Rules and Regulations

Federal Register
Vol. 70, No. 176
Tuesday, September 13, 2005

FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 612, 614, 615, and 620

RIN 3052–AC21

Organization; Standards of Conduct and Referral of Known or Suspected Criminal Violations; Loan Policies and Operations; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Disclosure to Shareholders; Preferred Stock

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA or Agency) amends its rules governing preferred stock issued by Farm Credit System (FCS or System) banks, associations, and service corporations. This final rule requires greater board involvement and oversight in the retirement of preferred stock, enhances FCA's current standards of conduct regulations to specifically address insider preferred stock transactions, modifies and streamlines the FCA review and clearance process, and requires disclosure of senior officer and director preferred stock transactions. Lastly, we add a new provision to require FCA prior approval of investments by FCS banks, associations, and service corporations in preferred stock of other System institutions, including the Federal Agricultural Mortgage Corporation (Farmer Mac).

EFFECTIVE DATE: This regulation will be effective 30 days after publication in the **Federal Register** during which either or both Houses of Congress are in session. We will publish a notice of the effective date in the **Federal Register**. However, we have delayed the effective date of § 612.2165(b)(12)–(15), § 615.5245(a), and § 615.5270(d) of the rule for 6 months from the effective date of this final rule in order to allow System institutions with existing preferred stock programs to adopt the policies and procedures necessary to comply with the rule. We will also publish a notice of the effective date for the delayed portion of this rule.

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SUPPLEMENTARY INFORMATION:

I. Objectives

Through this rulemaking we strive to:

- Ensure the stability and quality of capital at FCS institutions;
- Ensure fair and equitable treatment of all shareholders of FCS preferred stock and minimize the potential for insider abuse;
- Modify and streamline our review and clearance process for equity issuances; and
- Require disclosure of senior officer and director preferred stock purchases and retirements.

The Agency believes additional regulatory guidance and requirements will help ensure consistent treatment for all FCS institutions seeking to issue preferred stock.

II. Delay of Effective Date and Application of Rule to Existing Preferred Stock Programs

All provisions of this final rule will apply to existing preferred stock that has been issued by System institutions prior to the effective date of this rule. All System institutions issuing preferred stock subsequent to the effective date of this rule will be required to fully comply with the provisions of this rule as the preferred stock is issued. However, we have delayed the effective date of the following sections of the rule for 6 months from the effective date of this final rule to allow System institutions with existing preferred stock programs additional time to adopt the policies and procedures necessary to comply with the rule:

- Section 612.2165(b)(12)–(15) (Policies and Procedures);
- Section 615.5245(a) (Limitations on association-issued preferred stock); and
- Section 615.5270(d) (Policy on retirement of preferred stock).

Any institution-specific conditions of clearance for any previously cleared preferred stock program remain in effect regardless of the provisions of this rule. However, an institution may apply to FCA to revise any condition of clearance. Additionally, as before, any new or modified preferred stock issuances will be subject to institution-specific conditions that the FCA Board considers appropriate.

III. Background

On June 4, 2004, we published a proposed regulation (69 FR 31541) that would change the regulatory capital treatment for preferred stock issued by Farm Credit System institutions and place certain restrictions on a System institution's ability to retire [1] preferred stock. The proposed rule would also: (1) Require greater board involvement and oversight in the retirement of preferred stock, (2) enhance current standards of conduct regulations to specifically address insider preferred stock transactions, (3) require disclosure of senior officer and director preferred stock transactions, (4) modify and streamline our review and clearance process, and (5) add a new provision to require FCA prior approval of investments by FCS banks, associations, and service corporations in preferred stock of other FCS institutions, including Farmer Mac.

In the preamble to the proposed rule, we noted our concerns about the stability (or ''permanence'') of preferred stock that an institution plans to retire routinely with few limitations or without direct involvement or consideration by the institution's board of directors. (We will refer to this stock as ''continually redeemable preferred stock'' in our discussions that follow.) In particular, we noted our concerns about the risk associated with the capital and earnings volatility that may result from fluctuations in purchases and retirements that could occur daily. We further noted that continually redeemable preferred stock may be an especially volatile source of capital under adverse credit or interest rate

[1] In this preamble, we use the term ''redeem'' interchangeably with ''retire,'' which is the term used in the governing provisions of the Farm Credit Act.

conditions when the likelihood of requests for redemption increases.

In addition to that safety and soundness concern, we expressed ''mission and policy concerns'' over FCS institutions' issuance of equities that have many characteristics of deposit or money market instruments and limited attributes of equity. We did recognize, however, that System institutions have statutory authority to issue debt and equity securities (subject to FCA regulation) to fulfill their mission of serving the needs of farmers, ranchers, and rural residents. We noted that preferred stock can be a valuable tool for FCS institutions to increase their capital and generate additional loanable funds to meet the credit needs of their borrowers. Additionally, we recognized that preferred stock issued to eligible borrowers provides FCS associations a mechanism for members to invest and participate in their cooperative beyond minimum borrower stock purchases.

IV. General Comments

We received a comment on the proposed rule from the Farm Credit Council and 3 separate comments from individual FCS institutions. We also received a comment from the Independent Community Bankers of America (ICBA) and approximately 150 very similar comments from commercial banks or individuals associated with commercial banks. Both System and non-System commenters expressed strong opposition—albeit from very different perspectives—to major portions of the rule.

A. System Comments

System commenters stated that:

- The restrictions on retirement of preferred stock and the limits on inclusion of preferred stock in permanent capital ratios violate provisions of the Farm Credit Act of 1971, as amended (Act);
- The proposed rule's definition of ''effective maturity'' would improperly prohibit an association from issuing certain forms of preferred stock that meet the statutory definition of permanent capital;
- FCA has no discretion to narrow the statutory definition of permanent capital;
- FCA lacks a statutory basis to limit or restrict issuance or retirement of association preferred stock provided the association is in compliance with all regulatory capital standards;
- Many of the concerns raised about the ''permanence'' of preferred stock are also applicable to borrower stock, the primary form of equity issued by System associations;
- All System institutions are currently very well capitalized and System institutions would still meet or exceed all minimum capital levels even if all preferred stock were retired at once;
- Instead of adopting one rigid set of rules, the FCA should look at different approaches to address the issues and concerns raised by preferred stock programs and to deal with those issues through the examination process;
- Existing regulatory controls and conditions on preferred stock issuances adequately address safety and soundness concerns regardless of the permanent capital ratio;
- There have been no complaints from System institution members about any aspect of existing preferred stock programs; and
- Preferred stock programs provide value to System institution members while giving them an opportunity to support their cooperative lender.

B. Non-System Comments

Non-System commenters stated that:

- FCS institutions should not be allowed to issue preferred stock at all because such stock represents unfair and improper competition for commercial bank deposits by a Government-sponsored enterprise (GSE);
- Threatening the deposit base of community banks hurts rural America, which is inconsistent with the aims of the Act;
- System institutions have sufficient sources of capital and therefore don't need preferred stock to raise capital;
- If allowed at all, preferred stock issuance should be in lieu of System institutions offering cash management accounts in order to avoid System entities becoming depository institutions with unique GSE benefits; [2]
- Preferred stock should have a minimum effective maturity of 5 years to better recognize the purpose of preferred stock to provide stable, long-term capital and to prevent preferred stock from performing too much like money market or deposit instruments;
- FCS preferred stock should be subject to the same limits imposed by the Federal Deposit Insurance Corporation (FDIC) for commercial bank preferred stock;
- Retirements should be conducted on the basis of the entire class of stock, rather than on an individual basis, so that preferred stock does not function as a deposit; and
- Given the purpose of the FCS to serve a specific market—agricultural lending—and the risks associated with this industry, the retirement of preferred stock should be allowed only if the entity has a permanent capital ratio of at least 12 percent.

C. Our Consideration of the Comments Received

Upon consideration of all the comments, FCA has decided to delete proposed § 615.5203 (''Treatment of Preferred Stock in the Permanent Capital Ratio'') and proposed § 615.5270(c) and (d) (restrictions on preferred stock retirements) from the final rule because we believe that FCA can achieve the safety and soundness objectives articulated in the proposed rule in a manner that does not implicate the authority issues raised by commenters. As discussed in detail below, we also made other relatively minor changes in response to the comments.

V. Authority To Issue Preferred Stock

As discussed in the preamble to the proposed rule, Congress broadly authorized each FCS bank and association to adopt bylaws providing for the classes and terms of stock issued by the institution.[3] Congress specifically defined ''stock'' to include ''voting and nonvoting stock, (including preferred stock).'' [4] Congress did not further define ''preferred stock'' in the Act. Congress defined ''permanent capital'' in section 4.3A of the Act to mean:

(A) Current year retained earnings;

(B) Allocated and unallocated earnings * * *;

(C) All surplus (less allowances for losses);

(D) Stock issued by a System institution, except:

(i) Stock that may be retired by the holder of the stock on repayment of the holder's loan, or otherwise at the option or request of the holder; and

(ii) Stock that is protected under section 4.9A of the Act or is otherwise not at risk; and

(E) Any other debt or equity instruments or other accounts that the FCA determines appropriate to be considered permanent capital.

[2] As acknowledged by the ICBA, the Act specifically authorizes System lenders to offer its members a funds-held account (known as a Voluntary Advance Conditional Payment account). Additionally, the Act authorizes System institution members to invest in Farm Credit Bank bonds, which may be structured as short-term investment accounts. ICBA asserts that ''FCA is allowing FCS to offer cash management accounts, which basically amount to checking accounts, clearly in contradiction to the Act.'' This comment does not appear germane to the proposed rule, and FCA does not authorize any institution to engage in activities that violate the Act.

[3] *See* 12 U.S.C. 2013(9), 2073(16), 2093(8), 2122(9), and 2154a(b).

[4] 12 U.S.C. 2154a(a)(2).

Congress authorized System institutions to issue preferred stock so long as the stock is at risk and the institution's board retains discretion over stock retirements. When first implementing the new capitalization statutes added by the 1987 amendments to the Act, FCA stated: ''[n]o stock may be issued by Farm Credit institutions after October 5, 1988, that is not both at risk and retireable at the discretion of the board of directors provided minimum capital adequacy standards are met. These are the essential characteristics of permanent capital.'' [5]

While, from the holder's standpoint, continually redeemable preferred stock is in many ways functionally similar to a deposit, there is a significant legal distinction: a deposit is a debt on which the depositor has a legally enforceable right to demand repayment, while continually redeemable preferred stock is an ''at-risk'' equity of the issuing institution for which a preferred stockholder ordinarily does not have an enforceable right to demand redemption. Furthermore, the deposit holder (a creditor) has priority in liquidation over the preferred stockholder (an equity holder). This important distinction makes preferred stock ''at-risk'' (meaning the shareholder can lose some or all of the principal investment). This also means that preferred stock is not a deposit, not insured, and, contrary to non-System commenters' assertions, not subject to rules governing commercial bank deposits.

Non-System commenters suggest that FDIC rules related to issuance and treatment of preferred stock should apply to System institutions. While FCA's risk-based capital rules are generally similar to those of Federal banking regulators, FCA operates under a different controlling statute than those banking regulators. Unlike the banking statutes, Congress created and defined ''permanent capital'' in the Act and granted System institutions certain express authorities over the issuance and retirement of stock, including preferred stock that meets the statutory definition of permanent capital. FCA does not have discretion to adopt capital rules that contradict provisions of the Act.

Because Congress authorized System institutions to issue preferred stock, FCA has no basis to restrict the activity simply because it creates competition for commercial banks. However, we share the concern expressed by non-System commenters that System institutions not advertise or otherwise represent that their preferred stock offerings are deposits or ''money market'' accounts. Current § 615.5250(c)(1) (redesignated as new § 615.5255(c)(1)) requires that the disclosure statement that must be provided to purchasers of preferred stock must state that the equity is an ''at-risk'' investment. Existing § 615.5250(c)(4) (redesignated as new § 615.5255(h)) prohibits any System institution representative from making any disclosure in connection with the sale of an equity that is inaccurate or misleading. We consider any explicit or implicit representation by a System institution or its representatives that preferred stock is a ''deposit,'' ''money market instrument,'' or anything other than an ''at-risk'' equity investment to be a violation of our regulations.

VI. Inclusion of Preferred Stock in the Permanent Capital Ratio

Proposed § 615.5203 would have established a sliding scale of how much preferred stock could be included in an institution's permanent capital ratio calculation based on the ''effective maturity'' of the instrument. System commenters argued that this would violate the Act, since instruments that meet the statutory definition of ''permanent capital'' must be treated as permanent capital in the permanent capital ratio. Non-System commenters stated that preferred stock should not be included in permanent capital unless it is perpetual preferred stock that has no maturity and no requirements for future redemption.[6]

In addition, a System commenter stated that the proposed rule added ''needless complexity'' to the computation of the permanent capital ratio. System commenters also indicated that the proposal created confusion as to how a particular instrument's ''effective maturity'' would be established for purposes of computing the permanent capital ratio.

Upon review, we agree with the commenters that the proposal was more complex than needed and that we already have adequate means to address the safety and soundness concerns raised by the issuance of continually redeemable preferred stock. Therefore, we are eliminating proposed § 615.5203 in its entirety. FCA previously recognized the limitations of the permanent capital ratio as a meaningful measurement of the stability and adequacy of an institution's capital when we adopted new surplus and net collateral requirements in 1997.[7] Therefore, FCA's examiners will focus on total and core surplus, and net collateral measurements of capital when examining institutions. Moreover, when FCA examiners review an institution's capital, they continue to have the discretion to evaluate the effect continually redeemable preferred stock has on capital when assigning a numerical rating to an institution's capital under the Financial Institution Rating System (FIRS).[8]

Deleted § 615.5203(e) provided that the total amount of preferred stock with an effective maturity of less than 5 years that an institution may include as permanent capital for computation of the permanent capital ratio is limited to 25 percent of the institution's permanent capital (after deductions required in the permanent capital ratio computation). As discussed above, the FCA has adequate tools to evaluate an institution's capital without the need for this type of adjustment to the permanent capital ratio. Moreover, we recognize that System institutions require a diversified capital base and that one fixed cap amount may not be appropriate for all institutions.

Therefore, we expect each System institution to incorporate appropriate limits on preferred stock in its capitalization plan. FCA will review proposed limits in connection with its clearance of new preferred stock offerings, and FCA examiners will monitor the appropriateness of limitations on existing programs.

Additionally, FCA will monitor System disclosures to ensure that any public representations regarding strength of capital are not misleading because of the inclusion of ''continually redeemable preferred stock'' in the permanent capital ratio.

Additionally, we note that the volatility of continually redeemable preferred stock can affect an institution's funding and liquidity needs. Although funding and liquidity risks are not specifically addressed in this final rule, we expect an institution's board and management to consider these risks when deciding whether to issue continually redeemable preferred stock. We intend, through our examination efforts, to monitor an institution's management of its

[5] 53 FR 40033 (October 13, 1988).

[6] Continually redeemable preferred stock does meet the basic definition of perpetual preferred: it has no stated maturity and there is no binding obligation requiring the institution to redeem it. However, we interpret the comment as relating to what we described as ''continually redeemable preferred stock.''

[7] *See* 62 FR 4429 (January 30, 1997).

[8] The FIRS is the FCA's system for rating the capital, assets, management, earnings, liquidity, and interest-rate risk of an association. This rating is not subject to public disclosure.

preferred stock program and will consider the funding and liquidity effects of preferred stock issuances on an institution's risk profile.

VII. Restrictions on Retirement

Proposed § 615.5270(c) would have generally prohibited a System bank, association, or service corporation from retiring continually redeemable preferred stock unless the institution's permanent capital ratio would be in excess of 8 percent after any retirement. Proposed § 615.5270(d) would have generally prohibited retirement of any preferred stock prior to 12 months after the date of issuance. Proposed § 615.5270(e)(3) would have prohibited a board from delegating authority to retire preferred stock to institution management unless the institution's permanent capital ratio would be in excess of 9 percent after any retirement. System commenters asserted that these restrictions violated the Act. Non-System commenters stated that longer holding periods were appropriate and that preferred stock should only be retireable as a class.

Congress gave FCA broad powers over the adequacy of System institution capital. Section 4.3 of the Act requires FCA to ensure that System institutions ''achieve and maintain adequate capital.'' [9] Title V of the Act authorizes FCA to adopt regulations to implement the Act and to take enforcement actions in response to, or to prevent, an unsafe or unsound practice.[10] The Act also provides that capitalization of System institutions, including the manner in which stock is issued, held, transferred, and retired, is subject to FCA regulation.[11] However, as pointed out by System commenters, the Act gives System institutions specific authority over retirement of equities. In particular, section 4.3A(c)(1)(I) of the Act provides that ''notwithstanding any other provision'' of the Act, an institution's bylaws ''shall permit the retirement of stock at the discretion of the institution if the institution meets the capital adequacy standards established under section 4.3(a).'' [12] System commenters assert that any FCA restriction on the ability of an institution to retire stock when that institution meets capital adequacy standards would violate the Act. Non-System commenters' suggestion that retirements be allowed only by class raises the same legal issues.

We believe, as discussed above, that we can adequately address and monitor safety and soundness concerns over the potential volatility of preferred stock through our examination process. Therefore, we are not adopting the proposed restrictions on retirement of preferred stock. Instead, the final rule requires that each institution's board of directors establish policy guidance on retirement of preferred stock that is specific to the capital needs of the institution. This guidance must specify the threshold levels of total surplus and core surplus that must be met before any delegation of retirement of preferred stock from the board to management may be effective. Given the potential volatility of continually redeemable preferred stock, we expect these threshold delegation levels to be set above the regulatory minimums.

VIII. Section-by-Section Response to Comments

A. Standards of Conduct—§ 612.2165

Proposed § 612.2165(b)(14) requires FCS institutions to establish policies that prohibit directors and employees from purchasing or retiring any stock in advance of the release to other stockholders of material non-public information concerning the institution. Proposed § 612.2165(b)(15) requires FCS institutions to establish policies and procedures specifying when directors and employees may purchase and retire preferred stock in the institution.

One System commenter stated that the proposed rule addresses only retirements of preferred stock but that the establishment, allocation and distribution of dividends also present potential for conflicts of interest. The commenter suggested that each System institution have the opportunity to address these issues in its own way.

First, proposed § 612.2165 specifically applies to purchases as well as retirements of preferred stock. Second, we believe the timely disclosure requirements of this rule provide a check on potential conflicts of interest. Third, as stated in our Standards of Conduct regulations applicable to directors and employees, ''the avoidance of misconduct and conflicts of interest is indispensable to the maintenance'' of the standards.[13] Therefore, we adopt the proposed changes to § 612.2165 as final.

B. Lending Limits—§ 614.4351(a)(3)

This provision will require FCS institutions to deduct from their lending limit base any amounts of preferred stock not eligible to be included in total surplus as defined in § 615.5301(i). We received no comments and adopt the proposal as final.

C. Investments in FCS Institution Preferred Stock—§ 615.5175

Proposed § 615.5175 provides that FCS banks, associations, and service corporations may purchase preferred stock issued by another FCS institution, including Farmer Mac, only with the written prior approval of the FCA, except pursuant to § 615.5171 (which relates to transfer of capital from banks to associations).[14]

Non-System commenters requested that FCA prevent any System entity from purchasing preferred stock in any other System institution. We did not receive any other comments on this provision. As we stated in the preamble to the proposed rule, the Act specifically authorizes System institutions to purchase non-voting equities in other System institutions.[15] As we also stated in the proposed rule preamble, while there have not been any recent investments by one System institution in the preferred stock of another, System institutions have historically invested in preferred stock of other System institutions to provide financial assistance. In addition, because we are requiring FCA prior approval, we do not see any purpose or need for a rule prohibiting such investments. Therefore, we adopt proposed § 615.5175 as final without changes.

D. Capital Adequacy—Definitions—§ 615.5201

We proposed to modify our definitions in subpart H that apply to our capital adequacy regulations by defining preferred stock by class and maturity and to use those definitions in differentiating how each class is treated for permanent capital ratio computation purposes. However, since we are not adopting proposed § 615.5203, separately identifying classes of preferred stock is unnecessary. We retain the general definition of ''preferred stock'' and also add a separate definition of ''term preferred stock,'' which is currently located within the definition of ''permanent capital'' in § 615.5201.

[9] 12 U.S.C. 2154.

[10] 12 U.S.C. 2241 *et seq.*

[11] *See* 12 U.S.C. 2014, 2074(a), 2094, 2146.

[12] 12 U.S.C. 2154a(c)(1)(I).

[13] 12 CFR 612.2135.

[14] The FCA adopted on June 9, 2005, regulatory amendments that address investments by Farmer Mac in other FCS institutions. (70 FR 40635, July 14, 2005).

[15] *See* 12 U.S.C. 2013(11), (16), 2073(7), (8).

E. Treatment of Preferred Stock for Permanent Capital Computations—§ 615.5203

For the reasons discussed in detail above, we delete proposed § 615.5203 in its entirety from the final rule. This deletion does not affect FCA's existing ''phase-out'' treatment of term preferred stock, as is made clear by revised § 615.5201, which retains the definition (and treatment) of term preferred stock from previous § 615.5201(1)(5).

F. Implementation of Cooperative Principles—§ 615.5230

We proposed to make a one-word addition to § 615.5230(b)(1) to clarify that a class stockholder vote is required only when a new issuance would ''adversely'' affect the interests of that class. This change will conform the language of the rule to our current interpretation of this rule. We did not receive any comments on this proposal, and we adopt the proposal as final.

G. Permanent Capital Requirements—§ 615.5240

We did not propose any substantive changes to this section and we received no comments. We therefore adopt paragraphs (a) and (b) (with a minor grammatical correction) as proposed. Current paragraph (c), addressing an institution board's authority to delegate retirement of borrower stock to management, is moved to new § 615.5275(a) and broadened to include all ''stock.'' This was included in the proposed rule as § 615.5270(e).

H. Limitation on FCS Association Preferred Stock—§ 615.5245

Paragraph (a) of the proposal would limit the amount of preferred stock that a single investor may hold in any one FCS association offering to the greater of $2 million or 5 percent of the issuance. This limitation was intended to reduce the potential that any one holder of association preferred stock could have undue influence on any one class of stock.

Non-System commenters suggested that ''these levels seem excessive'' since individual borrowers ''supposedly'' capitalize the System with a $1,000 stock purchase when they apply for loans. They further suggested that this provision was aimed at allowing agribusinesses to invest in the FCS, which they asserted was unnecessary because the System can access capital markets for funding. The non-System commenters suggested a $5,000 cap for all borrowers.

We believe this comment contains an unrealistically narrow and outdated understanding of the role of borrower stock in the System. As we stated in the proposed rule preamble, we believe that it is important for System institutions to build their capital primarily through earnings, but that diversified capital can be a valuable source of additional financial strength. Most System associations have lowered their borrower stock purchase requirements to the statutory minimum so that borrower stock now plays a minor role in capitalizing the System. Additionally, FCA's capital rules now give greater consideration to other types of capital when gauging the stability of an institution's capital.

System commenters asserted that System institutions can and should be able to use all statutorily authorized programs at their disposal to determine the best method of capitalization. System commenters also asserted that, in addition to the capital benefits to the institution, preferred stock provides a valuable service to their members and allows them to further invest in their cooperative lender.

We continue to have concerns over the potential for one or a small group of holders to dominate a class of preferred stock. Related to that is our concern that all association members have an equal opportunity to purchase preferred stock. However, in considering all the comments, we concluded that a ''one size fits all'' rule establishing a specific dollar or percentage cap is not desirable or necessary to achieve our objectives. Instead, final § 615.5245(a) and (b) provides that each association offering preferred stock to its members must adopt a policy that:

(1) Addresses applicable ownership issues related to the issuance of the preferred stock. We expect an association's policy to address the association's limits on ownership by any one holder or small group of holders, if such limits are deemed necessary by the association's membership. In addition, we expect the policy to address such items as an amount (*e.g.*, 5 percent) of preferred stock held by any one holder that would require internal disclosure to the association's membership of such ownership concentration.

(2) Makes the stock available for purchase to each of its members on the same basis. In other words, an association may not limit the opportunity to purchase preferred stock to only selected members.

We believe that these provisions will be more effective than a specific cap to ensure, on an institution-specific basis, that any one holder (or small group of holders) of association-issued preferred stock will not have undue influence over any one class of stock. The required association policy is designed to require the association board to develop and support institution-specific controls and procedures for administering its preferred stock issuances with the full knowledge and support of the association's membership. The policy requirement is intended to place ultimate control, outside of specific safety and soundness concerns, of the preferred stock program in the hands of the association membership. We will monitor the institution's policies and programs to determine whether these objectives are met and will consider in a future rulemaking whether additional disclosure requirements—such as requiring additional disclosure of preferred stock holdings to include non-insiders when those stock holdings exceed a certain numerical threshold—are necessary.

Paragraph (c) requires boards of directors of FCS associations offering preferred stock to eligible borrowers to adopt a policy that prohibits the association from extending credit to eligible borrowers to purchase preferred stock in the association. Non-System commenters supported this proposal and System institutions did not comment on the proposal. Therefore, we adopt paragraph (c) as final without change.

I. Disclosure Requirements for Borrower Stock—§ 615.5250

The proposed rule reorganized this section but retained the same requirements. We received no comments on this proposal and adopt § 615.5250 as final without changes.

J. Disclosure and Review Requirements for Other Equities—§ 615.5255

The proposed rule retained the same basic regulatory framework as our existing rules, requiring banks, associations, and service corporations to submit a proposed disclosure statement to FCA before any sale may take place, but clarifies and streamlines the current review and clearance process. The proposal also added a new paragraph (h) (now redesignated as paragraph (i)), under which each bank and association must establish a method to disclose and make information on insider purchases and retirements readily available to the public.

System commenters objected to proposed paragraph (h), because it makes insider information available to the public generally, and not just to institution stockholders/members and the FCA. System commenters stated that the requirement served no legitimate

safety and soundness issue, was invasive of insiders' privacy, and would provide competitors with an opportunity to distort the operations of the System and FCA. Non-System commenters supported the proposed disclosure requirements.[16] We believe that transparency in this area is very important to avoid any appearance of impropriety by institution insiders and that disclosure should not be limited to existing institution members. Publicly disclosing this information reduces the potential for insider abuse and may provide potential new members/stockholders with useful information. Therefore, we have adopted redesignated paragraph (i) as final without changes.

One Farm Credit Bank suggested that because proposed § 615.5255(d) (streamlined review process for issuances to sophisticated investors) incorporates the Securities and Exchange Commission (SEC) definitions of ''accredited investor'' and ''qualified institutional buyer,'' we should remove the $250,000 minimum purchase requirement because there is no comparable requirement in the Federal securities law. The purpose of this provision is to minimize the possibility that privately offered FCS securities could be marketed to non-qualified investors by subsequent purchasers in the secondary market. Because FCA does not have comparable securities enforcement authority to the SEC, we believe that a prohibition on sales in denominations below $250,000, coupled with a requirement that such prohibition be disclosed on the face of the instrument, is necessary to effectively achieve the purpose of the rule.

The Farm Credit bank commenter also requested that the expedited review process be available for any registered offering for which SEC approval is required in the event that the bank becomes an SEC registrant. Since no System institution currently registers securities with the SEC, the request is premature and beyond the scope of this rule.

Additionally, FCA must review applications to ensure compliance with Farm Credit Act and FCA regulatory requirements (including permanent capital requirements), something the SEC review does not cover. Therefore, we have adopted § 615.5255(d) as redesignated § 615.5255(e) without change.

[16] The ICBA stated that this information ''should be available through Freedom of Information Act (FOIA) requests without restrictions.'' We note, however, that System institutions are not Government entities subject to FOIA.

In the final rule we adopt proposed § 615.5255(j) as redesignated § 615.5255(k), which provides that in addition to FCA requirements, each institution is responsible for ensuring its compliance with all applicable Federal and state securities laws. Therefore, each institution must affirmatively determine whether they are subject to SEC oversight requirements. Non-System commenters ''strongly urged'' FCA to require any issuance of System preferred stock to be registered with the SEC. We do not believe that we need to address this issue in order to achieve the objectives of this rule and therefore the suggestion is beyond the scope of this rulemaking.

We received no other comments to proposed § 615.5255 and adopt all other proposed changes as final.

K. Retirement of Other Equities—§ 615.5270

As discussed above, because we have decided to address our safety and soundness concerns through other means, we have deleted proposed § 615.5270(c), which would have tied the ability to retire preferred stock to levels of permanent capital in excess of the regulatory minimum. We also delete proposed paragraph (d), which would have generally required a 12-month holding period before retirements of preferred stock were allowed.

In the final rule, we adopt proposed paragraph (e), now designated as new paragraph (c), placing limitations on the ability of bank, association, or service corporation boards of directors to delegate authority to retire any at-risk stock to management. Non-System commenters stated that boards should not be allowed to delegate any decisions regarding retirement of preferred stock. They said this would help avoid any conflicts of interest with management and their decisions to retire stock when it may not be completely in the best interests of the institution. They also stated that if all decisions on preferred stock retirements are made directly by the board, then all relevant information will be recorded and maintained in the minutes of the board meetings. We continue to believe that the proposed restrictions, coupled with the other provisions of this rule, are sufficient to ensure that institution boards retain sufficient control and oversight over all stock retirements, not just preferred stock and therefore adopt paragraph (c) without change.

We also adopt proposed § 615.5270(f), now designated as § 615.5270(d), without substantive change other than as described in Section VII, *Restrictions on Retirement*, of this preamble. This provision requires each bank, association, or service corporation that issues preferred stock to adopt a written policy covering retirement of preferred stock that, at a minimum: (1) Describes any delegations of authority, (2) identifies any limits on the amount of stock that may be retired during a single quarterly (or shorter) time period, (3) ensures all stockholder requests for retirement are treated fairly and equitably, (4) prohibits any insider from retiring preferred stock in advance of the release of material non-public information concerning the institution to other stockholders, and (5) establishes when insiders may retire their preferred stock.

As we stated in the preamble to the proposed rule, we believe these new regulations are necessary to ensure that FCS institutions operate in a safe and sound manner and that these provisions will reduce the potential for insider abuse and the potential or appearance of unfair treatment or dealings relating to the retirement of preferred stock. We received no comments on this provision.

L. Payment of Dividends—§ 615.5295

Proposed § 615.5295 would: (1) Require an institution's board of directors to declare a dividend before any dividends may be paid to stockholders; (2) prohibit an institution from declaring or paying any dividend unless after declaration or payment of the dividend the institution would continue to meet its regulatory capital standards under this part; and (3) require an FCS institution to exclude any accrued but unpaid dividends from regulatory capital computations.

Non-System commenters agreed with this proposal because, in their view, it helps address the issue of the stock functioning like a deposit and helps ensure there are no discriminatory practices involved with the payment of dividends only to particular stockholders upon their request.

System commenters suggested that FCA clarify that institutions may declare dividends on at least a monthly basis and that a board may adopt a continuing resolution to pay dividends as long as the institution continues to meet regulatory capital standards. First, the rule does not include any frequency restrictions, so board action could theoretically take place on a monthly basis. However, we expect that any board decision on dividends be undertaken with the same formality as any other decision of the board. Second, a ''continuing resolution'' to pay dividends would defeat the purpose of the rule and therefore, FCA will

consider such a resolution to violate this rule. As we stated in the preamble to the proposed rule, we are adding this provision to emphasize the distinction between debt and equity securities. Declaration of dividends relates to the capitalization of the institution and is not equivalent to setting interest rates or other routine business decisions. Therefore, we adopt § 615.5295 without change and expect System institutions to treat dividend decisions in the same manner as other capitalization issues.

M. Disclosure of Insider Preferred Stock Transactions

Proposed § 620.5(j)(2) would add new required disclosures of transactions with senior officers and directors in FCS institution annual reports to shareholders. System commenters asserted that the proposal is overly broad and that disclosure of individual information is unnecessary. They suggest that FCA impose certain minimum thresholds, such as aggregating all directors and senior officers or, at a minimum, impose specific amounts or percentages below which no individual disclosure need be made.

We proposed this new disclosure requirement along with other disclosure amendments previously discussed in an effort to increase the transparency of insider preferred stock transactions. Because we are removing some of the most restrictive provisions of the proposed rule, full disclosure of insider activities is even more vital to ensure transparency of System operations. Therefore, we adopt the proposed rule as final without change.

IX. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the rule will not have a significant impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations and service corporations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not ''small entities'' as defined in the Regulatory Flexibility Act.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

12 CFR Part 612

Agriculture, Banks, banking, Conflicts of interests, Rural areas.

12 CFR Part 614

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

12 CFR Part 615

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

12 CFR Part 620

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

■ For the reasons stated in the preamble, we now amend parts 611, 612, 614, 615, and 620 of chapter VI, title 12 of the Code of Federal Regulations as follows:

PART 611—ORGANIZATION

■ 1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.3, 1.13, 2.0, 2.10, 3.0, 3.21, 4.12, 4.15, 4.20, 4.21, 5.9, 5.10, 5.17, 6.9, 6.26, 7.0–7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2011, 2021, 2071, 2091, 2121, 2142, 2183, 2203, 2208, 2209, 2243, 2244, 2252, 2278a–9, 2278b–6, 2279a–2279f–1, 2279aa–5(e)); secs. 411 and 412 of Pub. L. 100–233, 101 Stat. 1568, 1638; secs. 409 and 414 of Pub. L. 100–399, 102 Stat. 989, 1003, and 1004.

Subpart I—Service Organizations

■ 2. Amend § 611.1135 by revising paragraph (f) to read as follows:

§ 611.1135 Incorporation of service corporations.

* * * * *

(f) *When your service corporation issues equities, what are the disclosure requirements*? Your service corporation must provide the disclosures described in § 615.5255 of this chapter.

PART 612—STANDARDS OF CONDUCT

■ 3. The authority citation for part 612 continues to read as follows:

Authority: Secs. 5.9, 5.17, 5.19 of the Farm Credit Act (12 U.S.C. 2243, 2252, 2254).

■ 4. Amend § 612.2165 by revising paragraphs (b)(12) and (b)(13) and adding new (b)(14) and (b)(15) to read as follows:

§ 612.2165 Policies and procedures.

* * * * *

(b) * * *

(12) Establish reporting requirements, consistent with this part, to enable the institution to comply with § 620.5 of this chapter, monitor conflicts of interest, and monitor recusal compliance;

(13) Establish appeal procedures available to any employee to whom any required approval has been denied;

(14) Prohibit directors and employees from purchasing or retiring any stock in advance of the release of material non-public information concerning the institution to other stockholders; and

(15) Establish when directors and employees may purchase and retire their preferred stock in the institution.

PART 614—LOAN POLICIES AND OPERATIONS

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

Authority: 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128; secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 1.11, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.25, 4.26, 4.27, 4.28, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.8, 7.12, 7.13, 8.0, 8.5, of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2097, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2206a, 2207, 2211, 2212, 2213, 2214, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a–2, 2279b, 2279c–1, 2279f, 2279f–1, 2279aa, 2279aa–5); sec. 413 of Pub. L. 100–233, 101 Stat. 1568, 1639.

Subpart J—Lending and Leasing Limits

■ 6. Amend § 614.4351 by adding a new paragraph (a)(3) to read as follows:

§ 614.4351 Computation of lending and leasing limit base.

(a) * * *

(3) Any amounts of preferred stock not eligible to be included in total surplus as defined in § 615.5301(i) of this chapter must be deducted from the lending limit base.

* * * * *

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

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

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b–6, 2279aa, 2279aa–3, 2279aa–4, 2279aa–6, 2279aa–7, 2279aa–8, 2279aa–10, 2279aa–12); sec. 301(a) of Pub. L. 100–233, 101 Stat. 1568, 1608.

Subpart F—Property, Transfers of Capital, and Other Investments

■ 8. Add new § 615.5175 to read as follows:

§ 615.5175 Investments in Farm Credit System institution preferred stock.

Except as provided for in § 615.5171, Farm Credit banks, associations and service corporations may only purchase preferred stock issued by another Farm Credit System institution, including the Federal Agricultural Mortgage Corporation, with the written prior approval of the Farm Credit Administration. The request for approval should explain the terms and risk characteristics of the investment and the purpose and objectives for making the investment.

Subpart H—Capital Adequacy

■ 9. Amend § 615.5201 by removing and reserving paragraph (5) of the ''permanent capital'' definition and adding new definitions for the terms ''preferred stock'' and ''term preferred stock'' to read as follows:

§ 615.5201 Definitions.

* * * * *

Preferred stock means stock that is permanent capital and has dividend and/or liquidation preference over common stock.

* * * * *

Term preferred stock means preferred stock with an original maturity of at least 5 years and on which, if cumulative, the board of directors has the option to defer dividends, provided that, at the beginning of each of the last 5 years of the term of the stock, the amount that is eligible to be counted as permanent capital is reduced by 20 percent of the original amount of the stock (net of redemptions).

* * * * *

Subpart I—Issuance of Equities

■ 10. Revise § 615.5230(b)(1) to read as follows:

§ 615.5230 Implementation of cooperative principles.

(b)* * *

(1) Each issuance of preferred stock (other than preferred stock outstanding on October 5, 1988, and stock into which such outstanding stock is converted that has substantially similar preferences) shall be approved by a majority of the shares of each class of equities adversely affected by the preference, voting as a class, whether or not such classes are otherwise authorized to vote;

* * * * *

■ 11. Revise § 615.5240 to read as follows:

§ 615.5240 Permanent capital requirements.

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

(b) In order to qualify as permanent capital, equities issued under the bylaws must meet the following requirements:

(1) Retirement must be solely at the discretion of the board of directors and not upon a date certain (other than the original maturity date of preferred stock) or upon the happening of any event, such as repayment of the loan, and not pursuant to any automatic retirement or revolvement plan;

(2) Retirement must be at not more than book value;

(3) The institution must have made the disclosures required by this subpart;

(4) For common stock and participation certificates, dividends must be noncumulative and payable only at the discretion of the board; and

(5) For cumulative preferred stock, the board of directors must have discretion to defer payment of dividends.

■ 12. Add a new § 615.5245 to read as follows:

§ 615.5245 Limitations on association preferred stock.

(a) The board of directors of each association offering preferred stock must adopt a policy that addresses the association's conditions or limits on the amount of preferred stock that any one holder, or small number of holders may acquire.

(b) Each association offering preferred stock must make the stock available for purchase to each of its members on the same basis.

(c) An association may not extend credit for purchases of preferred stock in the association.

■ 13. Revise § 615.5250 to read as follows:

§ 615.5250 Disclosure requirements for borrower stock.

(a) For sales of borrower stock, which for this subpart means equities purchased as a condition for obtaining a loan, an institution must provide a prospective borrower with the following documents prior to loan closing:

(1) The institution's most recent annual report filed under part 620 of this chapter;

(2) The institution's most recent quarterly report filed under part 620 of this chapter, if more recent than the annual report;

(3) A copy of the institution's capitalization bylaws; and

(4) A written description of the terms and conditions under which the equity is issued. In addition to specific terms and conditions, the description must disclose:

(i) That the equity is an at-risk investment and not a compensating balance;

(ii) That the equity is retireable only at the discretion of the board of directors and only if minimum permanent capital standards established under subpart H of this part are met;

(iii) Whether the institution presently meets its minimum permanent capital standards;

(iv) Whether the institution knows of any reason the institution may not meet its permanent capital standard on the next earnings distribution date; and

(v) The rights, if any, to share in patronage distributions.

(b) Notwithstanding the provisions of paragraph (a) of this section, no materials previously provided to a purchaser (except the disclosures required by paragraph (a)(4) of this section) need be provided again unless the purchaser requests such materials.

■ 14. Add new § 615.5255 to read as follows:

§ 615.5255 Disclosure and review requirements for other equities.

(a) A bank, association, or service corporation must submit a proposed disclosure statement to the Farm Credit Administration (FCA) for review and clearance prior to the proposed sale of any other equities, which for this subpart means equities not purchased as a condition for obtaining a loan.

(b) An institution may not offer to sell other equities until a disclosure statement is reviewed and cleared by FCA.

(c) A disclosure statement must include:

(1) All of the information required by part 620 of this chapter in the annual report to shareholders as of a date within 135 days of the proposed sale. An institution may incorporate by reference its most recent annual report to shareholders and the most recent quarterly report filed with the FCA in satisfaction of this requirement;

(2) The information required by § 615.5250(a)(3) and (a)(4); and

(3) A discussion of the intended use of the sale proceeds.

(d) An institution is not required to provide the materials identified in

paragraphs (c)(1) and (c)(2) of this section to a purchaser who previously received them unless the purchaser requests it.

(e) For any class of stock where each purchaser and each subsequent transferee acquires at least $250,000 of the stock and meets the definition of ''accredited investor'' or ''qualified institutional buyer'' contained in 17 CFR 230.501 and 230.144A (or successor provisions), a disclosure statement submitted pursuant to this section is deemed reviewed and cleared by FCA and an institution may treat stock that meets all requirements of part 615 as permanent capital for the purpose of meeting the minimum permanent capital standards established under subpart H unless FCA notifies the institution to the contrary within 30 days of receipt of a complete disclosure statement submission. A complete disclosure statement submission includes the proposed disclosure statement plus any additional materials requested by FCA.

(f) For all other issuances, a disclosure statement submitted pursuant to this section is deemed cleared by FCA, and an institution may treat stock that meets all requirements of part 615 as permanent capital for the purpose of meeting the minimum permanent capital standards established under subpart H unless FCA notifies the institution to the contrary within 60 days of receipt of a complete disclosure statement submission. A complete disclosure statement submission includes the proposed disclosure statement plus any additional materials requested by FCA.

(g) Upon request, FCA will inform the institution how it will treat the proposed issuance for other regulatory capital ratios or computations.

(h) No institution, officer, director, employee, or agent shall, in connection with the sale of equities, make any disclosure, through a disclosure statement or otherwise, that is inaccurate or misleading, or omit to make any statement needed to prevent other disclosures from being misleading.

(i) Each bank and association must establish a method to disclose and make information on insider preferred stock purchases and retirements readily available to the public. At a minimum, each institution offering preferred stock must make this information available upon request.

(j) The requirements of this section do not apply to the sale of Farm Credit System institution equities to:

(1) Other Farm Credit System institutions,

(2) Other financing institutions in connection with a lending or discount relationship, or

(3) Non-Farm Credit System lenders that purchase equities in connection with a loan participation transaction.

(k) In addition to the requirements of this section, each institution is responsible for ensuring its compliance with all applicable Federal and state securities laws.

Subpart J—Retirement of Equities and Payment of Dividends

■ 15. Amend subpart J of part 615 by revising the heading to read as stated above.

■ 16. Amend § 615.5270 by adding new paragraphs (c), (d), and (e) to read as follows:

§ 615.5270 Retirement of other equities.

* * * * *

(c) A bank, association, or service corporation board of directors may delegate authority to retire at-risk stock to institution management if:

(1) The board has determined that the institution's capital position is adequate;

(2) All retirements are in accordance with the institution's capital adequacy plan or capital restoration plan;

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

(4) The institution will continue to satisfy all applicable minimum surplus and collateral standards after any retirements; and

(5) Management reports the aggregate amount and net effect of stock purchases and retirements to the board of directors each quarter.

(d) Each board of directors of a bank, association, or service corporation that issues preferred stock must adopt a written policy covering the retirement of preferred stock. The policy must, at a minimum:

(1) Establish any delegations of authority to retire preferred stock and the conditions of delegation, which must meet the requirements of paragraph (c) of this section and include minimum levels for total surplus and core surplus commensurate with the volatility of the preferred stock.

(2) Identify limitations on the amount of stock that may be retired during a single quarterly (or shorter) time period;

(3) Ensure that all stockholder requests for retirement are treated fairly and equitably;

(4) Prohibit any insider, including institution officers, directors, employees, or agents, from retiring any preferred stock in advance of the release of material non-public information concerning the institution to other stockholders; and

(5) Establish when insiders may retire their preferred stock.

(e) The institution's board must review its policy at least annually to ensure that it continues to be appropriate for the institution's current financial condition and consistent with its long-term goals established in its capital adequacy plan.

■ 17. Add new § 615.5295 to read as follows:

§ 615.5295 Payment of dividends.

(a) The board of directors of a bank, association, or service corporation must declare a dividend on a class of stock before any dividends may be paid to stockholders.

(b) No bank, association, or service corporation may declare or pay any dividend unless after declaration or payment of the dividend the institution would continue to meet its regulatory capital standards under this part.

(c) Each bank, association, and service corporation must exclude any accrued but unpaid dividends from regulatory capital computations under this part.

PART 620—DISCLOSURE TO SHAREHOLDERS

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

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

Subpart B—Annual Report to Shareholders

■ 19. Amend § 620.5 by revising paragraph (j)(2) to read as follows:

§ 620.5 Contents of the annual report to shareholders.

* * * * *

(j) * * *

(2) *Transactions other than loans.* For each person who served as a senior officer or director on January 1 of the year following the fiscal year of which the report is filed, or at any time during the fiscal year just ended, describe briefly any transaction or series of transactions other than loans that occurred at any time since the last annual meeting between the institution and such person, any member of the immediate family of such person, or any organization with which such person is affiliated.

(i) For transactions relating to the purchase or retirement of preferred stock issued by the institution, state the name of each senior officer or director

that held preferred stock issued by the institution during the reporting period, the current amount of preferred stock held by the senior officer or director, the average dividend rate on the preferred stock currently held, and the amount of purchases and retirements by the individual during the reporting period.

(ii) For all other transactions, state the name of the senior officer or director who entered into the transaction or whose immediate family member or affiliated organization entered into the transaction, the nature of the person's interest in the transaction, and the terms of the transaction. No information need be given where the purchase price, fees, or charges involved were determined by competitive bidding or where the amount involved in the transaction (including the total of all periodic payments) does not exceed $5,000, or the interest of the person arises solely as a result of his or her status as a stockholder of the institution and the benefit received is not a special or extra benefit not available to all stockholders.

* * * * *

Dated: September 7, 2005.

Jeanette C. Brinkley,

Secretary, Farm Credit Administration Board.

[FR Doc. 05–18053 Filed 9–12–05; 8:45 am]

BILLING CODE 6705–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2005–22332; Directorate Identifier 2005–CE–46–AD; Amendment 39–14262; AD 2005–18–21]

RIN 2120–AA64

Airworthiness Directives; Raytheon Aircraft Company Models 1900, 1900C, 1900C (C–12J), and 1900D Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule; request for comments.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for certain Raytheon Aircraft Company Models 1900, 1900C, 1900C (C–12J), and 1900D airplanes. This AD requires you to inspect all elevator hinge support attachments on both left and right elevators for loose and missing rivets, replace rivets if loose or missing rivets are found, inspect the elevator hinge joints for looseness and clearance of each elevator to its stabilizer, correct looseness and clearance if incorrect, and report results of the required inspections. This AD results from a report of excessive movement of the elevator and elevator trim. The hinge support attachment that attaches the elevator to the horizontal stabilizer was loose and had loose and missing rivets. The elevator counterweight horn showed evidence of rubbing against the horizontal stabilizer, indicating possible incorrect clearance. We are issuing this AD to detect and correct any looseness in the elevator hinge support attachments, which could result in binding of the elevator control system. This elevator binding could lead to loss of control of the airplane.

DATES: This AD becomes effective September 13, 2005.

As of September 13, 2005, the Director of the Federal Register approved the incorporation by reference of certain publications listed in the regulation.

We must receive any comments on this AD by October 20, 2005.

ADDRESSES: Use one of the following to submit comments on this AD:

- *DOT Docket Web site:* Go to *http://dms.dot.gov* and follow the instructions for sending your comments electronically.
- *Government-wide rulemaking Web site:* Go to *http://www.regulations.gov* and follow the instructions for sending your comments electronically.
- *Mail:* Docket Management Facility; U.S. Department of Transportation, 400 Seventh Street, SW., Nassif Building, Room PL–401, Washington, DC 20590–001.
- *Fax:* 1–202–493–2251.
- *Hand Delivery:* Room PL–401 on the plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

To get the service information identified in this proposed AD, contact Raytheon Aircraft Company, P.O. Box 85, Wichita, Kansas 67201; telephone: (800) 625–7043.

To view the comments to this AD, go to *http://dms.dot.gov.* The docket number is FAA–2005–22332; Directorate Identifier 2005–CE–46–AD.

FOR FURTHER INFORMATION CONTACT: Steven E. Potter, Aerospace Engineer, Airframe and Services Branch, ACE–118W, 1801 Airport Road, Wichita, Kansas 67209; telephone: (316) 946–4124; facsimile: (316) 946–4107.

SUPPLEMENTARY INFORMATION:

What events have caused this AD? On a recent flight, a Model 1900D experienced a binding elevator control column during takeoff. The pilot was able to free the control column. During continuation of the flight the elevator trim moved slowly nose up and required a one-half unit trim adjustment every one to two minutes. An inspection found a missing rivet and other loose rivets on the outboard hinge attachment that attaches the elevator to the horizontal stabilizer. The elevator counterweight horn showed evidence of rubbing against the horizontal stabilizer, indicating possible incorrect clearance. Loose rivets were found on other airplanes of the same type design.

What is the potential impact if FAA took no action? Looseness in the elevator hinge support attachments could result in binding of the elevator control system. This elevator binding could lead to loss of control of the airplane.

Is there service information that applies to this subject? Raytheon Aircraft Company has issued Safety Communiqué No. 261, dated August 2005.

What are the provisions of this service information? The service information specifies inspecting all elevator hinge support attachments on both left and right elevators.

FAA's Determination and Requirements of the AD

What has FAA decided? We have evaluated all pertinent information and identified an unsafe condition that is likely to exist or develop on other products of this same type design.

Since the unsafe condition described previously is likely to exist or develop on other Raytheon Aircraft Company Models 1900, 1900C, 1900C (C–12J), and 1900D airplanes of the same type design, we are issuing this AD to detect and correct any looseness in the elevator hinge support attachments, which could result in binding of the elevator control system. This elevator binding could lead to loss of control of the airplane.

What does this AD require? This AD requires you to inspect all elevator hinge support attachments on both left and right elevators for loose and missing rivets, replace rivets if loose or missing rivets are found, inspect the elevator hinge joints for looseness and clearance of each elevator to its stabilizer, correct looseness and/or clearance if incorrect, and report results of the required inspections.

How does the revision to 14 CFR part 39 affect this AD? On July 10, 2002, we published a new version of 14 CFR part 39 (67 FR 47997, July 22, 2002), which governs FAA's AD system. This regulation now includes material that relates to altered products, special flight permits, and alternative methods of compliance. This material previously