The authority citation for part 614 continues to read as follows:

Authority: Secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 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, 4.19, 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, 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, 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.

2. Part 614 is amended by revising subpart F to read as follows:

Subpart F—Collateral Evaluation Requirements

Sec.

- 614.4240 Collateral definitions.
- 614.4245 Collateral evaluation policies.
- 614.4250 Collateral evaluation standards.
- 614.4255 Independence requirements.
- 614.4260 Evaluation requirements.
- 614.4265 Real property evaluations.
- 614.4266 Personal and intangible property evaluations.
- 614.4267 Professional association membership; competency.

Subpart F—Collateral Evaluation Requirements

§ 614.4240 Collateral definitions.

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

(a) *Abundance of caution*, when used to describe decisions to require collateral, means that the collateral is taken in circumstances in which:

(1) It is not required by statute, regulation, or the institution's policies; and

(2) A prudent lender would extend credit based on a borrower's income and/or other collateral, absent the real estate, and the decision to extend credit was, in fact, based on other sources of revenue or collateral.

(b) *Appraisal* means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(c) *Appraisal Foundation* means the Appraisal Foundation established on November 30, 1987, by professional appraisal organizations, as a not-for-profit corporation under the laws of Illinois, in order to enhance the quality of professional appraisals.

(d) *Appraisal Subcommittee* means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(e) *Business loan* means a loan or other extension of credit to any corporation, general or limited partnership, business trust, joint venture, sole proprietorship, or other business entity (including entities and individuals engaged in farming enterprises).

(f) *Cost approach* means the process by which an evaluator establishes an indicated value by measuring the current market cost to construct a reproduction of or replacement for the improvements, minus the amount of depreciation (physical deterioration, or functional and/or external obsolescence) evident in the structure from all causes, plus the market value of the land.

(g) *Evaluation* means a study of the nature, quality, or utility of, interest in, or aspects of, an asset. An evaluation may take the form of a valuation or an appraisal.

(h) *Fee appraiser* means a qualified evaluator who is not an employee of the party contracting for the completion of the evaluation and who performs an evaluation on a fee basis. For purposes of this subpart, a fee appraiser may include a staff evaluator from another Farm Credit System institution only if the employing institution is not operating under joint management with the contracting institution. In addition, for purposes of personal and intangible collateral evaluations, the term "fee appraiser" includes, but is not limited to, certified public accountants, equipment dealers, grain buyers, livestock buyers, and auctioneers.

(i) *FIRREA* means the Financial Institutions Recovery, Reform, and Enforcement Act of 1989.

(j) *Highest and best use* means the reasonable and most probable use of the property that would result in the highest market value of vacant land or improved property, as of the date of valuation; or that use, from among reasonably probable and legally alternative uses, found to be physically possible, appropriately supported, financially feasible, and which results in the highest land value.

(k) *Income capitalization approach* means the procedure that values property by measuring the present value of the expected future benefits of property ownership. This value is derived from either:

(1) Capitalizing a single year's income expectancy or an annual average of several years' income expectancies at a market-derived capitalization rate that reflects a specific income pattern, return on investment, and change in the value of the investment; or

(2) Discounting the annual cashflows for the holding period and the reversion at a specified yield rate or specified yield rates which reflect market behavior.

(l) *Market value* means the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably, and assuming neither is under duress. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(1) Buyer and seller are typically motivated;

(2) Both parties are well informed or well advised, and acting in what they consider their best interests;

(3) A reasonable time is allowed for exposure in the open market;

(4) Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and

(5) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(m) *Personal property*, for purposes of this subpart, means all tangible and movable property not considered real property or fixtures.

(n) *Qualified evaluator* means an individual who is competent, reputable, impartial, and has demonstrated sufficient training and experience to properly evaluate property of the type that is the subject of the evaluation. For the purposes of this definition, the term "qualified evaluator" includes an appraiser or valuator.

(o) *Real estate* means an identified parcel or tract of land, including improvements, if any.

(p) *Real estate-related financial transactions* means any transaction involving:

(1) The sale, lease, purchase, investment in, or exchange of real property, including interests in property or the financing thereof; or

(2) The refinancing of real property or interests in real property; or

(3) The use of real property or interests in real property as security for a loan or investment, including mortgage-backed securities.

(q) *Real property* means all interests, benefits, and rights inherent in the ownership of real estate.

(r) *Sales comparison approach* means the procedure that values property by comparing the subject property to similar properties located in relatively close proximity, having similar size and utility, and having been recently sold in arm's-length transactions (comparable sales). The sales comparison approach requires the evaluator to estimate the degree of similarity and difference between the subject property and comparable sales. Such comparison shall be made on the basis of conditions of sale, financing terms, market conditions, location, physical characteristics, and income characteristics. Appropriate adjustments shall be made to the sales price of the comparable property based on the identified deficiencies or superiorities of the subject property to arrive at a probable price for which the subject

property could be sold on the date of the collateral evaluation.

(s) *State certified appraiser* means any individual who has satisfied the requirements for and has been certified as a real estate appraiser by a State or territory whose requirements for certification currently meet or exceed the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation. No individual shall be a State certified appraiser unless such individual has achieved a passing grade on a suitable examination administered by a State or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualification Board of the Appraisal Foundation. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of the State or territory are inconsistent with title XI of FIRREA.

(t) *State licensed appraiser* means any individual who has satisfied the requirements for licensing and has been licensed as a real estate appraiser by a State or territory in which the licensing procedures comply with title XI of FIRREA and in which the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the State or territory are inconsistent with title XI of FIRREA.

(u) *Transaction value* means:

(1) For loans or other extensions of credit, the amount of the loan, loan commitment, or other extensions of credit;

(2) For sales, leases, purchases, investments in, or exchanges of real property, the market value of the property interest involved; and

(3) For the pools of loans or interests in real property, the transaction value of the individual loans or the market value of the real property interests comprising the pool.

(v) *USPAP* means the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Foundation.

(w) *Valuation* means the process of estimating a defined value of an identified interest or interests in a specific asset or assets as of a given date. A valuation results from the completion of a collateral evaluation that does not require an appraisal.

§ 614.4245 Collateral evaluation policies.

(a) The board of directors of each Farm Credit System institution that engages in lending or leasing secured by collateral shall adopt well-defined and effective collateral evaluation policies and standards, that comply with the

regulations in this subpart, to ensure that collateral evaluations are:

(1) Sufficiently descriptive and detailed to provide ample support to the institution's related credit decisions;

(2) Performed based on criteria established for the purpose of determining the circumstances under which collateral evaluations will be required and when they will be required. Such criteria must, at a minimum:

(i) Establish when an institution will require a collateral appraisal completed under the USPAP rather than a collateral valuation; and

(ii) Take into account such factors as market trends, market volatility, and various types of credit, loan servicing, collection, and liquidation actions; and

(3) Completed by a qualified evaluator in an unbiased manner.

(b) The policies and standards required by this section shall, at a minimum, address the criteria outlined in §§ 614.4250 through 614.4267 of this subpart.

§ 614.4250 Collateral evaluation standards.

(a) When real, personal, or intangible property is taken as security for a loan or is the subject of a lease, an evaluation of such property shall be performed in accordance with § 614.4260 and the institutions' policies and procedures. Such a collateral evaluation shall be identified as either a collateral valuation or a collateral appraisal. Specifically, all collateral evaluations must:

(1) Value the subject property based upon market value as defined in § 614.4240(l);

(2) Be presented in a written format;

(3) Consider the purpose for which the property will be used and the property's highest and best use, if different from the intended use;

(4) Be sufficiently descriptive to enable the reader to ascertain the reasonableness of the estimated market value and the rationale for the estimate;

(5) Provide sufficient detail (including an identification and description of the property) and depth of analysis to reflect the relevant characteristics and complexity of the subject property;

(6) Analyze and report, as appropriate, for real, intangible, and/or personal property, on:

(i) The current income producing capacity of the property;

(ii) A reasonable marketing period for the property;

(iii) The current market conditions and trends that will affect projected

income, to the extent such conditions will affect the value of the property;

(iv) The appropriate deductions and discounts as they would apply to the property, including but not limited to, those based on the condition of the property, as well as the specialization of the operation and property; and

(v) Potential liabilities, including those associated with any hazardous waste or other environmental concerns; and

(7) Include in the evaluation report a certification that the evaluation was not based on a requested minimum valuation or specific valuation or approval of a loan.

(b) For purposes of determining appraisal value as required in section 1.10(a) of the Act, the definition of market value and the requirements of this subpart shall apply.

§ 614.4255 Independence requirements.

(a) *Prohibitions.* For all personal and intangible property, and for all real property exempted under § 614.4260(c) of this subpart, no person may:

(1) Perform evaluations in connection with transactions in which such person has a direct or indirect interest, financial or otherwise, in the loan or subject property;

(2) As a director, vote on or approve a loan decision on which such person performed a collateral evaluation; or

(3) As a director, perform a collateral evaluation in connection with any transaction on which such person made or will be required to make a credit decision.

(b) *Officers and employees.* If the institution's internal control procedures required by § 618.8430 of this chapter include requirements for either a prior approval or post-review of credit decisions, officers and employees may:

(1) Participate in a vote or approval involving assets on which they performed a collateral evaluation; or

(2) Perform a collateral evaluation in connection with a transaction on which they have made or will be required to make a credit decision.

(c) *Real estate appraiser.* Except as provided in § 614.4260(c) of this subpart, all evaluations of real property that serve as the primary security for a loan shall be performed by a qualified real estate appraiser who has no direct or indirect interest, financial or otherwise, in the loan or subject property and is not engaged in the marketing, lending, collection, or credit decision processes of any of the following:

(1) A Farm Credit System institution making or originating the loan;

(2) A Farm Credit System institution operating under common management

with the institution making or originating the loan; or

(3) A Farm Credit System institution purchasing an interest in the loan.

(d) *Fee appraisers.* Fee appraisers shall be engaged directly by the Farm Credit System institution or its agent, and shall have no direct or indirect interest, financial or otherwise, in the property or transaction. A Farm Credit System institution may accept a real estate appraisal that was prepared by an appraiser engaged directly by another Farm Credit System institution, by a United States Government agency, a Government-Sponsored Enterprise or by a financial institution subject to title XI of FIRREA.

(e) *Loan purchases.* No employee who, acting as a State licensed or State certified appraiser, performed a real estate appraisal on any collateral supporting a loan shall subsequently participate in any decision related to the loan purchase.

§ 614.4260 Evaluation requirements.

(a) *Valuation.* Valuations of personal and intangible property, as well as real property exempted under paragraph (c) of this section, shall be performed by qualified individuals who meet the established standards of this subpart and the Farm Credit System institution obtaining the collateral valuation.

(b) *Appraisal.*

(1) Appraisals for real estate-related financial transactions with transaction values of more than \$250,000 shall be performed by a qualified appraiser who is a State licensed or a State certified real estate appraiser.

(2) Appraisals for real estate-related financial transactions with transaction values of more than \$1,000,000 shall be performed by a qualified appraiser who is a State certified real estate appraiser.

(c) *Appraisals not required.* An appraisal performed by a State certified or State licensed appraiser is not required for any real estate-related financial transaction in which any of the following conditions are met:

(1) The transaction value is \$250,000 or less;

(2) The transaction is a "business loan" as defined in § 614.4240(e) that:

(i) Has a transaction value of \$1,000,000 or less; and

(ii) Is not dependent on income derived from the sale or cash rental of real estate as the primary source of repayment;

(3) A lien on real property has been taken as collateral in an abundance of caution, and the application, when evaluated on the five basic credit factors, without considering the subject real estate, would support the credit

decision that was based on other sources of repayment or collateral;

(4) A lien on real estate is not statutorily required and has been taken for purposes other than the real estate's value;

(5) Subsequent loan transactions involving an existing extension of credit, provided that either:

(i) The transaction does not involve the advancement of new loan funds other than funds necessary to cover reasonable closing costs; or

(ii) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the Farm Credit System institution's real estate collateral protection, even with the advancement of new loan funds;

(6) A Farm Credit System institution purchases a loan or an interest in a loan, pool of loans, or interests in real property, including mortgage-backed securities, provided that:

(i) The appraisal prepared for each loan, pooled loan, or real property interest, when originated, met the standards of this subpart, other Federal regulations adopted pursuant to FIRREA, or the requirements of the government-sponsored secondary market intermediaries under whose auspices the interest is sold; and

(ii) There has been no obvious and material change in market conditions or physical aspects of the property that would threaten the Farm Credit System institution's collateral position, or

(7) A Farm Credit System institution makes or purchases a loan secured by real estate, which loan is guaranteed by an agency of the United States Government and is supported by an appraisal that conforms to the requirements of the guaranteeing agency.

To qualify for exceptions in paragraphs (c)(1) through (c)(7) of this section from the requirements of this subpart, the institution must have documentation justifying the use of such exceptions in the applicable loan file(s). In addition, the institution must document that the repayment of a "business loan" is not dependent on income derived from the sale or cash rental of real estate.

(d) *FCA-required appraisals.* The FCA reserves the right to require an appraisal under this subpart whenever it believes it is necessary to address safety and soundness issues.

(e) *Reciprocity.* The requirements of this subpart are satisfied by the use of State certified or State licensed appraisers from any State provided that:

(1) The appraiser is qualified to perform such appraisals;

(2) The applicable Farm Credit System institution has established policies providing for such interstate appraisals; and

(3) The applicable State appraiser licensing and certification agency recognizes the certification or license of the appraiser's State of permanent certification or licensure.

§ 614.4265 Real property evaluations.

(a) Real estate shall be valued on the basis of market value.

(b) Market value shall be determined by a reasonable valuation method that:

(1) Considers the income capitalization approach, the sales comparison approach, and/or the cost approach, as appropriate, to determine market value;

(2) Explains and documents the elimination of any approach not used.

(3) Reconciles the market values of the applicable approaches; and

(c) Where real estate appraisals or real estate collateral valuations for business loans in excess of \$250,000 that would not otherwise be exempted under § 614.4260(c) are required, such evaluations shall be completed in accordance with the USPAP and shall include a legal description of the subject property.

(d) At a minimum, the institution shall develop and document the evaluation of the income and debt servicing capacity for the property and operation where the transaction value exceeds \$250,000 and the real estate taken as collateral:

(1) Is an integral part of and supports the principal source of loan repayment; or

(2) Is not an integral part of and does not support the principal source of loan repayment, but has demonstrable rental market appeal, is statutorily required, and fully or partially constitutes an integral part of an agricultural or aquatic operation.

(e) The income-earning and debt-servicing capacity established under paragraph (d) of this section on such properties shall be documented as part of the credit analysis for any related loan action, whether or not the income capitalization approach value is used as the basis for the market value conclusion stated in the evaluation report.

(f) Collateral closely aligned with, an integral part of, and normally sold with real estate (fixtures) may be included in the value of the real estate. All other collateral associated with the real estate, but designated as personal property, shall be evaluated as personal property in accordance with §§ 614.4250 and 614.4266.

(g) The evaluation shall properly identify all nonagricultural influences, including, but not limited to, urban development, mineral deposits, and commercial building development value, and the reasoning supporting the evaluator's highest and best-use conclusion.

(h) Where an evaluation of real property is completed by a fee appraiser, as defined in § 614.4240(g), the institution's standards shall include provisions for periodic collateral inspections performed by the institution's account officer or appropriate designee.

§ 614.4266 Personal and intangible property evaluations.

(a) Personal property and intangibles shall be valued on the basis of market value in accordance with the institution's evaluation standards and policies.

(b) Personal property evaluations shall include a source of comparisons of value (i.e., equipment dealer listings, Blue Book, market sales reports, etc.) and a description of the property being evaluated, including location of the property and, where applicable, quantity, species/variety, measure/weight, value per unit and in total, type of identification (such as brand, bill of lading, or warehouse receipt), quality, condition, and date.

(c) Evaluations of intangibles shall include a review and description of the documents supporting the property interests and the marketability of the intangible property, including applicable terms, conditions, and restrictions contained in the document that would affect the value of the property.

(d) Where an evaluation of personal or intangible property is completed by a fee appraiser, as defined in § 614.4240(g), the institution's standards shall include provisions for periodic collateral inspections and verification by the institution's account officer or appropriate designee.

When a Farm Credit System institution deems an appraisal necessary, personal or intangible property shall be appraised in accordance with procedures and standards established by the institution by individuals deemed qualified by the institution to complete the work under the USPAP Competency and Ethics Provisions.

§ 614.4267 Professional association membership; competency.

(a) *Membership in appraisal organizations.* A State certified appraiser or a State licensed appraiser

may not be excluded from consideration for an assignment for a real estate-related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee evaluators, including appraisers, performing evaluations in connection with real, personal, or intangible property taken as collateral in connection with extensions of credit must meet the qualification requirements of this subpart. However, an evaluator (as defined in § 614.4240(n)) may not be considered competent solely by virtue of being certified, licensed, or accredited. Any determination of competency shall be based on the individual's experience and educational background as they relate to the particular evaluation assignment for which such individual is being considered.

Subpart L—Actions on Applications; Review of Credit Decisions

3. Section 614.4443 is amended by revising paragraph (c) to read as follows:

§ 614.4443 Review process.

* * * * *

(c) *Independent collateral evaluations.*

(1) An applicant for a loan that has been denied may, as part of the request for a review, request an independent collateral evaluation by an independent evaluator, as defined in § 614.4440 of this subpart, of any interests in property securing the loan (other than the stock or participation certificates of the lender held by the borrower).

(2) Within 30 days after a request for a collateral evaluation, the credit review committee shall present the applicant or borrower with a list of three independent evaluators approved by the qualified lender. The borrower shall select and engage the services of an evaluator from the list to perform the collateral evaluation. The collateral evaluation must be completed within a reasonable period of time. The cost of the evaluation shall be borne by the applicant or borrower.

(3) The credit review committee shall consider the results of any such collateral evaluation in any final determination with respect to the loan or restructuring, provided the applicant's or borrower's evaluator has provided a copy of the evaluation report to the lender not less than 15 business days prior to any scheduled meeting of the credit review committee.

(4) Any such collateral evaluations that are not completed in conformance with the collateral evaluation

requirements described in subpart F of this part, relative to collateral evaluation standards, independence requirements, and qualification requirements, need not be considered by the credit review committee. To facilitate the proper completion of such collateral evaluations, a copy of part 614, subpart F, shall be provided to the borrower for presentation to the borrower's evaluator, and a copy signed by the borrower's evaluator shall be a required exhibit in the subsequent evaluation report.

* * * * *

PART 618—GENERAL PROVISIONS

4. 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, 2200, 2211, 2218, 2243, 2244, 2252).

Subpart G—Releasing Information

5. Section 618.8320 is amended by adding a new paragraph (b)(11) to read as follows:

§ 618.8320 Data regarding borrowers and loan applicants.

* * * * *

(b) * * *

(11) Collateral evaluation reports may be released to a loan applicant, when required by the Equal Credit Opportunity Act or related regulations.

* * * * *

§ 618.8325 [Amended]

6. Section 618.8325 is amended by removing the words "appraisal" and "an appraisal" and adding in their place the words "collateral evaluation" and "a collateral evaluation" consecutively in the second and third sentences in paragraph (b).

Dated: September 1, 1994.

Curtis M. Anderson,
Secretary, Farm Credit Administration Board.
[FR Doc. 94-22220 Filed 9-9-94; 8:45 am]
BILLING CODE 6705-01-P

12 CFR Part 630

RIN 3052-AB23

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

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA), by the FCA Board, adopts new final regulations

governing the Farm Credit System's (FCS or System) preparation and reporting of Systemwide financial information to investors. The final rule requires that each bank of the System, the Federal Farm Credit Banks Funding Corporation (Funding Corporation), and the Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) jointly publish periodic reports to investors and potential investors in Systemwide debt obligations and consolidated bank debt obligations of the Farm Credit System (FCS debt obligations).

The purpose of the rule is to ensure that timely and accurate Systemwide financial information continues to be disclosed to investors and the public to assist them in making informed decisions regarding FCS debt obligations and System institutions. The required report to investors must present Systemwide combined financial statements, supplemental financial statement information, and related analyses pertaining to System institutions on a combined basis. The final rule covers Systemwide financial and non-financial information now regularly disclosed by the Funding Corporation in annual and quarterly information statements and press releases.

The final regulations generally parallel the existing Farm Credit System Disclosure Program (System Disclosure Program) and should not impose any significant additional burdens on System institutions. Consistent with the System Disclosure Program, the final rule preserves the existing reporting relationship between a System bank and its related associations.

EFFECTIVE DATE: The regulations shall become effective upon the expiration of 30 days after publication in the **Federal Register** during which either or both Houses of Congress are in session. Notice of the effective date will be published in the **Federal Register**.

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SUPPLEMENTARY INFORMATION:

I. Background

Under the System Disclosure Program, the Funding Corporation, on behalf of the System, periodically distributes to investors a disclosure document containing Systemwide financial information. The System institutions that participate in the System Disclosure Program (*i.e.*, each of the System banks, the Funding Corporation, and the Financial Assistance Corporation¹) jointly publish the Report to Investors of the Farm Credit System (FCS Report) on an annual basis. The FCS Report includes an Information Statement and a general report. The Information Statement contains combined financial statements and related analyses pertaining to all System institutions. The general report contains other information about the System, its debt obligations, and the environment in which it operates. Except for the quarter that coincides with the end of the fiscal year, System institutions also jointly publish a quarterly Information Statement. In connection with the sale of debt securities, the Funding Corporation routinely distributes the FCS Report and quarterly Information Statement to the investment dealers and dealer banks (selling group) that sell FCS debt securities. The FCA currently has no regulations that specifically govern the System's disclosure of Systemwide financial information to investors.

II. Statutory Authority and Proposed Rulemaking

Under section 5.17(a)(8) of the Farm Credit Act of 1971, as amended (1971 Act), 12 U.S.C. 2252(a)(8), the FCA is authorized to "Regulate the preparation by System institutions and the dissemination to stockholders and investors of information on the financial condition and operations of such institutions. * * * On February 4, 1994, the FCA proposed regulations for a new part 630, Disclosure to Investors in Systemwide and Consolidated Bank Debt Obligations of the Farm Credit System, to govern the System's preparation and reporting of Systemwide financial information to investors. (59 FR 5341) In general, the proposed regulations reflected the current division of responsibilities among the institutions participating in the System Disclosure Program, and included requirements for disclosures

similar to those contained in the Information Statements currently published by the System. The institutions participating in the System Disclosure Program were designated as the "disclosure entities" in the proposed regulations, in recognition of their shared responsibility for disclosure of Systemwide financial information to investors and the general public.

III. Discussion of the Final Rule and Summary of Public Comments

The FCA is adopting part 630 largely as proposed. The final rule includes changes and clarifications to address comments received on the proposed rule. As in the proposed regulations, the final regulations (1) Require the System to publish annual and quarterly reports to investors; (2) delineate responsibilities relating to the preparation of the report; (3) reinforce internal controls over Systemwide financial disclosure; and (4) establish reporting standards for the report to ensure that relevant information concerning the combined financial condition and results of operations of the System is disclosed to investors and potential investors. The final rule will prevent any inconsistency between Systemwide disclosure to investors and FCA regulations governing accounting and reporting standards and individual System institution disclosure to shareholders. These new FCA regulations will apply to the information currently contained in the System's Information Statements and press releases that contain Systemwide financial information. The final rule also implements section 514 of the Farm Credit Banks and Associations Safety and Soundness Act of 1992, Pub. L. 102-552 (1992 Act), which requires adequate disclosure to investors of financial and conflict-of-interest information.

The final regulations will ensure that timely and accurate Systemwide financial information continues to be disclosed to investors and the public to assist them in making informed decisions regarding FCS debt obligations and System institutions. This is consistent with the FCA Board's regulatory policy to "Protect the public, the investors, and the customer/shareholders of the System in an effort to create an environment whereby customer/shareholders and investors can take advantage of the System's strength and rely on its future viability with confidence." (See FCA Board Policy Statement on Regulatory Philosophy, 59 FR 32189, June 22, 1994)

The FCA received six comment letters on the proposed regulations during the

comment period, which expired on April 20, 1994. One letter was submitted by the Farm Credit Council (FCC) on behalf of its membership. The FCC comments were the product of input from a number of sources, including System banks, the System's Accounting Standards Work Group, and the Funding Corporation. The FCC recognized and concurred with the FCA's efforts to ensure that timely and accurate Systemwide financial information continues to be disclosed to investors and potential investors in FCS debt securities. Noting the System's general support for the proposed regulations, the FCC submitted comments on several provisions of the proposed regulations in the body of its letter and provided technical comments on other provisions in an attached appendix.

The Funding Corporation, the Farm Credit Bank of Texas (FCBT), and the Farm Credit Bank of Baltimore (FCBB) each submitted a letter addressing specific issues. The Funding Corporation commented concerning its access to FCA Examination Reports of System banks and associations. The FCBT addressed the same issue in its letter. In addition, the FCBT urged that the FCA prohibit directors of System institutions from serving on the System Audit Committee. While endorsing the comments submitted by the FCC, the FCBB urged that the FCA clarify, for purposes of Systemwide disclosure, the treatment of the FCBB's wholly-owned subsidiary, the Farm Credit Finance Corporation of Puerto Rico.

The American Institute of Certified Public Accountants (AICPA) and Price Waterhouse, the external auditor currently engaged to provide an opinion on the Systemwide combined financial statements, also commented on the proposed regulations. Both of these commenters suggested that the requirements for an accountant's opinion on supplemental information be clarified. The AICPA also commented on issues concerning the definition of "material," the due dates of the reports to investors, and the requirement for filing a letter with the FCA explaining the preferability of an accounting change.

After the FCA published the proposed rule, the General Accounting Office (GAO) issued a report entitled "Farm Credit System: Repayment of Federal Assistance and Competitive Position" (GAO/GGD-94-39, dated March 10, 1994), which recommended that the FCA require the System to exclude the Farm Credit Insurance Fund (Insurance Fund) from the System's combined financial statements because of the

¹ Since the board of the Funding Corporation is also the board of the Financial Assistance Corporation, the Financial Assistance Corporation's participation in the System Disclosure Program is implied.

GAO's view that exclusion is the most appropriate accounting treatment. On May 10, 1994, the FCA responded to the GAO's recommendation in a letter to Congressional committees which described the FCA's approach to Insurance Fund reporting as reflected in this rulemaking. The final regulations require that the System prepare the Systemwide combined financial statements in accordance with generally accepted accounting principles (GAAP), provide supplemental financial statement data with and without the Insurance Fund, and give a thorough discussion and analysis of the fund in the report to investors. The FCA believes that these regulations, as adopted, will ensure that investors are provided with meaningful information regarding the Insurance Fund and the effect of the fund on the System's financial position.

Provided below are a section-by-section analysis of changes to the proposed rule and FCA responses to the comments received.

IV. Section-by-Section Analysis of Public Comments

A. Section 630.2—Definitions

1. Section 630.2(b) and (h)—Definitions of "Combined Financial Statements" and "Systemwide Combined Financial Statements"

For preparation of the Systemwide combined financial statements, the final rule requires that each bank provide the Funding Corporation with bank-only financial data as well as with combined financial data of the bank and its related associations. The FCC and the FCBB commented that the proposed regulations should be clarified to address how the consolidated financial data of a bank and its wholly-owned subsidiaries should be reported in the Systemwide disclosure.

To distinguish financial data prepared on a combined basis from that prepared on a consolidated basis, a new definition of "combined financial statements" has been added in § 630.2(b) of the final rule. The definition is added to clarify that combined financial statements are prepared by a group of affiliated entities that share the same financial interest regardless of whether any of the entities has the ability to exercise control over another. In contrast, consolidated financial statements are prepared by a parent-entity to include the financial data of subsidiaries that are under its "control."

To prevent this newly added definition of "combined financial statements" from being confused with

the definition of "Systemwide combined financial statements" contained in § 630.2(g) of the proposed rule, proposed § 630.2(g) has been simplified to define "Systemwide combined financial statements" as the combined financial statements required by this part. Proposed § 630.2(g) also is redesignated as § 630.2(h). The proposed language specifying the purpose for which the Systemwide combined financial statements are prepared has been moved and combined with provisions pertinent to financial statements in § 630.20(l).

2. Proposed Definition of "Material"

Section 630.2(f) of the proposed regulations provided a definition of "material" similar to that found in Securities and Exchange Commission (SEC) Rule 405. The FCA received two comments on the proposed definition of "material." The AICPA asserted that defining "material" other than as established in accounting literature would be confusing and inconsistent if audits of the Systemwide combined financial statements are required to be performed in accordance with generally accepted auditing standards (GAAS). The AICPA recommended either deleting the proposed definition of "material" or amending it to refer to the materiality definition in GAAS or in Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information (FAC No. 2).

The FCA notes that the definition of "material" in the proposed rule was intended to govern information presented outside the basic financial statements.² Regardless of the proposed definition, the Systemwide combined financial statements required by this part are subject to materiality criteria established in GAAP. Specifically, pursuant to § 630.3(c),³ the Systemwide combined financial statements must be prepared in accordance with the accounting and reporting standards set forth in part 621 of this chapter. Because § 621.2(g) defines the term "material" in accordance with FAC No. 2, the GAAP definition of "material" contained in part 621 of this chapter will govern the

² Information presented "outside" the basic financial statements refers to information that is not considered necessary for presentation of financial position, results of operations, or cashflows in conformity with GAAP, e.g., management's discussion and analysis.

³ Section 630.3(c) provides that "All items of essentially the same character as items required to be reported in the reports of condition and performance pursuant to part 621 of this chapter shall be prepared in accordance with the rules set forth in part 621 of this chapter."

System's preparation of Systemwide combined financial statements. Consequently, materiality judgments for preparation of the Systemwide combined financial statements must be made in accordance with GAAP.

The FCC recommended that the proposed definition of "material" be expanded to recognize the different levels of reporting and disclosure responsibilities of the System banks and the Funding Corporation. The FCC suggested two separate definitions of "material." One of the suggested definitions would apply to the Banks' reporting responsibilities to the Funding Corporation and the second would apply to the Funding Corporation's disclosure responsibilities on a Systemwide basis as subject to antifraud provisions of the Federal securities laws.

Under GAAP, individual materiality judgments are made on a case-by-case basis and materiality is measured at each reporting level in light of surrounding circumstances. The GAAP position is supported by FAC No. 2 and recognizes that no general standards of materiality could be formulated to take into account all the considerations that enter into an experienced human judgment. In line with this approach to the concept of materiality, the FCA believes that it is unnecessary to include, as suggested by the FCC, two separate definitions of "material."

Materiality judgments regarding information presented outside the financial statements, while not covered by the GAAP definition, are governed by current standards of materiality under the securities laws.⁴ The FCA believes that the case law standard of materiality provides sufficient guidance to the System in preparing information to be presented outside the financial statements. To avoid any confusion between the GAAP materiality standard which governs preparation of the financial statements, and the standard of materiality enunciated in the case law, which governs information presented outside of the financial statements, the proposed definition of "material" has been eliminated from the final rule.

3. Section 630.2(g)—Definition of "Report to Investors"

The FCC commented that, although the preamble clarifies that the term "report to investors" used throughout the proposed rule is intended to mean the Information Statement currently published by the Funding Corporation, confusion exists as to whether the term

⁴ See *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) and cases following.

refers to the FCS Report or the Information Statement. Because the FCS Report currently prepared by the Funding Corporation contains certain information that is not part of the System Disclosure Program, and for which System banks are not responsible, the FCC suggested that all references to the "report to investors" in the regulation be replaced with the term "Information Statement."

The FCA does not intend to regulate the name of the report required by this part. The term "report to investors" used in the proposed rule is merely a general reference to the disclosure document required by this part. However, in response to the FCC's comment, a new definition of "report to investors" has been added as § 630.2(g) of the final rule to clarify that the term "report to investors" referred to in the regulations means "a report that presents the Systemwide combined financial statements, supplemental financial statement information, and related financial and nonfinancial information pertaining to the System required by this part." Under this provision, a document containing only information that is not required by this part and that is clearly identified as separate from the required report will not be subject to this final rule.

B. Section 630.3—Publishing and Filing the Report to Investors

1. Section 630.3(a)

The FCA received two comments on § 630.3(a), which establishes the due dates for publishing the annual and quarterly reports to investors. The FCC opined that the word "publish" in § 630.3(a) is subject to interpretation, and could mean printed, mailed, or received by the investors. The commenter suggested that the word "publish" be replaced with the phrase "make available."

Section 630.3(a) requires not only that the System "make available" the report to investors by the dates specified in § 630.3(a)(1) and (a)(2) but that the System take affirmative steps to distribute the report to investors. One such step, as noted in the rule proposal, is distribution of sufficient copies of the report to the selling group dealers for subsequent distribution to interested investors. The FCA believes that the suggested substitution of the phrase "make available" may discourage exploration of other report distribution techniques and, accordingly, has retained the word "publish" in § 630.3(a).

The AICPA also commented on § 630.3(a), suggesting that the FCA

reconsider whether the due dates prescribed in § 630.3(a) provide sufficient time for preparation of the combined information from various entities within the System. The FCA believes that the due dates established in § 630.3(a) for publishing and filing an annual report within 90 days after the end of each fiscal year and a quarterly report within 60 days after the end of each reporting quarter are adequate. The 90-day requirement for publishing the annual report to investors is consistent with industry practice. The 60-day requirement for publishing the quarterly report permits the Funding Corporation to publish the report 15 days after the constituent System banks and associations have filed their quarterly reports with the FCA pursuant to part 620 of this chapter. In addition, in the event the Funding Corporation is unable to prepare and publish the report to investors because one or more banks fail to fulfill their responsibilities for providing information to the Funding Corporation in accordance with § 630.4(c), § 630.4(a)(7) authorizes the Funding Corporation to request the FCA to extend the due date for publishing the report to investors. Accordingly, the FCA has adopted the due dates established in § 630.3(a) as proposed.

2. Section 630.3(f)—Banks' Joint and Several Liability for Consolidated Bank Debt Obligations

Section 630.3(f) requires that each report to investors include a statement that Systemwide debt securities and consolidated bank debt obligations are joint and several liabilities of individual banks. The FCC questioned the statutory basis for this required statement as regards individual bank joint and several liability for consolidated bank debt obligations. The FCC requested that the FCA provide a legal analysis of the statutory basis and extend the comment period for this provision.

The FCA believes that no extensive analysis is required to justify the position that consolidated bank debt obligations are joint and several liabilities of individual banks. The basis for this disclosure is found in section 4.4 of the 1971 Act, which clearly establishes joint and several liability of all banks for consolidated and Systemwide debt regardless of the title of the 1971 Act under which the bank operates. The FCA notes that the 75-day comment period on these regulations included a 30-day extension of the original comment period and believes that another extension of the comment period is unnecessary. The FCA has adopted § 630.3(f) as proposed.

C. Section 630.4—Responsibilities for Preparing the Report to Investors

1. Section 630.4(a)(2)(ii), (a)(3), and (a)(9)—Report of Examination

Proposed § 630.4(a)(9) authorizes the Funding Corporation to make a request to the FCA regarding the content of the latest Reports of Examination of any banks and related associations if the information is necessary for preparation of the report to investors. Two System institutions—the Funding Corporation and the FCBT—commented on the proposed provision.

The Funding Corporation suggested that the regulation be expanded so that, upon its request, each bank would be required to provide the Funding Corporation with the Reports of Examination and related information for the bank and related associations. The Funding Corporation is concerned that the regulation as proposed may be interpreted to implicitly absolve a bank of its responsibility to report to the Funding Corporation any significant regulatory conditions imposed or actions taken by the FCA against the bank or its related associations.

Conversely, the FCBT supported proposed § 630.4(a)(9) as written on the basis that it maintains an appropriate balance between the confidentiality of examination reports required by § 602.205 of this chapter and the need to provide complete and accurate disclosure to investors required by the proposed rule. Section 630.4(c) sets forth the responsibilities of each bank for preparation of the report to investors. Based on § 630.4(c)(5)(i), which requires that each bank certify to the Funding Corporation that the bank has submitted all information needed for preparation of the report to investors in accordance with the instruction of the Funding Corporation, the FCBT concluded that protection of the confidentiality of examination reports will not encourage banks to avoid their primary disclosure responsibilities with respect to material matters that may be discussed in the examination report.

While the FCBT supports § 630.4(a)(9) as proposed, it commented that the phrase "if necessary" leaves doubt as to whether the Funding Corporation should request the FCA to provide information contained in the examination reports in all cases or simply in those cases where a bank does not provide information contained in the examination report to the Funding Corporation. The FCBT requested that the FCA provide a definitive and unambiguous rule regarding the obligation to furnish copies of these reports.

In response to the comments received, the FCA has revised paragraphs (a)(2)(ii), (a)(3), and (a)(9) of § 630.4 to clarify that the Funding Corporation is responsible for collecting from each disclosure entity information needed for preparation of the report to investors, including any information that is material to a single disclosure entity. Likewise, in accordance with the Funding Corporation's instructions, each bank is responsible for providing the Funding Corporation with information that is material either to the bank or, on a combined basis, to the bank and its related associations. If information necessary for preparation of a report to investors that is meaningful and not misleading is not forthcoming from a bank in accordance with the provisions of § 630.4(c), the Funding Corporation may request the FCA to provide information regarding the content of the latest Reports of Examination of any banks or related associations necessary to ensure that the information presented in the report to investors is meaningful and not misleading. The FCA will then make a determination whether to provide the Funding Corporation with relevant information contained in the Report of Examination or, if appropriate, the entire report.

The FCA is cognizant of both the Funding Corporation's desire to have direct access to Reports of Examination and the FCBT's concern with protection of the confidentiality of the Reports of Examination. The FCA does not believe that § 630.4(a)(9) would relieve a bank of its responsibility to report any significant regulatory conditions that would have a material impact on the information being presented in the report to investors. It remains the primary responsibility of each bank to provide accurate and complete information to the Funding Corporation for preparing disclosure to investors. Each bank is required to certify to this effect to the Funding Corporation.

Section 630.4(a)(9) is established to provide the Funding Corporation with a contingency source for obtaining information needed to prepare accurate and comprehensive annual and quarterly reports to investors, while maintaining the confidentiality of the Reports of Examination. However, such requests from the Funding Corporation to the FCA are expected to be rare. Also, as the FCBT noted in its comment letter, § 630.5 prohibits banks from making incomplete, inaccurate, or misleading disclosures. Failure to disclose material information would violate these regulations and subject a bank and its

officers and directors to possible FCA enforcement action.

2. Sections 630.4(c)(1) and 630.20(m)(3)—Bank-Only Financial Data

Section 630.4(c)(1) requires that each bank provide the Funding Corporation with information needed for preparation of the report to investors. The FCC suggested that proposed § 630.4(c)(1) be revised to clarify that, for Systemwide disclosure, information to be provided by each bank to the Funding Corporation includes not only financial information, but nonfinancial information as well, including information covering structural changes and regulatory enforcement activity. Proposed § 630.4(c)(1) has been clarified to refer to other nonfinancial information.

The FCC also suggested that proposed §§ 630.4(c)(1) and 630.20(m)(3)(i) be revised to clarify that it is appropriate to include any wholly-owned subsidiary of a bank in the bank-only information. The FCBB submitted a separate comment in which it urged the FCA to include the FCC's suggestion in the final rule to address the treatment of the Farm Credit Finance Corporation of Puerto Rico, a wholly-owned subsidiary of the FCBB.

To address the concerns raised by the commenters regarding a bank's reporting of consolidated financial data in Systemwide disclosure, the FCA has removed the wording "bank-only" from § 630.4(c)(1) and clarified that, if a bank is required to prepare consolidated financial statements in accordance with GAAP, it is appropriate that the bank provide consolidated financial data of the bank and its consolidated subsidiaries to the Funding Corporation. Conforming changes were also made to § 630.20(m)(3) and Appendix A of the final rule.

3. Section 630.4(d)—Responsibilities of Associations

Proposed § 630.4(d) provides the banks with access to their related associations' auditors for preparation of the report to investors. The FCC commented that the banks sometimes may need to have access to others, such as legal counsel. To ensure that the banks have the ability to obtain any information necessary to accurately prepare their submission to the Funding Corporation, the FCC suggested that the regulation include a general statement that the banks may have access to any material association information. Under sections 2.2 and 2.12 of the 1971 Act, each association is subject to supervision by its related bank. Each

Farm Credit Bank is responsible for preparing the combined financial statements of the bank and related associations for disclosure to shareholders pursuant to part 620 of this chapter. Part 620 of this chapter does not, however, specify how the disclosure responsibilities between banks and related associations are shared. To clarify this issue for purposes of part 630, the FCA has expanded proposed § 630.4(d) by adding a general statement in § 630.4(d)(1) of the final rule to require that each association provide its related bank with the information necessary to allow the bank to provide accurate and complete information to the Funding Corporation for preparation of the report to investors. The original text of proposed § 630.4(d) has been redesignated as § 630.4(d)(2).

D. Section 630.5—Prohibition Against Incomplete, Inaccurate, or Misleading Disclosure

The FCC suggested that the FCA clarify that § 630.5 concerning prohibition against incomplete, inaccurate, or misleading disclosure would apply only when the defective disclosure is material. Since compliance with the disclosure standards of this part is generally subject to a materiality test in any event, the FCA finds it unnecessary to add the suggested materiality language to § 630.5 and has adopted this section as proposed.

E. Section 630.6—System Audit Committee and Bank Audit Committees

1. Section 630.6(a)(2)

Under § 630.6(a)(2), officers or employees of a System institution are prohibited from serving on the System Audit Committee (SAC) because they are not independent of management. The FCBT urged the FCA to prohibit System directors from serving on the SAC due to potential conflicts of interest based on competition between System institutions.

The FCA believes that the suggested prohibition would be disruptive to the existing SAC and force the Funding Corporation to recruit SAC members from outside the System. In addition, the FCA views the FCBT's argument as relating less to conflict of interest than to concern regarding preservation of the confidentiality of information reviewed by the SAC. Under section 4.9 of the 1971 Act, directors and management of System institutions are eligible to serve on the board of the Funding Corporation. As a practical matter, any information available to SAC members is equally available to the members of

the board of the Funding Corporation. Thus, precluding System directors from serving on the SAC would not necessarily prevent confidential information from being exposed to directors of other System banks. In light of these considerations, the FCA is adopting the rule as proposed but will monitor SAC activities for apparent inappropriate use of information. Finally, the FCA notes that § 630.6(a) does not prevent the Funding Corporation board from adopting a policy to disqualify System directors from serving on the SAC.

2. Section 630.6(a)(4)(iii)

The FCC commented that the word "approve" contained in § 630.6(a)(4)(iii) of the proposed rule implies that the SAC has the authority to dictate individual bank accounting policies or that the Funding Corporation has the authority to require banks to uniformly and consistently adopt or change accounting policies. This was not the intent of the proposed rule. The primary duty of the SAC is to ensure the integrity of the report to investors jointly prepared by the Funding Corporation and System banks. The SAC is responsible for overseeing the reporting process and internal controls implemented by the Funding Corporation for preparation of the System's report to investors. To clarify that neither the SAC nor the Funding Corporation is charged with the responsibility for dictating individual banks' accounting policies, the FCA has substituted the word "review" for the word "approve" as suggested.

3. Section 630.6(a)(4)(iv)

Under proposed § 630.6(a)(4)(iv), the SAC is required to review each disclosure document containing Systemwide information prescribed in this part, including annual reports, quarterly reports, and press releases, prior to its release. The FCC commented that the SAC's responsibility should pertain only to financial information and disclosures contained in the annual information statements because the SAC generally would not have the expertise to review and evaluate nonfinancial information, such as is found in the description of business and description of debt securities. The FCC also suggested that, to facilitate timely issuance of quarterly information, the requirement for a review of each quarterly report or press release by the SAC prior to its release be eliminated.

To ensure the quality of the report to investors, the FCA believes that each annual or quarterly report should be reviewed by the SAC in its entirety.

Under § 630.6(a)(2), which provides that "members shall be knowledgeable in public and corporate finance and financial reporting and disclosure," members selected to serve on the SAC should have the expertise to review the entire report to investors, including both financial and nonfinancial information. However, the FCA agrees that the essence of press releases is to provide timely release of interim information and has deleted the requirement for a review of press releases by the SAC from § 630.6(a)(4)(iv).

4. Section 630.6(a)(4)(v) and (b)(3)(ii)

The FCC suggested that the word "oversee" contained in proposed § 630.6(a)(4)(v) and (b)(3)(ii) regarding the responsibility of the SAC and the bank audit committee be replaced with the word "review" because the proposed wording implies that the audit committee would perform a management function in the System or the bank. The FCC also suggested other changes to proposed § 630.6(a)(4)(v) to avoid this implication.

The audit committee is commonly recognized as an entity established to perform an oversight function in the areas of financial reporting, internal control, and corporate governance. The word "oversee" contained in the proposed rule is consistent with the customary role of audit committees. The FCA has retained the word "oversee" in § 630.6(a)(4)(v) and (b)(3)(ii). The FCA notes that it is the responsibility of the board of each System institution to determine the steps the audit committee should perform to fulfill its oversight responsibilities. Thus, the boards of individual System institutions could charter their audit committee to review and direct management to take necessary corrective actions or merely to review and make corrective recommendations to the board.

F. Subpart B—Annual Report to Investors

1. Section 630.20(c)(2)—Description of Legal Proceedings and Enforcement Actions

The FCC suggested that the proposed § 630.20(c)(2) disclosure requirement for a summary of FCA enforcement actions against individual institutions be clarified and that any required discussion of the impact of the enforcement actions on the System's operations be linked to materiality. The FCA agrees with this suggestion and has revised the language of § 630.20(c)(2) of the final rule accordingly.

2. Section 630.20(d)—Description of Liabilities

The FCC expressed the view that the information called for by § 630.20(d)(1) regarding System debt obligations is too detailed and, thus, impractical. Section 630.20(d)(1)(ii) is, in large part, based upon the disclosure currently furnished by the System in its Information Statements. Unless otherwise needed to provide readers of the report to investors with information needed to understand the characteristics of System debt, the FCA does not expect extensive detail regarding the characteristics of specific debt offerings. To clarify this position, the FCA has deleted the words "terms and conditions" and added prefatory language to § 630.20(d)(1)(ii) requiring a description of debt obligations statutorily authorized to be issued and currently issued by the System, as well as other pertinent information.

The FCC also requested that the regulation clearly set forth the option of incorporating by reference the annual and quarterly reports to investors into specific offering documents. The FCA notes that the focus of this regulation is on periodic reports of the System to investors. It does not govern offering circulars or specific offering documents. Nothing in this regulation precludes the System from incorporating by reference information contained in the annual or quarterly reports to investors into specific offering documents if otherwise appropriate.

3. Section 630.20(g)(1)—Loan Portfolio

Proposed § 630.20(g)(1)(ii) required disclosure of the amount of loans outstanding that were used to finance the purchases of stock or other equities of System institutions.

The FCC expressed concern regarding the System's ability to comply with this requirement and questioned its relevance to investors. The FCC opined that disclosures currently provided by the System in its annual Information Statement are sufficient. The System's 1993 annual Information Statement states that association borrowers do not typically purchase capital stock for cash, but instead add the aggregate par value of stock to the principal amount of the related loan obligation. The 1993 report also provided the amount of capital stock and participation certificates outstanding at December 31, 1993. The FCC indicated that System compliance with the proposed requirement could only be on a prospective basis because System banks do not have a system in place to track needed information. Further, the FCC

argued that the costs involved in complying with this proposed requirement would outweigh the benefits derived from the disclosure.

The FCA supports the commenter's view that the cost involved in providing meaningful information to investors should not outweigh the benefits derived. The FCA also notes that § 630.20(e)(2), which requires the System to "describe the statutory requirement that a borrower purchase stock as a condition of obtaining a loan; how such stock is purchased, transferred, and retired; and how earnings are distributed," will ensure that investors continue to receive information that describes the nature of borrower stock of the System. As a result, proposed § 630.20(g)(1)(ii) has been deleted from the final rule and proposed § 630.20(g)(1)(iii) and (iv) have been redesignated.

4. Section 630.20(g)(1)(ii)—Risk Exposure

Proposed § 630.20(g)(1)(iii) requires discussion and analysis of the risk exposure of the loan portfolio. The FCC suggested that the term "nonperforming loans" replace the term "high-risk assets" in this section of the regulation because it is more widely used in the commercial banking industry. Use of the term "high-risk assets" in proposed § 630.20(g)(1)(iii) is consistent with the recent amendment of the FCA's accounting and reporting guidelines in part 621 of this chapter. See 58 FR 48780 (September 20, 1993). In the FCA's regulations, the term "high-risk assets" is a generic reference to loans and loan-related assets that are to be categorized for loan performance and valuation assessment purposes according to the criteria set forth in § 621.6 of this chapter. Collectively, the classifications identified in § 621.6 of this chapter are consistent with the terminology used in the commercial banking industry for nonperforming loans. There is no regulatory requirement to categorize the classification as "high-risk assets" in the report to investors. Rather, proposed § 630.20(g)(1)(iii) requires discussion of any risks that could adversely affect the loan portfolio and loan-related assets. Accordingly, the FCA has retained the term "high-risk assets" and adopted § 630.20(g)(1)(iii) essentially as proposed. Proposed § 630.20(g)(1)(iii) is redesignated as § 630.20(g)(1)(ii). The FCA further notes that it expects to revisit the issue of accounting for impaired loans in the future to assess the impact of the implementation of Statement of Financial Accounting Standards No. 114, Accounting by

Creditors for Impairment of a Loan, issued by the Financial and Accounting Standards Board.

5. Section 630.20(g)(1)(iii)—Secondary Market Activities

The FCC commented that secondary market activities have never been and currently are not anticipated to be material to the System's financial condition. The FCC suggested that proposed § 630.20(g)(1)(iv) be modified to require these activities to be described when they become material to the System's financial condition. The FCA agrees with the commenter that the System's involvement in the secondary markets should be disclosed to investors when the effect of such activities on the financial condition of the System is material and has revised proposed § 630.20(g)(1)(iv) to add materiality tests. This provision is redesignated as § 630.20(g)(1)(iii) of the final rule.

The FCA believes that the System's statutory authority to participate in secondary markets should be disclosed to investors in any event. A new paragraph has thus been added in § 630.20(a)(1)(vi) of the final rule to require, without regard to materiality, a description of the authority of System institutions to purchase and sell interests in loans in secondary markets and the risk involved.

6. Section 630.20(g)(3)(ii) and (iii)—Liquidity and Investment

Section § 630.20(g)(3)(ii) and (iii) require that the System provide a brief description of the System's policies regarding liquidity and investment. The FCC pointed out that each System bank adopts its own liquidity and investment policies according to its business objectives. In the absence of universal policies regarding investment and liquidity among System institutions, the commenter suggested that the proposed regulations be revised to require only a general description of System banks' policies. The suggested change is consistent with the intent of the proposed regulations. The FCA has clarified the proposed regulations by revising § 630.20(g)(3)(ii)(A) and (g)(3)(iii) to require a brief overview of liquidity and investment matters.

7. Section 630.20(g)(3)(iv)—Interest Rate Sensitivity

Section 630.20(g)(3)(iv) requires a general description of the System's risk management practices, including a brief discussion of derivative transactions. Due to the heightened interest of the public, financial institution regulators, and Congress in this area, the FCA solicited comments on whether

disclosure requirements regarding derivative activities should be more detailed. The FCC suggested that, given the changing GAAP environment for derivative transactions, the FCA consider the approach to derivatives activity regulation used by other bank regulators. This approach requires regulated institutions to adopt policies in accordance with GAAP. The regulator provides any clarification of GAAP or additional guidance through Call Report instructions or other mechanisms.

The FCA adopts § 630.20(g)(3)(iv) as proposed, with a clarification to provide for a "brief overview" of the System's asset and liability management practices. The FCA believes that this approach to derivatives activities disclosure is consistent with the FCC's suggestion. In addition, along with other financial institution regulators, the FCA is monitoring the area of derivatives activities. The FCA will consider requiring more extensive disclosure based on its assessment of the level and significance of System derivatives activities and as the need for regulatory policy in this area becomes more clearly defined.

8. Section 630.20(g)(5)—Insurance Fund

The FCC commented that § 630.20(g)(5), which requires a discussion of the Insurance Fund in the Discussion and Analysis (D&A) section of the report to investors, is unnecessary and would duplicate the disclosure contained in the notes to the System's combined financial statements. Section 630.20(g)(5) requires a discussion of the purposes of the Insurance Fund, a schedule itemizing Insurance Fund assets that have been identified for specific purposes, and an explanation of how expenditures of Insurance Fund assets affect the assets and capital of the System.

The FCA does not believe that the requirement of § 630.20(g)(5) will result in duplication of information in the report. Section 630.3(e) provides that "Information in any part of the report may be incorporated by reference * * * to any other item of the report. Information * * * may be presented in any order deemed suitable by the Funding Corporation." Accordingly, the Funding Corporation has the flexibility to determine where the D&A regarding the Insurance Fund is to be presented. The FCA has adopted § 630.20(g)(5) as proposed.

The FCA notes that the regulation does not require the D&A regarding the Insurance Fund to be audited. Pursuant to § 630.3(e), the System could opt to include the required D&A in the notes to the Systemwide combined financial

statements and incorporate the disclosure by reference into the D&A. In this situation, the required D&A regarding the Insurance Fund would be covered in the independent accountant's report on the Systemwide combined financial statements.

9. Section 630.20(g)(6)—Instructions for Discussion and Analysis

Proposed § 630.20(g)(6)(ii) requires that discussions required by proposed § 630.20(g) cover the 3-year period covered by the financial statements. The FCC suggested that the words "3-year" be deleted. In recognition that the reporting period for the balance sheet is only 2 comparative years, the FCA agrees with the commenter and has amended § 630.20(g)(6)(ii) of the final rule as suggested and revised the introductory paragraph of § 630.20(g) accordingly.

10. Section 630.20(i)—Compensation of Directors and Senior Officers

Section 630.20(i) requires the annual report to state that information on the compensation of directors and senior officers of System banks is contained in each bank's annual report to shareholders and that the annual report of each bank is available to investors upon request pursuant to § 630.3(f). The FCC commented that this requirement provides no useful information to investors and is redundant.

As stated in the rule proposal, the FCA is required by section 514 of the 1992 Act to ensure that the disclosure of financial and conflict-of-interest information by System personnel provides investors and potential investors with information necessary to assist them in making investment decisions regarding FCS debt obligations or institutions. The FCA believes that information on compensation of System directors and senior officers presented in individual System institutions' disclosure to shareholders pursuant to part 620 of this chapter could provide useful information to investors in making investment decisions. Thus, to implement the requirement of section 514 of the 1992 Act, § 630.20(i) requires that the report provide a statement informing investors of the availability of such information. The FCA adopts § 630.20(i) of the final rule as proposed.

11. Section 630.20(l) and (m)—Financial Statements and Supplemental Information

Proposed § 630.30(l) requires that the System prepare the combined financial statements in accordance with GAAP and instructions and other requirements

of the FCA. Proposed § 630.20(m) further requires that the System provide supplemental information in addition to the audited financial statements and that the supplemental information be examined by a qualified public accountant for compliance with FCA regulations and guidelines and an opinion expressed thereon. The FCA received comments on proposed § 630.20(l) from the AICPA and the FCC and comments on proposed § 630.20(m) from the AICPA and Price Waterhouse.

With respect to proposed § 630.20(l), both the FCC and the AICPA suggested, for different reasons, that the phrase "instructions and other requirements of the FCA" be deleted from the proposed rule. The FCC was concerned that the proposed language indicates that regulatory accounting practices (RAP) may be utilized, causing investor confusion. On the other hand, the AICPA provided suggested language that would require both the basic financial statement and the supplemental information required by proposed § 630.20(l) and (m) to be audited in accordance with GAAS. The AICPA asserted that the requirements of proposed § 630.20(m) regarding supplemental information disclosure appear to comprise the "instructions and other requirements of the FCA" referred to in § 630.20(l) and, further, that GAAS addresses auditors' reporting on information presented outside financial statements.

Price Waterhouse, the external auditor of the System, also commented on proposed § 630.20(m). Price Waterhouse asserted that the proposed language that "supplemental information be examined by a qualified public accountant for compliance with FCA regulations and guidelines" is too broad and would be interpreted as requiring the independent accountant to render a report on the System's compliance with all FCA regulations and guidelines. This would require significant work by the independent accountant. Price Waterhouse commented that the proposed regulatory language in § 630.20(m) provides insufficient detail to enable the external auditor to determine the scope of additional work to be performed and the type of report to be issued by the auditor on the supplemental information.

Proposed § 630.20(l) was intended to preserve the FCA's ability to prescribe additional requirements for preparation and presentation of the Systemwide combined financial statements. However, after consideration of the comments received, the FCA adopts the AICPA's suggestion in the final rule to require that both the basic financial

statements and the supplemental information required by § 630.20(l) and (m) be examined in accordance with GAAS and an opinion expressed thereon by an independent accountant. This change will resolve the FCC concern regarding RAP financial statements and Price Waterhouse's concern regarding the scope of examination of supplemental information and reporting by the independent accountant. However, to preserve the flexibility to revise the format and content specified in Appendix A of the final rule, the FCA retains the requirement that supplemental information be prepared in accordance with any additional FCA guidance or instructions.

12. Section 630.20(o)—Cross-Reference Sheet

Proposed § 630.20(o) called for a cross-reference sheet giving the location of information required by these regulations, in the order required, and identified by item numbers and captions. The FCC did not object to the preparation of a cross-reference sheet, but suggested that the cross-reference sheet would only be useful to the FCA and should only be required as an exhibit to copies of the report filed with the FCA. The FCA believes the cross reference to the content of the report provides useful information to readers of the report. To make this indexing requirement more useful to investors, the FCA has revised § 630.20(o) to inform readers of the location in the report of the information required under the major disclosure captions of this part.

G. Subpart C—Quarterly Report to Investors

Proposed § 630.40(b)(5) requires that the System file a "preferability" letter with the FCA disclosing any accounting changes made during the reporting period that are not required by new accounting pronouncements. The AICPA and the FCC commented that the requirement for filing a separate letter with the FCA explaining the reason for the preferable alternative accounting principle is unnecessary. They suggested that the requirement be deleted from § 630.40(b)(5).

The preferability letter was intended as a notice to inform the FCA of any accounting change made by the System during the interim period that is not required by existing accounting pronouncements. Because the quarterly report will be required to disclose such accounting changes, upon further consideration, the FCA has deleted the requirement of filing a preferability

letter from § 630.40(b)(5) of the final rule.

List of Subjects in 12 CFR Part 630

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

For the reasons stated in the preamble, part 630 of chapter VI, title 12 of the Code of Federal Regulations is added to read as follows:

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

Subpart A—General

Sec.

- 630.1 Purpose.
- 630.2 Definitions.
- 630.3 Publishing and filing the report to investors.
- 630.4 Responsibilities for preparing the report to investors.
- 630.5 Prohibition against incomplete, inaccurate, or misleading disclosure.
- 630.6 Farm Credit System audit committee and bank audit committees.

Subpart B—Annual Report to Investors

- 630.20 Contents of the annual report to investors.

Subpart C—Quarterly Reports to Investors

- 630.40 Contents of the quarterly report to investors.

Appendix A to Part 630—Supplemental Information Disclosure Guidelines

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

Subpart A—General

§ 630.1 Purpose.

This part sets forth the requirements for preparation and publication by the Farm Credit System (FCS or System) of annual and quarterly reports to investors and potential investors in Systemwide and consolidated bank debt obligations of the System and to other users of the reports in the general public.

§ 630.2 Definitions.

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

(a) *Bank* means any bank chartered under the Farm Credit Act of 1971, as amended (Act).

(b) *Combined financial statements* means financial statements prepared on a combined basis by a group of affiliated entities that share the same financial interest, regardless of whether any of the entities has the ability to exercise

control over another. For purposes of this part, unless otherwise specified, combined financial data of a bank and its related associations includes financial data of the bank's consolidated subsidiaries.

(c) *Disclosure entity* means any bank, the Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation), and the Federal Farm Credit Banks Funding Corporation (Funding Corporation).

(d) *Engagement letter* means the proposal, contract, letter, and other documents reflecting the understandings between the audit committee or board of directors of a bank or an association and its independent public accountant regarding the scope, terms, and nature of the audit services to be performed.

(e) *Farm Credit System* means, collectively, the banks, associations, and such other institutions that are or may be made a part of the System under the Act, all of which are chartered by and subject to regulation by the Farm Credit Administration (FCA). For purposes of this part, the System does not include the Federal Agricultural Mortgage Corporation (Farmer Mac).

(f) *FCS debt obligation* means, collectively, notes, bonds, debentures, and other debt securities issued by banks pursuant to section 4.2(c) (consolidated bank debt securities) and section 4.2(d) (Systemwide debt securities) of the Act.

(g) *Report to investors or report* means a report that presents the Systemwide combined financial statements, supplemental financial statement information, and related financial and nonfinancial information pertaining to the System required by this part.

(h) *Systemwide combined financial statements* means the combined financial statements required by this part.

§ 630.3 Publishing and filing the report to investors.

(a) The disclosure entities shall jointly publish the following reports in order to provide meaningful information pertaining to the financial condition and results of operations of the System to investors and potential investors in FCS debt obligations and other users of the report:

(1) An annual report to investors within 90 days after the end of each fiscal year;

(2) A quarterly report to investors within 60 days after the end of each quarter, except for the quarter that coincides with the end of the fiscal year.

(b) Each report to investors shall present Systemwide combined financial

statements and related footnotes deemed appropriate for the purpose of the report to provide investors with the most meaningful presentation pertaining to the financial condition and results of operations of the System.

(c) All items of essentially the same character as items required to be reported in the reports of condition and performance pursuant to part 621 of this chapter shall be prepared in accordance with the rules set forth in part 621 of this chapter.

(d) Each report to investors shall contain the information required by subparts B and C of this part, as applicable, and such other information as is necessary to make the required statements, in light of the circumstances under which they are made, not misleading.

(e) Information in any part of the report may be referenced or incorporated in answer or partial answer to any other item of the report. Information required by this part may be presented in any order deemed suitable by the Funding Corporation.

(f) The report shall include a statement in a prominent location that Systemwide debt securities and consolidated bank debt obligations are joint and several liabilities of individual banks and that copies of each bank's recent periodic reports to shareholders are available upon request. The report shall also include addresses and telephone numbers where copies of the report to investors and the periodic reports of individual banks can be obtained. Copies of the report to investors shall be available for public inspection at the Funding Corporation.

(g) Three complete copies of the report shall be filed with the Chief Examiner, Farm Credit Administration, McLean, Virginia 22102-5090, within the applicable period prescribed under paragraphs (a)(1) and (a)(2) of this section.

(1) At least one copy of the report filed with the FCA shall be dated and manually signed by the following officers and director(s) of the Funding Corporation on its behalf:

(i) The officer(s) designated by the board of directors to certify the report;

(ii) The chief executive officer; and

(iii) Each member of the board or, at a minimum, one of the following board members formally designated by action of the board to certify on behalf of individual board members: the chairperson of the board or a board member designated by the chairperson of the board.

(2) The name and position title of each person signing the report shall be typed or printed beneath his or her

signature. Signers of the report shall attest as follows:

The undersigned certify that this report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of his or her knowledge and belief.

§ 630.4 Responsibilities for preparing the report to investors.

(a) *Responsibilities of the Funding Corporation.* The Funding Corporation shall:

(1) Prepare the reports to investors required by § 630.3(a), including the Systemwide combined financial statements and notes thereto, and such other disclosures, supplemental information, and related analysis as are required by this part to make the reports meaningful and not misleading.

(2) Establish a system of internal controls sufficient to reasonably ensure that any information it releases to investors and the general public concerning any matter required to be disclosed by this part is true and that there are no omissions of material information. The system of internal controls, at a minimum, shall require that the Funding Corporation:

(i) Maintain written policies and procedures, approved by the System Audit Committee, to be carried out by the disclosure entities for preparation of the report to investors;

(ii) Provide instructions to the disclosure entities regarding the information needed for preparation of the Systemwide combined financial statements and disclosures required to be presented in the report to investors;

(iii) Review the information submitted to it for preparation of the report to investors, and make reasonable inquiries to ascertain whether the information is reliable, accurate, and complete; and

(iv) Specify procedures for monitoring interim disclosures of System institutions and disclose, in a timely manner, any material changes in information contained in the most recently published report to investors.

(3) Collect from each disclosure entity financial data and related analyses and other information needed for preparation of the report to investors, including any information that is material to the disclosure entity.

(4) File the reports with the FCA in accordance with § 630.3(g).

(5) Ensure prompt delivery of sufficient copies of each report to selling group dealers for distribution to investors and potential investors in FCS debt obligations.

(6) Make the report available to the general public upon request.

(7) Notify the FCA if it is unable to prepare and publish the report to investors in compliance with the requirements of this part because one or more banks have failed to comply with the requirements of paragraph (c) of this section. A notification, signed by the officer(s) designated by the board of directors of the Funding Corporation to certify the report to investors and by the chief executive officer, shall be made to the FCA as soon as the Funding Corporation becomes aware of its inability to comply. The Funding Corporation shall explain the reasons for the notification and may request that the FCA extend the due date for the report to investors.

(8) Include in the report a statement that briefly explains the respective responsibilities of the disclosure entities and states that the Funding Corporation has policies and procedures in place to ensure, to the best of the knowledge and belief of management and the board of the Funding Corporation, that the information contained in the report is true, accurate, and complete. The statement shall be signed by the chief executive officer and the chairperson of the board of the Funding Corporation.

(9) Request the FCA to provide information regarding the content of the latest Reports of Examination of any banks and related associations, if such information is necessary for preparation of a report that is meaningful and not misleading and is not forthcoming from a bank in accordance with paragraph (c) of this section. The request shall be made to the Chief Examiner, Farm Credit Administration, McLean, Virginia 22102-5090.

(b) *Responsibilities of the Financial Assistance Corporation.* The Financial Assistance Corporation shall provide to the Funding Corporation such information as may be required by the Funding Corporation to prepare the report.

(c) *Responsibilities of banks.* Each bank shall:

(1) Provide to the Funding Corporation annual, quarterly, and interim financial and other information in accordance with instructions of the Funding Corporation for preparation of the report to investors, including:

(i) Financial data of the bank or, if the bank is required under generally accepted accounting principles (GAAP) to prepare its financial statements on a consolidated basis with its subsidiaries, consolidated financial data of the bank and its consolidated subsidiaries; and

(ii) Combined financial data of the bank (including any consolidated

subsidiaries of the bank) and related associations of the bank.

(2) Respond to Funding Corporation inquiries and provide any followup information requested by the Funding Corporation in connection with the preparation of the report to investors in accordance with instructions of the Funding Corporation.

(3) Notify the Funding Corporation promptly of any events occurring subsequent to publication of the report that may be material either to the financial condition and results of operations of the bank or to the combined financial condition and results of operations of the bank and its related associations. Furnish the Funding Corporation with any information necessary to provide interim Systemwide disclosure to investors to make the most recently published report to investors not misleading.

(4) Provide in the engagement letter with its external auditor that the external auditor shall, after notifying the bank, respond to inquiries from the Funding Corporation relating to preparation of the report.

(5)(i) Certify to the Funding Corporation that:

(A) All information needed for preparation of the report to investors has been submitted in accordance with the instructions of the Funding Corporation;

(B) The information submitted is prepared in accordance with all applicable statutory and regulatory requirements; and

(C) The information submitted is true, accurate, and complete to the best of management's knowledge and belief.

(ii) The certification required by paragraph (c)(5)(i) of this section shall be prepared as specified by the Funding Corporation and shall be manually signed and dated on behalf of the bank by:

(A) The officer(s) designated by the board of directors to certify the information submitted to the Funding Corporation; and

(B) The chief executive officer.

(d) *Responsibilities of associations.* Each association shall:

(1) Provide its related bank with the information necessary to allow the bank to provide accurate and complete information regarding the bank and its related associations to the Funding Corporation for preparation of the report.

(2) Provide in the engagement letter with its external auditor that the external auditor of the association shall, after notifying the association, respond to inquiries of the related bank

pertaining to preparation of the combined financial data of the association and its related bank.

§ 630.5 Prohibition against incomplete, inaccurate, or misleading disclosure.

Neither the Funding Corporation, nor any institution supplying information to the Funding Corporation under this part, nor any employee, officer, director, or nominee for director of the Funding Corporation or of such institutions, shall make or cause to be made any disclosure to investors and the general public required by this part that is incomplete, inaccurate, or misleading. When any such institution or person makes or causes to be made disclosure under this part that, in the judgment of the FCA, is incomplete, inaccurate, or misleading, whether or not such disclosure is made in published statements required by this part, such institution or person shall promptly furnish to the Funding Corporation, and the Funding Corporation shall promptly publish, such additional or corrective disclosure as is necessary to provide full and fair disclosure to investors and the general public. Nothing in this section shall prevent the FCA from taking additional actions to enforce this section pursuant to its authority under title V, part C of the Act.

§ 630.6 Farm Credit System audit committee and bank audit committees.

(a) *Farm Credit System audit committee.* (1) The board of the Funding Corporation shall establish and maintain a System Audit Committee and adopt a written charter describing the committee's composition, authorities, and responsibilities.

(2) The System Audit Committee shall consist of no fewer than three members. Members shall be independent of management of any disclosure entity and association and free from any relationship that, in the opinion of the board of directors of the Funding Corporation, would interfere with the exercise of independent judgment as a committee member. Members shall be knowledgeable in public and corporate finance, and financial reporting and disclosure.

(3) The System Audit Committee shall report to the board of the Funding Corporation and shall be given adequate resources and authorities to discharge its responsibilities, including the ability to consult the Funding Corporation's legal counsel.

(4) *Responsibilities.* At a minimum, the System Audit Committee shall:

(i) Make recommendations to the board of the Funding Corporation regarding the selection of an

independent auditor of the Systemwide combined financial statements;

(ii) Oversee the Funding Corporation management's preparation of the report to investors;

(iii) Review the impact of any significant accounting and auditing developments, and review accounting policy changes relating to preparation of the Systemwide combined financial statements;

(iv) Review the System's annual and quarterly reports to investors prior to their release; and

(v) Oversee the Funding Corporation's system of internal controls relating to preparation of the report, including controls relating to the System's compliance with applicable laws and regulations.

(b) *Farm Credit System bank audit committees.* (1) Each System bank shall establish and maintain a bank audit committee that shall report to the board of the bank.

(2) The bank audit committee shall consist of no fewer than three members. Members shall be independent of management and free from any relationship that, in the opinion of the board of directors of the bank, would interfere with the exercise of independent judgment as a committee member. Members shall be knowledgeable in public and corporate finance, and financial reporting and disclosure.

(3) *Responsibilities.* At a minimum, the bank audit committee shall:

(i) Review the bank's financial statements and significant accounting policies;

(ii) Oversee the bank's financial reporting regarding its disclosure to shareholders and to the Funding Corporation for disclosure to investors;

(iii) Oversee the audit activities of the external auditor; and

(iv) Monitor internal controls, including those relating to compliance with laws and regulations.

Subpart B—Annual Report to Investors

§ 630.20 Contents of the annual report to investors.

The annual report shall contain the following:

(a) *Description of business.* (1) The description shall include a brief discussion of the following:

(i) The System's overall organizational structure, its lending institutions by type and their respective authorities, the relationships between different types of institutions, and the overall geographic area and eligible borrowers served by those institutions;

(ii) The types of lending activities engaged in and financial services offered by System institutions;

(iii) Any significant developments within the last 5 years that have had or could have a material impact on the System's organizational structure and the manner in which System institutions conduct business, including, but not limited to, statutory or regulatory changes, mergers or liquidations of System institutions, terminations of System institution status, and financial assistance provided by or to System institutions through loss-sharing or capital preservation agreements or from any other source;

(iv) Any acquisition or disposition of material assets during the last fiscal year that took place outside the ordinary course of business;

(v) Any concentrations of more than 10 percent of total assets in particular types of agricultural activities or businesses, and any dependence of an institution or a group of institutions of the System upon a specific activity or business, a single customer, or a few customers, including other financing institutions (OFIs), as defined in § 614.4540(e) of this chapter, the loss of any one of which would have a material effect on the System; and

(vi) The authority of System institutions to purchase and sell interests in loans in secondary markets and the risk involved in such activities.

(2) List the address of the headquarters of each disclosure entity and service organization of the System.

(b) *Federal regulation and insurance—(1) Farm Credit Administration.* Describe the regulatory and enforcement authority of the FCA over System institutions under the Act.

(2) *Farm Credit System Insurance Corporation.* (i) Describe the role and authorities of the Farm Credit System Insurance Corporation (FCSIC) under part E of title V of the Act. Describe specifically the role of the FCSIC in insuring the timely payment of principal and interest on FCS debt obligations and in providing assistance to System institutions.

(ii) Describe the FCSIC's status as a Government corporation and state that System institutions have no control over the management of the FCSIC or the discretionary expenditures from the Farm Credit Insurance Fund (Insurance Fund), which are the sole prerogative of the FCSIC.

(3) *Farm Credit System Financial Assistance Corporation.* Describe the role and authorities of the Financial Assistance Corporation under title VI of the Act, debt obligations of the Financial Assistance Corporation issued

to provide financial assistance to the System, and statutory repayment obligations of System institutions.

(c) *Description of legal proceedings and enforcement actions.* (1) Describe any material pending legal proceedings in which one or more System institutions are a party, or that involve claims that a System institution(s) may be required by contract or operation of law to satisfy, and the potential impact of such proceedings, to the extent known, on the System.

(2) Provide a summary of the types of enforcement actions in effect during the year, and any material impact of such proceedings on the System.

(d) *Description of liabilities.* (1) Describe how the System funds its lending operations, including:

(i) System banks' authority to borrow, and issue notes, bonds, debentures, and other obligations, and limitations thereof under section 4.2 of the Act;

(ii) A description of the types of debt obligations authorized to be issued under the Act, the types of debt obligations currently issued, the manner and form in which they are issued, rights of securities holders, risk factors, use of proceeds, tax effects of holding securities, market information, and other pertinent information;

(iii) For each of the types of obligations that may be issued, whether it is insured, and the extent of any joint and several liability for the obligations; and

(iv) Any applicable statutory and regulatory requirements affecting a bank's ability to incur debt.

(2) Describe agreements among System banks and the Funding Corporation affecting a bank's ability to incur debt.

(3) Describe agreements among System institutions regarding capital preservation, loss sharing, or any other forms of financial assistance.

(e) *Description of capital.* (1) Describe the capitalization of the System, including capital structure, types of stock and participation certificates, and voting rights of holders of stock and participation certificates.

(2) Describe the statutory requirement that a borrower purchase stock as a condition of obtaining a loan; how such stock is purchased, transferred, and retired; and how earnings are distributed.

(3) Describe any statutory or other authority of a System institution to require additional capital contributions from stockholders.

(4) Describe regulatory minimum permanent capital standards and capital adequacy requirements for banks and associations. State the number of

institutions, if any, categorized by banks and associations, that are not currently in compliance with such standards and include a brief discussion of the reasons for the noncompliance.

(5) Describe any statutory and regulatory restrictions on retirement of stock and distribution of earnings by System institutions. State the number of System institutions, if any, categorized by banks and associations, that are currently affected by such restrictions and provide a summary of the causes of such prohibitions.

(f) *Selected financial data.* At a minimum, furnish the following combined financial data of the System in comparative columnar form for each of the last 5 fiscal years.

(1) *Balance sheet.*

(i) Loans.

(ii) Allowance for losses.

(iii) Net loans.

(iv) Cash and investments.

(v) Other property owned.

(vi) Total assets.

(vii) FCS debt obligations and other bonds, notes, debentures, and obligations, presented by type, with a descriptive title.

(viii) Total liabilities.

(ix) Capital stock and surplus.

(2) *Statement of income.*

(i) Net interest income.

(ii) Net other expenses.

(iii) Provision for loan losses.

(iv) Extraordinary items.

(v) Provision for income taxes.

(vi) Net income (loss).

(3) *Key financial ratios.* (i) Return on average assets.

(ii) Return on average capital stock and surplus.

(iii) Net interest income as a percentage of average earning assets.

(iv) Net loan chargeoffs as a percentage of average loans.

(v) Allowance for loan losses as a percentage of gross loans outstanding at yearend.

(vi) Capital stock and surplus as a percentage of total assets at yearend.

(vii) Debt to capital stock and surplus at yearend.

(g) *Discussion and analysis.* Fully discuss any material aspects of financial condition, changes in financial condition, and results of operations of System institutions, on a combined basis, for the comparative years required by paragraph (g)(6)(ii) of this section or such other time periods specified in the following paragraphs of this section. Identify favorable and unfavorable trends, and significant events or uncertainties necessary to understand the financial condition and results of operations of the System. At a minimum, the discussion shall include the following:

(1) *Loan portfolio*—(i) *Categorization.* Describe the loan portfolio of the System by major loan purpose category, indicating the amount and approximate percentage of the total dollar portfolio represented by each major category.

(ii) *Risk exposure.* (A) Describe and analyze all high-risk assets, including an analysis of the nature and extent of significant current and potential credit risks within the loan portfolio and of other information that could adversely affect the loan portfolio and other property owned.

(B) Provide an analysis of the allowance for loan losses that includes the ratios of the allowance for loan losses to loans (outstanding at yearend) and net chargeoffs to average loans, and a discussion of the adequacy of the allowance for loan losses to absorb the risk inherent in the loan portfolio and the basis for such determination.

(iii) *Secondary market activities.* (A) If material, quantify System institutions' secondary market activities and the risk involved in such activities.

(B) If material, provide an analysis of historical loss experience and the amount provided for risk of loss associated with secondary market activities.

(2) *Results of operations.* (i) Describe, on a comparative basis, changes in the major components of net interest income. Include a discussion of significant factors that contributed to the changes and quantify the amount of change(s) due to an increase or decrease in volume and the amount due to changes in interest rates earned and paid, based on averages for each period.

(ii) Describe any unusual or infrequent events or transactions, or any significant economic changes that materially affected reported income and, in each case, indicate the extent to which income was so affected.

(iii) Discuss the factors underlying any material changes in the return on average assets and return on average capital stock and surplus.

(iv) Describe, on a comparative basis, the major components of operating expense and any other significant components of income or expense, indicating the reasons for any significant increases or decreases.

(v) Describe any known trends or uncertainties that have had, or that are reasonably expected to have, a material impact on net interest income or net income. Disclose any known events that will cause a material change in the relationship between costs and revenues.

(vi) Explain the changes that have taken place, by major components on a comparative basis, in Insurance Fund

assets and related restricted capital and how such changes affected reported income.

(3) *Funding sources and liquidity*—(i) *Funding sources.*

(A) Provide, in tabular form, the component amounts and the total amount of FCS debt obligations, debt obligations issued by banks individually, and Financial Assistance Corporation debt obligations outstanding at yearend for each of the past 2 fiscal years. List debt obligations issued by System institutions separately by type, also separating insured obligations from uninsured obligations. For each type of debt obligation listed, provide the following, at a minimum, for each fiscal year listed:

(1) The beginning balance, the total amount of debt issued, the total amount of debt retired, and the yearend balance; and

(2) The average maturities and average interest rates on debt outstanding at yearend, and the average maturities and average interest rates of new debt issued during the year.

(B) Summarize any other sources of funds, including lines of credit with commercial lenders, and their terms.

(ii) *Liquidity.* (A) Include a brief overview of any FCA regulations or System policies with regard to liquidity and liquidity reserves.

(B) Identify any known trends, demands, commitments, events, or uncertainties that will result in, or that are reasonably likely to result in, System liquidity increasing or decreasing in any material way. If a material liquidity deficiency is identified, indicate the course of action that has been taken or is proposed to be taken by management of affected System institutions to remedy the deficiency.

(iii) *Investment.* Provide a brief overview of the System's investment policies and objectives, any regulatory limitations thereon, and the contents of the System's existing investment portfolio.

(iv) *Interest rate sensitivity.* (A) Provide a brief overview of the System's asset and liability management practices, including interest rate risk measurement systems, and methods used to control interest rate risk, such as the use of investments, derivatives, and other off-balance-sheet transactions.

(B) Provide an analysis of the System's exposure to interest rate risk and its ability to control such risk.

(4) *Capital resources.* (i) Describe any material commitments to purchase capital assets and the anticipated sources of funding.

(ii) Describe any material trends, favorable or unfavorable, in the

System's capital resources, including any material changes in the mix of capital and debt, the relative cost of capital resources, and any off-balance-sheet financing arrangements.

(iii) Provide a general discussion of any trends, commitments, contingencies, or events that are reasonably likely to have a material adverse effect on System institutions' ability to comply with regulatory capital standards.

(5) *Insurance Fund.* (i) Describe the purposes for which expenditures from the Insurance Fund may be made and the statutory requirements for making such expenditures.

(ii) Provide a schedule itemizing the amount of Insurance Fund assets that have been specifically identified by the FCSIC for payment of estimated obligations of the FCSIC and the amount of Insurance Fund assets for which no specific use has been identified or designated by the FCSIC. Information provided shall be as of the end of the most recent fiscal year.

(iii) Explain how FCSIC expenditures or designations of Insurance Fund assets for payment of future obligations affect the combined assets and capital of the System, and quantify the effect, if any.

(6) *Instructions for discussion and analysis.* (i) The purpose of the discussion and analysis (D&A) shall be to provide to investors and other users information relevant to an assessment of the combined financial condition and results of operations of System institutions as determined by evaluating the amounts and certainty of cashflows from operations and from outside sources. The information provided pursuant to this section need only include that which is available to System institutions and which does not clearly appear in the combined financial statements.

(ii) The D&A of the financial statements and other statistical data shall be presented in a manner designed to enhance a reader's understanding of the combined financial condition, results of operations, cashflows, and changes in capital of System institutions. Unless otherwise specified in § 630.20(g), the discussion shall cover the period covered by the financial statements and shall use year-to-year comparisons or any other understandable format. Where trend information is relevant, reference to the 5-year selected financial data required by paragraph (f) of this section may be necessary.

(iii) The D&A shall focus specifically on material events and uncertainties known at the time of reporting that would cause reported financial

information not to be necessarily indicative of future operating results or of future financial condition. This should include descriptions and amounts of:

(A) Matters that would have an impact on future operations but that have not had an impact in the past; and

(B) Matters that have had an impact on reported operations but are not expected to have an impact on future operations.

(h) *Directors and management*—(1) *Board of directors.* Briefly describe the composition of boards of directors of the disclosure entities. List the name of each director of such entities, including the director's term of office and principal occupation during the past 5 years, or state that such information is available upon request pursuant to § 630.3(f).

(2) *Management.* List the names of chief executive officers and presidents of disclosure entities, including position title, length of service at current position, and positions held during the past 5 years.

(i) *Compensation of directors and senior officers.* State that information on the compensation of directors and senior officers of System banks is contained in each bank's annual report to shareholders and that the annual report of each bank is available to investors upon request pursuant to § 630.3(f).

(j) *Related party transactions.* (1) Briefly describe how System institutions, in the ordinary course of business and subject to regulation by the FCA, may enter into loan transactions with related parties, including their directors, officers, and employees, the immediate family members (as defined in § 620.1(e) of this chapter) of such persons, and any organizations with which such persons and their immediate family members are affiliated.

(2) On a comparative basis for each of the fiscal years covered by the balance sheet, state the aggregate amount of the following:

(i) Loans made to related parties;

(ii) Loans outstanding at yearend to related parties;

(iii) Loans outstanding at yearend to related parties that are made on more favorable terms than those prevailing at the time for comparable transactions with unrelated borrowers; and

(iv) Loans outstanding at yearend to related parties that involve more than a normal risk of collectibility (as defined in § 620.1(i) of this chapter).

(k) *Relationship with independent public accountant.* If a change in the accountant who has previously

examined and expressed an opinion on the Systemwide combined financial statements has taken place since the last annual report to investors or if a disagreement with an accountant has occurred that the Funding Corporation would be required to report to the FCA under part 621 of this chapter, disclose the information required by § 621.4(c) and (d) of this chapter.

(l) *Financial statements.* Furnish Systemwide combined financial statements and related footnotes prepared in accordance with GAAP, and accompanied by supplemental information prepared in accordance with the requirements of § 630.20(m). The Systemwide combined financial statements shall provide investors and potential investors in FCS debt obligations with the most meaningful presentation pertaining to the financial condition and results of operations of the System. The Systemwide combined financial statement and accompanying supplemental information shall be audited in accordance with generally accepted auditing standards by a qualified public accountant (as defined in § 621.2(i) of this chapter). The Systemwide combined financial statements shall include the following:

- (1) A balance sheet as of the end of each of the 2 most recent fiscal years; and
- (2) Statements of income, statements of changes in capital stock and surplus (or, if applicable, statements of changes in protected borrower capital and capital stock and surplus), and statements of cash flows for each of the 3 most recent fiscal years.

(m) *Supplemental information.* Furnish supplemental information regarding the components of the Systemwide combined financial statements that has been prepared in accordance with the requirements of this paragraph and any additional guidance or instructions provided by the FCA.

(1) At a minimum, the supplemental information shall include the following:

- (i) Supplemental balance sheet information as of the end of the most recent fiscal year; and
- (ii) Supplemental income statement information for the most recently completed fiscal year.

(2) At a minimum, the report shall present supplemental information showing combined financial data for the following components on a stand-alone basis:

- (i) Banks;
- (ii) Associations;
- (iii) Financial Assistance Corporation;
- (iv) Combined financial data of the System without the Insurance Fund;

(v) The Insurance Fund and related combination entries; and

(vi) Combined financial data of the System with the Insurance Fund.

(3) The supplemental information shall be presented in a columnar format and include, at a minimum, the selected financial data listed in the schedules in Appendix A of this part. The prescribed components shall be designated as column headings and they may be abbreviated in the schedules. The financial data required by § 630.20(m)(2)(i) shall include the financial data required to be submitted by each bank pursuant to the requirement of § 630.4(c)(1)(i).

(4) The supplemental information may be presented separately or in accompanying notes to the Systemwide combined financial statements and shall contain additional disclosures sufficient to explain the basis of the presentation of the supplemental information, the components, and any adjustments contained therein to enable readers to understand the effect of each component on the Systemwide combined financial statements.

(n) List the names of the System Audit Committee members in the report to investors.

(o) Include a detailed index setting forth the major disclosure captions of this subpart and the page or pages on which the required information appears in the report.

Subpart C—Quarterly Reports to Investors

§ 630.40 Contents of the quarterly report to investors.

(a) *General.* The quarterly report to investors shall contain the information specified in this section along with any other material information necessary to make the required disclosures, in light of the circumstances under which they are made, not misleading. The quarterly report must be presented in a format that is easily understandable and not misleading.

(b) *Rules for condensation.* For purposes of this subpart, major captions to be provided in interim financial statements are the same as those provided in the financial statements contained in the annual report to investors, except that the financial statements included in the quarterly report may be condensed into major captions in accordance with the rules prescribed under this paragraph.

(1) *Interim balance sheets.* When any major balance sheet caption is less than 10 percent of total assets and the amount in the caption has not increased or decreased by more than 25 percent

since the end of the preceding fiscal year, the caption may be combined with others.

(2) *Interim statements of income.* When any major income statement caption is less than 15 percent of average net income for the 3 most recent fiscal years and the amount in the caption has not increased or decreased by more than 20 percent since the corresponding interim period of the preceding fiscal year, the caption may be combined with others. In calculating average net income, loss years should be excluded. If losses were incurred in each of the 3 most recent fiscal years, the average loss shall be used for purposes of this test.

(3) The interim financial information shall include disclosure either on the face of the financial statements or in accompanying footnotes sufficient to make the interim information presented not misleading. It may be presumed that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year, and the adequacy of additional disclosure needed for a fair presentation may be determined in that context. Accordingly, footnote disclosure that would substantially duplicate the disclosure contained in the most recent audited financial statements (such as a statement of significant accounting policies and practices) and details of accounts that have not changed significantly in amount or composition since the end of the most recently completed fiscal year may be omitted.

(4) Interim reports shall disclose events that have occurred subsequent to the end of the most recently completed fiscal year that have a material impact on the System. Disclosures should encompass, for example, significant changes since the end of the most recently completed fiscal year in such items as accounting principles and practices, estimates used in the preparation of financial statements, status of long-term contracts, capitalization, significant new indebtedness or modification of existing financing agreements, financial assistance received, significant business combinations and liquidations of System institutions, and terminations of System institution status. Notwithstanding the provisions of this paragraph, where material contingencies exist, disclosure of such matters shall be provided even though a significant change since yearend may not have occurred.

(5) In addition to meeting the reporting requirements specified by existing accounting pronouncements for

accounting changes, state the date of any material accounting change and the reasons for making it.

(6) Any material prior period adjustment made during any period covered by the interim financial statements shall be disclosed, together with its effect upon net income and upon the balance of surplus for any prior period included. If results of operations for any period presented have been adjusted retroactively by such an item subsequent to the initial reporting of such period, similar disclosure of the effect of the change shall be made.

(7) Interim financial statements furnished shall reflect all adjustments that are necessary to a fair statement of the results for the interim periods presented. A statement to that effect shall be included. Furnish any material information necessary to make the information called for not misleading, such as a statement that the results for interim periods are not necessarily indicative of results to be expected for the year.

(8) If any amount that would otherwise be required to be shown by this section with respect to any item is not material, it need not be separately shown. The combination of insignificant items is permitted.

(c) *Discussion and analysis of interim financial condition and results of operations.* Discuss any material changes to the information disclosed to investors pursuant to § 630.20(g) that have occurred during the periods specified in paragraphs (d)(1) and (d)(2) of this section. Provide any additional information needed to enable the reader to assess material changes in financial condition and results of operations between the periods specified in paragraphs (d)(1) and (d)(2) of this section.

(1) *Material changes in financial condition.* Discuss any material changes in financial condition from the end of the preceding fiscal year to the date of the most recent interim balance sheet provided.

(2) *Material changes in results of operations.* Discuss any material changes in the combined results of operations of the System with respect to the most recent fiscal year-to-date period for which an income statement is provided and the corresponding year-to-date period of the preceding fiscal year. Such discussion shall also cover material changes with respect to the most recent fiscal quarter and the corresponding fiscal quarter in the preceding fiscal year.

(d) *Financial statements.* Interim combined financial statements shall be provided in the quarterly report to investors as set forth in paragraphs (d)(1) through (4):

(1) An interim balance sheet as of the end of the most recent fiscal quarter and a balance sheet as of the end of the preceding fiscal year.

(2) Interim statements of income for the most recent fiscal quarter, for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and for the comparable periods for the previous fiscal year.

(3) Interim statements of changes in capital stock and surplus (or, if applicable, interim statements of changes in protected borrower capital and capital stock and surplus) for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and for the comparable period for the preceding fiscal year.

(4) Interim statements of cash flows for the period between the end of the preceding fiscal year and the end of the

most recent fiscal quarter, and for the comparable period for the preceding fiscal year.

(e) *Supplemental information.* The interim report shall present supplemental information in accordance with the requirements of § 630.20(m)(2), (m)(3), and (m)(4), as well as other requirements and instructions of the FCA, and shall include, at a minimum, the following:

(1) Supplemental balance sheet information as of the end of the most recent quarter; and

(2) Supplemental income statement information for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter.

(f) *Review by independent public accountant.* Unless otherwise ordered by the FCA as a result of a supervisory action, the interim financial statements and supplemental information need not be audited or reviewed by an independent public accountant prior to filing. If, however, a review of the report is made in accordance with the established professional standards and procedures for such a review, a statement that the independent accountant has performed such a review may be included. If such a statement is made, the report of the independent accountant on such review shall accompany the interim financial information.

Appendix A to Part 630—Supplemental Information Disclosure Guidelines

Supplemental information required by §§ 630.20(m) and 630.40(e) shall contain, at a minimum, the current year financial data for the components listed in the following tables and be presented in the columnar format illustrated in the following tables:

BILLING CODE 6705-01-P

TABLE A—SUPPLEMENTAL BALANCE SHEET INFORMATION

	Banks ¹	Associations ²	Financial assistance corporation	Eliminations	Combined without insurance fund ³	Insurance fund and related combination entries	Combined with insurance fund
Cash and investments							
Net loans							
Restricted assets							
Other Assets							
Total assets							
Total liabilities							
Protected borrower capital ⁴							
Restricted capital							
Capital stock and surplus							
Total liabilities, protected borrower capital, and capital stock and surplus							

¹ Provide combined financial data of all FCS banks, including any consolidated subsidiaries of the banks.² Provide association-only combined financial data of all FCS associations.³ Provide the combined financial data of all columns on the left.⁴ Any item that is no longer applicable, e.g., protected borrower stock, may be omitted.

TABLE B—SUPPLEMENTAL INCOME STATEMENT INFORMATION

	Banks ¹	Associations ²	Financial assistance corporation	Eliminations	Combined without insurance fund ³	Insurance fund and related combination entries	Combined with insurance fund
Net interest income							
Provision for loan losses							
Other income							
Other expenses							
Net income							

¹ Provide combined financial data of all FCS banks, including any consolidated subsidiaries of the banks.² Provide association-only combined financial data of all FCS associations.³ Provide the combined financial data of all columns on the left.

Dated: September 1, 1994.

Curtis M. Anderson,
Secretary, Farm Credit Administration Board.
[FR Doc. 94-22221 Filed 9-9-94; 8:45 am]
BILLING CODE 6705-01-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Airspace Docket No. 94-AEA-06]

Modification of Class D Airspace and Establishment of Class E Airspace; Baltimore, MD

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule; request for comments.

SUMMARY: This action modifies the Class D airspace area at Baltimore, Martin State Airport, MD by amending this area's effective hours to coincide with the associated control tower hours of operation. This action also establishes Class E airspace in this area when the associated control tower is closed. The intended effect of this action is to clarify when two-way radio communication with the air traffic control tower is required and to provide adequate Class E airspace for instrument approach procedures when the control tower is closed.

DATES:

Effective Date: 0901 U.T.C. December 8, 1994.

Comment Date: Comments must be received on or before September 22, 1994.

ADDRESSES: Send comments on the rule in triplicate to: Manager, Air Traffic Division, AEA-500, Airspace Docket Number 94-AEA-06, F.A.A. Eastern Region, Fitzgerald Federal Building #111, John F. Kennedy International Airport, Jamaica, New York 11430. An informal docket may also be examined during normal business hours at the address listed above.

FOR FURTHER INFORMATION CONTACT:

Mr. Frank Jordan, Airspace Specialist, System Management Branch, AEA-530, F.A.A. Eastern Region, Fitzgerald Federal Building #111, John F. Kennedy International Airport, Jamaica, New York 11430; telephone: (718) 553-0857.

SUPPLEMENTARY INFORMATION:

Request for Comments on the Rule

Although this action is a final rule, and was not preceded by notice and public procedure, comments are invited on the rule. All comments should be

submitted, in triplicate, to Mr. Frank Jordan at the address specified above. An informal docket may also be examined during normal business hours at the address specified above. This rule will become effective on the date specified in the "DATES" section. However, after the review of any comments, and if the FAA finds that further changes are appropriate, it will initiate rulemaking proceedings to extend the effective date of the rule or to amend the regulation.

Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in evaluating the effects of the rule, and in determining whether additional rulemaking is required. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy-related aspects of the rule which might suggest the need to modify the rule.

The Rule

This amendment to part 71 of the Federal Aviation Regulations (14 CFR part 71) modifies the Class D airspace area at Baltimore, Martin State Airport, MD, by amending this area's effective hours to coincide with the associated control tower's hours of operation. This action also establishes Class E airspace in this area when the associated control tower is closed. Prior to Airspace Reclassification, an airport traffic area (ATA) and a control zone (CZ) existed at this airport. However, Airspace Reclassification, effective September 16, 1993, discontinued the use of the term "airport traffic area" and "control zone," replacing them with the designation "Class D airspace." The former CZ was continuous, while the former ATA was contingent upon the operation of the air traffic control tower. The consolidation of the ATA and CZ into a single Class D airspace designation makes it necessary to modify the effective hours of the Class D airspace to coincide with the control tower's hours of operation. This action also establishes Class E airspace during the hours the control tower is closed. The intended effect of this action is to clarify when two-way radio communication with the air traffic control tower is required and to provide adequate Class E airspace for instrument approach procedures when this control tower is closed.

The coordinates for this airspace docket are based on North American Datum 83. Class D and E airspace designations are published in Paragraphs 5000 and 6002, respectively, of FAA Order 7400.9B dated July 18, 1994, and effective September 16, 1994,

which is incorporated by reference in 14 CFR 71.1. The Class D and E airspace designations listed in this document will be published subsequently in the Order. Under the circumstances presented, the FAA concludes that there is an immediate need to modify this Class D and establish this Class E airspace area in order to promote the safe and efficient handling of air traffic in these areas. Therefore, I find that notice and public procedures under 5 U.S.C. 553(b) are impracticable and contrary to public interest.

The FAA has determined that this regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It therefore—(1) is not a "significant regulatory action" under Executive Order 12866; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (Air).

Adoption of the Amendment

In consideration of the foregoing, the Federal Aviation Administration amends 14 CFR part 71 as follows:

PART 71—[AMENDED]

1. The authority citation for part 71 continues to read as follows:

Authority: 49 U.S.C. app. 1348(a), 1354(a), 1510; Executive Order 10854, 24 FR 9565, 3 CFR, 1959-1963 Comp., p. 389; 49 U.S.C. 106(g); 14 CFR 11.69.

§ 71.1 [Amended]

2. The incorporation by reference in 14 CFR 71.1 of the Federal Aviation Administration Order 7400.9B, Airspace Designations and Reporting Points, dated July 18, 1994, and effective September 16, 1994, is amended as follows:

Paragraph 5000—General

* * * * *

AEA MD D Baltimore, Martin State Airport, MD [Revised]

Martin State Airport, Baltimore, MD